# *A study on the corporate social responsibility of Islamic financial institutions: learning from the experience of socially responsible financial institutions in the UK*

Loughborough University

# A Study on the Corporate Social Responsibility of Islamic Financial Institutions:

## *Learning from the Experiences of Socially Responsible Financial Institutions in the UK*

by

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*The Prophet (pbuh) said: 'Whoever does not thank people (for their favours) has not thanked Allah (properly), Mighty and Glorious is He!' (Ahmad, Tirmidhi)*

# ABSTRACT

In order to fulfill 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 they 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 to be a discretionary responsibility of IFIs, with the objective of CSR being sought merely as a peripheral practice. Recent debates on the evolution of the practice 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 practical field of Islamic banking and finance has been argued to be arising over the years. An assessment of this contention motivates this study.

The study seeks to assess the Corporate Social Performance (CSP) of a sample of forty six financial institutions offering Islamic products (FIIPs), located worldwide, which have responded to a questionnaire survey and whose CSR practices have been further verified by content analysis. The findings revealed that the majority of the Islamic financial practitioners believed in attributing an integrated social role to FIIPs. However, the practices of the FIIPs reflected a more limited approach to CSR. Most of the FIIPs were observed to be focused on meeting their legal, economic and *Shari'ah* responsibilities, that is, were concerned with the goals of profit maximisation and for their transactions to meet *Shari'ah* compliance.

Concurrently, the study appreciates the lessons that can be learnt from the socially responsible financial (SRF) movement that has evolved in the West to promote ethical finance. The ethical worldview of these socially responsible financial institutions (SRFIs) is guided by secular humanistic values which are largely socially determined rather than being drawn from a religious philosophy. The CSR practices of twelve British SRFIs – comprising mainly banks and asset management firms – have therefore been critically analysed through content analysis of their published and electronic materials. The analysis revealed that a sophisticated understanding of CSR shaped the culture of SRFIs which have mostly embedded CSR within their business transactions. CSR constituted an integral, explicit and strategic decision of management, with appropriate management system in place and, in some cases, with indicators developed to assess CSR performance against planned targets.

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# ABBREVIATIONS

| | |
|---|---|
| AAOIFI | Accounting and Auditing Organization for Islamic Financial Institutions |
| BITC | Business in the Community |
| CDFI | Community Development Financial Institutions |
| CSP | Corporate social performance |
| CSR | Corporate social responsibility |
| $CSR_1$ | Corporate social responsibility |
| $CSR_2$ | Corporate social responsiveness |
| EIRIS | Ethical Investment Research Service |
| ESG | Environmental, Social and Governance |
| EUROSIF | European Social Investment Forum |
| FIIPs | Financial Institutions Offering Islamic Products |
| GSEE | Governance, Social, Ethical and Environmental |
| IFIs | Islamic financial institutions |
| NBFIs | Non-Bank financial institutions |
| RDAP | Reactive-Defensive-Accommodative-Proactive |
| SEE | Social, Ethical and Environmental |
| SRF | Socially responsible finance |
| SRFIs | Socially responsible financial institutions |
| SRI | Socially responsible investment |
| UK | United Kingdom |
| UKSIF | UK Social Investment Forum |
| USA | United States of America |

# CHAPTER 1

# Introduction

## 1.0 Background of the Study

The idea of incorporating moral values and an element of social responsibility in economic and financial matters has received considerable attention in the business world in recent times. Socially responsible financing has, for instance, emerged in the West as a recent phenomenon to bring about a fairer and more sustainable society. Concurrently, Islamic financing has evolved to provide alternative ways of financing the development needs of communities. Both Islamic and socially responsible finance (SRF) are guided by ethical values. Islamic finance is rooted in Islamic ethics, derived from the teachings of the Qur'an and the Prophet. SRF, in contrast, is based on secular humanistic values which are socially driven. Socially responsible investors, in general, endeavour to avoid investment in certain sectors that are damaging to society and encourage investment in other sectors that add positively to the progress of society.

Socially responsible concepts of finance are basically linked with the principles of corporate social responsibility (CSR) – a subject which has been gaining prominence in the academic literature as well as in practice. Overall, CSR is about the concern of corporations to be 'socially responsible' such that they have a positive and productive impact on society. Within the financial arena, this concern has led to the development of socially responsible financial products (like ethical investments, pensions, mortgages and others) and the involvement of financial institutions in more social and philanthropic activities. In this respect, the role of socially responsible financial institutions (SRFIs) and financial institutions offering Islamic products (FIIPs) in the financing process is of key importance. An evaluation of the socio-economic impact that these institutions have, following their embrace of CSR principles, is also deemed important.

In particular, the need to assess the socio-economic contribution of Islamic banking and finance appears to have increased in importance in the light of recent debates arising on this issue in the literature. Academicians such as El-Gamal (2000), Halim (2001), Siddiqi (2004a) and Hasan (2005a and 2005b) point out to a divergence between the theoretical literature on Islamic economics and the course taken by the practical field of Islamic finance. The basis of the argument is a comparison of the theoretical literature on Islamic economics with the practice of Islamic finance by FIIPs. It is argued that the literature promotes the social commitment of the discipline by emphasising socio-economic goals such as social justice, equity, poverty alleviation and human well-being that inevitably have recourse to the *maqasid al-Shari'ah* (objectives of Islamic law). The practice of Islamic finance, on the other hand, is contended to be evolving along a profit-efficiency motive.

Several explanations have been proposed in the literature to shed light on this divergence which in turn raise criticisms against (i) the heavy bias in the use of debt based instruments, like *murabaha*, relative to profit and loss sharing modes of financing (Iqbal *et. al.*, 1998: 62; Hasan, 2005a; Ahmad, A. Y., 2005; Yousef, 2004); (ii) the strategic vision adopted by Islamic banking that seems to have been inspired by the debt-oriented conventional banking culture (Tag el-Din, 2005a); (iii) the choice of financial instruments which tends to give higher weight to 'efficiency' criteria while neglecting the 'equity' criteria (El-Gamal, 2000); (iv) the greater emphasis placed on 'financial engineering' which is propelled by monetary gains relative to the drive for 'social engineering' which is inspired by social goals (Siddiqi, 2004a); and (v) the degree of high networthism prevailing in investment banking and asset management in the Gulf countries as compared to the search for empowering middle class corporate Muslims (Parker, 2004b). Plausible justifications have been provided in the literature to support such practices, some of which include (i) the early stage of development that Islamic banks are at (Warde, 2000; Haron and Kamaruddin, 2005); (ii) the mixed economic-conventional banking system environment that Islamic banks operate in, where their survival rests on how successfully they compete with their mainstream counterparts (Haron and Kamaruddin, 2005); and (iii) the many challenges faced in reality specifically in terms of the legal and regulatory framework, political and economic climate, and lack of human infrastructure and the right organisational structure (Hasan, 2004).

The apparent divergence in the practice of Islamic finance from its initial ethical and social objectives of targeting general human well-being is the problem that motivates this study. The aim is to critically appraise this contention and determine how far FIIPs are being socially responsible in their objectives, actions and commitments such that they contribute in achieving the socio-economic goals of Islam.

Concurrently, the similarities between Islamic finance and SRF – which are founded on core ethical values such as individual responsibility, man's role as a vicegerent, commitment to the social interest, promotion of human welfare, care for the environment, and concern for economic and social justice – motivate this study to examine the parallel movement of SRF. The SRF movement has evolved in the 1920s and is today expanding in different parts of the world. It is, however, more prominent in the West. By endorsing the principles of CSR, this industry endeavours to contribute positively to societal welfare. This, in turn, prompts this study to learn from the experiences and best practices of SRFIs. However, it is noted that similar to the case of Islamic finance, contentions have been made against the practices of SRFIs, questioning in general whether they actually deliver what they promise (e.g. Schepers and Sethi, 2003). This study therefore examines the performance of a selection of SRFIs and by so doing highlights how FIIPs can draw from the experiences of their counterparts to further the goal of human well-being.

## 1.1 Aims and Objectives of the Study

The study aims to examine the corporate social performance (CSP) of financial institutions adhering to two parallel ethical worldviews: the Islamic and the secular humanistic. To this end, the research seeks to study how far FIIPs and SRFIs embrace a socially responsible approach in their core operations. It endeavours to examine the extent to which the institutions fulfil their economic, legal, ethical and discretionary responsibilities that society assigns onto them; how best they manage CSR issues; how responsive they are towards the adoption of CSR issues; and how does the adoption of CSR by these institutions impact on society. The focus of the empirical study however lies in the appraisal of the CSP of FIIPs. The practices of SRFIs are critically analysed with the aim of drawing useful lessons from the experiences of an industry which has been in operation far longer than its Islamic counterparts.

In the light of the above, the objectives of the study are three-fold, spelt out as follows:

1. To evaluate the corporate social performance of FIIPs.

2. To examine the practices of SRFIs relating to their corporate social performance.

3. To determine what lessons FIIPs can learn from the experiences and practices of SRFIs to better attend to the needs of their stakeholders.

In order to attain the above objectives, the study utilises the literature on CSR and CSP. Reference is particularly made to the four-part definition of CSR by Carroll (1979) to define the CSR issues of the financial institutions. The CSP model of Wood (1991) is further adopted as a conceptual framework to assess the social performance of the financial institutions. The CSP assessment of the financial institutions is studied from the perspectives of the internal stakeholders of the firm, in particular, from the viewpoint of those who are employed as bankers, managers, and financial experts who are termed as 'financial practitioners' in this research.

## 1.2 Research Hypothesis

The hypothesis of this research is based on the vision endorsed by the Islamic economics literature which assigns an attribute of social responsibility to Islamic financial institutions. In this respect, the practices of FIIPs are analysed in order to appraise whether the institutions are living up to their CSR responsibilities. Similarly, SRF promotes a social, ethical, and environmental (SEE) approach to investing. SRFIs are thus probed to ascertain whether they actually deliver what they promise.

In other words, the null hypothesis assumes that CSR responsibilities are assigned to FIIPs and SRFIs. The alternative hypothesis questions as to whether these institutions are fulfilling their CSR responsibilities.

## 1.3 Research Questions

In line with the set objectives and the conceptual framework, the following research questions are addressed in this study:

- What is CSR?
- What particular CSR issues relate to the domain of finance?
- How the practice of CSR is being increasingly endorsed by mainstream financial institutions?
- How CSP has been especially reflected in the financial domain through the practices of the two parallel streams of financing: the secular humanistic socially responsible approach and the Islamic approach?
- What criticisms have been raised against the practices of SRFIs and FIIPs?
- How responsive SRFIs and FIIPs are in practice towards their corporate social responsibilities?
- Whether CSR principles form an integral part of the business strategy of SRFIs and FIIPs? Or whether the financial institutions adopt CSR as a peripheral practice which is merely perceived as an optional business activity?
- What lessons and experiences can FIIPs learn from the practices of their counterparts, the SRFIs?
- Whether there is a need to re-orientate the practice of FIIPs towards fulfilling their CSR responsibilities such that their contribution towards meeting the socio-economic development needs of the Muslim community is enhanced?

## 1.4 Significance of the Study

This research examines the issue of social responsibility within the field of finance and thus devolves around relatively new themes of study, interlinking CSR and CSP with socially responsible finance and Islamic finance. Previous researches on CSR have delved on numerous areas, including:

(i) Defining CSR and its issues (e.g. Friedman, 1970; Carroll, 1979, 1998; Carroll and Buchholtz, 2006; Sethi, 1975; Frederick, 1978; Wartick and Cochran, 1985);

(ii) Highlighting the business benefits of adopting CSR (e.g. Little, 2003; Business in the Community, 2000; Holme and Watts, 2000; Porter and Kramer, 2002);

(iii) Examining CSR within different country contexts (e.g. Aurpele *et. al.*, 1985; Aaronson, 2003; Worthington *et. al.*, 2003; Hamid, 2003; Habisch *et. al.*, 2005);

(iv) Associating CSR with the financial performance of firms (e.g. McGuire *et. al.*, 1988; Luther and Matatko, 1994; Waddock and Graves, 1997; McWilliams and Siegel, 2001; Orlitzky *et. al.*, 2003; Brinkman, 2003; Johnson, 2003; Tsoutsoura, 2004);

(v) Associating CSR with corporate citizenship (e.g. Lewin *et. al.*, 1995; Matten and Crane, 2003; Moon *et. al.*, 2003; Valor, 2005);

(vi) Examining CSR from a stakeholder perspective (e.g. Carroll, 1989; Brenner and Cochran, 1991; Dusuki, 2005; Dusuki and Dar, 2005; Carroll and Buchholtz, 2006); and

(vii) Investigating CSR and corporate social reporting (e.g. Belkaoui and Karpik, 1989; Gray *et. al.*, 1995; Greenwood, 2001; Ho and Wong, 2001; Eng and Mak, 2003; Maali *et. al.*, 2003; Douglas, Doris and Johnson, 2004; Peterson and Hermans, 2004; Farook and Lanis, 2005).

The underlying ethical issues in CSR have also been discussed at great length within the Western and Islamic literature on business ethics (e.g. Al-Habshi, 1987; Ahmad, S. F., 1991; Wärneryd and Lewis, 1994; Prodhan, 1994; Beekun, 1997; Ahmad and Sadeq, 2001; Naqvi 1981, 2003). Moreover, the question of ethics has been linked with the concept of corporate governance as scandals at Enron and Worldcom have brought the management systems of modern corporations under closer scrutiny. Within the financial arena, the subject of corporate governance has been discussed by many (e.g. Banaga *et. al.* 1994; Holland, 2001; Chapra and Ahmed, 2002; Lewis, 2005).

Nonetheless, it is noticed that researches which empirically assess the CSP of firms have hardly prevailed. Most empirical studies, within both the Western and Islamic perspectives, have instead focused on the relationship between CSR and a firm's corporate financial performance rather than examining its social performance. More so, researches linking CSR especially to socially responsible finance or Islamic finance are sparse (e.g. Decker, 2004; Strandberg, 2005). The study by Strandberg (2005) is particularly noted to be of significance to this research as it examined the *"best practices in sustainable finance"* in a number of SRFIs internationally renowned for their social, ethical and environmental leadership.

Therefore, this research rises to the call of some Islamic researchers (e.g. Hasan, 2004, 2005a, 2005b; Tag el-Din, 2005b) who voiced out the need to assess the performance of Islamic financial institutions vis-à-vis their social objectives. Accordingly, the literature on CSP is utilised to evaluate the social performance of a sample number of FIIPs.

In appraising the CSP of the sampled FIIPs this research further adopts a cross-country approach. The attitudes and perceptions of financial practitioners from a wide number of countries are analysed and compared with the actual social performance of their financial institutions. In this way, the study contrasts the beliefs held by a number of financial practitioners with their actions and commitments towards CSR. The perceptions of the Islamic practitioners and the practices of the FIIPs are in turn compared with the Islamic worldview on CSR. The overall view obtained on the CSP of the FIIPs through the cross-country approach is believed to add significantly to the Islamic literature. Prior researches have focused mostly on single-country analyses (e.g. Dusuki, 2005; Haron and Kamaruddin, 2005).

Furthermore this research extends the efforts of Wilson (1997, 2002, and 2004) and others in the search for similarities between the practices of the ethical finance industry and the Islamic finance industry. Indeed, the drive of both movements is to bring ethics and social responsibility within the domain of finance. This serves as the underlying basis for building bridges between the two financial paradigms. Socially responsible investing has been in practice long before the institutionalisation of the Islamic finance industry. Its modern origins is said to have evolved as early as the 1920s out of the concerns of religious institutions to avoid so-called "sin industries" like alcohol, gambling or tobacco (Schlegelmilch, 1997: 49). The Islamic finance movement, on the other hand, took off in the 1970s. The experience gained over many years of managing the worldwide SRF industry, worth about US$ 2.5 trillion (Hamid, 2003), certainly provides ample scope to learn useful lessons from it. These lessons will add to the progress of the Islamic finance industry which is relatively newer and smaller in size.

Thus, by undertaking a comparative study of SRFIs and FIIPs and endeavouring to gain from the experiences of the SRF industry, this research is expected to represent a significant contribution to original knowledge. The task it sets itself to achieve is however recognised to be challenging. The practical difficulties involved in undertaking this new study on CSP were daunting. One of such difficulties encountered related to the compilation of empirical data from the sampled SRFIs and FIIPs. It represented a major research handicap.

However, the following characteristics of this research make it a valuable contribution to the Islamic finance literature as well as differentiate it from similar past studies:

(i) The cross-country approach that it adopts. Previous studies have utilised a single country case study in assessing the social performance of Islamic financial institutions (e.g. Dusuki, 2005; Haron and Kamaruddin, 2005).

(ii) The conduct of the empirical analysis from a firm's perspective. It has been pointed out earlier that limited empirical research has been undertaken in the field of CSP. Moreover, previous studies have examined the issue from the perspectives of the stakeholders of the Islamic financial institutions (e.g. Dusuki, 2005). By seeking the views of financial practitioners who are taken to represent the FIIPs, this study endeavours to compare what the financial practitioners say 'they believe in' with what they say 'their institutions actually do'. It therefore adds to the literature by studying the link between the intent and the actual behaviour of the practitioners.

(iii) The lessons it seeks to learn from the SRF industry. Earlier studies by Wilson (1997, 2002, and 2004) have considered a limited number of examples from the SRF industry (mainly the Co-operative Bank and Friends Provident Stewardship Fund). This study considers a larger sample of SRFIs primarily located in the United Kingdom, with some however having international operations. The UK is chosen as the country of reference due to its explicit and progressive stance in promoting CSR and SRF.

## 1.5 Chapter Outlines

The study draws from the literature on both mainstream and 'alternative' economic and financial discourses which are ethically and socially geared. The ethical and literature from Islamic economics, banking and finance, management studies, and secular socially responsible finance is therefore drawn upon to present to present the relevant issues of interest. An outline of the chapters included in this study is as follows.

*Chapter 1 - Introduction.* The current chapter introduces the main themes of the research, setting out its motivating factors and significance.

*Chapter 2 - The Mainstream Western Perspective: CSR and Its Implications on the Financial Sector.* This chapter defines CSR, its concepts and dimensions and examines the CSR responsibilities commonly assigned to financial institutions. It examines how the practice of CSR is being conceived in mainstream financial institutions.

*Chapter 3 - The Secular Humanistic Perspective: CSR and Socially Responsible Financial Institutions.* This chapter elucidates how CSR is exemplified within the financial arena as a special stream called socially responsible finance (SRF). It defines SRF, considers its underlying beliefs and objectives, and establishes some key facts on the SRF market. It further examines some of the criticisms raised in the literature against the performance of SRFIs related mainly to their ethical and social responsibilities.

*Chapter 4 - The Islamic Perspective: CSR and Islamic Financial Institutions.* This chapter examines how the concept of CSR is embraced within Islamic finance. After delineating some important facts on the expansion of the Islamic finance industry, the chapter projects Islamic financing as an ethical and socially responsible paradigm based on its theoretical underpinnings and the socially responsible vision and objectives of Islamic economics. It further discusses the objectives and responsibilities assigned to Islamic financial institutions in theory. In this respect, it is noted that the social performance of Islamic financial institutions has been criticised in the literature, in the same way that some contentions have been levelled against the practices of SRFIs.

*Chapter 5 - Theoretical Framework for Assessing CSP and Research Methodology.* This chapter elaborates the methodology expounded in the literature to assess a firm's responsiveness to CSR and the impact of CSR policies on society. It hence reviews the leading models of CSP and sets out the research questions that will be used in this study as the basis for evaluating the CSP of FIIPs and examining the practices SRFIs. Thereafter, the chapter defines the research methodology used in conducting the empirical study. The difficulties encountered and the limitations of the subject researched are also explained.

*Chapter 6 - Gauging the Social Responsibility of FIIPs: A Cross Country Analysis.* This chapter presents and discusses the empirical findings relating to the CSP of FIIPs by adopting a cross country approach. The aim is to assess the attitudes of Islamic financial practitioners towards CSR and to compare the practices of the FIIPs in the light of the theoretical teachings of Islamic economics, banking and finance.

*Chapter 7 - Examining the Social Responsibility of SRFIs: The UK Experience.* This chapter examines the best practices of some leading SRFIs in the UK. The sampled SRFIs are studied to answer the same research questions set out for the sampled FIIPs.

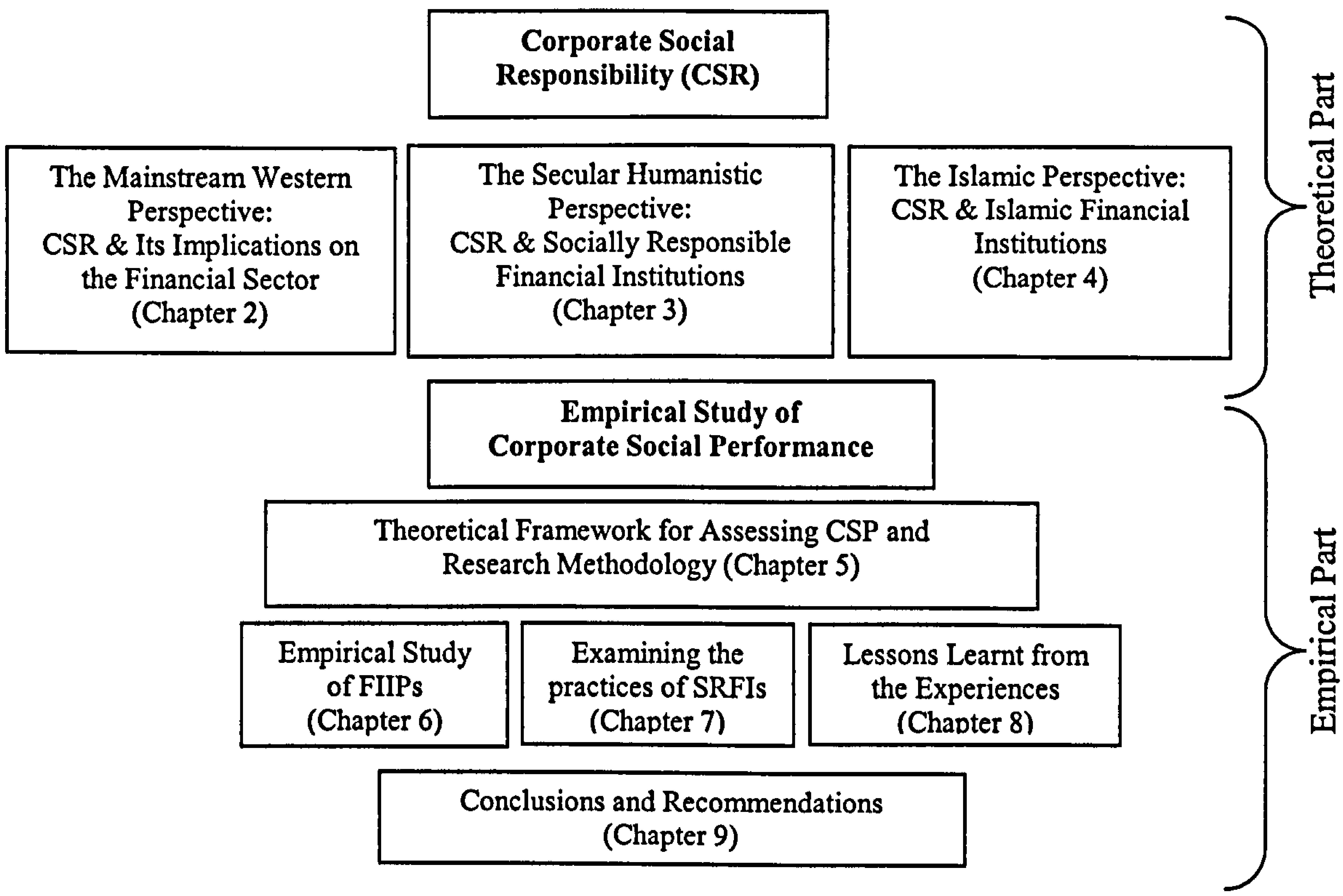
Chapter 8 - *Comparison of the CSR Practices of FIIPs and SRFIs: Lessons Learnt from their Experiences.* This chapter makes a comparison of the practices of the FIIPs and SRFIs and delineates some of the lessons that can be learnt from the SRF industry, which are believed to be relevant for consideration by the Islamic finance industry.

*Chapter 9 - Conclusions and Recommendations.* This chapter summarises the findings of the study, presents some policy implications and concludes.

## 1.6 Flow Chart of the Thesis

A flow chart of the thesis is presented below to elucidate the flow of ideas involved in the study.

**Figure 1.1 Flow Chart of the Thesis**



# CHAPTER 2

# The Mainstream Western Perspective: CSR and Its Implications on the Financial Sector

## 2.0 Introduction

It is common practice for businesses to get involved in different forms of social provisions. Until the 20th century, the social responsibility of European and American businesses has remained mostly implicit and voluntary, taking the form of charitable donations, corporate philanthropy, or paternalistic behaviour (Moon, 2005: 51). Recent discussions on the social responsibility of businesses have, however, extended the concept of corporate social responsibility (CSR) to involve more than philanthropy. The trend since the 1990s, particularly in Europe, is for CSR to move towards a more explicit yet voluntary role of businesses. The participation of businesses in CSR has in turn broadened, to encompass such issues like – socially responsible products and processes, socially responsible employee relations, socially responsible investments, ethical trade, social reporting, stakeholder engagement, and business codes and standards (Moon, 2005: 55-57).

This chapter discusses the concept of CSR from a firm's perspective and highlights the increasing attention attributed to it at the corporate level. Thereafter, it examines its various definitions and dimensions. In the light of the growing significance of CSR for financial institutions – which like any other firms cannot be dissociated from their economic and social contexts – this chapter uses Carroll's (1979) four-part definition of CSR to discuss the CSR responsibilities of financial institutions. To this end, it emphasises how the practice of CSR is impacting on high street banks, has given rise to the development of global CSR codes within the financial sector and is leading to the development of a range of socially-oriented financial institutions.

## 2.1 Projecting Responsibility onto Corporations: A Firm's Perspective

The debate about the social responsibility of corporations in the first instance centres on their roles in society (Habisch and Jonker, 2005: 1). The challenging questions posed are: Should the objectives of corporations be profit oriented and/or be social and philanthropic? Should corporations balance their economic and financial prerogatives with social welfare objectives? Is it meaningful to assign ethical and social responsibilities to corporations?[1]

Earlier discussions on the social responsibility of businesses, which developed in the USA, are usually associated with the views of Friedman (1970). Friedman proposed that *"the social responsibility of business is to increase its profits"* and thus defined a socially responsible business as one which *"use*[s] *its resources and engage*[s] *in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud"*. In other words, Friedman believed that the financial priorities, whilst undertaken within the framework of the law and ethics, should rank as the prime concern of a business. To this end, he asserted that the social benefit of the business would be in terms of its contribution in the creation of wealth and employment. Charitable activities or so-called moral responsibilities were not perceived by Friedman (1970) as part of the objectives of a business. His reasoning was based on three key premises: (i) moral responsibilities are to be assigned only to individuals and in this case the corporate executives, not the corporation which is considered an independent entity, (ii) it is the responsibility of managers to serve the interests of the shareholders and increase their wealth rather than giving it away through overt charitable activities, (iii) social issues should be addressed by the state rather than be the prerogative of corporate executives who are neither trained to set and achieve social goals nor democratically elected to do so (Crane and Matten, 2004: 39). Friedman's position that corporations should pursue profits and work to increase shareholders' value has been associated with the worldview of neo-classical economics which is motivated by the self-interest principle as opposed to a concern for the social interest (Dusuki, 2005: 19). His argument is also referred to as the

[1] This question is asked in the light of the definition of a corporation, which is taken as a juristic legal person with ownership of its own assets and with certain rights and responsibilities (Crane and Matten, 2004: 38). In view of its ownership structure (where shareholders are only responsible to the extent of their share held in the corporation) and its management structure (where management's fiduciary responsibility is to foremost protect the interest of shareholders), it can be argued that the social responsibilities of corporations are inherently limited (Crane and Matten, 2004: 38-39). This leads to the question as to how far a corporation can spend towards the social welfare of its stakeholders.

"efficiency" view of CSR (Rodriguez *et. al.*, Not dated) or the "economic model" of CSR (Carroll and Buchholtz, 2006: 31).

Others – with some of the proponents being Sethi (1975, 1979), Carroll (1979), Wartick and Cochran (1985), Wood (1991) – believed that businesses can simultaneously seek to be philanthropic or society-concerned while maintaining a profit-seeking strategy. The best practice, according to this viewpoint, is not merely the maximisation of profits, economic efficiency or fair dealing. Rather, it is about businesses endeavouring to uphold the moral standards acceptable to society and fulfilling their responsibilities towards the general community (Lewis, 2005: 13-14). The model of CSR has therefore progressed from the 'economic' to a 'social' or 'stakeholder' model where not only the benefits of the corporation are sought but also those of the stakeholders, including shareholders and the larger society (Carroll, 1998: 593; Carroll and Buchholtz, 2006: 32).

Several theoretical explanations have been put forward in the literature which set the foundational basis for firms to embrace a socially responsible approach which extends beyond profit maximisation. The social contract theory, for instance, establishes a formal or explicit relationship between society and businesses in the form of laws, regulations, rules and procedures; such relationship may also be informal or implicit in the form of commonly accepted traditions (Lenssen and Vorobey, 2005: 358). The explicit or implicit contracts provide a reference point to businesses with regard to society's expectations of them.

Wood's (1991: 695-699) propositions of the *"principle of institutional legitimacy"*, the *"principle of public responsibility"* and the *"principle of managerial discretion"* could moreover be used to explain the motivations for businesses to abide by social contracts. According to the *"principle of institutional legitimacy"* of Wood (1991: 696), legitimacy and power are granted to businesses by society such that business institutions are expected to use this power in a socially responsible way. Those who abuse this power will otherwise tend to lose their *"license to operate"* in the long run (Davies, 2003: 304). Preston and Post (1975) added that socially responsible behaviour is expected of firms because they exist and operate in a shared environment. The *"principle of public responsibility"*, on the other hand, argues that business organisations are responsible for the outcomes related to their primary and secondary areas of societal involvement. To this end, they are deemed responsible for solving problems they have caused and those related to their business operations and interests (Wood, 1991: 697). Lastly, the *"principle of managerial discretion"* focuses on the discretion possessed by managers as moral actors to promote socially responsible outcomes and not to shun their responsibility *"through reference to rules, policies, or procedures"* (Wood, 1991: 699).

## 2.2 The Growing Movement of CSR

According to Davies (2003: 307), the growing movement of CSR has emerged in response to a combination of forces, such as government involvements, market forces, and social regulation.

Davies (2003) notes the increase in *"top-down compliance"* in the form of reporting requirements or government regulations. This is particularly relevant in the case of the UK where the government has made domestic and global CSR policies one of its priorities. Government has, for instance, appointed a cabinet minister to coordinate CSR policies. It has also amended a number of regulations requiring the disclosure of SEE factors in investment decisions (Aaronson, 2003: 313).[2] As a result of government initiatives, for example through the publication of the EU Green paper to facilitate CSR, and initiatives taken by the UK Department of Trade and Industry, the institutionalisation of CSR policies within the UK is increasingly taking the form of a voluntary, yet, explicit business strategy (Matten and Moon, 2005: 350).[3] In this way, investments towards CSR initiatives have been growing. It is reported that Britain's

[2] For instance, on 3 July 2000 the amendment of the 1995 Pension Act and the enactment of the SRI Pensions Disclosure Regulation came into effect. This encouraged more and more UK pension funds to formally consider SEE factors in their investment strategies (UK Social Investment Forum, 2003). Similarly, the Charity Trustee Act 2000, which became operational since February 2001, requires charity trustees to ensure that investments are "suitable" financially and ethically and are in line with the charities' aims and purposes (UK Social Investment Forum, 2003).

[3] As Crane and Matten (2004: 28-29) further note, the promotion of CSR within Europe has been primarily collective, with involvement of government, trade unions and corporate associations, and with a tendency for CSR guidelines to be codified in the negotiated framework of business. As such, socio-ethical issues like genetic engineering, nuclear power, animal testing have been observed to be concerns which ranked higher in the public-corporate agenda in Europe than in the USA (Crane and Matten, 2004: 47). Likewise, the philanthropic responsibilities of businesses have been mainly the discretionary acts of successful companies or wealthy capitalists in the USA whilst these are compulsory via the legal framework in Europe (Crane and Matten, 2004: 47).

largest companies have invested up to £855 million in CSR initiatives since 1999 and more than 100 major UK companies now contribute one percent – the recommended standard set by the Business in the Community (BITC) – of their pre-tax profits to community investment in terms of cash donations, staff time, management time, and gifts-in-kind (Steele and Cleverdon, 2004).

This compares with the case of the USA where CSR policies are not promoted at a governmental level but left to be determined by market values. The prevailing belief is that market forces will reward the ethically-conscious and penalise the corrupted, hence coercing corporations to act responsibly (Aaronson, 2003: 312). Government regulation is instead commonly regarded as *"interference with private liberty"* (Crane and Matten, 2004: 47). In the USA, CSR is also driven by a strong culture of individualism where decision making on ethical issues is perceived to be the responsibility of every individual rather than being the state's responsibility (Crane and Matten, 2004: 27-28). The key actor in the development of CSR policies is therefore viewed to be the corporation, with CSR guidelines being developed in the form of corporate codes of ethics and internal compliance programmes at the individual firm level (Crane and Matten, 2004: 29).

Davies (2003: 307) further cited the working force of markets where CSR is being driven by the demands of customers, employees or investors. In this respect, the growing consumer demand for 'ethical' products is highlighted – a trend which has led to the rise in the fair trade and ethical trade movements (Worthington *et. al.*, 2003: 10). The growth in investor pressure for the integration of SEE criteria in investment selection can also be emphasised here. This has encouraged the setting up of socially responsible investment (SRI) funds which have especially taken off in the USA and the UK. This growth in consumer demand can perhaps be explained by the rise in demand for ethics at both the institutional and individual levels as a result of increased occurrences of issues like bribery, corruption, money laundering and terrorist financing. Worthington *et. al.* (2003: 10) noted the growing stakeholder demands for CSR and social reporting in the light of a series of corporate scandals and environmental preoccupations.

Moreover, Davies (2003: 307) highlights the *"reputation pull"* force where, in order to safeguard their reputation and attract investment, firms are motivated to act responsibly. In fact, several studies have reported on the business case for CSR (e.g. Davis (1973), Business in the Community (2000); Little (2003); Walter (2004: x); Diamantopoulou (2004: v), Roberts *et. al.* (Not dated)). Some of the recognised benefits for adopting CSR as a management strategy are argued to include: (i) improved corporate reputation from the media, government, investors, community, employees, clients; (ii) better management of long term risks by protecting the business from being involved in irresponsible social and environmental scandals and avoiding government regulations; (iii) build up in credibility and trust which assist in hiring and retaining staff and increasing employee satisfaction; (iv) stimulation of learning and innovation as companies identify new market opportunities and improve their business processes to maintain competitiveness; and (v) improved market positioning and long term profitability.

Finally, there is the impact of shocks, scandals and crises – in the form of lawsuits, embarrassing protests, revelations, denial of capital, threats, sanction of regulation – which are said to *"have often, if regrettably, achieved more progress in raising ethical behaviour than has moral suasion"* (Davies, 2003: 303). These scandals entail both legal and moral risks – whether through adverse consequences of non-compliance with the law or reputational damage – which corporations seek to mitigate through CSR compliance.

## 2.3 CSR: Definitions and Dimensions

After all, what does the notion of social responsibility actually mean? It is noted that there is a variety of terms that are used in the literature to connote the social responsibility of businesses – examples include CSR, corporate citizenship, corporate accountability, corporate governance, business ethics, ethical corporation, corporate responsibility and sustainability, stakeholders' interests, sustainable corporations, and the triple bottom line approach (Worthington *et. al.*, 2003: 9; Valor, 2005: 191). The wide array of terms utilised inevitably reflects the broad arena of concepts involved under the umbrella term CSR: social, ethical, moral issues; accounting;

reporting; governance; sustainability; the environment; and responsible business behaviour. Nonetheless, the underlying principle in these terms is that corporations are concerned not only with the quest for profits and economic performance. Rather other criteria of evaluating firm performance are deemed important.

A variety of definitions of CSR can be found in the business and management literature (see Carroll and Buchholtz, 2006: 34-35). Different organisations and authors have submitted their respective definitions, with some focusing on the notion of *"sustainable development"*, *"increased economic welfare"*, search for a balance between positive and negative impacts of the firm, and meeting *"the legal, ethical, social, and commercial responsibilities of businesses"*.[4] Overall, the idea of social responsibility is associated with the concern of corporations of the impact of their actions on the welfare of society (Carroll and Buchholtz, 2006: 30). With a view to have a *"positive and productive"* impact on society, CSR thus represents the set of standards of behaviour that corporations subscribe to (Davies, 2003: 306).

One of the most widely accepted definitions is the one provided by Carroll (1979: 499). He utilises a sophisticated approach in defining CSR in terms of four responsibilities that society expects corporations to shoulder: economic, legal, ethical, and discretionary.

1. The **economic responsibility** *required* of a business is for it to be foremost profitable, efficient, and viable. It would, for instance, include producing goods and services that society demands, supplying quality products at fair prices,

[4] Often CSR presumes the notion of sustainable development and asks of businesses to set economic, social and environmental objectives and act in such a way as to meet society's expectations (Henderson, 2001: 15-16). This is reflected in the definition of CSR provided by the 'World Business Council for Sustainable Development' which stipulates: *"Corporate Social Responsibility is the continuing commitment by business 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"* (Holme and Watts, 2000). Hopkins (2004: 1) associates CSR with the concept of increased economic welfare by creating *"higher and higher standards of living, while preserving the profitability of the corporation, for peoples both within and outside the corporation"*. Jupiter, an investment fund in the UK, perceives CSR more as a way of balancing positive and negative impacts. It defines CSR as *"operating a company in a responsible way so as to maximise its positive impact and minimise any negative impact on the environment, society and the economy"* (Jupiter Asset Management, www.jupiteronline.co.uk). The 'Business for Social Responsibility' associates CSR *"to business decision making linked to ethical values, compliance with legal requirements and respect for people, communities and the environment, in a manner that meets or exceeds the ethical, legal, commercial and public expectations that society has of businesses"* (www.bsr.org).

earning a reasonable return for its shareholders, providing safe and fairly paid employment to the workforce, and above all to operate in such a way as to stay in business (Matten and Moon, 2005: 337).

2. The **legal responsibility** *required* of a business is for it to obey the laws and regulations of the land under which it operates.

3. The **ethical responsibility** *expected* of a business refers to those over and above the legal requirements – responsibilities that embody ethical norms, but not necessarily codified into law. According to Carroll (1998: 594), the ethical responsibility *"embraces a response to the "spirit" of laws and regulations and helps guide business actions in those decision arenas in which regulations are ill-defined or non-existent"*. Some examples could include, ensuring compliance to societal values, norms and standards; showing concern for the environment and sustainable development; adopting fair practices in employee recruitment; discouraging child labour; not engaging in misleading advertising; and showing concern for Third World debt.

4. The **discretionary responsibility** is the *desired* social expectation that the firm will assume social roles over and above those aforementioned. It will act as a good corporate citizen by caring for and investing in the society it operates in. This may take the form of corporate philanthropy or corporate giving, which is considered the highest level of responsibility desired by society, assumed after the economic, legal and ethical responsibilities have been respectively met (Gitman and McDaniel, 2002: 110). Corporate philanthropy may include monetary contributions to charitable causes, supporting educational institutions and NGOs, offering managerial expertise and technological resources for causes the institution supports, providing staff welfare, and sponsoring community events (Coffey, 1998: 151). Discretionary responsibility is said to be connoted with social roles which are adopted purely on a voluntary basis to help society and not necessarily expected of businesses in a moral sense.

It is noted that the core debate within CSR, as defined by Carroll (1979), relates mainly to the voluntary corporate policies with respect to the ethical and discretionary responsibilities (Matten and Moon, 2005: 337-338). Despite the voluntary nature of these two types of responsibilities (since they are *expected* and *desired* of corporations), it has been observed that many corporations have begun to include them as part of their business strategic objectives (Coffey, 1998: 151). Often, the concept of CSR is being defined as a *"decision-making strategy"* rather than as an *"ethical commitment"*. This is reflected in the definitions of CSR provided by the largest organisations promoting CSR in the USA and the UK (Aaronson, 2003: 310).[5]

The literature highlights two other extensions to the concept of CSR. These relate to the terms 'Corporate Social Responsiveness' and 'Corporate Social Performance'. These terms have been developed in the 1970s through discussions on CSR which progressed from the definition of the CSR issues to the need for evaluating action and eventually assessing social performance. After the identification of socially responsible issues by firms, corporate social responsiveness is the second stage of the CSR philosophy discussed in the literature. As defined by Carroll (1979: 501), corporate social responsiveness addresses the *"philosophy, mode, or strategy behind business (managerial) response to social responsibility and social issues ... [it] can range on a continuum from no response (do nothing) to a proactive response (do much)"*.

The action-oriented variant of CSR – corporate social responsiveness – is expected to yield a societal impact. The literature has, to this effect, discussed the *"outcomes"* of the implementation of CSR policies and their measurement – the Corporate Social Performance (CSP).

The three facets of (i) CSR principles, (ii) responsiveness to CSR principles and (iii) measurement of CSR outcomes have been denoted by Frederick (1978) as $CSR_1$, $CSR_2$ and CSP. Wood (1991: 693) accordingly defined the three stages of measuring a corporation's social performance as an evaluation of *"a business organization's*

[5] The American organisation named 'Business for Social Responsibility' defines CSR as *"business decision making linked to ethical values, compliance with legal requirements, and respect for people, communities, and the environment around the world"* (www.bsr.org/BSRLibrary/Todetail.cfm?documentID=138). Britain's 'Prince of Wales Business Leaders Forum' similarly defines CSR as *"open and transparent business practices that are based on ethical values and respect for employees, communities, and the environment."* (www.pwblf.org/csr/csrwebassit.nsf/content/a1.html).

*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"*. This last aspect of CSP – verification of the social impacts of CSR policies – is assumed to form the main focus of the measurement process (Hopkins, 2004: 23).

**Figure 2.1 Wood's Concepts of Corporate Social Responsibility**


Note: Categorisation of the CSR Concepts in the above diagram is by the Author

Besides the four-part CSR definition of Carroll and the three-part concept of the CSR model of Wood, CSR may also be examined in terms of its four-part dimensions and the three markets it impacts on.

With regard to the CSR dimensions, CSR is reported to have four spheres of influence on businesses:

1. At the 'workplace' in terms of responsible business practices, good corporate governance and ethics, human resource management;

2. At the 'marketplace' in terms of consumer responsibility, responsible behaviour in the production and sales of goods and services;

3. At the 'environmental' level in terms of the impact of businesses on the environment through the building of sustainable business enterprises; and

4. At the 'community' level through corporate philanthropy, corporate involvement in community development, community investment (www.bitc.org.uk, Roome, 2005: 321; Davies, 2003: 306; World Economic Forum/International Business Leaders Forum, 2002).[6]

This integral concept of CSR is especially relevant to the European context where CSR is asserted to be growing into a mainstream management and business issue through its adoption as a core business strategy (Davies, 2003: 316). The above CSR influences on the strategies of businesses may alternatively be classified according to the impacts on the markets in which firms compete. Valor (2005: 198) specified three markets where the social performance of firms has gained attention: product, labour and capital. Some of the CSR issues involved within each of the markets may be elaborated as follows:

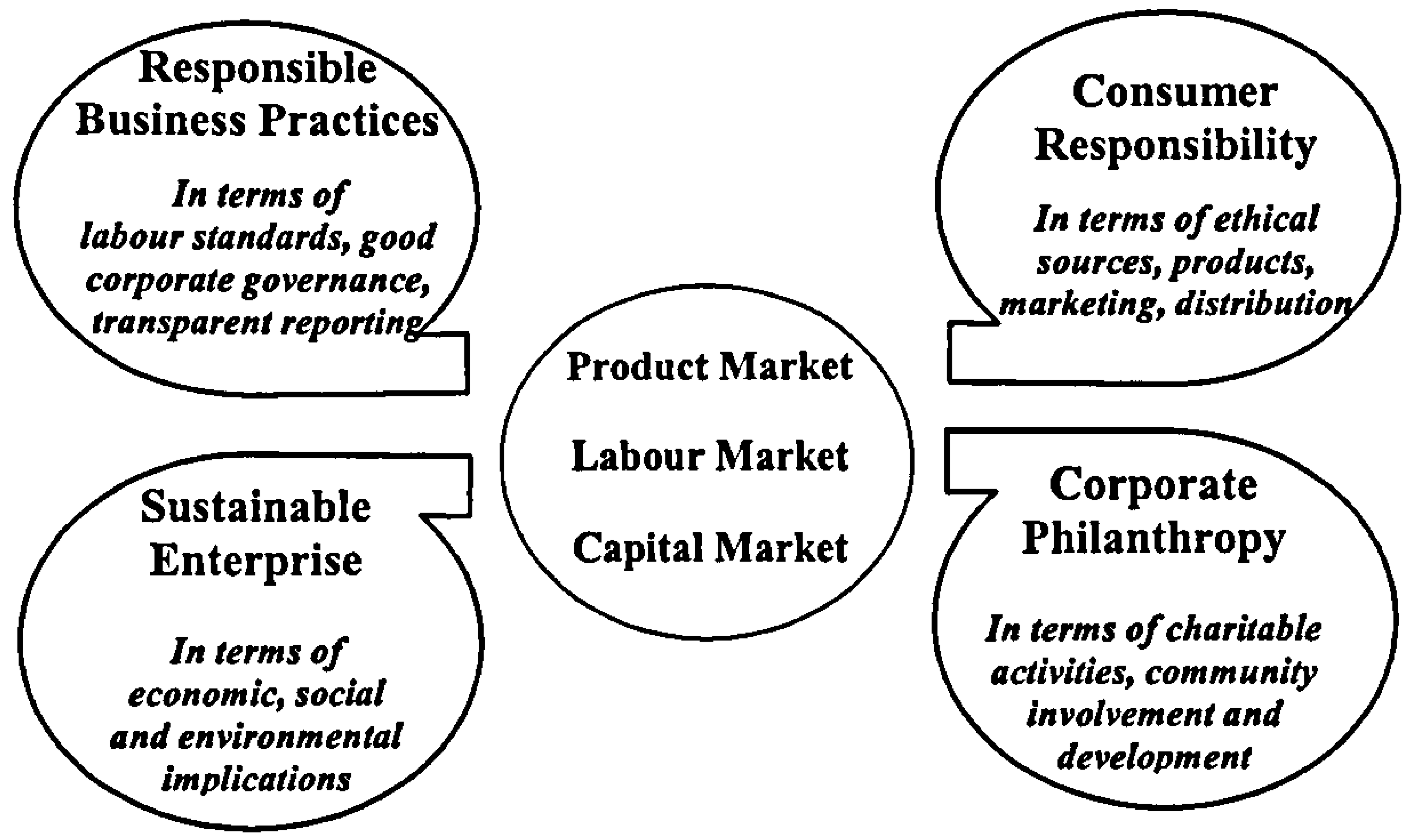
1. Product market – through ethical sourcing and purchasing, subscription to fair trade principles, promotion of ethical consumerism, abidance by socially responsible marketing and advertising standards, and instilling quality management procedures.

2. Labour market – through abidance by human rights standards, development of high standards in the area of human resource management, establishment of good working conditions, opposition to child labour and oppressive regimes.

3. Capital market – through socially responsible investment, support for cooperative or mutual banking, development of community and social banking, financing of micro-enterprises, promotion of Islamic financing.

[6] Business in the Community (BITC) – one of the largest business associations for CSR in the UK – termed the four main agendas of CSR as *"responsible business behaviour in the workplace, market place, environment and community"* (www.bitc.org.uk). Roome (2005: 321), alternatively, defined them in terms of responsible business practices, consumer responsibility, sustainable enterprise and corporate philanthropy and corporate community involvement. The World Economic Forum and the International Business Leaders Forum (2002), on the other hand, defined the dimensions of CSR or rather corporate citizenship as *"good corporate governance and ethics, responsibility to people, responsibility for environmental impacts, and the broader contribution to development"*.

**Figure 2.2 The Dimensions and Impacts of CSR**




Note: Categorisation of the CSR dimensions in the above diagram is by the Author

However, this study focuses on the capital market implications of CSR, or more particularly, financial institutions. A growing number of financial institutions have been influenced by the concept of CSR, bringing about a change in their operating structure and their impact on society. The idea of including social responsibility within financial and economic decisions has thus launched a whole movement on socially responsible finance in the West – a core subject of study in this thesis.

## 2.4 CSR and Its Relevance to Financial Institutions

Financial institutions, including banks and non-banks, are firms which offer an important economic and financial service to society. Their interface with the general society inevitably raises the question pertaining to their social responsibilities. Like other businesses, it can be argued that they cannot divorce themselves from their economic and social contexts. Particularly in today's world where inequalities in wealth, health, knowledge, influence and life chances prevail, financial institutions play a key role towards the alleviation of problems such as poverty and social and economic exclusion (Davies, 2003: 301).

Financial institutions are above all considered legally-operated businesses with an economic purpose (Zeegers, 2001: 153). Regarded as profit maximisers, they are evidently not taken to be charities (Mayo and Guene, 2001: 1). But their involvement with the public instils upon them their own set of ethical and philanthropic responsibilities. Therefore, Carroll's (1979) four-part definition of CSR is believed to be applicable to financial institutions. The four-part area of influence of CSR namely – responsible business practices, consumer responsibility, sustainable enterprise, and community involvement – are also deemed relevant to their operations.

### 2.4.1 The Economic Responsibilities of Financial Institutions

The primary purpose of a financial institution is to provide a range of financial services to customers, public authorities, private individuals and businesses to further their own objective of economic and financial gains (Zeegers, 2001: 153).[7] The following economic functions have specifically been attributed to financial institutions in the literature (Lewis and Algaoud, 2001: 62-63).

- Provide indirect financing. Acting as financial intermediaries, transferring resources from savers to borrowers and investors;
- Accumulate capital. Funding long term projects by pooling funds from various savers;
- Provide liquidity. Reconciling the liquidity preferences of borrowers and savers;
- Select projects. Screening and funding viable projects;
- Monitor funds. Ensuring that funds are used as agreed;
- Enforce contracts. Ensuring that repayments are made by borrowers;
- Manage, transfer, share and pool risks. Raising funds, determining repayment rules as well as establishing who bears the risks;
- Diversify risks. By pooling a large number of investment projects together; and

[7] Financial institutions are conventionally defined as institutions that serve financial markets and include both depository and non-depository institutions (Baye and Jansen, 1995: 35). The former comprise such institutions like commercial banks, community development banks, savings and loan associations, mutual savings banks, and credit unions (Baye and Jansen, 1995: 35-36). Non-depository institutions act like a bank except that they do not accept checking deposits or do not make commercial loans (Kohn, 2004: 161). These constitute of mutual funds, insurance companies, pension funds, brokerage firms and investment funds (Baye and Jansen, 1995: 37-41).

- Record transactions. Keeping records of the payment systems and all exchange transactions.

As financial institutions provide the above services, they add social and economic value by offering products and services needed by society and generating employment in society. These are considered important contributions of financial institutions towards socio-economic development. Nonetheless, as in the case of businesses and firms, it is commonly argued that financial institutions should promote other social responsibilities over and above their economic and legal responsibilities (Zeegers, 2001; Decker, 2004).

### 2.4.2 The Social Responsibilities of Financial Institutions

Zeegers (2001: 153-157) noted some of the ethical and philanthropic responsibilities of relevance to financial institutions.

- Providing security guarantees to their depositors for funds entrusted to them so that confidence in the financial system is maintained;
- Exercising care in the use of funds deposited with them;
- Offering protection to customers for funds deposited with them;
- Showing concern for local social needs by ascribing funds to meet these needs;
- Showing concern for the environment by not lending to or investing in polluting industries;
- Combating social and financial exclusion by allowing access to its services by all groups in society;
- Operating on the basis of mutual trust and transparency; and
- Combating fraudulent and dubious activities.

Other authors like Hodgson (2002) and Ogrizek (2001) attributed to financial institutions the social responsibility to *"know the customer"*. Knowledge of the customer is believed to reduce the information asymmetry problem inherent in lending as well as the likelihood of fraud and money laundering transactions (Decker, 2004: 715). Douglas *et. al.* (2004: 388) further noted that the societal expectations of financial institutions include *"strengthening corporate governance, fighting money laundering, preventing tax evasion, protecting financial privacy, equal opportunity employment, and promoting environmental awareness"*. Decker (2004) mentioned such issues like *"secure products ...appropriate for the lifestyle of a cross section of society"*, *"trust, customer knowledge, prudent management of funds, proximity and accessibility"*, *"channelling funds from savers to productive uses"* and *"promoting social cohesion"*.

Inevitably, these social responsibilities could be argued to represent a challenging task for financial institutions to undertake. Specifically, it is noted that the literature does not attribute philanthropic responsibilities *per se* to financial institutions – for example in terms of donations and charities. Rather the emphasis appears to be on the need for developing responsible corporate behaviour, professional and ethical business practices, customer responsibility and developing social responsibility in project financing. These have in turn been encouraged through the establishment of voluntary CSR codes of conduct relating to financial institutions like the "Equator Principles" and the standards set by the Forge Group.[8] A number of other voluntary global CSR guidelines which seek to promote responsible corporate behaviour also prevail. Examples are the Caux principles, the Global Reporting Initiative, the Global Sullivan Principles, the Principles for Global Corporate Responsibility: Benchmarks,

[8] The Equator Principles are voluntary guidelines developed by the International Finance Corporation and supported by major financial institutions to ensure that responsible environmental stewardship and social safeguard policies are incorporated into the infrastructure projects financed by financial institutions, especially in emerging markets (www.equator-principles.com; EIRIS, 2003a: 2; Blecher, 2004). It has been endorsed by about 33 financial institutions, including major banks such as Barclays Plc, HSBC, Citigroup, Bank of America and Westpac Banking Corporation (www.equator-principles.com).

The Forge Group, on the other hand, relates to a group of major financial services providers – including Barclays, Abbey National, Lloyds TSB, Royal Bank of Scotland – which published its "Guidance on Corporate Social Responsibility Management and Reporting for the Financial Services Sector" in 2002. This was meant to provide a practical toolkit to financial institutions to understand and address CSR issues relevant to the financial services sector such as financial inclusion, involvement and investment in the community, labour standards and other ethical issues (EIRIS, 2003a: 2; FORGE-Group, 2002).

the UN Global Compact, and the OECD Guidelines for Multinational Enterprises (Carroll and Buchholtz, 2006: 324; HSBC 2003: 11-12; Hopkins, 2004: 31).[9]

## 2.5 The Practice of CSR by High Street Banks in the UK

Some of the above voluntary codes of conduct have been endorsed by even commercially-oriented high street banks such as the Hong Kong and Shanghai Banking Corporation (HSBC) which since the mid-1990s has been seen to publicise its CSR initiatives more vigorously (see HSBC Report, 2003: 11-12). In its CSR Report (2003: 2), the bank states "*For HSBC, good CSR is good business*" and is thus observed to perceive CSR as a long term business practice for addressing the needs of its stakeholders.[10] In recognition of its leadership and innovation in integrating SEE objectives into its operations without neglecting the goal of maximising shareholder value, it is noted that HSBC, UK has been nominated in the list of the 'Sustainable Bank of the Year' for the Financial Times Sustainable Banking Awards 2006.[11]

The practice of CSR by high street banks in the UK has been much influenced by the moral suasion used by government to address CSR issues and gain the compliance of

[9] A brief description of these voluntary codes of conduct is as follows (Carroll and Buchholtz, 2006: 324; HSBC 2003: 11-12):

- Caux Principles (Issued in 1994). Recommendations which promote ethical and responsible corporate behaviour, especially addressing the social impact of company operations on the local community.
- Global Reporting Initiative (Revised in 2000). An international voluntary reporting standard promoting the reporting of the economic, environmental and social dimension of an organisation's activities, products and services.
- Global Sullivan Principles (Proposed in 1999). Standards which address social, economic and political justice issues such as human rights, equal opportunities in employment, ethics and environmental practices for endorsement by multinational companies and their business partners.
- Principles for Global Corporate Responsibility: Benchmarks (Revised in 1998). Include 60 principles and benchmarks that could be used as a model framework to assess corporate social performance.
- UN Global Compact (Issued in 1999). Advances nine principles in three key fields, namely labour standards, human rights and environmental responsibility.
- OECD Guidelines for Multinational Enterprises. Encourage responsible business conduct in the field of sustainability.

[10] Reporting its CSR policies has been one way of promoting how the bank meets its social responsibilities. The HSBC CSR Report (2003: 3) highlights the bank's CSR approach since its early days, including publication of its first environmental policy in 1997, publication of its first statement of *Business Principles and Values* in 1998, and publication of its CSR Report in 2001 entitled *HSBC in the Community: Sharing our Success 2000.*

[11] http://news.ft.com/

retail banks with government schemes (Decker, 2004: 722). The government for instance instituted a universal banking programme whereby it required *"banks to either set up basic bank accounts as part of their existing product range or participate in the Post Office's "universal bank""* (Decker, 2004: 722). Government's expectations for banks to "meet their social obligations" as well as "discharge financial exclusion obligations" were also incorporated into the Banking Code – which is reported to have largely influenced the behaviour and strategies of banks to demonstrate appropriate CSR policies (Decker, 2004: 721-722).

EIRIS (2003a) reported on the following non-financial performance of thirteen leading UK high street banks: their holding of third world debt, publication of ethical lending policies, operations in countries under oppressive regimes, publication of policies addressing financial and social exclusion, environmental policy, equal employment policy, and community involvement commitment. It was observed that banks like Barclays, Lloyds TSB, Northern Rock, Royal Bank of Scotland and the Co-operative Bank were the best performers in terms of their SEE screening, with the Co-operative bank being judged as the best overall performer (EIRIS, 2003b). The Co-operative Bank, in particular, is considered one of the main UK high street banks with a clear commitment to social responsibility. The bank developed its ethical policy out of a survey conducted in 1991 wherein it found that 84% of its 30,000 sampled customers wanted the bank to have an explicit ethical policy (Kitson and Campbell, 1996: 68). This support from its customers, according to the bank, had increased to 97% in 2001.[12] The bank considered such strong support of ethics as a *"mandate to pursue"* and it is today well-known for the institutionalisation of its ethical policies (Kitson and Campbell, 1996: 68).

According to Becker (2004: 725), some high street banks in the UK are addressing the challenges presented by CSR by collaborating with other banks, social organisations, and other financial institutions embracing a socio-economic mission like Community Development Financial Institutions (CDFIs) and credit unions. In this way they participate in addressing problems like financial exclusion and assist in community regeneration. Retail banks like Lloyds TSB have further been seen to

[12] www.co-operativebank.co.uk

support charity works in the fields of social and community needs and encourage education and training programmes through its various UK foundations.[13] The NatWest Group – one of the world's largest and best capitalised banking groups involved in retail and corporate banking – is another mainstream financial institution which is reported to have made considerable effort in fulfilling its philanthropic responsibilities through its corporate community investment strategy (Hughes and Robinson, 2001: 164-169).

## 2.6 Growing Prevalence of Socially-Oriented Financial Institutions

Besides the promotion of CSR by mainstream financial providers, it is observed that since the 1990s there has been an elevation in the provision of financial services to a prominent social role such that banks and non-bank financial institutions (NBFIs) have been re-engineering their products, processes and services in order to increase their social impact (Mayo and Guene, 2001: 1). These suppliers of financial services are said to "*take a positive interest in the social outcomes and effects of their activities*" whilst being driven by financial returns (Mayo and Guene, 2001: 1). In some cases, ethics is another key motivating factor of these financial institutions. This trend could be recognised under the labels of 'social banking', 'socially responsible investment', 'ethical banking', 'micro-financing', 'community reinvestment', and 'cooperative banking' (Mayo and Guene, 2001).

To this end, a diverse range of financial institutions have emerged which, above all, seek to service the local economy and the community. Some of these experiences have developed in Third World countries, like the micro-credit movement, which have been in turn employed in industrialised countries to serve their respective local needs (Rocard, 2001: vii). Micro-credit institutions act as 'social banks', taking initiatives to support the disadvantaged, the poor and small and medium businesses which are otherwise excluded from financial assistance. In the UK, the emphasis on the social goals of financial institutions has led to the development of a number of "mutual" financial institutions – like credit unions, savings and loans funds, retail

[13] See www.lloydstsbfoundations.org.uk/reports_funded.html for a list of reports on areas like homelessness, training, young people, disabled people which the Lloyds TSB Foundations have funded over the recent years.

cooperatives, friendly societies, provident and building societies (Decker, 2004: 721). According to the Government Policy Action Team 14 of 1999, the scope for developing credit unions in the UK was looked into as a government strategy to combat financial exclusion among communities in disadvantaged areas (Decker, 2004: 717). Mutual financial institutions are said to play an equally, if not more, important role in the retail financial market in countries such as Australia, Germany and the USA (Decker, 2004: 723).

Community Development Financial Institutions (CDFIs) are another type of financial institution with a social mission.[14] Generally defined as "*private sector*" "*locally controlled*" "*market driven*" "*specialised financial institutions*" "*with community development as their primary mission*", they are perceived as *"a vital tool for boosting enterprise and wealth creation"* (Dewees, 2004; Coalition of CDFIs (a), Social Investment Task Force, 2003: 12). Their key role is to serve in the social, economic and physical renewal of under-invested communities – by creating jobs, economically empowering individuals, building local businesses, and developing entrepreneurial capacity. Importantly, they seek to help people out of poverty by encouraging self-sufficiency through enterprising instead of depending on grants Social Investment Task Force, 2005: 10). CDFIs have spread largely in Europe and the USA and are expanding worldwide.[15]

Schuster (2001: 160-161) further observed that the commitment of financial institutions (in particular banks) towards social objectives has been in the form of

[14] CDFIs have a variety of structures and development lending goals. Six basic types of CDFIs have been noted in the literature: (i) community development banks, (ii) community development credit unions, (iii) community development loan funds, (iv) community development venture capital funds, (v) micro-enterprise development loan funds, and (vi) community development corporation-based lenders and investors (Coalition of CDFIs (a)).

[15] The CDFI industry registered a dramatic boost in the USA in the 1990s and based on its success, the CDFI sector in the UK was modelled in the years 2000s (UK Social Investment Forum, 1998-2003). The number of CDFIs in the USA is reported to be over 700, operating in every state and serving both urban and rural communities (Coalition of CDFIs (b)). The US Government agency – the CDFI Fund – has awarded more than US$ 700 million of funding to CDFIs since its inception in 1994 (Coalition of CDFIs (b)). In the UK, the community development finance sector is said to have a capital base of £400 million as at April 2005 and has financed over 9,000 businesses in under-invested communities, thus creating 10,000 jobs and sustained an additional 85,000 jobs (Social Investment Task Force, 2005). It is reported that there are about 55 CDFIs which form part of the Community Development Finance Association (cdfa) in the UK (Community Development Finance Association, 2003-2005).

"corporate citizenship". As an act of good corporate citizenship, many banks have set up socially-oriented foundations under which they fulfil their social obligations.

Some financial institutions have taken one step further by specifically promoting social and ethical issues, over and above embracing professional ethics. They have labelled themselves as "socially responsible" or "ethical" financial institutions. Their activities would combine commercial (economic) functions as well as SEE strategies. The socially responsible investment (SRI) movement has largely emerged in the Anglo-American societies and since the 1990s it has been attracting increasing attention from investors in other parts of the world. Financial institutions, mainly those located in the West, have accordingly responded to this demand for ethical financial services. Chapter 3 examines in further detail developments in the SRI industry.

## 2.7 Conclusion

On the basis of discussions in this chapter, the concept of CSR can be said to be associated with the following characteristics: (i) it is not limited to the concept of philanthropy, (ii) it is concerned with the economic, legal, social, environmental, ethical and philanthropic aspects of organisational behaviour, (ii) it is rooted in ethics, (iii) it can be perceived as a balance between ethics and profits (iv) it takes account of a multiple stakeholder approach (Worthington *et. al.*, 2003: 10), and (v) it is of a voluntary nature but being increasingly adopted as an explicit approach in the form of an integral business strategy (especially in the European model and particularly in the UK). As a business practice, CSR is impacting on the operations of all types of businesses, including financial services providers. Studies examining the practice of CSR in the financial sector are relatively few as this is a new development evolving since the 1990s. However, the UK model has attracted considerable attention, especially with the developments in the SRI industry – the focus of the next chapter.

# CHAPTER 3

# The Secular Humanistic Perspective: CSR and Socially Responsible Financial Institutions

## 3.0 Introduction

There is a growing number of investors who are interested in the decisions of how their resources are channelled and accordingly question financial institutions about those to 'whom' they direct funds to, 'what' kind of activities they finance, and 'how' the financial resources impact on society and the natural environment (Asaria, 2002). These investors do not limit their concerns to the security or profitability of their investments. They ensure that the funds invested are utilised in an ethical or socially responsible way by investment funds and banks. The idea of including social, ethical and environmental (SEE) values – and recently corporate governance issues (see Baue, 2005b and 2005c) – within financial and economic decisions has sparked a new momentum towards socially responsible finance (SRF) in the West. The debate on SRF has also brought into question the issue of CSR in the arena of finance – a debate which affects both the management structure of financial institutions and deals with their impacts on society.

This chapter examines the SRF movement which is guided by secular humanistic values. It provides an overview of the SRF market, detailing its general evolution and manifestation in mainly the USA and the UK, and discussing the underlying objectives of socially responsible financial institutions (SRFIs) and their screening criteria. It is noticed that the literature has raised some criticisms against the ethical and social performance of SRFIs. These are in turn expounded in this chapter.

## 3.1 Defining Socially Responsible Finance

The SRF movement was initially known as 'ethical investment' in the UK on account of its underlying ethical values (Lewis and Webley, 1994: 171; Sparkes, 2002: 23). The mainstreaming of SRF however contributed in its redefinition to 'socially responsible investment' (SRI) – a term commonly used in the USA (Sparkes, 2002: 23).[1] SRI is equally known in the literature as social investment, socially-aware investment, mission-based investment, cause-based investment, green or sustainable investment, or at times faith-based investment (Social Investment Forum, 2003: 3; Hawken, 2004: 7). SRI has also been defined as the choice of *"investments that reflect the values of the investor"* or investments that express the social conscience of the investor. This has in turn led to its reference as conscience investing (www.eiris.org.uk; Schlegelmilch, 1997: 52; Entine, 1996; Atta, 2000: 9; Grandison, 2003).

Put simply, the investment philosophy of SRI is to integrate ethical values and societal concerns in investment selection decisions and the management of investment portfolios, besides the strict criterion of financial performance (Sparkes, 2002: 22; Cowton, 1994: 215). Non-financial qualitative issues like the nature of the company's activities, the location of the business, and the way it conducts its business affairs thus become important in the choice of investments (Cowton, 1994: 215). These values are generally referred to as SEE issues – social, ethical and environmental. More recently, issues of corporate governance have been included within the concept of SRI and the abbreviation used is ESG – environmental, social and governance (Baue, 2005b and 2005c).[2] Although these values originated from a religious (Christian) background, associated with the Quakers, they do not promote an *"overtly religious message"* and are instead reported to be largely socially determined (Wilson, 2005). The values are said to be derived from the sources of secular ethics which are intuition, the exercise of conscience, social norms, human wisdom, human legislation, valuable consequences, traditions, or past history of societies (Ahmad and Sadeq, 2001: 3; Amjad, 2000).[3] The bases of such values are

[1] According to Sparkes (2002: 23), the association of ethics with personal values within the Anglo-Saxon tradition led to the label 'ethical investment' being most commonly used in the UK, rather than the term SRI which was utilised in the USA. In the light of the increase in institutional investors within SRI and the general negative connotation attributed to the word 'ethical' when used to describe a profit maximising activity of the financial services industry, the label SRI is now preferred. In this research, the terms ethical investment and SRI are considered synonymous.

[2] In this research, we also use the abbreviation GSEE to combine corporate governance, social, ethical and environmental issues.

[3] Beekun (1997: 9-19) further expands on six major ethical systems which serve as general guides to ethical thinking: (i) *self-interest (relativism)* or an individual's own criterion of what is ethical or not;

inevitably subject to changes in opinions over time, space and societies and are believed to be of a transitory nature (Wilson, 2002). Hence, this explains the addition of new issues of current relevance like corporate governance within SRI in the recent years. At times, some investors labelled as *"value-seeking"* may altogether reject the moral underpinning of SRI and instead seek investments in SRI portfolios simply because unethical behaviour causes harm to the financial performance of investments (Baue, 2005a).

Overall, the consideration of non-financial qualitative issues within investment decisions implies that SRI investors seek a balance between financial return, financial risk and the source of the investment return. Through SRI, investors attempt to choose *"investments that make a difference"* thus conveying the ideas of a socially responsible goal, a sustainable development objective, a concern for human welfare, social justice, economic development, peace and a healthy environment, as well as promotion of a fairer financial world (Domini, 2001; Brill *et. al.*, 1999). Yet, the concern for financial return is said to clearly distinguish SRI from charitable giving, for SRFIs are not viewed as charitable organisations (Sparkes, 2002: 22; Cowe, 2003). The premise of financial gain is considered an important goal of SRI.

## 3.2 Evolution of the SRF Movement and Its Driving Factors

The development of the SRF movement is reported to have its roots in the Christian religion. Concerned with religious values, the Methodist Church of North America deliberately avoided the *"sin industries"* – like gambling and alcohol companies – when it decided to invest in the stock market in the 1920s (UK Social Investment Forum, 2003). Its relative success encouraged others to follow suit. The Quakers thereafter pooled investments which avoided weapons manufacture.[4] Thus, public

(ii) *calculation of costs and benefits (utilitarianism)* or the consequences of one's behaviour (an action is stated to be ethical if it brings the greatest benefits for the largest number of people); (iii) *duty (universalism)* or the intention to be dutiful towards other people; (iv) *individual rights (entitlement)* or the value of liberty and rights of individuals to freedom, dignity and choice; (v) *fairness and equity (distributive justice)* or the value of justice which endorses equitable distribution of wealth, benefits and burdens; (vi) *scripture (eternal law)* which corresponds to laws revealed through scripture and the state of nature.

[4] Coombe Financial Services, http://www.coombe.co.uk/investment/ethic_invest.htm

demand for ethically screened investments started initially in the USA. Several geopolitical factors, henceforth, motivated the demand for SRI.

Following discontent with the environmental and social effects of the Vietnam War, the Pax World Fund was established in the USA in 1971.[5] Opposition to apartheid in South Africa also fuelled the ethical movement in both the USA and the UK in the 1980s. Shareholder activism proved successful in leading a large number of firms to divest from South Africa and ultimately contributed in the passing of the Apartheid Act 1986. In the 1990s, the SRI movement gained further attention with increased public's consciousness about anti-globalisation issues, sustainable development issues and the demand for corporate governance on the part of government, corporations and investment institutions (Schlegelmilch, 1997: 49; Eurosif, 2003: 6). Environmental sustainability is, in fact, perceived as a likely catalyst of the SRI movement in the year 2000s as more investors and companies recognise the *"enormous opportunity that exists to prosper by providing the products, services and technologies that are needed to create a sustainable society"* (Henningsen, Not dated). The upsurge in ethical issues like terrorist financing, bribery and fraud in the year 2000s is also noted to have driven the demand for SRI (Schlegelmilch, 1997: 49; Wilson, 1997: 1326).

In the UK, the growth of the SRI sector has been largely propelled by political, legal and regulatory changes since the 1990s. Political interest like that from the then Pensions Minister John Denham contributed to the promulgation of regulations which gave a boost to the ethical movement (Sparkes, 2002: 9). The July 2000 amendment of the UK Pension Act 1995 is asserted to have led investments by UK pension funds using SRI criteria to leap from a nil value in 1997 to £80 billion in 2001 (Sparkes, 2002: 348).[6] Similarly, the February 2001 amendment of the Charity Trustee Act 2000, requiring charity trustees to ensure that investments are *"suitable"* financially and ethically, resulted in a boost in SRI assets held by charities from £8

[5] Coombe Financial Services, http://www.coombe.co.uk/investment/ethic_invest.htm

[6] The UK Pensions Disclosure Regulation requires trustees of occupational pension funds to disclose in their "Statement of Investment Principles" (SIPs) the extent to which SEE considerations are taken into account in their investment strategies (Higgs, Not Dated). This encouraged an increasing number of pension funds to formally consider SEE policies in their investment strategies and/or delegate SRI to the investment houses that manage their funds (UK Social Investment Forum, 2003).

billion in 1997 to £25 billion in 2001 (Sparkes, 2002: 348). Regulatory issues have additionally gained importance following the many instances of financial scandals and unethical business conduct involving well-known international firms. The frequency of mass media reports on cases of frauds, insider trading and the manipulations of books in the last decades has seemingly placed issues like shareholder and management responsibilities, corporate governance, and corporate social reporting onto the political agenda. There is now increasing pressure on companies to be transparent about their SEE impacts (EIRIS, 2003b).

## 3.3 The Screening Criteria: Endorsing Humanistic Values

SRF, by its nature, is selective in its composition of investment portfolios. SRI investors or providers adopt a screening technique to select their investments. These non-financial qualitative screening criteria, as stated earlier, are classified under SEE or ESG issues and range from international to domestic concerns. Accordingly, SRI funds and investors screen companies on a positive or negative basis – choosing companies whose activities include socially laudable practices that will entail making a positive contribution to society and avoiding companies engaged in socially negative behaviour that will cause harm to society. In practice, SRI funds tend to include/exclude one or several of the positive/negative company attributes.[7] Investors, on their part, tend to invest in those SRI funds which meet their social and ethical preferences.

Some of these negative and positive criteria endorsed by investors are listed in Table 3.1. In general, the issues centre on the environment, human rights, animal welfare, and corporate governance.

[7] Funds which employ positive screening in their investment decision analyses are referred to as "dark green" or "light green" funds (Pridham, 2001). While the former are viewed as the most ethical or the greenest investments available in the market, the latter's policies will not include strict evaluative criteria in choosing their investments. The light green funds evolved in the mid-1990s while the dark green funds prevailed mostly in the 1980s (Pridham, 2001).

**Table 3.1 Positive and Negative Screening Criteria Underlying SRI**

| Positive Criteria | Negative Criteria |
|---|---|
| • Exhibition of proactive HRM and high employee welfare standards | • Poor employment conditions |
| • Good equal opportunities record | • Contravening labour and human rights |
| • Environmental improvements, pollution control, waste management | • Environmental destruction, Logging, Mining, poor pollution control |
| • Conservation of natural resources | • Poor health and safety records |
| • Recycling, Renewable energy | • Mistreating of animals; Animal testing |
| • Investment in public transport, education and training, telecommunications, IT | • Exploitation of Third World countries |
| • Charitable giving and support to the community | • Armaments trade and financing of the armament industry |
| • Production and supply of basic necessities | • Pornography |
| • Good relations with customers and suppliers | • Nuclear power |
| • Involved in reducing the debt problem of Less Developed Countries | • Tobacco, Alcohol, Gambling, Drugs |
| • Financing of third world projects | • Offensive or false advertising |
| • Advancement of science and technology | • Lending to oppressive regimes |
| • Investing in employment generation projects | • Fraud, insider trading, manipulation of books |
| • Fighting social and financial exclusion | • Bribery and corruption |

Note: The Screening Criteria are drawn from various sources

Some investors attempt to balance a diverse set of positive and negative issues that companies are involved in to select the best ethical performers. This is usually termed as *"best of sector investing"* and includes companies which make the greatest effort in addressing SEE issues. This approach is expected to encourage least ethical companies to improve their activities. It is thus described as *"invest[ing] in the best, encourag[ing] the rest"* or investing in *"the better companies and encouraging them to do even better"* (McCallin, 2001; Cowe, 2003).

While choosing companies that make a positive contribution to society, some investors select companies that represent industries of the future. This practice is called *"thematic investing"* and includes companies that play an important role in sustainable and environmentally safe development, that are involved in renewable energy, waste management, public transport, and encourage emerging industries. Some others prefer funds which direct finance to communities that would, otherwise, not deserve traditional financial services – a practice which is termed *"community* *investing".*[8] The target groups are mainly low-income individuals and small businesses that encounter difficulties in accessing credit. In the USA, four types of institutions have emerged that focus on the economic development of low- and moderate-income communities: community development banks, community development credit unions, community development loan funds and community development venture capital funds (Baue, 2003b).

A further approach often used by SRI investors to encourage the adoption of CSR processes is to utilise their rights as shareholders to advocate for socially responsible changes in corporate policies, without engaging in screening. This approach is called *"engagement", "shareholder advocacy"* or *"shareholder activism".*[9] It has become a key trend in SRI since the mid-1990s. Its use is believed to generate investor pressure as well as direct media attention – which in turn add more pressure – on corporate executives to improve their behaviour (Shareholder Action Network, 2002).[10] If discussions through engagement with companies fail to improve their ethical performance, often shareholders embark on a stage of "confrontation" where they seek to "embarrass" companies by deploying negative publicity for their unethical behaviour (Smith, Not dated).

In sum, it is useful to highlight the classification of the various layers of screening which underlie SRI. Three categories have been delineated by Eurosif (2003: 10):

- **Core SRI** which includes positive screening (including best of sector) and extensive exclusions (negative screening).

[8] Some authors argue against the inclusion of community investment within the definition of SRI. Sparkes (2002: 25) argued that community development investing *"is based on a banking model rather than on equity finance"* whereby *"investors voluntarily accept lower returns than they could otherwise achieve on these loans to promote social objectives".* Financial return is, on the other hand, a key distinguishing factor of SRI.
[9] UK Social Investment Forum, www.uksif.org/Z/Z/Zsri/mkts/index.shtml#meth
[10] The Shareholder Action Network (2002) highlights several occasions when coercion from shareholders has succeeded in bringing about a turn-around in social and environmental policies and in increasing corporate social responsibility. Abbey (2004) also cites a range of examples where shareholder pressure and a drop in share value caused by negative publicity has spurred change in corporate policies in Canada and around the world. One commonly cited and successful instance of social activism in investment policies is the end of apartheid in South Africa through corporate divestment.

- **Simple exclusions** (negative screening) which resemble a risk management strategy undertaken as a protection against bad reputation.

- **Engagement practices** as a means to influence the behaviour of corporations.

It is observed that, over the years, the screening criteria has progressed from shunning negative issues to including more positive issues and making increasing use of engagement practices between SRI funds and companies. The greater collaboration between investors and companies in the 1990s is suggestive of the growing move of SRI into the mainstream financial market as simple exclusions and engagement are accepted and adopted by the larger financial community (Eurosif, 2003: 11). The head of global SRI at Mercer Investment Consulting noted that mainstream institutional investors already believe that ESG issues can impact on investment performance (quoted in Baue, 2005b). Mainstream investors are not necessarily interested in moral issues *per se*; however, they are increasingly seen to assess their investments based on SRI criteria. This shows a gradual shift of SRI into the mainstream market.[11]

A review of the SRI movement, including developments in the screening criteria, is described in terms of the chronology that follows.

**1920s** In 1928, the first socially responsible mutual fund which screened against alcohol and tobacco was established in the USA. It was named the Pioneer Fund (Sparkes, 2002: 48).

[11] A recent study by Strandberg Consulting (2005) (cited in Baue, 2005f), based on the interview of 42 SRI leaders, predicted that within the next decade there is likely to be a gradual shift of SRI from a moral philosophy to SRI as an instrument for mainstream investors who are concerned that the immoral behaviour of companies will impact negatively on the financial performance of their investments. The study also forecasted that SRI will move from a niche market into the mainstream market as more firms realise that the holding of value-based products implies that other products are non value-based, hence motivating them to ensure that their entire portfolio of investments is socially responsible. Another aspect confirming the mainstreaming of the SRI movement is the increase in the number of players within the industry. These include:

- Specialist research organisations which have been set up to research on the SEE activities of companies, the practice of SRI funds, and help in the setting up of SRI funds. Some examples are EIRIS (UK), IMUG (A German environmental consultancy), Caring (Sweden), Ethibel (Belgium), ARESE (France) (EIRIS, 2000: 2).
- Rating agencies which rate the ethical credibility of SRI funds. Some examples are the Ethical Investors Group (www.ethicalinvestors.co.uk) and Core Ratings (www.coreratings.com).
- Compilers of SRI indices to track the performance of SRI funds. Some examples are Domini 400 Social Index (USA, 1990), Nature Equity Index (Austria, 1997), FTSE4Good Indexes (UK, 2001).

**1960s** In 1967, there occurred the first example of Shareholder Advocacy in the USA when the social justice group "FIGHT" bought shares in Eastman Kodak to campaign for better living conditions and job opportunities for black employees (Sparkes, 2002: 48).

**1970s** Two major events took place: boycott against South Africa and discontent with the environmental and social effects of the Vietnam War. They led to the establishment of the first 'modern' SRI mutual fund in the USA, the Pax World Fund, in 1971.

There was increasing consumer activism against corporate irresponsible behaviour. Social proxy resolution was, for instance, filed against General Motors at its 1970 annual general meeting for its poor safety record (Sparkes, 2002: 50).

Assertion for CSR grew with the establishments of a number of organisations supporting the cause e.g. Council for Economic Priorities (CEP, 1969), Interfaith Center on Corporate Responsibility (ICCR, 1973), Investor Responsibility Research Center (IRRC, 1971) (Sparkes, 2002: 51).

The first ethical bank was set up in the Netherlands, the Triodos Bank, in 1974.

**1980s** The first research organisation on SRI, the Ethical Investment Research Service (EIRIS), was set up in 1983 in the UK with the support of Church groups and Quakers.

The first ethical unit trust fund (mutual fund) was established in the UK, the Friends Provident Stewardship Fund, in 1984.

There were rising concerns about the environment which were motivated by disasters like Chernobyl. The first 'green fund' was launched in the UK, the Jupiter Ecology Fund (originally called Merlin Ecology Fund), in 1988.

**1990s** More geopolitical issues were on the rise: ethical consumerism seeking justice and fairness in trade (fair trade movement); anti-genetically modified foods; anti-globalisation movement.

Screening criteria were gradually shifting from the avoidance of negative activities towards targeting positive activities and investment in 'best of sector' and 'industries of the future'.

**2000s** The SRI movement registered a boost thanks to regulatory support from Governments in European countries. In July 2000 the 1995 Pensions Act was amended, requiring SRI disclosure in the UK. The Netherlands, Belgium, Switzerland, Sweden, Germany, and France followed suit with similar legislation (UK Social Investment Forum, 2003).

SRI movement expands to other continents. Australian government passed the Financial Services Reform Act 2003 which required investment firms to disclose labour standards and SEE considerations in their product disclosure statements (Baue, 2003a).

Prevalence of social indices to track SRI fund performance evolved. Examples include FTSE4GOOD, Dow Jones Sustainability Index, Domini 400 Social Index.

There is increasing use made of shareholder advocacy as a form of SRI criteria.

## 3.4 Growth and Expansion of SRFIs: Some Facts

Essentially, SRI is about equity investments, with the SRI financial products ranging from investments in unit and investment trusts to personal pensions, endowment policies, ethical current and savings accounts, and ethical mortgages.[12] These financial products are dispensed by retail and institutional investment funds.[13] With a view to meeting the diverse financial needs of ethical investors, SRI providers have also come to include high street banks, building societies, mutual societies, investment groups, insurance companies, pension funds, foundations, co-operatives, community development funds, venture capital funds and several speciality ethical funds – with the group taken to equate to the generic term SRFIs in this research.[14]

Motivated by healthy investor demand, competitive financial performance and coupled with regulatory support, a number of SRFIs have come to be currently established in Western environments where they benefit from favourable conditions. The biggest market for SRI is the USA, with US$ 2,164 billion worth of assets invested under SRI in 2003, representing 87% of the world SRI market (Social

[12] www.uksif.org.uk

[13] Retail investors include private individuals who seek investments in ethical investment trusts and personal pension funds. Institutional investors constitute the bulk of the market, comprising banks, corporations, insurance companies, churches and charities, pension funds, as well as other social investors interested in community development.

[14] SRFI is the generic term used in this research to refer to financial institutions adopting a socially responsible approach in their financial activities. It is noted that SRI funds especially are also known as ethical funds, sustainable funds, socially responsible funds, environmental technology funds, green funds, ethically screened funds (Kreander, 2001; The Ethical Investors, www.ethicalinvestors.co.uk).

Investment Forum, 2003: ii and 33). The assets under SRI in the USA are said to represent about 11.3% of the country's total assets under management (worth US$ 19.2 trillion) (Social Investment Forum, 2003: i). In other words, more than *"one out of every nine dollars"* invested in the USA is directed towards SRI (Social Investment Forum, 2003: i). The Social Investment Forum Report (2003: i) further asserts that growth of SRI assets in the USA has been faster than growth of assets under purely commercial professional management: the former grew by 240% between 1995 and 2003 compared to 174% for the latter. With regard to retail SRI, the Social Investment Forum Report (2003: 7) states that there are about 200 socially screened mutual funds in the US with assets totalling around US$ 151 billion.

Over the 1990s, SRI funds have expanded from their original US base to include Europe as the second world's largest market for SRI. Europe is reported to constitute 10% of the total SRI market, with US$ 260 billion worth of SRI investment, both retail and institutional (Social Investment Forum, 2003: 33). The size of the institutional SRI market ranges from €34 billion (including core SRI i.e. positive screening and extensive exclusions) to €336 billion (including core SRI, simple exclusions and engagement practices) (Eurosif, 2003: 10-11). Under the core market approach, the UK ranks first with 69% of the European market share, followed by the Netherlands, Switzerland and Germany. Within the enlarged view of SRI which includes engagement practices, the Eurosif Report (2003: 11) suggests that SRI is becoming a mainstream financial practice mainly in the Netherlands and the UK, with the former corresponding to 54% and the latter 44% of the total institutional SRI market. Table 3.2 provides an overview of the institutional SRI market in Europe.

**Table 3.2 Institutional SRI Market in Europe (In Euros)**

| Core SRI | | Core SRI and Simple Exclusions | Core SRI, Simple Exclusions and Engagement Practices | |
|---|---|---|---|---|
| €34 Billion | UK (69%) | €218 Billion | €336 Billion | |
| | Netherlands (8%) | | | Netherlands (54%) |
| | Switzerland (8%) | | | UK (44%) |
| | Germany (8%) | | | Germany (0.9%) |
| | France (5%) | | | France (0.6%) |
| | Austria (1%) | | | Italy (0.1%) |
| | Spain (0.5%) | | | |
| | Italy (0.5%) | | | |

Source: Adapted from Eurosif (2003: 10-11)

The UK is a leading SRI market in Europe. It is said to have registered almost a ten-fold increase of more than £200 billion in SRI assets over the period 1997 to 2001 (Sparkes, 2002: 348). This increase was mainly the result of a growing number of charities, pension funds and insurance companies subscribing to SEE policies in their investment strategies. The total value of investments grew from £22.7 billion in 1997 to £224.5 billion in 2001 as shown in Table 3.3 (Sparkes, 2002: 348).

**Table 3.3 SRI Assets in the UK (£ Billion)**

| | 1997 | 1999 | 2001 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| SRI Unit Trusts | 2.2 | 3.1 | 3.5 | 4.3* | 5.5** | 6.1*** |
| Churches | 12.5 | 14.0 | 13.0 | | | |
| Charities | 8.0 | 10.0 | 25.0 | | | |
| Pension Funds | 0.0 | 25.0 | 80.0 | | | |
| Insurance Companies | 0.0 | 0.0 | 103.0 | | | |
| TOTAL | 22.7 | 52.2 | 224.5 | | | |

* EIRIS reports an estimated figure of £4.3 billion being invested in retail SRI funds as at December 2003 (Alam, 2004).
** The Ethical Consumerism Report 2005 of the Co-operative Bank (Vickery *et. al.*, 2005: 6) reported a growth of 31% in ethical investment to £5.5 billion in 2004.
*** EIRIS News Release (12 July 2006)

Primary Source: Sparkes (2002: 348)

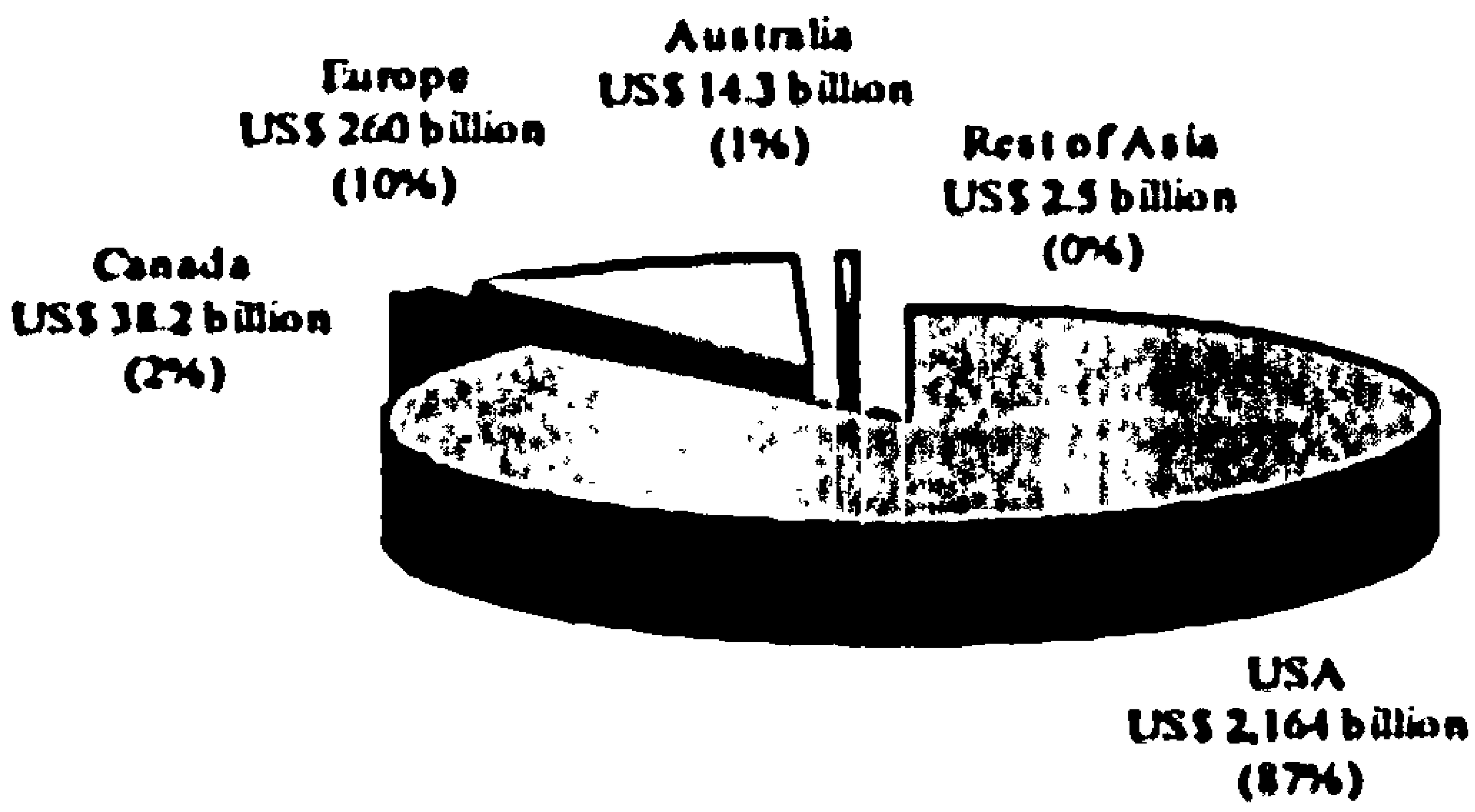
Table 3.3 also shows the position of retail SRI investment in the UK. It occupies only a small percentage of the total market. The latest figures released by EIRIS (2006) state that there are about 75 ethical funds in the UK, with the number of ethical policy holders reaching almost half a million and with £6.1 billion being invested ethically in 2005.[15] One of the leading UK ethical funds is the Friends Provident Stewardship Fund having more than £1.9 billion assets under management.[16] This increase in ethical investment is largely explained by an increased availability of ethical investment products, better comparative performance of these investments, and a better informed public about the impacts of their spending and investments (Vickery *et. al.*, 2005: 6; EIRIS, 2006). Still, the £6.1 billion worth of assets invested under SRI for 2005 represents less than 1% of the

[15] It is noted that, including ethical investment, ethical banking and credit union deposits, money invested ethically in the UK is reported by the Co-operative Bank to have passed the £10 billion mark, reaching £10,626 million in 2004 (Vickery *et. al.*, 2005: 6). This compares with 1999 when total ethical finance in the UK amounted to only around £5,175 million (Vickery *et. al.*, 2005: 4). Relative to the demand for other ethical products like fair-trade, organics, green home, and ethical fashion, it was further noted that the demand for ethical finance ranked the highest amongst consumers in the UK between the period 1999 and 2004 (see Graph depicted in Vickery *et. al.*, 2005: 4).
[16] www.friendsprovident.com/sri

total mainstream retail investment market in the UK with its total number of 1,972 retail funds and assets valuing at £979 billion.[17]

Overall, the SRI industry, as at 2003, is reported to be encompassing a worldwide industry worth around US$ 2.5 trillion, incorporating 760 retail funds and a larger and more complex SRI institutional market (Social Investment Forum, 2003: 33; Hamid, 2003).[18] Figure 3.1 provides a general overview of the dispersion of the SRI market worldwide. Table 3.4 in turn summarises the global trends in the SRI market in three main continents – North America, Europe and Asia – and indicates the screening criteria in practice as well as the regulatory support in place.

**Figure 3.1: Global Distribution of the SRI Market**
**Total Market Size US$ 2.5 trillion**




Source: Based on data provided by Social Investment Forum (2003: 33)

[17] www.uksif.org

[18] As mentioned by Schepers and Sethi (2003: 12), the data regarding the number of retail funds in operation is difficult to confirm because of definitional ambiguities related to SRI. However, Hawken (2004: 10) reports the number of identified publicly available funds (including mutual funds selling to individual and institutional investors, open-ended investment companies and unit investment trusts) to total to 602 worldwide. A breakdown of the number of funds in each region is as follows: Africa (3), Australia and New Zealand (45), Canada (40), Europe (367), Japan (12), South America (2), Asia excluding Japan (8), USA (109) and Middle East (16).

**Table 3.4 The SRI Industry: A Global Picture**

| | Screening Approaches | Regulatory Environment | Relative SRI Market Size (US$) |
|---|---|---|---|
| North America | In the early years of SRI, religious values were a determining factor in negatively screening tobacco, alcohol and gambling companies. Today's concerns incorporate a whole range of GSEE issues.<br><br>SRI inclusion and exclusion screens are the key methods of selecting investment portfolios in the USA. These are followed by shareholder advocacy and community investing. | Increased regulatory attention being given to SRI. Disclosure and transparency requirements promoted by the Securities and Exchange Commission in the US. | USA: Total SRI amounts to $2.16 trillion (Dec. 2002), with 200 retail mutual funds. US SRI market is the largest, representing 87% of the world's SRI market.<br><br>Canada: Total SRI amounts to $38.2 billion (Jun. 2002), representing about 2% of the world's SRI market. 53 retail mutual funds prevail. |
| Europe | Most popular screens are the environment and labour. SRI is increasingly perceived as the application of not only single exclusionary screens. There is common use of shareholder advocacy. | Europe is leading the SRI industry by encouraging its mainstreaming through supportive regulation. Within Europe, the UK government led the way through its legislation in 2000 to change the 1995 Pension Act so that SEE considerations are taken into account in investment decisions. Other European countries like the Netherlands, Belgium, France and Germany thereafter followed suit (Eurosif, 2003: 9; Social Investment Forum, 2003: 31). | Europe: Total SRI amounts to $260 billion (including retail funds, pension funds, and shareholder advocacy), with 280 retail and institutional funds (as at 2001). Europe is the second largest SRI market, representing 10% of the world's SRI market. |
| Asia | A common screen is the environment. Community investing is active at local level. A growing number of funds is being established in Australia, Japan, and Hong Kong which provide opportunities for SRI pensions. | Disclosure requirements prevail in Australia on social and environmental issues in investment decisions.<br><br>No real SRI policy exists in the rest of Asia, although there is increasing attention being given to SRI by multinational fund managers. | Australia: SRI amounts to $14.3 billion (Aug. 2003, with $2.2 billion in managed SRI funds). A total number of 74 funds prevail. SRI is Australia represents about 1% of the world's SRI market.<br><br>Rest of Asia: Total SRI is about $2.5 billion (Dec. 2002). |

Source: Adapted from Social Investment Forum (2003: 33)

## 3.5 SRFIs and Corporate Social Responsibilities: Some Criticisms

The above data provide a broad overview of the spread of SRFIs worldwide and reveal the value of SRI assets and their screening criteria. However, it was noticed

4. Improved capital growth
5. Less risk of fines
6. Improved capital and income performance
7. Advantage over competitors
8. More secure covenant
9. Essentially moral
10. Improved income performance
11. Good for the business in the short run

From the above, it is observed that the primary reason elicited by the ethical fund management institutions was that ethical investments are important for the business in the long run, whilst the association of ethical investments with morality was ranked in the ninth position by the financial institutions.

Thus, on the one hand it is seen that an increasing belief in the business case for SRI is contributing positively to the mainstreaming of CSR and SRI (Baue, 2005b; 2006). On the other hand, it can be counter-argued that the search for the business case of SRI reflects a loss in the moral grounding underlying SRI (Baue, 2005a). The premise of this argument may be based on the assertion that *"you do not do right because it is right, but because it pays"* (Baue, 2005a). This calls the following into question: is there erosion in the ethical values underlying the practice of SRI?

The genuineness in the ethical behaviour of SRI funds has also been put to question on several other counts. One of the contentions relates to the packaging of ethical portfolios which often serves as a marketing strategy to differentiate SRI products from those of other purely commercial funds or other competing SRI funds. In such cases, SRI is viewed as a *"source of competitive advantage or a condition to be competitive"* (Valor, 2005: 199) and may be pursued only if it is rewarded by the market. It could thus be argued that in similar circumstances, the adoption of ethical standards would be prompted by a long-sighted strategy to gain competitive advantage (or financial return) rather than be motivated by genuine concerns for SEE issues. This has been labelled as a *"marketing trick"* to attract customers or a mere public relations exercise and it may in turn be paradoxically classified as representing unethical behaviour on the part of SRI funds (Lewis and Webley, 1994: 172; Valor, 2005: 200; Frankental, 2001; Wilson, 1997: 1325).

Another criticism pertains to the exploitative potential of SRI funds – in the sense that they pay back lower returns, involve higher investment risks and charge higher management fees relative to other commercial funds. It has been highlighted that inferior financial performance could be an outcome of the increased monitoring costs involved and/or the restricted potential for portfolio diversification (Luther *et. al.*, 1992: 57; Wilson, 1997: 1325). Increased risks of SRI could further be a consequence of the general tendency of SRI funds to hold a greater percentage of shares in small and medium enterprises whose performance can be more volatile than larger companies (Investment Management Association, 2003).[21] SRI funds may moreover impose higher management fees and suffer from limited research capabilities as a result of their small operation size. These are argued as representing possible justifications for a lower overall financial performance – justifications that could be perceived as the costs of one's choice of ethics or social responsibility over financial performance.

A further contradiction about the SRI movement compares the process and the corporate social performance (CSP) of SRI. It is noted that the literature on SRI often explicitly markets the "ethicality" of SRI funds as *"investment to make a difference"* (Domini, 2001; Brill *et. al.*, 1999) – implying that the purpose for SRI funds to employ SEE criteria in their investment ventures is in order to make a positive impact on society. However, a survey of the literature revealed that there is no academic study *per se* that evaluates the social performance of the SRI industry based on social responsibility criteria. This has been confirmed by Schepers and Sethi (2003: 25) who highlighted that a large part of the promotional effort of the SRI industry attempts to justify the financial performance of the funds rather than focus on their social performance, which *"in the final analysis is the raison d'être of these funds"*.

[21] According to Luther *et. al.* (1992: 61, 69), the ethical investment industry in the UK is clearly skewed towards small market capitalization. This could be based on the following advantages that smaller companies offer: (i) they are less probable to choose potentially objectionable activities in their investments; and (ii) they are easily monitored by ethical fund managers in view of their narrow range of products and by virtue of their small size.

Nonetheless, attempts have been made at gauging the corporate social responsiveness of SRI funds towards CSR issues. A few online information websites rate SRI funds based on the degree of their ethical performance. For instance, the Ethical Investors Group rate SRI funds vis-à-vis areas of concern classified in such categories as humanist, animal welfare and environment.[22] In addition, there exist ethical indices like FTSE4Good, the Dow Jones Sustainability Index (DJSI) and the Domini 400 Social Index (DSI) which rank major international companies according to their environmental and social performance (Hopkins, 2004: 9). The Business in the Community – a movement with a core membership of 650 companies across the UK – has also 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 practice throughout the organisation, in managing four key areas – Community, Environment, Marketplace and Workplace"* (Business in the Community, 2004). While these indices serve as consumer guides in assessing the corporate social responsiveness of SRI funds towards SEE issues, measurement of the impact of SRI funds on the larger society is believed to be lacking.

Then again, concerns have been raised by Mayo and Doane (2002: 7) about the ethical credentials of some of the companies which comprise the ethical indices. As an example, the authors reflect on the case of Shell which ranked among the "best of the class" companies on account of its adoption of CSR management techniques. This led to its eligibility in being categorised among the SRI company list and its quotation under the SRI indices such as FTSE4Good. Yet, according to Mayo and Doane's (2002: 7) arguments, Shell was not sufficiently ethical in the first instance to be classified within the FTSE4Good index as it was unaccountable of its financial and social costs of carbon emissions. They state *"even the 'best of the class' of the oil companies ought to be excluded from SRI categories concerned with the environment, if their core activities continue to support a primary market failure"*.

[22] www.ethicalinvestors.co.uk.

Thus, SRI companies may be ranked within ethical indices – chosen on the basis of being "best in the class" – yet could still be considered poor performers on the ethical front.

Shortcomings in the form of lack of transparency and credibility, high complexity and significant gaps in meeting disclosure and other standards by SRI funds have also been found by other studies like the Australian survey (2004) which questioned over 400 current and prospective social investors on their views of the practice of SRI funds (Baue, 2005d). It was reported that over half of the respondents highlighted such inadequacies on the part of SRI funds. Another study by Hawken (2004) raised similar criticisms regarding the SRI industry, some of which are summarised below:

- The American companies included in the investment portfolio of the SRI mutual funds the author examined were virtually no different to the companies included in the portfolio of conventional mutual funds. Hawken (2004: 17) highlighted that 19 of the 30 large cap companies included in the top equity holdings of the SRI mutual funds were also part of the Dow Jones Industrial Average.
- The screening methodologies of most of the SRI funds were quite broad, allowing for most of the publicly held corporations to be included within the SRI portfolio. Hawken (2004: 18) noted that over 90 percent of Fortune 500 companies were included in SRI portfolios.
- Literature on the SRI funds did not reveal how the screening criteria promoted by the fund were actually applied in terms of investment selection (Hawken, 2004: 19). Hawken (2004: 21) highlighted a lack of transparency and accountability on the screening criteria and portfolio selection.[23]
- The principles adhered to by companies included in the portfolio holdings were often conflicting with the objectives of the SRI funds (Hawken, 2004: 20).

[23] It is noted that, following such criticisms about lack of transparency, the European Social Investment Forum (Eurosif) prepared a transparency guidelines to which a number of SRI funds in Europe subscribed and disseminated detailed information about their SRI approach, process, screening criteria, engagement approach and voting policy (www.eurosif.org/transparency-guidelines-retail).

- The environmental screens used by portfolio managers were loose and not effective in impacting positively on the environment (Hawken, 2004: 23).

## 3.6 Conclusion

The SRI literature has mainly discussed the evolving CSR issues underlying SRI, the SRI criteria, the different SRI approaches, the providers and investors in the SRI market, and the financial performance of SRI funds. Attempts at assessing the responsiveness of SRI funds towards CSR issues have also been made. Little empirical evidence, however, is available on the evaluation of SRFIs based on the management and fulfilment of their social responsibilities. This is an important tool of assessment of SRFIs since an ethical and social approach is presumably the principal philosophy which guides the actions of SRFIs. Already the literature has highlighted some criticisms raised against the ethical credentials and social performance of SRFIs. By seeking to examine the CSP of SRFIs, this study therefore hopes to shed light on the best practices of some of these financial institutions. Such a task is undertaken by studying the practices of a sample number of SRFIs located in the UK. The lessons learnt from this study are expected to be useful in improving the contribution of another socially responsible paradigm – the Islamic finance industry – in meeting the needs of its stakeholders. In the first instance, a literature review on the developments in the Islamic finance industry is provided in the next chapter.

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# CHAPTER 4

# The Islamic Perspective: CSR and Islamic Financial Institutions

## 4.0 Introduction

Based on its core ethical values, Islamic finance is promoted as a socially responsible paradigm rooted on religious tenets. It has been compared in the literature with the parallel theme of socially responsible investment (SRI), examined in the last chapter (e.g. Wilson 2002, 2004; Asaria, 2002). Similar to SRI, social, ethical, economic, environmental and governance issues also underlie the screening criteria of Islamic financing. Likewise, the four-part CSR definition of Carroll (1979) in terms of the economic, legal, ethical and philanthropic responsibilities is relevant to the Islamic finance paradigm. An additional element, however, guides the philosophy and principles of the Islamic finance movement: the religious or faith factor. The premise of the Islamic finance paradigm is founded on the *maqasid al-Shari'ah* (objectives of Islamic law) which is believed to provide a holistic Islamic worldview based on which the relationship between CSR and Islamic financial institutions (IFIs) can be defined.

This chapter examines the development and expansion of the Islamic finance industry. It seeks to highlight the socially responsible vision and objectives of Islamic economics which have recourse to the *maqasid al-Shari'ah* and the institutionalisation of the Islamic ethical values in the discipline's practical component, Islamic banking and finance. It also examines the debate in the literature on whether a socially responsible function should be attributable to IFIs which, in the first instance, are viewed as profit seeking rather than charitable institutions. In this respect, the roles and responsibilities of IFIs – including the social responsibilities – are discussed. Moreover, it is noted that several criticisms have been raised in the literature regarding the practices of IFIs. The contention made is that there is a divergence between the theory and the practice of Islamic finance. This chapter delineates these arguments.

## 4.1 Islamic Finance: Its Institutionalisation, Growth and Expansion

The Islamic banking and finance industry constitutes a parallel institutionalisation of socially responsible finance from the perspective of the religion of Islam. It has developed from the early theoretical writings on interest free finance in the 1940s-60s into the growing global establishments of IFIs in the 21st century. By and large, it reflects the increasing commitment of Islamic bankers, economists, jurists and academicians to implementing the principles of Islamic banking and finance. Warde (2000) termed the period 1970-1990 as the *"first aggiornamento"* of the Islamic finance industry, depicted by the: (i) setting up of the first Islamic commercial bank (the Dubai Islamic Bank, 1975); (ii) establishment of the first Islamic international multilateral development financial institution (the Islamic Development Bank, 1975); (iii) announcement of the first country to take resolve to Islamise its financial system (Pakistan, 1979). The *"second aggiornamento"* is noted to have started in the early 1990s with the end of the cold war, the emergence of the new world of finance with the blurring of distinctions between commercial banking and other areas of finance, deregulation, the increased openness of markets, financial innovation, and technological change (Warde, 2000: 24, 79). In the years 1990-2000, the ensuing developments in the Islamic financial industry are said to have occurred (Warde, 2000: 84-87).

- Islamic finance is taken to be more than interest-free banking. Accordingly, a diverse and innovative generation of IFIs, often in competition with one another, has emerged. A more diverse and sophisticated range of Islamic financial products is also made available to both Muslims and non-Muslims.
- There is greater convergence of Islamic finance with conventional finance in terms of product development such that the products are made financially attractive to the general public; the participation of conventional institutions in the development of Islamic finance; and the 'conversion' of mainstream financial institutions into IFIs.[1]

[1] It is noted that the Islamic finance industry has witnessed several conventional banks "converting" into IFIs in the past years. The *Islamic Banker* (Parker, 2004a: 2) quotes the conversion of six mainstream banks as at 1 March 2004: Bank Kerjasama Rakyat (Malaysia), Bank Al-Jazira (Saudi

- There is growing integration of Islamic finance into the global economy. Islamic market indices have developed. Examples are the Dow Jones Islamic Market Index$^{SM}$ (DJIM) and Financial Times Stock Exchange (FTSE) Global Islamic Index Series (GIIS). An increasing number of secular institutions are also offering Islamic financial products to Muslim communities settled in non-Muslim environments. For instance, the UK is led by HSBC, the USA by Citibank, France by Banque Nationale de Paris, and Switzerland by UBS (Henry and Wilson, 2004: 6).

- There is increased multi-polarity of the Islamic world with emerging nations. To this end, Malaysia is seen to be playing a key role in the development and expansion of Islamic finance.

- A number of multinational financial institutions working on *Shari'ah* principles have been set up. Examples include the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) (Bahrain), the General Council for Islamic Banks and Financial Institutions (GCIBFI) (Bahrain), the International Islamic Financial Market (IIFM) (Bahrain), the Islamic Financial Services Board (IFSB) (Malaysia) and the International Islamic Rating Agency (IIRA) (Bahrain) (Iqbal and Molyneux, 2005: 38). The incorporation of four key multinational financial institutions in Bahrain shows its rising status as a player in the Islamic financial industry.

Over the 30 years of Islamic commercial banking (1975-2005), the industry is said to have grown from a few hundred thousands of dollars in 1975 to more than US$ 260 billion worth in assets, with over 265 IFIs operating in about 60 countries world wide (Bahrain Monetary Agency, 2004).[2] Publicly owned banks, private commercial banks, offshore banks, investment funds and insurance companies now form part of the Islamic finance industry. Thus, the Islamic finance industry entails more than

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Arabia), Kuwait Real Estate Bank (Kuwait), National Bank of Sharjah (UAE), Amlak Finance (UAE), and Middle East Bank (UAE). For many, this is often taken as proof of the viability of Islamic banking in the 21st century.

[2] This confirms Beng's (2004: 1) (quoted in Hasan, 2004: 5) estimation of the assets under management in the Islamic finance industry which is stated to be no less than US$ 250 billion. However, it is noted that the figures quoted in the Islamic finance literature tend to vary.

equity investments. Islamic equity funds are reported to manage assets worth around US$ 5.1 billion as at 2005, compared with US$ 260 billion for the entire Islamic finance industry (Al-Rifai, 2005).[3] Table 4.1 provides details on the number of Islamic banks and financial institutions in operation as at 2004.

**Table 4.1 Islamic Banks and Financial Institutions as at 2004**

| Islamic Banks and Financial Institutions | Number |
|---|---|
| Fully-fledged Islamic Banks | 69 |
| Insurance Companies | 47 |
| Islamic Banking Windows and NBFIs | 43 |
| Islamic Investment Funds | 110 |
| Total | 269 |

- This table has been based on the dataset of Iqbal and Molyneux (2005) and the data published by the *Islamic Banker* (Parker, 2005). The total number of IFIs approximates 269. This is close to the estimate provided by Gassner (2004) and the Bahrain Monetary Agency (2004) who reported that there are over 265 IFIs currently in operation.
- A safe figure of 110 Islamic investment funds is adopted, as listed in the *Islamic Banker* (Parker, 2005: 17). The rest of the data pertain to those provided by Iqbal and Molyneux (2005) which exclude IFIs in Iran and Sudan.

The developments of the Islamic finance industry are summarised through the following timeline (Iqbal and Molyneux, 2005: 64).

**1950s** Precursors of modern Islamic banking experiences with non-bank applications of interest free finance e.g. Tabung Hajji (Pilgrims' Administration and Fund) in Malaysia (1956-).

**1960s** Establishment of the Mit Ghamr Savings Houses in Egypt (1963-67)

**1970s** First Islamic 'Bank' established at governmental level in Egypt, the Nasser Social Bank (1971), without the title 'Islamic' in the name.

[3] We note that the *Islamic banker* (Parker, 2005) lists around 110 Islamic investment funds in operation. On the other hand, Iqbal and Molyneux (2005: 55) argue that the number of Islamic investment funds (including fully-fledged Islamic funds and those offered by mainstream NBFIs as part of their activities) could range around 200. These will comprise commodity funds, lease funds, *mudaraba* funds etc. The difference in the numbers published by different sources indicates the difficulty in having accurate data with respect to institutions operating in the Islamic financial industry.

First Islamic international multilateral development finance institution, the Islamic Development Bank (1975), set up in Saudi Arabia.

First 'Islamic' commercial bank set up, the Dubai Islamic Bank (1975).

First country, Pakistan (1979), decides to Islamize its financial system.

Other Islamic commercial banks followed: Faisal Islamic Bank in Egypt (1977) and Sudan (1977); Kuwait Finance House, Kuwait (1977); Jordan Islamic Bank, Jordan (1978).

*Islamic assets are worth about a few hundred thousands dollars. Al-Jarhi (2005) termed the period 1950s to mid-1970s as the "formative stage".*

**1980s** Other countries like Sudan (1983) and Iran (1983) pledge to Islamize their economies.

Islamic equity funds start with the Amana Income Fund in the USA (1986).[4]

Conventional banks start offering Islamic products/windows.

*Islamic Assets pass US$100 billion mark*

**1990s** First Islamic Indices launched in 1999, the Dow Jones Islamic Market Index[SM] (DJIM) and Financial Times Stock Exchange (FTSE) Global Islamic Index Series (GIIS).[5] These Islamic market indices, similar to ethical fund indices, track the on-going performance of companies that adhere to Islamic precepts.

Islamic secondary markets start.

Establishment of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) in Bahrain (1991) to *"develop accounting, auditing, governance and ethical ideas relating to the activities of Islamic financial institutions"* (Iqbal and Molyneux, 2005: 61). AAOIFI standards were introduced in 1993.

Assets-based Islamic financial products developed.

**2000s** Other supporting institutions established: the General Council of Islamic Banks and Financial Institutions (GCIBFI) (Bahrain,

[4] www.failaka.com
[5] www.dowjones.com and www.ftse.com

2001); the International Islamic Financial Market (IIFM) (Bahrain, 2002); the Islamic Financial Services Board (IFSB) (Malaysia, 2002) and the International Islamic Rating Agency (IIRA) (Bahrain, 2002).

Engineering of alternative Islamic financial products continues in the form of Islamic fixed income securities (*sukuk*), Islamic call option (*bai al-urboun*), Islamic collateralised debt obligation (CDO), and Islamic securitisation (Alshubaily, 2004: 67-71; Adam and Thomas, 2004: 72-80).

Targeting of the exclusive clientele of very high-net-worth individuals and financial institutions as candidates for hedge fund investments.[6] For instance, at the International Islamic Finance Forum (IIFF) held in Dubai in 2003, the viability of a *Shari'ah* compliant hedge fund, created by "Shariah Funds Inc." from USA, was debated among the scholars (Banker Middle East, 2003).

*Islamic Assets pass US$ 260 billion mark (Bahrain Monetary Agency, 2004). Al-Jarhi (2005) labelled the period from 1975 until the end of the last century the "founding stage". He further states that the "growth and entrenchment stage" has started in 2000 and the "take off stage" is yet to come.*

## 4.2 Islamic Finance and Its Socially Responsible Underpinnings

The expanding Islamic finance industry has been developed in the context of the endeavours of early Muslim economists to live according to Islamic injunctions and ideals and to set up an economic system consistent with the *Shari'ah* (Islamic law). Within the Islamic worldview, the *Shari'ah* – which is a system of ethics and values founded on the teachings in the Qur'an and of the Prophet (*sunnah*) – is believed to set the guidelines on all aspects of human life including the personal, social, political, economic, financial and intellectual (Sardar, 2003). As such, *Shari'ah* compliance is considered a prerequisite requirement for the fulfilment of economic and financial transactions within the Islamic faith – whether at the individual, institutional, governmental or societal levels.

[6] Hedge funds are described in the *Handbook of Financial Instruments* as "a privately organized investment vehicle that manages a concentrated portfolio of public securities and derivative instruments on public securities, that can invest both long and short, and can apply leverage" (cited in Anson, 2002: 606). They are made available to individuals or institutions having a net worth in excess of $5 million (Anson, 2002: 606).

The goals of the Islamic economic system are summarised by Siddiqi (1980: 202) in socially laudable terms: (i) promotion of economic well-being; (ii) attainment of sufficiency and peace, eradication of hunger and fear in society; (iii) fulfilment of basic human needs; (iv) provision of ease and convenience in life, optimisation in the utilisation of natural resources; (v) fulfilment of spiritual needs; (vi) establishment of economic and social justice, equality of opportunity and cooperation; (vii) promotion of universal brotherhood and justice, equitable distribution of income and freedom of the individual within the context of social welfare (Abu Sa'ud, 1967; Baqir al Sadr, 1968; Mawdudi, 1969; Chapra, 1970; Qutb, 1970; Kahf, 1973; Al-Tahawi, 1974). These goals inevitably have recourse to and are meant to further the *maqasid al-Shari'ah* which provides a framework encapsulating the concept of human well-being. According to al-Ghazāli, the *maqasid al-Shari'ah* is deemed to promote the well-being of all mankind through the promotion, protection and enrichment of faith (*din*), human self (*nafs*), intellect (*aql*), posterity (*nasl*) and wealth (*mal*) (quoted in Chapra, 2000: 118). Al-Shātibi equally emphasised the idea of welfare promotion by defining the aims of the *maqasid al-Shari'ah* as *"the attainment of good, welfare, advantage, benefits, and warding off evil, injury, loss...for the creatures...in this life and the life hereafter"* (quoted in Khan and Ghifari, 1985). It is for this purpose, highlighted Khan and Ghifari (1985), that the *Shari'ah* stipulates and advises people to adopt permissible (*halal*) and reject prohibitive (*haram*) "means and measures" – a stipulation which upholds the responsibility of promoting productive activities and shunning harmful activities.

It is in this respect that within the Islamic economic model, individuals – whether investors, consumers, producers, suppliers, or traders – are attributed a socially responsible role. The expectation is that faith which instils a concern for the afterlife will influence an individual's levels of personal motivation such that he behaves altruistically, pursuing his self-interest within the bounds of the social interest (Dar, 2004). Therefore, unlike the individual who is guided by self interest under the *homo economicus* principle in the neo-classical literature, the individual guided by the norms of Islam would exhibit altruism, humanism, and social responsibility. He is accordingly given the special name of *homo islamicus* (Kuran, 1983). Other philosophical notions of 'human accountability before God', 'man's role as a vicegerent on earth' and 'promotion of socio-economic justice' are further assumed to be the drivers which restrain self interest, motivate individuals to make careful use of limited resources, care for the environment and fulfil their social obligations (Ahmad, 1980: 178).[7]

The individual within the Islamic paradigm is also expected to be socially responsible with respect to his finance. Islamic investors, like their western ethical counterparts, are concerned with not just what kinds of activities are being financed (i.e. the end products) but also with the way they are funded (i.e. the means of financing) (Asaria, 2002). They would seek the deployment of their funds in a *halal* (Islamically permissible) way. This search for *Shari'ah* permissibility in one's decisions contributed in putting market pressure on businesses to produce and market *halal* products. Within the financial arena, it set the basis for the development of the Islamic banking and finance industry.

The institutionalisation of Islamic banking and finance in the 1970s was, therefore, a means of fulfilling the afore-mentioned socially responsible goals of the Islamic economic system. It is based on the following requirements:

- Abolition of interest (*riba*) which is perceived as an act of injustice, exploitation, unfairness.
- Prohibition of dealings in *haram* products like pork, other non-permissible meat, statues, idols, intoxicants (*khamr*), and the entertainment industry.
- Adoption of other negative screening criteria in investment selection, involving elimination of uncertainty (*gharar*), shunning of alcohol, tobacco, drugs, pornography, prostitution, gambling, armaments, animal

[7] In the Islamic teachings, it is noted that a fundamental belief is that all resources are God-given and human beings are assigned merely as their trustees. Since every individual is ultimately believed to be accountable to God for its trust, it is expected that he or she will steward the scarce resources to their best possible use for the welfare of society. All the stakeholders in the economic development process are therefore assigned a 'social responsibility function' under the Islamic paradigm. In this way, Islamic teachings are expected to harmonise the socially responsible goal embedded within the quest for human well-being with socially responsible means of achieving socio-economic development.

experimentation, genetic engineering, financial exploitation – areas which are considered *"value destroyers"* (Khan, 2001).[8]

- Prohibition of dealings in unfair practices e.g. price manipulation, greed, bribery, money laundering, and involvement in activities that would cause environmental damage or imbalance.
- Positive screening of *halal* (Islamically permissible) investments.
- Promotion of fixed return modes of financing, incorporating the concept of real exchange of goods and services and including the exchange of usufruct (services) generated by durable assets. E.g. *murabaha* (cost plus profit sale); *ijarah* (leasing involving sale of usufruct); *salam* and *istisnaa*.
- Sharing of risk and profit between the investor (capital provider), the financial intermediary (Islamic bank) and the entrepreneur (user of funds) through financial contracts like *mudaraba* (passive partnership) and *musharaka* (partnership) (Iqbal *et. al.*, 1998: 15).
- Promotion of an entrepreneur-friendly project financing based on the soundness of the project, the business acumen and managerial competence of the entrepreneur, and the expected long term return on the project instead of relying on the credit-worthiness of the entrepreneur (Iqbal and Molyneux, 2005: 28). A more careful evaluation of application of funds for equity financing is thus encouraged.
- Promotion of moderation, balance and harmony in life e.g. fair competition, honesty, justice, protection of the weak, safeguarding the public interest, financial and social inclusion policies, pursuit of genuine profits, protection of the market mechanism, abidance by the legal system, transparency in

[8] Under the Islamic paradigm, it is believed that prohibitions by God are due to the impurity and harmfulness of the prohibited item (Al-Qaradawi, 1992: 24). Furthermore, if the harm of a product outweighs its benefit, it has been made *haram* (prohibited) in Islam. Examples are wine and gambling (Qur'an 2: 219). Moreover, prohibitions in Islam are generally based on the purpose of setting a level playing field to protect the interests of weaker parties; establishing justice and fairness; ensuring mutual benefit for the parties involved and for society in general; and promoting social harmony (Iqbal and Molyneux, 2005: 6-7). Based on these reasons, thus, the prohibition of *riba*, debt, *gharar* and certain non-permissible goods and services are established within Islamic thoughts.

dealings, dissemination of reliable information, safeguarding of individual rights and obligations, sanctity of contracts and contractual obligations.

- Payment of poor due (*zakah*) and voluntary charity (*sadaqah*) which help in the development of a social conscience through the sharing of one's resources with the under-privileged. Other voluntary charity, encouraged as an expression of man's gratitude to God for His grace, similarly has the economic impact of alleviating poverty while promoting social cohesion and harmony (Ahmad Z., 1991: 43).
- Advancement of interest free loans (*qard hassan*) to deserving individuals facing exceptional financial difficulties.

## 4.3 Islamic Financial Institutions: Their Roles and Responsibilities

The distinguishing characteristic of *Shari'ah* compliancy can be said to have an all-encompassing effect on the operations of an IFI. Indeed, IFIs are expected to comply with both the text and the spirit of the Islamic law (Badawi, 1997: 20). This is deemed to affect the financial institution's vision and mission, objectives, organisational structure and management, procedures, modus operandi, products and services, training requirements, regulation and corporate governance (Hasan, 2004: 23; Parker, 2005: 7). Adherence to the *Shari'ah* entails not only legal implications which subject the practice of Islamic finance to a strict application of the textual directive of the religious law and jurisprudence – necessitating the elimination of all dealings prohibited by *Shari'ah* and the promotion of Islamic exhortations. It also includes abidance by the spirit of the *maqasid al-Shari'ah* which attributes a more holistic long term objective to IFIs – that of working towards the optimisation of human well-being. In this respect, a social role is often assigned to IFIs in addition to the objectives of being economically and financially viable and of being *Shari'ah* compliant. Hence, Islamic banking and finance is much about the combination of economics, finance and law with ethics, religion and society. Consequently, the four-part model of CSR advanced by Carroll (1979) – defined in terms of the economic, legal, ethical and discretionary responsibilities a corporation is expected to shoulder – can also be attributed to IFIs.

In terms of the economic responsibilities, it is conventionally agreed that IFIs are not charitable institutions. They are expected to act as efficient financial intermediaries, meeting the needs of the Muslim community in a modern society (Siddiqi, 2000: 22). And like other financial intermediaries, they are in the business of managing and making money (Ahmed, 2000: 307). Yet, the Islamic philosophical foundations underpinning their establishments require that profit making is not their sole objective of doing business. Inevitably, *Shari'ah* compliance requires that the IFI also abides by the law of the land it operates in and that any inconsistencies between the *Shari'ah* and the law of the land are addressed. In terms of regulation, Islamic banks in particular tend to face two levels of regulatory checks: an external check for adherence to banking and financial laws; and an internal check through religious audits by the *Shari'ah* supervisory board. As such, inclusion of a *Shari'ah* board sometimes figures as one of the criteria defining an Islamic bank (Warde, 2000: 5).

As regards the ethical dimension of *Shari'ah* compliance, it requires that IFIs adopt the Islamic screening criteria when selecting investments. Corporate governance at the level of IFIs further adds to the ethical dimension of Islamic finance. Accountability of the board of directors and senior management, risk management, transparency, fight against money laundering and bribery are necessarily Islamic principles which are expected to be endorsed by IFIs. Moreover, the Islamic financial system requires the application of ethics not only at the level of financial dealings but also at the level of the organisational structure – what the Institute of Islamic Banking and Insurance (1994: 3) referred to as development of an *"Islamic banking culture"*. This has been argued to relate Islamic banking to the polite and helpful attitude of Islamic bankers; provision of an efficient and reliable service; development of innovative products; and promotion of corporate ethics and responsibilities (Institute of Islamic Banking and Insurance, 1994: 3).

To this end, Islamic banking and finance is projected as being more than *riba*-free banking (Warde, 2000: 5). This assertion is also made on two other grounds. First, Islamic banks are often compared with universal banks instead of pure commercial banks which attribute a commercial as well as an investment and development banking role to them (Al-Jarhi and Iqbal, 2001: 22; Schaik, 2001: 46; Ayub, 2002:

209). Second, social responsibilities are attributed to Islamic banks, besides their economic and financial objectives, on basis of their aim to improve human well-being.

## 4.4 Islamic Financial Institutions and Social Responsibilities

With regard to the attribution of social responsibilities to IFIs, two viewpoints prevail in the literature: the views of the early contributors to the Islamic economics literature who assigned an integral, explicit socio-economic role to IFIs; and the alternative views of other academicians who considered IFIs part of the commercial sector and thus only responsible for economic and financial dealings and not for morally-motivated social activities.

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) (Chapra, 1985; Siddiqi, 1983). This has been referred to as Chapra's model in Lewis and Algaoud (2001: 95). According to this model, the Islamic financial set-up imposes upon the IFIs an extra parameter – namely a socio-economic purpose – in addition to the responsibilities assigned to them by the conventional financial laws. Islamic banks, according to this view, assumes the role of a multi-purpose bank – also known as a universal bank – which is conceived as a hybrid between a conventional commercial and investment bank (Iqbal and Mirakhor, 2002: 43-44). The *Handbook of Islamic Banking* (1982), cited by Warde (2000: 174-175), mentions a number of socio-economic objectives to be endorsed by IFIs as described below. These are supplemented by the objectives of Islamic banking advocated by the Islami Bank of Bangladesh.[9] In sum, these objectives appear to be conventionally recognised objectives assigned to state banks and development agencies, hence attributed to IFIs as they are called upon to play the role of universal banks in promoting socio-economic development.

- To offer contemporary financial services in conformity with the *Shari'ah*;
- To contribute towards economic development and prosperity through:

[9] www.islamibankbd.com

- Job creation and focusing on promising economic sectors like agriculture, industry and technology-intensive activities;
- Encouragement and stimulation of entrepreneurship by, e.g., adopting profit and loss sharing mechanisms;
- Fulfilment of broad socio-economic benefits, e.g., through investment policies which meet the needs of the community;
- Alleviation of poverty, e.g., though establishment of *zakah* fund and provision of interest free loans (*qard hassan*); and
- Promotion of regional distribution of investments, e.g., through investments in under-invested areas and investments of savings where they were mobilized.

* To optimise the allocation of scarce financial resources; and
* To help ensure equitable distribution of income, maintenance and dispensation of social justice and establishment of equity and fairness.

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. Besides prohibiting *riba*, Islamic commercial banks are exhorted to attribute public funds *"to serve the common interest and no individual gain"* (Lewis and Algaoud, 2001: 95). Within Chapra's framework of the financial system, social welfare responsibilities are also assigned to NBFIs, specialised credit institutions, insurance corporations and investment audit corporations.

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.[10] It is argued that its behaviour *"needs to be*

[10] The International Association of Islamic Banks (IAIB) for instance attributes social goals to Islamic banks, as reflected in this quote: *"[T]he Islamic bank takes into prime consideration the social implications that may be brought about by any decision or action taken by the bank. Profitability – despite its importance and priority – is not therefore the sole criterion or the prime element in evaluating the performance of Islamic banks, since they have to match both between the material and the social objectives that would serve the interests of the community as a whole and help achieve their*

*guided, among others, by the consideration of altruism – a concern for others to be shown as a principle of action"* (Mannan, 1992: 120). Iqbal and Molyneux (2005: 119) also define an Islamic firm as *"a nexus of contracts whose objective is to minimize transaction costs and maximize profit and return to investors subject to constraints that these objectives do not violate the right of any other party (whether it interacts with the firm directly or indirectly)."* In this respect, much in line with the corporate governance literature on stakeholder theory, it is argued that Islamic banks should seek the welfare of not only their shareholders, but should equally respect the rights of other key stakeholders like employees, customers, investors, suppliers and the larger society (e.g. Tag el-Din, 2005b: 44). Besides, while conformity to the principles of *Shari'ah* would be essential in the behaviour of a firm, it could be 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.

On the other hand, academicians like Ismail (1986) and Tag el-Din (2003) 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 ensuring equitable income distribution, undertaking community enhancing projects or social welfare activities, is therefore argued not to fall under

*role in the sphere of social mutual guarantee. Social goals are understood to form an inseparable element of the Islamic banking system that cannot be dispensed with or neglected."* (cited in Al-Omar and Abdel Haq, 1996). Other supporters of the attribution of social responsibilities to IFIs are Warde (2000), Al-Zuhayli (2003), Hasan (2004). Al-Zuhayli (2003: 349) for instance considers among the aims of IFIs *"the goals of rebuilding the Islamic society and the realization of Islamic cooperation while adhering to the fundamental Islamic laws"* and *"the aim to help assist the needy through interest-free loans, as well as supporting the socio-economic foundations of an Islamic society"*.

the responsibility of IFIs. As an alternative, socially oriented projects are expected to be undertaken by NGOs and social organisations, which situate themselves in the third sector. Proponents of the three-sector economy further argue that voluntary spending, the institution of *zakah*, and the *waqf* system would fall under this sector. Nevertheless, Tag el-Din (2003: 16) would still agree with Chapra's idea for the need of a *"morally driven process of socio-economic restructuring"*. The only point of disagreement lies in the fact that he believes this force could not be provided by the market sector which is profit oriented, guided by the self interest motive and encompassing the "acquisitive stage" of wealth generation. Tag el-Din (2003: 16) argues for morally motivated spending to take place at the "disposal stage" – within the third sector – once the right on that wealth has been established at the "acquisitive stage".

The two viewpoints in the above discussion can be related to the CSR debate expounded in Chapter 2, especially to Friedman's (1970) and Carroll's (1979) viewpoints of CSR as well as be compared to the UK or the USA model of CSR. In the main, Chapra's model can be asserted to (i) regard IFIs as institutions with multi-purpose goals including the furthering of socio-economic objectives as well as the goal of profit maximisation, (ii) perceive the undertaking of social welfare activities to be in line with acting within the objectives of the *Shari'ah* and (iii) focus on the maximisation of stakeholders' interests instead of mainly shareholders' value. The religious imperatives upon which IFIs would act in Chapra's model would also suggest that the concept of philanthropy appears to be considered an integral business policy for IFIs, undertaken as part of the communal role played by the institution. Chapra's model can therefore be associated to the larger view of CSR defined by Carroll (1979) and embracing the four-part dimension which CSR entails (responsible business practices, consumer responsibility, sustainable enterprise and corporate philanthropy). Chapra's model can further be compared with the UK model of CSR which is increasingly advocating a voluntary yet explicit role of CSR to be endorsed by businesses (Matten and Moon, 2005: 350). The business policy on social responsibility in such a case is taken as part of the wealth creation process and viewed as a means to increase the competitiveness of the business and the value to society (Baker, 2004) – with the motivation for acting in a socially responsible way within the Islamic paradigm being faith driven.

Ismail's (1986) conceptual framework of IFIs, on the other hand, can be compared with Friedman's (1970) view of CSR where the role of corporations are primarily seen in terms of its pursuit of profits, with the concept of social responsibility taken to imply the fulfilment of wealth and employment creation. Similarly, within Ismail's model, IFIs are perceived as commercial institutions operating under the guidelines of Islam, however with their responsibilities directed mainly towards their shareholders and depositors. Social objectives in this model are indirectly pursued by the IFIs as they become viable, profitable and sustainable. This model may further be compared with the voluntary and implicit concept of CSR within the American model where CSR is not taken as an integral part of the core business but viewed as a peripheral policy of the business (Baker, 2004). CSR in such a case is mostly viewed as an extra activity – an ad hoc philanthropic exercise – and not internalised as part of business policy. Hence, social welfare activities have been attributed to the third sector within Ismail's (1986) model.

## 4.5 Debating the Practices of Islamic Banking and Finance

As the practice of Islamic banking and finance has progressed over the recent decades, it has concurrently faced a number of criticisms, with discussions often comparing the promise of the Islamic economics literature with the performance (practice) of IFIs. The criticisms levelled against the practice of Islamic banking and finance have overall questioned the extent to which IFIs are living up to their roles and responsibilities, specifically with respect to upholding the spirit of the *maqasid al Shari'ah*.

One of the common criticisms deliberated in the literature concerned the financial products used by IFIs. At one point, doubts were particularly raised regarding the *Shari'ah* compliance, or abidance by the ethical and legal guidelines of Islam, of the *murabaha* (mark up) mode of financing which resembles modes that are closer to interest. The *murabaha* transaction was furthermore reproved for violating the Prophetic rule of sale prior to possession of the good (Badawi, 1997: 20). This was termed as involvement in an "artificial" *murabaha* by the Fiqh Academy in Jeddah in 1988 (Vogel and Hayes, 1998: 143). Accordingly, Siddiqi (2000: 29) argues, Islamic banks have been increasingly pushed by *Shari'ah* scholars to be involved directly into the purchase and sale deals, instead of merely carrying out the function of financial intermediation.[11]

The heavy bias of *murabaha* and short-term trade-based financing transactions in the portfolio of Islamic banks relative to the use of profit-and-loss sharing arrangements as advocated in the literature, has itself subjected the practice of Islamic finance to various contentions.[12] Islamic banks have, in this respect, been claimed to (i) mirror conventional finance by adopting interest-like fixed return instruments (Warde, 2000: 240); (ii) choose financial products so that they are as closest as possible to the efficiency level of conventional financial products while they neglect the equity criteria of concern to Islamic jurists (El-Gamal, 2000); (iii) direct financial resources into consumption channels rather than into production (Hasan, 2005a); (iv) direct the contribution of Islamic finance towards the growth of money rather than the growth of the economy (Badawi, 1996/1997: 20). In short, the excessive use of fixed return modes has questioned the Islamic credentials of Islamic banking and finance which is thus perceived as a mere gimmick, with the products and services of IFIs resembling those of their conventional counterparts except in name (Dusuki, 2005). It is further believed that the mere replacement of *riba* with other fixed return modes of financing reflects an implied risk-averseness of Islamic banks which do not show the socio-economic commitment on the part of the institutions.

[11] The Jordan Islamic Bank of Finance and Investment is noted to be one of the Islamic banks to have taken the injunctions of the Fiqh Academy seriously by inaugurating a bonded warehouse in 1999 as nearly half of its financing and investments (about 45.7 per cent) comprised *murabaha* transactions (Henry and Wilson, 2004: 4).

[12] Hasan (2005a), for instance, reported the case of Malaysia where the average share of profit and loss sharing financing was 8.2% as compared to 91.8% for deferred contracts for the years 2000-2001. In general, empirical evidence based on 1994-96 averages of the financing modes of ten leading Islamic banks, showed that *murabaha* accounted for 70 percent of their total financing relative to the profit-sharing modes which represented less than 14 percent of their finance (Iqbal *et. al*, 1998: 62). Recently, Ahmad A. Y. (2005: 32) highlighted the use of no less than 80 percent of *murabaha* financing by Islamic banks. Hence, there have been many criticisms raised in the current Islamic literature against the excessive employment of short-term deferred-sale contracts by the Islamic financial practice as opposed to the profit sharing modes which were advanced by the founders of Islamic economics (e.g. see Hasan, 2005a; Ahmad, A. Y., 2005; Yousef, 2004). This situation has prevailed despite the economic appeal of profit sharing promoted in the Islamic literature (e.g. Siddiqi, 1983, 1996, 2000; Masood, 1984; Chapra, 1985; Tag el-Din, 2002).

In fact, the lack of deep felt commitment to the Islamic financial sector by some financial practitioners has been highlighted by Parker (2004b: 2). Parker (2005: 2) further argued 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"*.[13]

On the other hand, the wide use of the debt-based financial instruments on the asset side of Islamic banks instead of the use of profit and loss sharing arrangements characterised by the two-tier *mudaraba* model and *musharaka* modes of financing has received more positive explanations. Tag el-Din (2005b: 46) explains the shift of the theoretically recommendable two-tier *mudaraba* model to the practical adoption of the one-tier *mudaraba* model to the problem of informational asymmetry which the former entails. As a financing mode, *mudaraba* involves higher risks to the financier in the form of Islamic moral hazard problems as well as higher monitoring costs (Wilson, 1997: 2). It is thus argued that Islamic banks can not simply assume righteous behaviour on the part of customers and employees on the basis of their adherence to the Islamic faith. Profit and loss sharing transactions would require the establishment of stricter control and more prudent management from Islamic bankers. Tag el-Din (2005b: 46) thus argues that the rise in the use of multiple fixed return instruments could be taken as *"Shari'ah compliant solutions to the problem of informal* [sic] *asymmetry rather than a sheer desire to supply multiple Islamic instruments"*. Yousef (2004: 64) also justifies their use in terms of the financial necessity and economic rationality of the instruments. Still, Warde (2000: 241), argues that a more fruitful approach would have been for banks to improve on the procedures to counter the problems faced with profit and loss instruments rather than neglecting their use altogether.

This failure of IFIs to develop more risk sharing mechanisms and to instead mirror conventional finance by adopting interest-like fixed return instruments is often seen as a failure of Islamic finance to deliver on its original promise of institutionalising

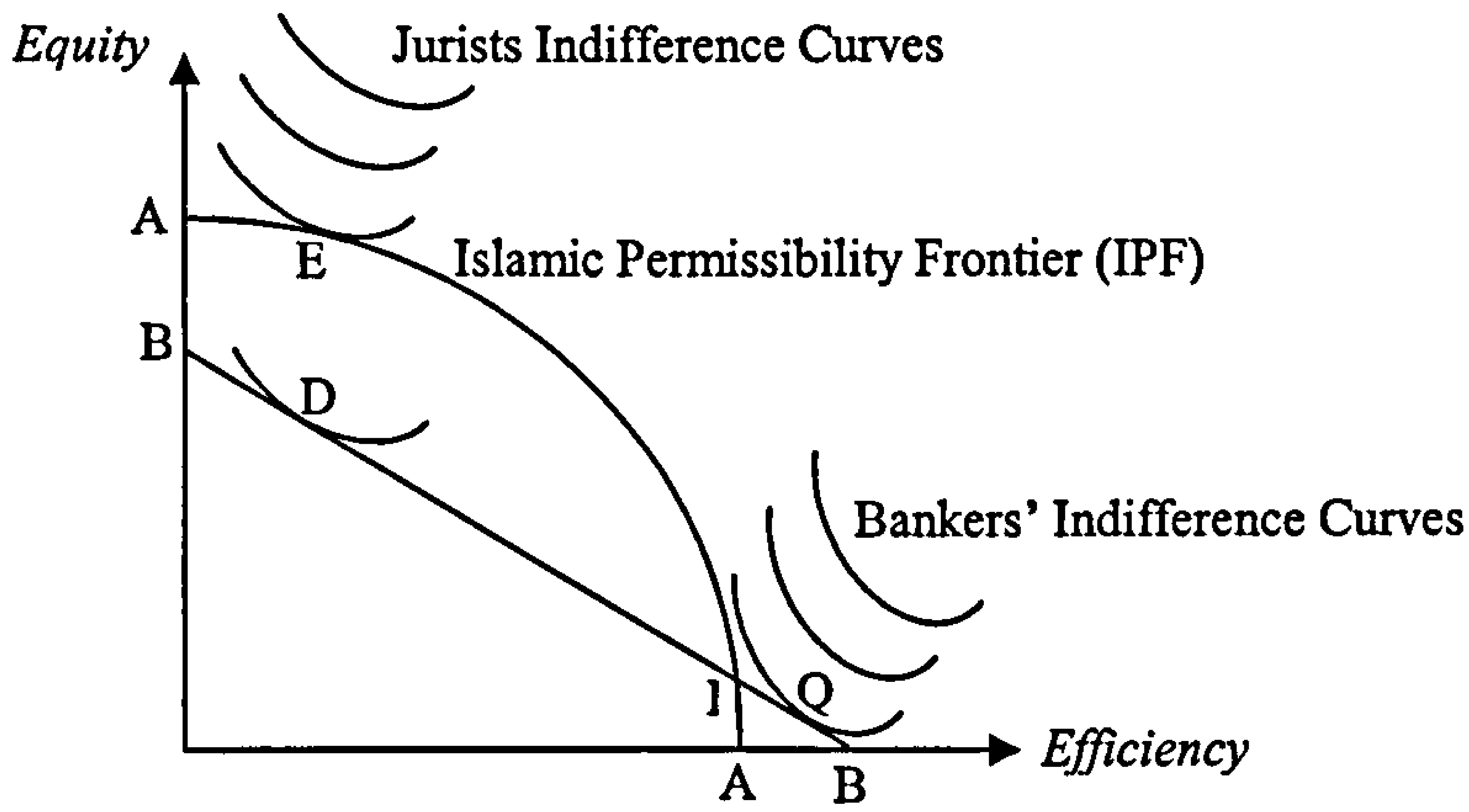
[13] To draw attention to the quest for profit maximisation of Islamic banks, Parker (2005: 2) quoted one Islamic banker who stated: *"As far as (my bank) is concerned, we are very committed to the development of the Islamic financial market. It is a means to enhance our shareholders' value. From an 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."*

an innovative financial system for bringing about social and economic benefits to the Islamic world (Warde, 2000: 240). Discussions by Islamic economists like El-Gamal (2000), Halim (2001), and Hasan (2005a) have labelled this *"gap between promise and performance"* (Warde, 2000: 240) of Islamic finance as a divergence occurring between the literature of Islamic economics – which emphasises the attainment of socio-economic goals by IFIs based on recourse to the *maqasid al Shari'ah* – and the contemporaneous practices of IFIs.[14]

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 4.1 (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 subjected to the current financial technology, and is as closest as possible to the efficiency level of conventional financial products. This point is noticed to substantially lack the equity criteria, of concern to jurists. However, it is said to represent *"those whose voice has become loudest, since it is backed by relatively massive profit-and-efficiency-seeking financial assets, as well as many decades of experience in the conventional financial sector"*. Those favouring Point E have, on the other hand, been described by El-Gamal (2000) as those who wish to address the problems of a theoretical society imbued with the values of Islam, promoting the vision of the Islamic financial system by commanding a different set of instruments and envisaging a paradigm shift for bringing about greater social justice. If this group insists on the superiority of Point E, they are often termed as being "ultra-theoretical" or "dogmatic".

[14] The actual practice of the industry has also been referred to in terms of different names such as the Malaysian and the Gulf model of Islamic finance, whilst referring to the practice in these areas (The International Islamic Finance Forum, www.iiff.net) – a practice seemingly different from, say, the Jeddah School of thought which has been developed by the early contributors to the discipline (Hasan, 2005a).

**Figure 4.1 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 (defined as *"institutional frameworks that render certain types of contracts and transactions feasible"*) which is still evolving and requires more decades of trial and error. Those who insist on the superiority of this point are often termed as being "ultra-theoretical" or "dogmatic".

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

Point D: Represents the 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. El-Gamal (2000) described this group as those who are seeking to find *"practical (or conventional) solutions for the lack of socio-economic equity in our current system"*. The author claims that the views of this group have been adopted to some extent by the Islamic finance industry in order to provide a public relations role to add to the Islamic credentials of the practice.

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 *Shari'ah* permissibility, of high efficiency but having lower equity characteristics. This group has been labelled by the author as *"those whose voice has become the loudest"*.

Source: El-Gamal (2000)

Siddiqi (2004a) 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 (2004a) 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 *maqasid al Shari'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 practice as compliance to the *"text of the law"* while there is neglect of the *"spirit of the law"*. Siddiqi (2004a) viewed this issue in terms of an over-emphasis on microeconomic issues while neglecting the macroeconomic outlook.[15]

Siddiqi (2004a) 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 (*sukuk*), 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 practices 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."* Parker (2004b: 2) moreover

[15] The emphasis on microeconomic issues within the study of Islamic financial management is asserted by Badawi (1996: 10) to be largely a trend in the books of *fiqh*. Badawi (1996) argues that *"jurists were trained to attend only to the business conduct of individuals or occasionally groups"* whilst addressing macroeconomic issues were not within their area of concern. Thus, despite the fact that the Islamic theory of development economics is holistic and comprehensive, aiming at furthering the *maqasid al Shari'ah*, it can be argued that its practical applicability has been severely limited by the microeconomic outlook endorsed by practitioners and jurists who looked at issues on an individual basis rather than as part of a whole system.

underlined the focus on high net worth (private banking) clients by investment banking and asset management sectors in the Gulf countries which tend to aim at wealth maximisation rather than contribute to the economic development of the Muslims. The objective of empowering the so-called "middle-class corporate Muslims" or the larger society – in other words, the 'social responsibility' of financial institutions – is questioned in this respect (Tag el-Din, 2005b: 46; Dar, 2002: 70; Badawi, 1996/1997: 20).

Some empirical studies have been conducted to verify this statement. A study by Haron and Kamaruddin (2005) 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 hassan* (benevolent loan) dispensed, (ii) the distribution of their financing by economic sector, (iii) their *zakah* contribution, and (iv) the overdrafts they provide and activities they support to preserve Islamic culture. Haron and Kamaruddin (2005) 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 activities of Islamic banks will increase as these institutions become more established.

Seeking to explain the lower social commitment of Islamic banks, Hasan (2004: 23) provided the following justification by saying that Islamic banks *"have mostly been designed on the pattern of commercial banks ... But they are expected to undertake project financing, long-term risky ventures, and address the social aspirations for economic development [while] they hardly have the structure, aptitude, environment, or personnel to do what we think they must do"*. This statement duly reflects on the lack of the right organisational structure of Islamic banks such that they are perceived as failing in meeting the socio-economic objectives of development and well-being which correspond to living up to the spirit of Islamic law.

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 Nasser Social Bank (1971) in Egypt. The launch of the Islamic Development Bank (1975) in Jeddah also showed a concern for development banking at an international level.

In line with Siddiqi's (2004a) arguments, Dar (2004) also believed that the initial thinking on the discipline considered the practice of banking and finance an integral part of the Islamic economic system, designed to achieve policy objectives like sustainable development.[16] 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.

Warde (2000: 24; 74-87), on the other hand, associates the changing practice of Islamic finance to the evolving political and economic contexts occurring over the period 1970s to date. During the *"first aggiornamento"* the creation of IFIs relied primarily on the guidance of the International Association of Islamic Banks (IAIB) which published the *Handbook of Islamic Banking*, designed to be a source of reference for IFIs, and on the advice of the Islamic Development Bank (IDB). With the global political economy undergoing profound changes by the late 1980s, the fall in oil prices, a new economic order emerging, and an increase in technological and financial innovations – a period termed as the *"second aggiornamento"* – a more pragmatic approach to Islamic finance emerged, notably observed in the Malaysian practice of Islamic finance. In this latter period, the compatibility of modern financial instruments with Islamic principles was assessed and a convergence of Islamic

[16] Kahf (2004: 20) also asserted that the initial experiments of Islamic banking were essentially developmental, with no import from commercial banking and short-term placement of funds.

finance with conventional finance was thus observed (Warde, 2004: 48). More sophisticated financing techniques were embraced and a diverse range of Islamic products were to this end marketed to both Muslims and non-Muslims *"on the basis of returns rather than because they are Islamic"* (Warde, 2000: 86). In the 1990s, IFIs were often in competition with one another as well as having to compete with their conventional counterparts. In this context, economic efficiency and profitability criteria have concurrently gained in emphasis compared to social objectives.

Warde's (2000) analysis explains the number of studies prevailing in the literature which have examined the financial performance of IFIs compared to those focusing on their social priorities and performance. Hasan (2004: 5-30) examines the different criteria and methods used in the literature to measure the efficiency of Islamic banks and in turn highlights the need to evaluate the performance of Islamic banks with reference to their social responsibilities. Hasan (2004) argues that while *"profit adequacy is a survival requirement"* for Islamic banks, fulfilment of the cost-profit criteria for performance appraisal can by no means be a sufficiency condition; instead he makes a case for the evaluation of Islamic banks in terms of their success in enhancing social well-being. No study *per se* has been found in the literature examining the social performance of IFIs so far.

## 4.6 Conclusion

This chapter provided an overview of the Islamic finance industry – its origins, development, expansion, underlying objectives, roles and responsibilities attributed to IFIs as well as the criticisms raised against IFIs. At several instances it was noted that the literature has revealed a divergence between the promise of Islamic economics and the performance of IFIs (Halim, 2001; El-Gamal, 2001; Hasan, 2005a). One main concern related to whether the financial institutions are focusing on the profit objective while neglecting their CSR responsibilities – in particular the social, community and development objectives initially reflected in the theoretical underpinnings of their origins. In view of the CSR responsibilities attributed to IFIs it was therefore deemed important that the social responsiveness ($CSR_2$) and corporate social performance (CSP) of IFIs be evaluated. The next chapter examines the models of CSP discussed in the literature and describes the research methodology used in this study to undertake the empirical assessment of the CSP of a sample of financial institutions offering Islamic products.

# CHAPTER 5

# Theoretical Framework for Assessing CSP and Research Methodology

## 5.0 Introduction

The previous chapters examined how CSR principles are increasingly reflected in the financial decisions of financial institutions – both socially responsible and Islamic – as they screen their investments based on socially and ethically guided criteria. As the development of these institutions keeps expanding, the measurement of their impacts on society is questioned. The underlying premise is that profits generated from their economic and financial transactions should find a way back into society to share the peoples' social and economic burdens. To this end, the literature has questioned and criticised the social and ethical performance of these institutions. These have been delineated in the last two chapters. In the light of these criticisms, the need to use real world data to empirically appraise the corporate social performance (CSP) of Islamic financial institutions, in particular, has been highlighted.

An expansive amount of literature prevails in the area of CSP, examining the issue from both a theoretical and an empirical perspective. Albeit, a limited number of studies has been found to assess the CSP of financial institutions (e.g. Dusuki, 2005; Dusuki and Dar, 2005; Sairally, 2005). This chapter examines the CSP models developed in the literature and endeavours to make use of some of their dimensions to empirically evaluate the social performance of a sample of financial institutions offering Islamic products (FIIPs) and socially responsible financial institutions (SRFIs). It moreover explains the research methodology used in this study to attain the objectives set out in this research.

## 5.1 The Modelling of Corporate Social Performance

The practice of measuring the social responsibility of a corporation is termed Corporate Social Performance (CSP) in the literature. This has developed as thinking on CSR has matured, shifting from its definition onto its management and henceforth onto its measurement aspects. The models developed by Sethi (1975, 1979), Carroll (1979) and Wartick and Cochran (1985) principally classified CSR as an adaptation of corporate behaviour to meet social needs, emphasising its dimensions, categories or principles, social issues, management, and social responsiveness.[1]

After defining the different categories of responsibilities from which principles are enacted and the identification of the CSR issues (denoted as $CSR_1$), the aspect of corporate social responsiveness (denoted as $CSR_2$) has gained emphasis in the literature. Carroll (1979: 502) described the philosophies of responsiveness of a corporation in terms of the possible stances it could take, from anticipating the CSR issues to their complete denial. Carroll (1979) classified this continuum of corporate behaviour in terms of Wilson's (1975) definition of four possible business strategies: reaction, defense, accommodation, and proaction. These possible strategies were further clarified by using the definitions of McAdam (1973) and Davis and Blomstrom (1975).

[1] With regard to the 'dimensions' of CSR, the three levels of CSR advanced by Sethi (1975, 1979) are: social obligation, social responsibility and social responsiveness. Corporate behaviour, on the other hand, is classified in terms of four dimensions: search for legitimacy, ethical norms, social accountability for corporate actions, and operating strategy (Sethi, 1975, 1979). The 'categories' or 'principles' of CSR is associated with Carroll's (1979) definition of CSR principles in terms of the four obligations of firms to society: economic, legal, ethical and discretionary. Carroll (1979: 503) further seeks to relate the four-part responsibilities to specific social issues, like, consumerism, the environment, safety at work, discrimination, product safety. This list can obviously be extended to involve current societal issues which require the attention of corporations. Wartick and Cochran (1985) fine-tuned Carroll's (1979) CSP model by introducing a *"management of the social issues"* dimension to it after defining the social issues facing the firm. Analysis of the social issues is expected to assist the firm in taking a decision about its response to these issues. Corporate social responsiveness is commonly referred as the next step of social responsibility, defined after stipulating the CSR issues. It addresses the philosophy, mode, strategy behind business responses to CSR (Carroll, 1979: 501). As stated by Sethi (1979: 66), it is *"not how corporations should respond to social pressures, but what their long run role in a dynamic social system should be"*.

**Table 5.1 The Reactive-Defensive-Accommodative-Proactive (RDAP) Scale of Corporate Social Responsiveness**

<table>
<tr><th></th><th colspan="5">CSR Responses</th></tr>
<tr><th>Wilson (1975)</th><th>Reactive</th><th>Defensive</th><th colspan="2">Accommodative</th><th>Proactive</th></tr>
<tr><td>McAdam (1973)</td><td>Resistance to change behaviour</td><td>Do only what is required</td><td colspan="2">Be progressive and adapt to society's expectations</td><td>Lead the industry</td></tr>
<tr><td>Davis and Blomstrom (1975)</td><td>Withdrawal</td><td>Embrace a public relations approach</td><td>Adopt a legal approach</td><td>Bargain for a compromise</td><td>Solve the problem</td></tr>
<tr><td>Clarkson (1995)</td><td>Deny responsibility (Doing less than what is required)</td><td>Admit responsibility but fight it (Doing the least that is required)</td><td colspan="2">Accept responsibility (Doing all that is required)</td><td>Anticipate responsibility (Doing more than what is required)</td></tr>
<tr><td></td><td colspan="5">Do Nothing <-----------------------------------------------------> Do Much</td></tr>
</table>

Sources: Adapted from Carroll (1979: 502) and Clarkson (1995: 109)

From Table 5.1, it is observed that 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 the expectations of society. A "proactive" firm progresses to *"solve the problem"* and *"lead the industry"* through exemplary behaviour (McAdam, 1973; Davis and Blomstrom, 1975). Sethi (1979) also uses the term "interactive" to describe firms which are proactive towards CSR issues and would take *"anticipatory and preventive"* measures with regard to future social changes.

On basis of the above definitions, an institution may alternatively be classified 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 attributes to it.

### Table 5.2 Categories of the Philosophy of Corporate Social Responsiveness

| Philosophy of Corporate Social Responsiveness | Defined as fulfilment of the following responsibilities |
|---|---|
| Reactive | Legal |
| Defensive | Legal and Economic |
| Accommodative | Legal, Economic, and Ethical |
| Proactive | Legal, Economic, Ethical, and Discretionary |

Source: Author's Own

Two alternative ways of classifying the continuum of CSR responses of firms have also been noted in the literature. These in fact provide a more detailed classification of firms' responses to CSR. One has been advanced by Henderson Global Investors – an international investment management firm – which has developed a CSR grading table to analyse the CSR performance of companies in which it chooses to invest. It classified the companies it examines as 'leaders', 'integrating', 'developing', 'reacting' or 'resisting' in their approaches towards CSR. Details on the key characteristics of this CSR rating are provided in Table 5.3.

### Table 5.3 Henderson Global Investors' CSR Grading of Companies

<table>
<tr><th>CSR Grades</th><th>Key Characteristics</th><th></th></tr>
<tr><td>Leaders</td><td>• Proactive in seeking improvement and opportunities in the sustainability agenda<br>• Corporate responsibility integrated into business practices and extended along value chain<br>• Processes for stakeholder dialogue and involvement<br>• Detailed disclosure and quantified reporting</td><td rowspan="5">Do Nothing <----------------------------------> Do Much</td></tr>
<tr><td>Integrating</td><td>• Formal policies and systems in place to manage key corporate responsibilities<br>• Tangible improvements in performance in key corporate responsibility areas<br>• Examples of key innovations<br>• Good disclosure track record</td></tr>
<tr><td>Developing</td><td>• Putting in place policies and programmes<br>• Management commitment to improvement<br>• Focus on key risks (e.g. environment)<br>• Descriptive reporting</td></tr>
<tr><td>Reacting</td><td>• Compliance focused<br>• Internal controls only<br>• Little/no reporting</td></tr>
<tr><td>Resisting</td><td>• Continual non-compliance in key responsibility areas<br>• Actively resisting the corporate responsibility and sustainability agendas<br>• Little/no formal policies and systems in place<br>• Poor disclosure</td></tr>
</table>

Source: Henderson Global Investors, www.henderson.com/home/sri/document_library/

The rating on corporate social responsiveness developed by Henderson Global Investors is comparable to the Islamic position on the CSR continuum advanced by Dusuki (2005: 56). Dusuki (2005) suggested that the CSR responses of an Islamic firm can be rated as 'irresponsible', 'minimalist', 'apathy', 'strategic' and '*taqwa* centric', with each level described as per Table 5.4. Dusuki's rating strategy of firms, however, does not consider such aspects like – disclosure, reporting, stakeholder dialogue, setting up of a CSR management system – which have been included in the CSR rating advanced by Henderson Global Investors.

**Table 5.4 CSR Grading of Islamic Firms according to Dusuki (2005)**

| CSR Grades | Key Characteristics | |
|---|---|---|
| ***Taqwa* Centric** | • Proactive in meeting social responsibilities irrespective of financial consequences.<br>• Commitment towards the society is based on the Islamic worldview, guided by the *Shari'ah*, which requires firms to be God-conscious of their responsibilities. This is further in line with the principles of vicegerency, trusteeship and justice that compliance with the *Shari'ah* requires.<br>• Considered the highest position of corporate responsiveness. | ---> **Do Much** |
| **Strategic** | • Fulfilling social responsibilities, including involvement in corporate philanthropy.<br>• CSR responsibilities are undertaken as a means of bringing long term benefits to the firm through positive publicity, better image and increase in shareholder value. | |
| **Apathy** | • Fulfil legal responsibilities while at the same time meet mandatory ethical responsibilities (e.g. do what is right, just and fair and avoid harm).<br>• Minimal participation in voluntary philanthropic responsibilities. These could be performed on an *ad hoc* basis for profitable or personal motives.<br>• No strategic effort to pursue CSR prevails. | |
| **Minimalist** | • Compliance focused, discharging minimum legal responsibilities.<br>• Involved in few or no voluntary CSR activities.<br>• Primary objective is to maximise profits or shareholders' wealth. | |
| **Irresponsible** | • Non-compliance in key responsibility areas.<br>• Involvement in such activities like fraud, misrepresentation, false advertising, violation of employees rights, environmental degradation, etc.<br>• Firm's behaviour can be considered irresponsible. | **Do Nothing** <--- |

Source: Dusuki (2005)

Coming back to the models of CSR, it is noted that Wood (1991) has improved on Carroll's (1979) and Wartick and Cochran's (1985) models by further focusing on the principles of CSR – not only defining CSR but also attributing the level where it should take effect e.g. institutional, organisational and individual. Wood (1991: 695) defined the "institutional principle of CSR" as *"expectations placed on all businesses because of their roles as economic institutions"*. She defined the "organisational principle of CSR" as *"expectations placed on particular firms because of what they are and what they do"*, and the "individual principle of CSR" as *"expectations placed on managers (and others) as moral actors within the firm"*. She also borrowed from Ackerman's (1975) and Strand's (1983) definitions of the processes of corporate social responsiveness to include environmental management, stakeholder management and issues management within the CSP model. According to Wood (1991: 703), a socially responsive corporation (i) assesses its environmental conditions, (ii) attends to the demands of stakeholders, and (iii) designs plans and policies to respond to changing conditions.

Wood's (1991) model added a more pragmatic dimension of CSP measurement through its introduction of measurable *"outcomes of corporate behaviour"* in its construct. According to Wood (1991: 708), the CSP outcomes relate to (i) the social impacts of corporate behaviour, regardless of the motivation behind such behaviour or the process by which it occurs; (ii) the programmes utilised by companies to implement CSR issues; and (iii) the policies put in place by companies to manage social issues and stakeholder interests. These important additions are said to have turned Wood's work into a key contribution to CSP modelling in the 1990s (Igalens and Gond, Not dated: 3).

CSP measurement, according to Wood (1991), therefore embraces three aspects commonly denoted as $CSR_1$, $CSR_2$ and CSP (Frederick, 1978):

- $CSR_1$ 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;
- $CSR_2$ relates to "corporate social responsiveness", examining the responses of firms towards the CSR principles; and
- CSP discusses the "outcomes" of the implementation of CSR policies and their measurement.

With regard to CSP measurement, a stakeholder approach which addresses the CSR impact on the stakeholders of a firm has also been developed since the 1990s. Some of the studies on the stakeholder approach are by Brenner and Cochran (1991), Clarkson (1995), Donaldson and Preston (1995), and Mitchell *et. al.* (1997). In the first instance, the literature has defined the stakeholders of a firm who can affect and are affected by the decisions and objectives of the firm.[2] Others have examined the activities that impact on stakeholders, within the arena of:

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

[2] The stakeholders of a firm are classified mainly into two categories – internal and external. Hopkins (2004: 23) elaborates on the internal and external stakeholder effects of CSR performance. He further adds external institutional effects in his assessment of CSR based on the stakeholder approach.

- *Internal stakeholder effects* – Internal stakeholders comprise stakeholders within the firm like employees and managers. They will be affected by, say, the adoption of a code of ethics, ethical hiring policies, promotion policies, training programmes, and practices of employee welfare benefits.
- *External stakeholder effects* – External stakeholders are those situated outside the firm like the environment, suppliers and customers. They will be affected by, say, the firm's decision to invest in the community, the negative effects of pollution caused by the firm, the firm's decision to recycle waste, the institution's decision not to invest in environmentally polluting industries.
- *External institutional effects* – These comprise the effects on the larger institutional business environment rather than on specific firms. For instance, the application of anti-money laundering regulatory laws will impact on all financial institutions and not only on a selected few.

deterioration – the environment being a further key external stakeholder to the firm. (Epstein *et. al.*, 1977).

In brief, progress on the modelling of CSP has evolved in various stages. First, emphasis was placed on the definition of $CSR_1$ and $CSR_2$; second, management and analysis of CSR issues was incorporated in the model; third, measurement of the outcomes of corporate social behaviour was added; and fourth, a stakeholder approach was introduced in CSP measurement. Table 5.5 provides a summary of the key CSP models discussed in the literature.

**Table 5.5 Key Models of Corporate Social Performance**

| Definition of CSP | CSP Modelling Approach |
|---|---|
| | ***$CSR_1$ and $CSR_2$*** |
| CSP defined in terms of an (a) articulation of the different categories of social responsibilities; (b) enumeration of the specific issues relating to such responsibilities; and (c) specification of the philosophies of responsiveness towards such issues. (Carroll, 1979: 499) | **Principles of CSR ($CSR_1$)**<br>Economic, Legal, Ethical and Discretionary Responsibilities<br>**Identification of CSR Issues**<br>E.g. Profitability, viability, product safety, employee safety, environment, fair recruitment, community investment<br>**Philosophy of Responsiveness ($CSR_2$)**<br>Reactive, Defensive, Accommodative, Proactive |
| | ***$CSR_1$ and $CSR_2$ including CSR Management*** |
| *"The CSP model reflects an underlying interaction among the principles of social responsibility, the process of social responsiveness and the policies developed to address social issues."* (Wartick and Cochran, 1985: 758) | **Principles of CSR ($CSR_1$)**<br>Economic, Legal, Ethical and Discretionary Responsibilities<br>**Social Issues Management**<br>Identification of CSR Issues<br>Analysis of CSR Issues<br>Response to CSR Issues<br>**Philosophy of Responsiveness ($CSR_2$)**<br>Reactive, Defensive, Accommodative, Proactive |
| | ***Corporate Social Performance (CSP)*** |
| CSP is about *"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."* (Wood, 1991: 693) | **Principles of CSR ($CSR_1$)**<br>Economic, Legal, Ethical and Discretionary Responsibilities<br>**Levels of CSR Actions**<br>Institutional, Organisational and Individual levels<br>**Processes of Corporate Social Responsiveness ($CSR_2$)**<br>Identification of CSR Issues<br>Analysis & Management of CSR Issues<br>• *Environmental Assessment & Analysis* (e.g. gather information about the external environment)<br>• *Stakeholder Management* (e.g. managing the corporation's relationships with its different stakeholders which affect or are affected by its operations)<br>• *Issues Management* (e.g. developing responses to issues that may affect the corporation)<br>**Outcomes of Corporate Behaviour (CSP)**<br>Social Impacts, Social Programmes and Social Policies |

*Table 5.5 (Continued)*

| | ***The Stakeholder Framework*** |
|---|---|
| CSP is analysed by *"using a framework based on the management of a corporation's relationships with its stakeholders"* (Clarkson, 1995: 92) | 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.* |

Sources: Carroll (1979); Wartick and Cochran (1985); Wood (1991); Clarkson (1995)

Inevitably, the coverage of studies on CSR has grown over time. Table 5.6 summarises some of the studies conducted on CSR. The literature survey provided by Rodriguez *et. al.* (Not dated: 12) has been extended to include more recent works on this subject.

**Table 5.6 Literature Survey on CSR Approaches**

| CSR Approaches | Literature Survey |
|---|---|
| **Efficiency View** | Friedman (1962, 1970) |
| **$CSR_1$** | Bowen (1953); Frederick (1960); Davis (1967, 1973); Preston and Post (1975); Jones (1980) |
| **$CSR_2$** | Ackerman (1973, 1975); Blake (1974); Ackerman and Bauer (1976); Frederick (1978, 1994); Sethi (1979); Carroll (1979); Strand (1983); Wartick and Cochran (1985) |
| **CSP** | Sethi (1975); Wood (1991, 1997); Swanson (1995, 1999); Clarkson (1995) |
| **Stakeholder Theory** | Carroll (1989); Preston and Sapienza (1990); Brenner and Cochran (1991); Clarkson (1995); Jones (1995); Donaldson and Preston (1995); Mitchell *et. al.* (1997); Freeman (1984, 1999); Jones and Wicks (1999); Scott and Lane (2000); Dusuki and Dar (2005); Dusuki (2005) |

Source: Author's Own

## 5.2 Translating the Theoretical CSP Concepts into Empirical Investigations

The CSP models described in the previous section have been qualitatively defined. An attempt to measure CSP using empirical data will essentially entail finding proxies for the concepts developed in the CSP models. In this study, the firms which are examined are financial institutions, namely FIIPs and SRFIs.

To reiterate, the key objectives of this research (as stipulated in Chapter 1) are:

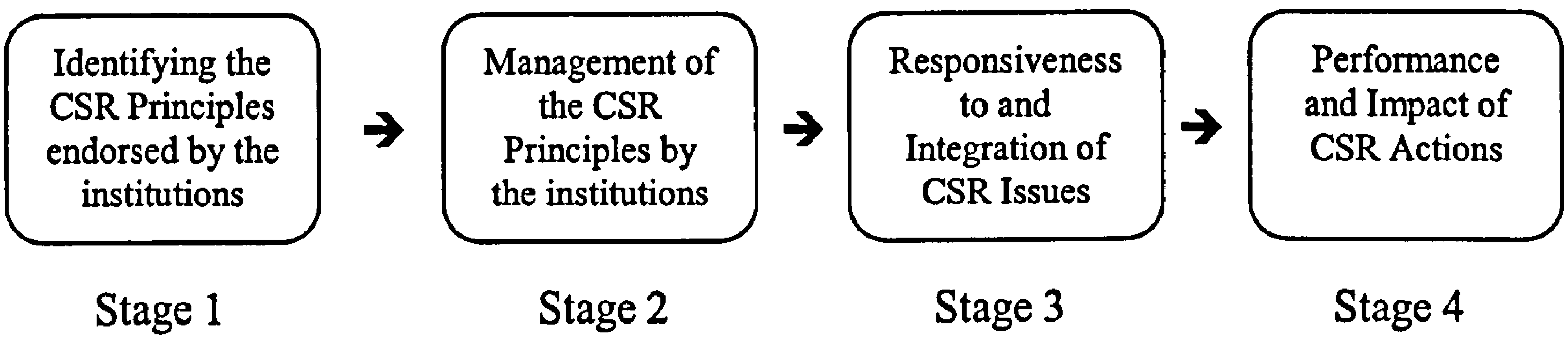
1. To evaluate the corporate social performance of FIIPs.

2. To examine the practices of SRFIs relating to their corporate social performance.

3. To determine what lessons FIIPs can learn from the experiences and practices of SRFIs to better attend to the needs of their stakeholders.

In this study, the four-part definition of CSR due to Carroll (1979) and the model of CSP measurement as defined by Wood (1991) are adapted within the context of financial institutions and used as a framework for assessing the social responsibility of FIIPs and SRFIs.[3] In particular, the following schema is utilised to translate the theoretical CSP concepts into empirical investigations. The assessment procedure is defined in terms of the four-stage process of CSP measurement, as delineated in Figure 5.1.

**Figure 5.1 The Four-Stage Process of CSP Measurement**




Note: The categorisation of the CSP measurement process in the above diagram is by the Author

Within each stage process, this research seeks to pose a number of questions in the way of finding proxies for the assessment procedure. It is noted that, in the light of the normative content of this performance appraisal, the questions raised in one stage of the appraisal may at times be associated with another stage of the assessment process, rendering it difficult to demarcate clearly the four stages of the assessment procedure. Nonetheless, the four stages in the evaluation of CSP tend to represent an

[3] It is noted that Carroll's (1979) definition of CSR is usually the most widely quoted and accepted definition in the literature. Wood's (1991) model of CSP, as noted earlier, is by far described in the literature as the key contribution to CSP modeling in the 1990s (Igalens and Gond, Not dated: 3). This substantiates the reasoning behind the use of the models developed by these two authors in this study.

important *"intellectual framework"* used for understanding the relationship between firms (in our case, financial institutions) and society (Wood, 1997: 154).

### 5.2.1 Identifying the CSR Principles Endorsed by the Financial Institutions

In Stage 1, the questions posed to the financial practitioners relate to their understanding of the meaning of CSR, the issues they associate with CSR and the CSR issues endorsed by their financial institutions. It is highlighted that 'financial practitioners' is the general term used in this study to include those with financial expertise working in FIIPs. Among those who have responded to the questionnaire-based survey conducted in this study are: chairman of FIIPs, bank managers, researchers, financial analysts, economic experts, bankers, investment asset and fund managers, legal and financial experts, and Islamic financial product developers.

The main research questions asked related to:

$R_1$: *Financial practitioners' understanding of CSR and their attitudes towards CSR issues.*

$R_2$: *The association of CSR issues to Islamic (socially responsible) finance by financial practitioners.*

$R_3$: *Financial practitioners' responses on the CSR issues endorsed by their financial institutions.*

The detailed questions with respect to each research question are further described below.

$R_1$: *Financial practitioners' understanding of CSR and their attitudes towards CSR issues.*

- What do financial practitioners understand by the term CSR?
- Do financial practitioners assign a social responsibility function to financial institutions?

- Would financial practitioners prefer to shift the responsibility of undertaking morally motivated economic and financial activities to 'social organisations', instead of attributing the responsibility to financial institutions? [4]

*$R_2$: The association of CSR issues to Islamic (socially responsible) finance by financial practitioners.*

- How do financial practitioners define Islamic (socially responsible) finance? Is their view of Islamic (socially responsible) finance comprehensive enough to cover socially responsible issues which have an impact on the community, employees, customers and the environment?

- Are the financial practitioners aware of the SRI movement? Do they believe that FIIPs should emulate the objectives of Western SRFIs? [5]

*$R_3$: Financial practitioners' responses on the CSR issues endorsed by their financial institutions.*

- Does the financial institution identify itself with CSR issues?

- What CSR issues are stipulated to be of concern to the financial institution?

### 5.2.2 Assessing the Management of CSR Issues by the Financial Institutions

After the identification of the CSR issues subscribed by the financial institutions, in Stage 2 the main research question relates to:

*$R_4$: The management of CSR by the financial institution*

The detailed questions asked are:

[4] This question is based on the arguments of Ismail (1986) and Tag el-Din (2003) who prefer to allocate FIIPs as part of the commercial sector of the economy and would instead assign morally motivated economic and financial activities to the non-profitable third sector.
[5] This question is drawn from Wilson (2002) who proposed that Islamic banks could usefully emulate the practice of Western ethical institutions which publicize their statements of ethical policy where in such objectives like the concern for establishing economic justice could be spelt out.

- Do financial practitioners perceive the existence of a conflict between profitability and the social objectives of their financial institution?

- How does the financial institution rank financial gains vis-à-vis social objectives? Do the financial practitioners place more emphasis on efficiency and profits rather than ethics, social responsibility and equity? [6]

- Do financial practitioners believe that being socially responsible can create value for their organisation?[7]

- What is the view of financial practitioners on the contribution of FIIPs towards sustainable development or socio-economic welfare?

- Has the financial institution set any policies that assist in the assessment of its environmental impact, fulfilment of the demands of its stakeholders, or respond to changing conditions or new issues facing the institution?[8]

- Does the financial institution work in accordance to a published code of ethics?

### 5.2.3 Evaluating the Corporate Social Responsiveness of the Financial Institutions

$CSR_2$ emphasises action and activity (Carroll and Buchholtz, 2006: 30). In Stage 3, the ensuing questions are raised to evaluate whether the financial institutions are 'reactive', 'defensive', 'accommodative' or 'proactive' towards CSR issues – as defined by Carroll's (1979) processes of firms' responsiveness towards CSR.[9]

*$R_5$: What is the corporate social responsiveness of the financial institution?*

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[6] This question is based on El-Gamal's (2000) hypothesis that the preferences of financial practitioners tend to be biased towards the considerations of profits and efficiency rather than towards equity.

[7] This seeks to assess whether the institutions believe in the business case for CSR.

[8] This question is based on Wood's (1991: 703) perception of a socially responsive corporation which, as stated in the earlier paragraphs, is required to (i) assess its environmental conditions, (ii) attend to the demands of stakeholders, and (iii) design plans and policies to respond to changing conditions.

[9] Alternatively, the CSR rating provided by Henderson Global Investors (detailed in Table 5.3) and Dusuki (2005) (detailed in Table 5.4) could also be used to rate the corporate social responsiveness of the financial institutions.

- Do the financial practitioners classify their institutions as socially responsible?

- If so, does the institution spell out or publicize its criteria of investment selection?

- Is this declaration of social responsibility by the financial institution reflected in a further declaration of socially responsible objectives or socially responsible mission and vision statements?

- How far does the financial institution appear to meet its legal, economic, ethical and discretionary responsibilities?

- How can the financial institutions be rated in terms of the RDAP ranking: Reactive, Defensive, Accommodative, or Proactive? [10]

- How far does the financial institution report its SEE 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?

### 5.2.4 Measuring the Outcomes of CSR Actions for the Financial Institutions

CSP emphasises results and outcomes (Carroll and Buchholtz, 2006: 30). It is, however, difficult to measure the effects that adoption of CSR policies has on the different stakeholders of the firm. As a proxy, the socially responsible actions of the financial institution are measured through the institution's commitment of its resources towards CSR issues. It is here assumed that the spending of resources on CSR activities will entail positive results and impact on the stakeholders. Hence, in Stage 4 the following questions are asked in an attempt to evaluate the CSP of the financial institutions.

*$R_6$: Does the institution commit its resources on CSR issues?*

[10] This is assessed based on the information published by the financial institution – e.g. mission statements, vision statements, objectives, activities involved.

*$R_7$: What kind of CSR activities does the institution participate in?*

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

## 5.3 Research Methodology

Research methodology, in broad terms, provides a general orientation to the conduct of the research (Bryman, 2001: 20).[11] As a study set within the social sciences, this research could subscribe to one of the three possible methodology structures which guide social researches.[12] It endorses the empirical research methodology. In particular, it seeks to assess the CSP of two sets of financial institutions within two parallel paradigms – the Islamic finance industry and the socially responsible finance movement. It does this by exploring and evaluating the attitudes of financial

[11] Technically, research methodology has been defined by Manunta (1998: 8) as *"a body of method, procedures, working concepts employed by a discipline"*. Manunta (1998) further describes it as *"the study of methods and of the principles for their application in a given field of inquiry"*. The methodological approach chosen is largely predicated upon the subject or paradigm of the related research and is influenced by the nature, context and objectives of the study researched (Birely and Moreland, 1998: 30). The choices of the research methodology and particular methods are, moreover, said to be dependent on the number and kind of people undertaking the study, the time limit allocated to the research and funding available for the research (McNeill, 1990: 11-13).

[12] According to Asutay (2004), social researches are generally guided by three possible methodology structures: empirical research methodology; emergent research methodology; and literature-based research methodology. Empirical research methodology involves the testing of specific research hypotheses, sampling of a representative population, data collection and data analysis. The emergent research methodology applies to a new research topic where no established and tested methodologies exist. This involves collection and analysis of an initial set of exploratory data and development of an appropriate research methodology technique. Literature-based researches rely on existing texts – based on primary and secondary sources – and seek to analyse these in a systematic way.

practitioners towards CSR issues, examining the responsiveness of the institutions to CSR, and comparing the social performance of the institutions with the theoretical teachings of the disciplines. The research is further empirical by design as it uses primary and secondary data to measure the CSP of a sample number of FIIPs and SRFIs.

In the main, the study is of a qualitative nature. The qualitative aspect is highlighted in the literature review section when discussing the CSR issues within the domain of finance and when describing the CSP models delineated in the literature.[13] Within the empirical section, the qualitative aspect of the study surfaces with the "exploration", "interpretation" and "evaluation" of the attitudes of financial practitioners with regard to the frame of reference on social responsibility provided by the literature (Hakim, 2000). The study also involves collection and analysis of the data drawn from the sample of SRFIs and FIIPs in order to assess their social performance. Essentially, primary data are collected with respect to FIIPs through a questionnaire-based survey. The use of secondary data – collected mainly from the websites of the FIIPs – is also made as a means to gather additional information on the FIIPs. The main source of data for the SRFIs is, however, of a secondary nature, in the form of data published on their websites. These data are analysed using the statistical package SPSS.[14] The qualitative approach of the study thus further emerges when the method of interpretivism is used to draw meaning and make inferences from the statistical results obtained.

[13] Qualitative research, as defined by Hakim (2000: 34), is about assessing the various patterns of people's attitudes, beliefs, perceptions, motivations and behaviour. It is used mainly for exploratory and evaluation studies which could henceforth lead into more structured or quantitative studies (Hakim, 2000: 34-37). As qualitative researches are valuable in identifying causal processes, they also play an important part in policy researches. Broadly, qualitative research emphasises description, explanation, interpretation, exploration and evaluation rather than prediction. The focus, according to Bryman (2001: 20), is therefore on the use of words rather than on quantification in the collection and analysis of data.

[14] More specifically, SPSS Version 11.0 for Windows was used.

## 5.4 Research Strategy

Of the two commonly quoted research strategies in the literature, this study makes use of the inductive approach.[15] This approach is mostly applicable to qualitative research methodology and starts with the process of data collection, proceeds with deriving general principles from the data, and henceforth makes generalised inferences from the patterns of the observations (Bryman, 2004: 9). Inductive reasoning is applied to the data collected from the relevant financial institutions to assess whether SRFIs and FIIPs embrace a 'social responsibility' attribute generally assigned to them by the literature on socially responsible finance and Islamic finance respectively. Analysis of the data is expected to reveal whether endorsement of the ethical principles of Islam or secular ethics contributes to making FIIPs and SRFIs more socially concerned and encourages them to take strategic measures to increase their contribution towards human well-being. Overall, the analysis of the data will further determine whether CSR is a peripheral or integral practice of the sampled financial institutions.

## 5.5 Research Methods

A research method can be understood to relate to the techniques or tools for data collection (Bryman, 2001: 28; Blaxter *et. al.*, 2001: 59). Inevitably, research methods tend to be distinctive to the research methodology (in this case, qualitative in nature) and strategy (in this case, the inductive approach) chosen. It is reiterated that in this study the objective is to evaluate the CSP of FIIPs as well as to examine the CSR practices and CSP of SRFIs. Accordingly, two sets of research methods are relevant in the empirical study of the two types of institutions.

### 5.5.1 Financial Institutions Offering Islamic Products

To initiate the empirical study, collection of data from a sample population of FIIPs from the banking, insurance and asset management sectors was necessary. FIIPs

[15] Research strategies are said to *"provide a logic, or set of procedures, for answering research questions"* (Blaikie, 2000: 24). The research strategy sets out how the research is planned and carried out by involving one or more research methods or techniques of investigation (McNeill, 1990: 14).

were defined as financial institutions, comprising banks or non-banks, operating fully-fledged Islamic or partly-Islamic offices.

As a means of drawing information on the activities and performance of firms, Igalens and Gond (Not dated) 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.

### 5.5.1.1 Primary Data Collection: Mail Questionnaire

In this study, the analysis on the CSP of FIIPs has been based primarily upon the responses to a mail questionnaire forwarded to Islamic financial practitioners. The questionnaire was sent to a sample of around 250 Islamic banks and NBFIs from a wide number of countries by post and via email. A sample of the questionnaire is at Appendix A. The mail questionnaire method was selected because of the following advantages it offered: (i) its usefulness in gathering information from a sample of FIIPs which are geographically widely dispersed (Bryman, 2004: 133; Oppenheim, 2000: 102); (ii) the convenience it offered to respondents to provide well thought out views to the questions posed as well as verify the practices of their institutions before these data are supplied; (iii) its suitability for collecting data about attitudes and opinions (Burns and Bush, 2000; Elanain, 2003); and (iv) the cost advantages it offered, as compared to the interview method, in terms of both financial resources and time. It is noted that the questionnaire method has been used in many similar studies which seek to assess perceptions on CSR issues and Islamic banking issues (see Dusuki, 2005: 120).

### 5.5.1.2 Questionnaire Content

The questionnaire-based survey was designed to gather primary data on the four-stage process of CSP measurement described in Figure 5.1. The questions included in the questionnaire sought to answer the research questions stipulated in sub-sections 5.2.1 to 5.2.4. The questionnaire constituted of mostly closed-ended questions. It attempted to:

(i) gauge the attitude of financial practitioners regarding the association of Islamic finance with CSR through their definition of Islamic finance, their understanding of what 'social responsibility' means, the objectives they assign to FIIPs, the value they attribute to the social mission of FIIPs;

(ii) assess the CSR practices of the FIIPs through their screening criteria, disclosure of any CSR responsibilities in their mission and vision statements, their involvement in community activities, their profit allocation towards the financing of community activities; and thus

(iii) compare what the financial practitioners say they believe in with what they say their financial institutions actually do.

In this way financial practitioners' theoretical understanding of the discipline of Islamic economics, banking and finance was assessed and compared to what they reported about the practice of their institutions. Thus, the study attempted at testing the hypothesis as to whether there is a divergence between the theory and practice of Islamic finance.

The questionnaire addressed to the Islamic financial practitioners was quite comprehensive in content. It consisted of three parts: (i) a personal profile section (6 questions), (ii) a section including general questions on the theoretical aspect of Islamic finance (9 questions), and (iii) a section consisting of questions relating to the practice of the financial institution and its CSR/Islamic finance policies (7 questions) (Refer to Appendix A for a sample copy of the questionnaire). In a number of the questions the attitudes of the respondents were gauged using the Likert scaling method. Likert scales provide a continuum scoring – running from 'strongly agree' to 'agree', 'neutral', 'disagree' and 'strongly disagree' – which gives precise information about the degree of agreement or disagreement of a respondent compared to the simple scaling method 'agree' and 'disagree' (Oppenheim, 2000: 195-200). Consequently, the pattern of responses to questions with a similar import becomes more interesting to explore, enabling subtler and deeper inferences to be made about the attitudes held by respondents.

The content of the questionnaire was initially pilot tested by emailing the questionnaire to the Islamic Business and Finance (IBF) Net Discussion forum where a number of finance professionals, bankers, researchers, scholars and students from all over the world discuss theoretical and practical issues on Islamic economics, banking and finance.[16] The choice of the forum was made based on its grouping of bankers and finance professionals – the ultimate target audience of the questionnaire – whose views could be obtained on CSR issues. The purpose of the pilot test was to verify the successful design and effectiveness of the questionnaire in terms of clarity of the language used, consistency and validity of the set of questions included, and reliability of the research instrument used. A review of the initial questionnaire thereafter ensued. Prior to its final mail-out to FIIPs, the revised questionnaire was again checked by some academicians at the Markfield Institute of Higher Education (Markfield, UK) who were specialised in the fields of social research and Islamic economics, banking and finance.

### 5.5.1.3 Questionnaire Response

Of the 250 Islamic banks and NBFIs which were contacted by post and email to complete the self-completion questionnaire, the response rate was 27.2% (68 respondents) out of which only 22% (55) of the responses was useful for analysis.[17] Some 81.8% of the responses (45 out of 55) were from banks and 18.2% (10 out of 55) was from NBFIs. Overall, the number of financial institutions included in the sample was 46, out of which 36 were banks and 10 were NBFIs.[18] The institutions may be further classified as those providing entirely Islamic financial services (35 institutions representing 76.1%) and those offering an Islamic window (11

[16] The IBF Net homepage is at http://islamic-finance.net and email address for posting messages is ibfnet@yahoogroups.com.

[17] A number of the responses could not be used in this study because of the following reasons: (i) the respondents failed to mention the name of their institutions; (ii) the institutions stated that they did not provide Islamic financial services although they filled the questionnaire (e.g. Habib Bank, Pakistan; Al-Jazeera Investment Company, Qatar; Gulf International Bank, Bahrain); (iii) some respondents were from the Central Banks (e.g. Indonesia).

[18] It is noted that in a few cases more than one response was received from the same institution. This explains why the number of respondents (55) is larger than the number of financial institutions (46).

institutions representing 23.9%). The respondents were, moreover, from 20 different countries, as shown in Table 5.8. It was noted that the highest returns were received from Pakistan, Bahrain, the UK, and Turkey.

A summary on the number of FIIPs and respondents who participated in the questionnaire is given in Table 5.7. Further details on the banks and NBFIs are provided in Table 5.8.

**Table 5.7 Brief Summary of FIIPs Participating in the Questionnaire Survey**

| | |
|---|---|
| No. of respondents from FIIPs, of which | 55 |
| - *Banks* | *45* |
| - *NBFIs* | *10* |
| No. of FIIPs participating in the survey, of which | 46 |
| - *Banks* | *36* |
| - *NBFIs* | *10* |
| No. of fully-fledged FIIPs | 35 |
| No. of FIIPs which are partly-Islamic, operating Islamic windows | 11 |
| No. of countries which are represented in the survey | 20 |

**Table 5.8 Details of FIIPs Responding to the Questionnaire**

| Country | Name of Financial Institution | Frequency of Response | Is the Institution a Bank or a NBFI? | | Is the Institution a Fully-fledged Islamic FIIP or a partly-Islamic FIIP? | | Total No. of FIIPs | Total No. of Responses Per Country |
|---|---|---|---|---|---|---|---|---|
| | | | Bank | NBFI | Islamic | Partly-Islamic | | |
| Australia | Muslim Community Cooperative Australia Ltd. | 1 | 1 | | 1 | | 1 | 1 |
| Bahrain | Bahrain Islamic Bank | 2 | 1 | | 1 | | 5 | 6 |
| | Shamil Bank | 1 | 1 | | 1 | | | |
| | Emerging Markets Partnership (Bahrain) E.C. | 1 | | 1 | | 1 | | |
| | NoRiba Bank | 1 | 1 | | 1 | | | |
| | AlBaraka Banking Group | 1 | 1 | | 1 | | | |
| Bangladesh | Islami Bank Bangladesh Ltd. | 1 | 1 | | 1 | | 1 | 1 |
| Brunei | Islamic Bank of Brunei | 3 | 1 | | 1 | | 1 | 3 |
| Dubai | HSBC Amanah | 1 | 1 | | 1 | | 2 | 4 |
| | Dubai Islamic Bank | 3 | 1 | | 1 | | | |
| Indonesia | Bank Bukopin | 1 | 1 | | | 1 | 3 | 4 |
| | Bank International Indonesia | 2 | 1 | | 1 | | | |
| | Bank Syariah Mandiri | 1 | 1 | | 1 | | | |

| Country | Name of Financial Institution | Frequency of Response | Is the Institution a Bank or a NBFI? | | Is the Institution a Fully-fledged Islamic FIIP or a partly-Islamic FIIP? | | Total No. of FIIPs | Total No. of Responses Per Country |
|---|---|---|---|---|---|---|---|---|
| | | | Bank | NBFI | Islamic | Partly-Islamic | | |
| Iran | Bank Tejarat | 1 | 1 | | 1 | | 1 | 1 |
| Jordan | Islamic International Arab Bank | 1 | 1 | | 1 | | 1 | 1 |
| Kuwait | The International Investor | 1 | 1 | | 1 | | 1 | 1 |
| Malaysia | Maybank | 1 | 1 | | | 1 | 3 | 3 |
| | Takaful Malaysia | 1 | | 1 | 1 | | | |
| | Bank Muamalat Malaysia Berhad | 1 | 1 | | 1 | | | |
| Mauritius | ALEEF | 1 | | 1 | 1 | | 2 | 2 |
| | AlBaraka Coop Society | 1 | | 1 | 1 | | | |
| Pakistan | Meezan Bank | 1 | 1 | | 1 | | | |
| | MCB Bank Ltd. (Islamic Banking Division) | 2 | 1 | | | 1 | 6 | 7 |
| | Zarai Taraqiati Bank Limited | 1 | 1 | | | 1 | | |
| | ABN Amro Bank | 1 | 1 | | | 1 | | |
| | Bank of Khyber | 1 | 1 | | 1 | | | |
| | Bank AlFalah | 1 | 1 | | | 1 | | |
| Philippines | Al-Amanah Islamic Investment Bank of Philippines | 1 | 1 | | 1 | | 1 | 1 |
| Qatar | Qatar International Islamic Bank | 2 | 1 | | 1 | | 1 | 2 |
| South Africa | AlBaraka Bank of South Africa | 1 | 1 | | 1 | | 1 | 1 |
| Saudi Arabia | Hussein Aoueini & Co. Ltd. | 1 | | 1 | 1 | | 3 | 3 |
| | Bank Al Jazira | 1 | 1 | | 1 | | | |
| | National Commercial Bank Ltd. | 1 | 1 | | | 1 | | |
| Sudan | Sudanese Islamic Bank | 1 | 1 | | 1 | | 2 | 2 |
| | Tadamon Islamic Bank | 1 | 1 | | 1 | | | |
| Switzerland | Encore Management S.A. | 1 | | 1 | | 1 | 1 | 1 |
| Turkey | Asya Finans Kurumu | 2 | 1 | | 1 | | 4 | 5 |
| | Kuveyt Turk Evkaf Finans Kurumu | 1 | 1 | | 1 | | | |
| | Family Finans Kurumu | 1 | 1 | | 1 | | | |
| | AlBaraka Turk | 1 | 1 | | 1 | | | |

*Table 5.8 (Continued)*

| Country | Name of Financial Institution | Frequency of Response | Is the Institution a Bank or a NBFI? | | Is the Institution a Fully-fledged Islamic FIIP or a partly-Islamic FIIP? | | Total No. of FIIPs | Total No. of Responses Per Country |
|---|---|---|---|---|---|---|---|---|
| | | | Bank | NBFI | Islamic | Partly-Islamic | | |
| United Kingdom | ABC International Bank Plc. | 1 | 1 | | | 1 | 6 | 6 |
| | Norton Rose | 1 | | 1 | 1 | | | |
| | Yasaar Ltd. | 1 | | 1 | 1 | | | |
| | Dawnay-Day | 1 | | 1 | | 1 | | |
| | Ansar Finance | 1 | | 1 | 1 | | | |
| | Islamic Bank of Britain | 1 | 1 | | 1 | | | |
| Total | | 55 | 36 | 10 | 35 | 11 | 46 | 55 |

### 5.5.1.4 Secondary Data Collection: Websites and Annual Reports

In order to gain further insight into the corporate social responsiveness of the FIIPs, the use of secondary data in the form of information published on the institutions' websites and their annual reports was made. Secondary data are known to offer the advantage of saving cost and time, making available high quality data and providing more time to be utilised for data analysis rather than collection (Bryman, 2001: 197-199). In this research, they are used to supplement the data collected through the questionnaires.

The websites and annual reports of the FIIPs were principally verified to examine the quality of the information publicised by the FIIPs. They were researched in order to:

(i) Record the objectives and mission and vision statements of the FIIPs;

(ii) Note if the institutions published an ethical policy statement and any corporate social reports;

(iii) Verify the stakeholders emphasised by the FIIPs (e.g. customers, investors, employees, shareholders, community, society, the environment);

(iv) Ascertain if the institutions publicised their criteria of investment selection;

(v) Note if the FIIPs placed emphasis on their pursuit of financial gain, profit or increase in shareholder value;

(vi) Confirm if the FIIPs placed emphasis on their *Shari'ah* supervisory boards;

(vii) See if the FIIPs informed the public on their different ways of doing business by publicising literature on Islamic banking and finance;

(viii) Observe if the concepts of CSR, corporate governance, corporate citizenship were recognised by the FIIPs;

(ix) Observe if the FIIPs recognised their legal, economic, ethical, *shari'ah*, philanthropic and communal responsibilities. Based on this information, it was determined if the FIIPs were reactive, responsive, accommodative or proactive to CSR issues.

In this way, the use of discourse and content analysis was made in examining the information posted on the websites of the FIIPs.[19] The approach of interpretivism was especially used to allocate meanings to the texts and literature published on the websites. Through evaluation, exploration and interpretation, general inferences were drawn on the CSR practices of the FIIPs.

The websites of the 46 FIIPs which responded to the questionnaire are as described in Table 5.9 below.

[19] According to Flick (1998: 203), discourse analysis includes the study of both spoken language, like conversations, speeches and data generated through interviews as well as written texts like reports and published and unpublished documents. In this case, discourse analysis is undertaken on materials and documents published on the corporate websites of the FIIPs. Content analysis, on the other hand, is defined as *"an approach to the analysis of documents and texts that seeks to quantify content in terms of predetermined categories and in a systematic and replicable manner"* (Bryman, 2004: 183).

## Table 5.9 Website Addresses of the FIIPs

| Country | Name of the Institution | Website Address |
|---|---|---|
| Australia | Muslim Community Cooperative Australia Ltd. | www.mcca.com.au |
| Bahrain | Bahrain Islamic Bank | www.bahisl.com.bh/english |
| | Shamil Bank | www.shamilbank.net |
| | Emerging Markets Partnership (Bahrain) E.C | www.empwdc.com |
| | NoRiba Bank | www.noriba.com |
| | AlBaraka Banking Group | www.barakaonline.com |
| Bangladesh | Islami Bank Bangladesh Ltd. | www.islamibankbd.com |
| Brunei | Islamic Bank of Brunei | www.ibb.com.bn |
| Dubai | HSBC Amanah | www.amanahfinance.hsbc.com |
| | Dubai Islamic Bank | www.alislami.co.ae |
| Indonesia | Bank Bukopin | www.bukopin.co.id |
| | Bank International Indonesia | www.bii.co.id |
| | Bank Syariah | www.syariahmandiri.co.id |
| Iran | Bank Tejarat | Website under construction |
| Jordan | Islamic International Arab Bank | www.iiabank.com/English |
| Kuwait | The International Investor | www.tii.com |
| Malaysia | Maybank | www.maybank2u.com.my |
| | Takaful Malaysia | www.takaful-malaysia.com |
| | Bank Muamalat Malaysia Berhad | www.muamalat.com.my |
| Mauritius | ALEEF | www.aleef-fund.com |
| | AlBaraka Cooperative Society | Not Available |
| Pakistan | Meezan Bank | www.meezanbank.com |
| | MCB Bank Ltd. Islamic Banking Division | www.mcb.com.pk |
| | Zarai Taraqiati Bank Limited | www.adbp.org.pk |
| | ABN Amro Bank | www.abnamro.com.pk |
| | Bank of Khyber | www.bok.com.pk |
| | Bank AlFalah | www.bankalfalah.com |
| Philippines | Al-Amanah Islamic Investment Bank of Philippines | www.islamicbank.com.ph |
| Qatar | Qatar International Islamic Bank | www.qiib.com.qa/english |
| South Africa | AlBaraka Bank of South Africa | www.albaraka.co.za |
| Saudi Arabia | Hussein Aoueini & Co. Ltd. | www.husseinaoueini.com |
| | Bank Al Jazira | www.baj.com.sa |
| | National Commercial Bank Ltd | www.alahli.com |
| Sudan | Sudanese Islamic Bank | www.sib-sd.com |
| | Tadamon Islamic Bank | www.sudancom.com/tadamon.htm |
| Switzerland | Encore Management S.A | www.encoremanagement.com |

*Table 5.9 (Continued)*

| Country | Name of the Institution | Website Address |
|---|---|---|
| Turkey | Asya Finans Kurumu | www.asyafinans.com.tr |
| | Kuveyt Turk Evkaf Finans Kurumu | www.kuveytturk.com.tr |
| | Family Finans Kurumu | www.bilisimcenter.com/en/family_finans |
| | AlBaraka Turk | www.albarakaturk.com.tr/Eng/Albaraka |
| United Kingdom | ABC International Bank Plc | www.arabbanking.com |
| | Norton Rose | www.nortonrose.com |
| | Yasaar Ltd | www.yasaar.org |
| | Dawnay-Day | www.dawnayday.com |
| | Ansar Finance | www.ansarfinance.com |
| | Islamic Bank of Britain | www.islamic-bank.com |

As stated above, the analysis made in this research on the practices of the 46 FIIPs was based on both the responses received through the self-completion questionnaire as well as on an examination of the corporate websites of the FIIPs. It may be objected that the small sample size included in the study may lead to biased inferences being drawn on the CSR practices of the FIIPs.

Therefore, in an attempt to confirm the findings of the study, it was thought useful to briefly examine the overall practices of another sample of FIIPs by visiting their websites. The same research questions were again explored. The second group of FIIPs, in this case, was randomly selected from the original population of 250 FIIPs. They referred to 24 FIIPs which did not respond to the questionnaire. The list and website addresses of these 24 FIIPs are as described in Table 5.10.

**Table 5.10 Website Addresses of 24 Additional FIIPs**

| Country | Name of the Institution | Website Address |
|---|---|---|
| Abu Dhabi | Abu Dhabi Islamic Bank | www.adib.co.ae/Main_E/index.asp |
| Algeria | Albaraka Bank of Algeria | www.albaraka-bank.com/index.php |
| Bahrain | Gulf Finance House | http://v2.gfhouse.com/v2/index2.asp |
| | Al-Amin Bank | www.alaminbank.com |
| | Citi Islamic Investment Bank | www.citiislamic.com/ciib/homepage |
| Bangladesh | Social Investment Bank Limited | www.siblbd.com/html/homepages.php |
| Brunei | Islamic Development Bank of Brunei Berhad | www.idbb-bank.com.bn/idbb.htm |
| Cayman Islands | Al Tawfeek Co for Investment Funds | www.altawfeek.com |

*Table 5.10 (Continued)*

| Country | Name of the Institution | Website Address |
|---|---|---|
| Dubai | Emirates Islamic Bank | www.emiratesislamicbank.ae/eib/default.htm |
| Dubai and UK | ihilal Financial Services | www.ihilal.com |
| India | Seyad Shariat Finance Ltd. | www.shariatfinance.net |
| | Al-Ameen Islamic Financial & Investment Corporation (India) Limited | www.alameen.edu/corporate/econ.htm |
| Iran | Bank Sepah | www.banksepah.com/EN/AboutUs/History.aspx |
| | Parsian Bank | www.parsian-bank.com/english/home.php |
| Jordan | Jordan Islamic Bank | www.jordanislamicbank.com/ |
| Kuwait | Kuwait Finance House | www.kfh.com/english/Aboutus/index.asp |
| Lebanon | Albaraka Bank | www.al-baraka.com |
| Malaysia | Bank Islam Malaysia Berhad | www.bankislam.com.my |
| Pakistan | Standard Chartered Modaraba (SCM) | www.standardchartered.com/global/index.html |
| Qatar | Qatar Islamic Bank | www.qib.com.qa/english/about_bank/index.html |
| Sudan | Omdurman National Bank | www.omd-bank.com |
| Switzerland | Faisal Finance (Switzerland) SA | www.faisalfinance.com |
| USA | Lariba American Finance House | www.americanfinance.com |
| | Amanah Mutual Fund Trust | www.saturna.com/amanafunds |

## 5.5.2 Socially Responsible Financial Institutions

SRFIs are mostly spread across Europe and the USA and are also currently expanding in various parts of the world. For the purpose of this research, the focus area chosen is the UK. This choice is based on the premise that the UK is considered one of the most developed markets in terms of SRI institutional investment (Social Investment Forum, 2003; Eurosif, 2003) and is more progressive as far as government initiatives towards CSR are concerned. As it was highlighted in Chapter 2, the CSR approach of businesses in the UK is taking an increasingly explicit, yet voluntary, form of business strategy (Matten and Moon, 2005: 350). As such, it was expected that the CSR practices of British SRFIs would be more apparent and hence, valuable lessons could be learnt from their experiences.

### 5.5.2.1 Selection of SRFIs

One of the main sources of information on the UK socially responsible organisations is the UK Social Investment Forum (UKSIF). The UKSIF provides membership to some 250 socially responsible organisations, of which 8 are banks and building societies and 32 are investment management institutions. The remaining organisations are (i) social finance organisations, (ii) independent financial advisers, (iii) professional advisory firms and research providers, and (iv) religious groups, foundations, associations, and trust funds.[20]

Among the banks and building societies, 4 are self-designated fully-fledged SRFIs, including the Co-operative Bank, the Ecology Building Society, Unity Trust Bank and Triodos Bank.[21] Among the investment management institutions, 8 of the leading UK investment funds have been signatories to the *European Social Investment Forum (Eurosif) Transparency Guidelines for the Retail SRI Fund Sector* since June 2005.[22] Eurosif developed the transparency guidelines in order to provide funds with an opportunity to proactively clarify their SRI approach and, thus, reflect in a positive way their principles of transparency and accountability to stakeholders.[23] The guidelines were also aimed at pre-empting any potential regulation against SRI funds.[24] The 8 financial institutions have accordingly published information on their (i) institutional background, (ii) SRI investment criteria, (iii) SRI research processes, (iv) evaluation and implementation of the research processes, (v) engagement approach, and (vi) voting policy. These guidelines are available on the institutions' websites.

In the light of the readily available data on the SRI approaches of the 8 key British SRI funds, these institutions were selected as case studies for the purpose of this

[20] See the list of the organisations at www.uksif.org/Z/Z/Z/dir/type/index.shtml

[21] The other four are mainstream financial institutions, including Barclays Plc, HSBC Holdings Plc, Lloyds TSB Group Plc, and Natwest Community Enterprise/Development (www.uksif.org/Z/Z/Z/dir/type/index.shtml)

[22] See the list of the signatories for the UK at www.eurosif.org/publications/retail_transparency_guidelines/signatories_responses/unitedkingdom. According to the UKSIF, the *Eurosif Transparency Guidelines for the Retail SRI Fund Sector* was developed in response to calls from the European Commission to regulate SRI (UKSIF Press Release, 8 June 2005).

[23] www.eurosif.org/transparency-guidelines-retail

[24] www.eurosif.org/transparency-guidelines-retail.

study. The abovementioned 4 banks and building societies were also added to the list of case studies.

The institutions examined in this study were therefore:

1. The Cooperative Bank Plc
2. Triodos Bank
3. Unity Trust Bank
4. Ecology Building Society
5. CIS Sustainable Leaders Trust Fund
6. F&C Asset Management
7. Friends Provident Plc
8. Henderson Global Investors
9. Insight Investment Management
10. Jupiter Asset Management
11. Morley Fund Management
12. Standard Life Investments

### 5.5.2.2 Secondary Data Collection: Company Websites and Publications

With regard to the collection of data on the above-mentioned SRFIs, the websites and publications of the institutions were surveyed to retrieve information on company objectives, statements, products, practices and policies. As Bryman (2004: 469) stated *"the analysis of websites and web pages is a new field that is very much in the flux"* and this new approach was chosen as a means of having ready access to information publicised by the institutions. The websites and publications of the SRFIs therefore served as objects of qualitative content and discourse analysis. For instance, such words like 'corporate social responsibility', 'corporate citizenship', and 'corporate responsibility' were looked for on the corporate websites in an attempt to discuss the recognition of CSR at the level of the institutions. Discourse analysis of the texts and documents published on the websites was also carried out in order to draw meanings on the views held by the SRFIs on CSR and SRI and the institutions' CSR and SRI practices. A search for meaning was undertaken beyond the words presented on the websites and those published in their literature. The use of interpretivism was therefore made to arrive at such meanings. It is noted that answers were particularly sought for the research questions set out in sub-sections 5.2.1 to 5.2.4 above. These related to an evaluation of the institutions' perception of CSR issues, their commitment towards CSR issues, emphasis on the profit objective, management of CSR/SRI policies, responsiveness towards CSR, involvement of stakeholders in policy decisions, as well as their commitment in corporate social reporting and transparency.

However, in the first instance, it is noted that a questionnaire method was initially endeavoured to be used to examine the CSR issues and performance of SRFIs in the UK. The questionnaire included at Appendix B was circulated to some 50 SRFIs located in the UK. Similar to the case of FIIPs, the purpose for researching the practices of SRFIs was to compare the attitude of the financial practitioners with the practices of the institutions and to evaluate the CSP of the SRFIs. The questions addressed to the financial practitioners therefore aimed at gauging the interviewees' understanding on certain concepts of CSR and SRI, like: (i) the relevance of CSR and SRI in the financial policies of financial institutions; (ii) the meeting of social welfare responsibilities by social organisations and government instead of financial institutions; (iii) the ranking of financial gain vis-à-vis ethical and social responsibilities; (iv) some misconceptions about CSR; and (v) criticisms raised against SRI. Another section of the questionnaire included questions on the CSR and SRI policies of the SRFIs. This section asked financial practitioners about: the basis of the CSR and SRI policies of their institutions; how their institutions ensured compliance to their CSR and SRI policies; the assessment of the social impact of their CSR and SRI policies; their screening criteria for investments; and details on philanthropic activities undertaken by the SRFI to promote societal welfare.

However, of the sampled SRFIs who were contacted for the purpose of completing the questionnaire-based survey, only 4 institutions responded positively (8%). The respondents were: the Ethical Investors Group, CCLA Investment Management Ltd., Quadris Environmental Investments Ltd., and the Christian Ethical Investment Group (CEIG). On the one hand, therefore, the response rate was deemed very poor and, on the other, the respondents were not considered representative of the SRI market in the UK.

Follow-up emails were consequently forwarded to the SRFIs to request for a response and/or seek an explanation for their non-response. The non-response of the SRFIs to the questionnaire was explained by some of the institutions in terms of time constraints or company policy which does not entertain student surveys. It is noted that some studies have pointed to the problem of 'questionnaire fatigue' where companies have to fill out an excessive number of reports to meet the requests received for information (Mayo and Doane, 2002: 6). The high demand on their time may equally explain the low response rate received. Alternatively, as Bryman (2004: 470) indicated, invitations to take part in research surveys may be perceived by some as *"just another nuisance e-mail"*, resulting in limited responses.

Most of the respondents (about 15) instead suggested that their websites be visited to draw the required information. As mentioned above, 8 of the key British SRFIs have disseminated company information and practices on their websites by subscribing to the *Eurosif Transparency Guidelines for the Retail SRI Fund Sector.* Indeed, a considerable amount of literature appears to be published on the websites of the SRFIs. This, to some extent, explains the requests of the institutions to consult their websites to seek the required information.

Consequently, the questionnaire responses were not utilised. Instead 12 institutions were selected as case studies, 4 of which were banks and building societies and 8 self-designated socially responsible investment funds. A brief analysis of the answers provided by the four respondents to the questionnaire further indicated that the information drawn on the practices of these institutions did not add much to the analysis of the other 12 selected SRFIs which was based on their websites literature (the results of this analysis is delineated in Chapter 7). This supported the decision not to use the questionnaires for the purpose of this study.

The main websites researched for the 12 British SRFIs are described in Table 5.11.

**Table 5.11 Website Addresses of the SRFIs**

| Name of the Institution | Website Address |
|---|---|
| The Cooperative Bank Plc | www.co-operativebank.co.uk |
| Triodos Bank | www.triodos.com |
| Unity Trust Bank | www.unity.uk.com |
| Ecology Building Society | www.ecology.co.uk |
| CIS Sustainable Leaders Trust Fund | www.cis.co.uk |
| F&C Asset Management | www.fandc.com |
| Friends Provident | www.friendsprovident.com/stewardship |
| Henderson Global Investors | www.henderson.com/home/sri/ |
| Insight Investment | www.insightinvestment.com |
| Jupiter Asset Management | www.jupiteronline.co.uk |
| Morley Fund Management | www.morleyfm.com/uk/ |
| Standard Life Investments | http://uk.standardlifeinvestments.com/ |

## 5.6 Developing Research Instruments for Analysis

The data generated from the questionnaire circulated to the FIIPs were analysed using the statistical package SPSS in performing descriptive and inferential statistical tests. The former summarise and organise the data collected by using such tools as tables, graphs, and averages; the latter examine a sample observation to generalise about the whole population (Witte and Witte, 2001: 3). Inferential analysis moreover uses inductive reasoning to observe whether the sample data collected support the theory from the literature.

The SPSS tests performed in the case of the FIIPs endeavour to answer the research questions set out in sections 5.2.1 to 5.2.4 which relate to (i) identification of the CSR principles endorsed by the FIIPs, (ii) assessment of the management of their CSR policies, (iii) evaluation of their corporate social responsiveness, and (iv) measurement of the outcomes of their CSR actions.

In the same way, through discourse and content analysis of the literature of the SRFIs, answers to the research questions set out under the above four-stages of CSR measurement were sought for the SRFIs. It necessitated the development of different themes associated with the research questions in order to analyse the CSR performance of SFRIs. Again the focus of attention has been on the perceptions and actions of the institutions with respect to their social responsibility.

## 5.7 Limitations and Difficulties

Reservations were felt with regard to the low response rate of FIIPs to the mail questionnaire. Out of the 250 institutions contacted for completion of the research questionnaire, it was noted that a response rate of 22% (55 respondents) was obtained. This response rate was generated after several reminders were sent to the institutions either by post or via email and by personally pursuing responses from some of the respondents at conference meetings. Generally, a lower response rate is expected from the administration of mail questionnaire, which can be viewed as unsolicited requests made by students on company officials. However, for the purpose of this study the use of this method was considered the best approach on account of the wide geographical dispersion of the financial institutions. The questionnaire content was also quite comprehensive and deemed to gather a wide selection of data on the views of practitioners on CSR. Each questionnaire was representative of an institution's response to its practices of CSR. The questionnaire analysis was further corroborated by examining the practices of the institutions as disseminated on the company websites. A discourse and content analysis was thus carried out on the published and electronic materials of the FIIPs. Moreover, a separate content analysis of the websites of a different sample of 24 FIIPs was conducted in an attempt to confirm the findings established in this study.

It is noted that a single case study approach – either in terms of country or financial institution – has not been adopted in this study to evaluate CSP. Instead, the general attitudes of Islamic financial practitioners towards CSR issues were explored as well as a comparison was made between the teachings of the Islamic economics and finance literature and the views and practices of the FIIPs. To this end, a cross country examination of a number of FIIPs has been deemed more relevant. This approach may, however, be perceived as imposing a limitation to this study in terms of the wide coverage of countries and institutions examined. The various locations of the FIIPs may also imply that the institutions would operate differently, subject to differences in local regulations, procedures, market requirements and economic and social aspirations of the stakeholders. These would, for instance, impact on the aims and objectives of the FIIPs, their activities and products on offer, and the degree of transparency and social reporting.

Another concern of this research was the poor response obtained from the UK-based SRFIs to the questionnaire initially forwarded to them for completion (as noted in sub-section 5.5.2.2). On account of this difficulty, a content and discourse analysis approach has been utilised to examine the CSR practices of 12 case studies of British SRFIs. This meant that it was no longer possible to "assess" the attitudes of the financial practitioners employed in the SRI industry. Instead, a general examination of the practices of the SRFIs was carried out, based on the information publicised by these institutions.

The use of corporate websites as a means of drawing secondary data can itself be an issue of concern to some. One of the objections highlighted by Chambers *et. al.* (2003: 8) is that companies may behave responsibly without necessarily reporting CSR on their websites or publishing a corporate social report. CSR may, for instance, be underreported in companies where CSR is a long embedded activity of the company and thus emphasis is placed on its practice rather than on reporting. In contrast, some companies may over-report their CSR activities in view of the increasing recognition of the business case for CSR and use CSR reporting as a marketing and branding strategy to improve their financial performance (Chambers *et. al.*, 2003: 9). Overall, the contention is that CSR reporting may not be a reliable reflection of an institution's CSR practices and policies.

In this study, the financial institutions self-designate themselves as providers of 'Islamic', 'ethical' or 'socially responsible' financial products. It is therefore expected that their claims are supported by reports to indicate how this objective is achieved. Moreover, corporate reporting and accountability comprise an important part of contemporary CSR (Chambers *et. al.*, 2003: 8). And especially in the UK where CSR is reported to becoming increasingly explicit, it is expected that companies will invest in the promotion of their CSR activities on their websites. However, the claim that institutions engage in the over-reporting of their CSR activities or use CSR reporting as a marketing gimmick may be altogether unlikely in the long term. This can be argued on the basis that information disseminated on websites is accessible to all the stakeholders of a firm and the publication of dishonest and unreliable information may prove harmful to the long run performance of the firm. To this end, corporate websites are utilised as a proxy for examining the policies and practices of SRFIs. The websites of the FIIPs were also checked to confirm the views expressed in the self-completion questionnaire. One of the key advantages of using this approach is expressed by Chambers *et. al.* (2003: 9) as follows: *"although the layout and style of websites vary enormously, they offer a functionally uniform unit of analysis in that in all cases it represents an official presentation of companies' policies and practices as opposed to representing the interpretation of these by, say, any one company official."*

# CHAPTER 6

# Gauging the Social Responsibility of FIIPs: A Cross-Country Analysis

## 6.0 Introduction

The aim of the study, as set out in Chapter 1, is to assess the corporate social performance of financial institutions offering Islamic products (FIIPs). It is recalled that a number of academicians have called attention to the neglect of the social commitment of Islamic financial institutions. The practices of Islamic banking and finance by Islamic financial institutions have generally been criticised for focusing more on the aspects of efficiency, profit, or private gain and less on the social or equity aspects. This study appraises this contention and, in this way, determines the internalisation of socially responsible practices within the operations of FIIPs in a number of countries. The evaluation process is based on Carroll's (1979) definition of CSR and Wood's (1991) model of CSP, conceptualised in the four-stage framework discussed in Chapter 5, which is reproduced below.

| Identifying the CSR Principles endorsed by the institutions | → | Management of the CSR Principles by the institutions | → | Responsiveness to and Integration of CSR Issues | → | Performance and Impact of CSR Actions |
|---|---|---|---|---|---|---|
| Stage 1 | | Stage 2 | | Stage 3 | | Stage 4 |

This chapter presents the empirical findings and analysis of the data gathered from the respondents who participated in the completion of the questionnaire sent to FIIPs. The websites of the FIIPs were further verified as a secondary source of information on the CSR practices of the institutions. Through evaluation, exploration and interpretation, general inferences were drawn on the CSR practices of the FIIPs.

## 6.1 Some Information on the FIIPs Responding to the Questionnaire

There were 55 respondents who participated in the questionnaire survey, corresponding to a response rate of 22% of the sample population (*i.e.* 55 out of

250). The participants represented 46, fully-fledged or partly Islamic, financial institutions which offer Islamic products from 20 countries. Banks consisted of 78.3% of the sample (36 banks out of 46 FIIPs) and NBFIs comprised 21.7% (10 NBFIs out of 46 FIIPs). The number of respondents from banks was about 81.8% (45 out of 55) and 18.2% (10 out of 55) was from NBFIs. Details of the banks and NBFIs were given in Table 5.8 in Chapter 5.

The age group of the respondents, as reflected in Table 6.1, was mainly from the range 36-45 years (38.2%) and 26-35 years (32.4%). Most of the respondents were highly qualified, with the majority (52.9%) holding a Masters degree and the others being university graduates (29.4%) and some having PhD degrees (14.7%) (Table 6.1). The majority of the respondents (96.1%, Table 6.2) were males occupying high level management positions within their institutions (e.g. training and development manager, marketing manager, relationship manager, head of structured finance department, senior vice president, head of department, deputy director, manager of operations, risk management and credit control, and bank manager). Some others were technicians within the Islamic banking field from various academic backgrounds (e.g. Islamic bankers, management accountant, financial analysts, asset managers, product developers, legal advisors, and economic experts).

**Table 6.1 Age and Educational Qualifications of the Participants**

| Age | Valid Percent | | Educational Qualifications | Valid Percent |
|---|---|---|---|---|
| 18-25 years | 5.9 | | GCSE | 2.9 |
| 26-35 years | 32.4 | | Graduate | 29.4 |
| 36-45 years | 38.2 | | Masters | 52.9 |
| 46-55 years | 17.6 | | PhD | 14.7 |
| Above 55 years | 5.9 | | | |
| Total | 100.0 | | Total | 100.0 |

**Table 6.2 Gender of the Participants**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Male | 49 | 89.1 | 96.1 | 96.1 |
| | Female | 2 | 3.6 | 3.9 | 100.0 |
| | Total | 51 | 92.7 | 100.0 | |
| Missing Values | | 4 | 7.3 | | |
| Total | | 55 | 100.0 | | |

## 6.2 Identifying the CSR Principles for the Financial Institutions

In an attempt to identify the CSR principles endorsed by the financial institutions from the respondents, their understanding of the terms 'social responsibility' was queried. About 43.9% of the respondents related the concept to the role played by FIIPs in community development as well as linked it to corporate philanthropy (Table 6.3). They utilised a variety of key wordings in their definitions, such as: 'responsive to social needs', 'community development', 'civic awareness', 'social obligation to the public', 'social role of the Islamic financial institutions', 'accountable to the community', 'community oriented', 'cooperation, assistance', 'solidarity', and 'charity, donation, *zakah*, *infaq*'. The second largest group (19.5%) associated social responsibility with 'social justice', 'against financial exploitation', 'concern of the haves for the have-nots'. Key words like 'ethical' were used by 14.6% of the respondents, who, however, did not clarify as to what being 'ethical' means to them. Awareness that social responsibility may be associated with the establishment of a 'sustainable enterprise' which is concerned about its effects on the environment was perceived by 7.3% of the respondents. Fewer respondents connoted social responsibility with responsible business practices (4.9%), and compliance with the *Shari'ah* (4.9%) and the law (4.9%).

Overall, it was noted that the respondents did not relate CSR with the responsibility of FIIPs to make profits (economic responsibility) or their responsibility towards the main stakeholders of the business like customers, investors and employees. As expected, the focus of the respondents was on the ethical and philanthropic aspects of CSR, however with vague definitions provided for these concepts. For instance, the term 'social justice' which is commonly referred to as an objective of Islamic law was mostly utilised to associate Islamic banking and finance with a 'just', 'responsible', 'equitable' and 'fair' system. The term 'ethical' was mainly left undefined. Some respondents, nonetheless, related it to a financial system based on '*taqwa*' (piety) and 'trust', and which is 'humane' and 'non-usurious'.

**Table 6.3 Key Words Used to Describe 'Social Responsibility'**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Ethical | 6 | 10.9 | 14.6 | 14.6 |
| | Legal | 2 | 3.6 | 4.9 | 19.5 |
| | Responsible Business Practices | 2 | 3.6 | 4.9 | 24.4 |
| | Sustainable Enterprise | 3 | 5.5 | 7.3 | 31.7 |
| | Corporate Philanthropy & Involvement | 18 | 32.7 | 43.9 | 75.6 |
| | *Shari'ah* Compliance | 2 | 3.6 | 4.9 | 80.5 |
| | Social Justice | 8 | 14.5 | 19.5 | 100.0 |
| | Total | 41 | 74.5 | 100.0 | |
| Missing Values | | 14 | 25.5 | | |
| Total | | 55 | 100.0 | | |

To compare the financial practitioners' understanding of CSR with their understanding of Islamic finance, the definition of Islamic finance was sought from the respondents. About 70.9% of the respondents, who defined Islamic finance, attributed a comprehensive definition to the discipline, equating it with the prohibition of *riba*, permissibility of trade without interest, being a socially acceptable, just, human-oriented, and environmentally-friendly financial system (Table 6.4). The social responsibility of Islamic finance was therefore seen by the majority as inclusive of community development, social justice, and ethical issues such as environmental policies, and anti-usury and pro-trade policies. The views of the respondents were, hence, in line with the socially responsible vision and objectives of the theoretical discipline of Islamic economics and finance. It was noted that those who shared this vision were mainly from countries like Pakistan (17.9%), Bahrain (12.8%), and the UK (10.3%). Those from Turkey were seen to favour a more limited definition of 'trade without interest' (75%), thus including the concept of *riba* elimination but excluding other important issues like environmental and human-oriented policies. This may correspond to the fact that most of the FIIPs in Turkey mainly pursue trade financing activities (Table 6.5).

**Table 6.4 What Islamic Finance is Equal to?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Only Prohibition of Riba | 1 | 1.8 | 1.8 | 1.8 |
| | Trade without interest | 4 | 7.3 | 7.3 | 9.1 |
| | Socially Acceptable Just Financial System | 9 | 16.4 | 16.4 | 25.5 |
| | Human oriented, environmental friendly financial system | 2 | 3.6 | 3.6 | 29.1 |
| | All the above | 39 | 70.9 | 70.9 | 100.0 |
| | Total | 55 | 100.0 | 100.0 | |

**Table 6.5 Financing Methods in Turkey**

| Method of Financing | 2000 |
|---|---|
| *Murabaha* | 74% |
| *Mudaraba* | 15% |
| *Ijara* | 10% |

Source: Baskan (2004: 227)

About 66% of the respondents also tend to agree or strongly agree that Islamic finance can be taken as a third way between capitalism and socialism (Table 6.6). Some 15.1% of the respondents, however, remained neutral to the statement. About 18.8% disagreed or strongly disagreed with this question, with some commenting that the systems are not comparable (Table 6.6).

**Table 6.6 Is Islamic Finance a Third Way between Capitalism and Socialism?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Strongly agree | 16 | 29.1 | 30.2 | 30.2 |
| | Agree | 19 | 34.5 | 35.8 | 66.0 |
| | Neutral | 8 | 14.5 | 15.1 | 81.1 |
| | Disagree | 6 | 10.9 | 11.3 | 92.5 |
| | Strongly disagree | 4 | 7.3 | 7.5 | 100.0 |
| | Total | 53 | 96.4 | 100.0 | |
| Missing Values | | 2 | 3.6 | | |
| Total | | 55 | 100.0 | | |

Those who viewed Islamic finance as a third way between capitalism and socialism mostly ranked *'Islamic finance prohibits riba and encourages trade'* as the primary reason for the discipline to be defined as such. This group of respondents totalled 58.1% (Table 6.7). The finding established the general recognition of *riba* elimination in Islamic finance as the crucial ethical factor which differentiates the discipline from other economic and financial systems. However, the focus on one of the ethical credentials of Islamic finance (*riba* prohibition) may be argued to also limit the role attributed to Islamic finance – it neglects other aspects such as the economic, political and social dimension of Islamic finance, which makes it an 'integrated system of financial affairs'. However, it was noted that a large percentage of the respondents (51.4%) equally assigned the following statement as their first criterion for equating Islamic finance with the third way concept: *'Islamic finance represents an integrated system of financial affairs which includes the civil society, the state and the private sector'.* Only 18.9% of the participants classified this criterion as fifth in the ranking they attributed to the definition of Islamic finance. This showed that a significant number of the financial practitioners believed in conveying a larger responsibility to the role of Islamic finance with participation from the government, private enterprises as well as the third sector. Table 6.7 provides more details on the results.

**Table 6.7 Islamic Finance is a Third Way between Capitalism and Socialism because it is...**

| | **Against *Riba* 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 Rank 5** |
|---|---|---|---|---|---|---|
| Rank 1 | **58.1** | 24.1 | 17.9 | 13.8 | **51.4** | Against *riba* and pro-trade |
| Rank 2 | 19.4 | 13.8 | **21.4** | 20.7 | 13.5 | Against speculation and pro-production |
| Rank 3 | 9.7 | 20.7 | 14.3 | **27.6** | 10.8 | Efficient financial system |
| Rank 4 | 9.7 | 10.3 | **28.6** | 27.6 | 5.4 | Against speculation and pro-production |
| Rank 5 | 3.2 | **31.0** | 17.9 | 10.3 | 18.9 | Pro-equity finance |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | |

Further evaluating the theoretical understanding of Islamic finance by financial practitioners, the latter were questioned as to whether they would attribute social responsibilities to FIIPs, in addition to economic, financial, ethical and legal responsibilities. Some 78.2% of the respondents agreed or strongly agreed with the statement; 16.4% remained neutral while 5.4% disagreed or strongly disagreed (Table 6.8). It was observed that the majority of those who agreed or strongly agreed to assign a social responsibility function to FIIPs (43 out of 55 respondents or 78.2%)

also favoured the broad definition of Islamic finance incorporating the prohibition of *riba*, trade without interest, socially acceptable, just, human-oriented, and environmentally friendly financial system (30 out of 39 or 76.9%) (*i.e.* an overall 70.9% as reflected in Table 6.9).

**Table 6.8 Ascription of Social Responsibilities to FIIPs**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Strongly agree | 16 | 29.1 | 29.1 | 29.1 |
| | Agree | 27 | 49.1 | 49.1 | 78.2 |
| | Neutral | 9 | 16.4 | 16.4 | 94.5 |
| | Disagree | 2 | 3.6 | 3.6 | 98.2 |
| | Strongly disagree | 1 | 1.8 | 1.8 | 100.0 |
| | Total | 55 | 100.0 | 100.0 | |

**Table 6.9 Socio-economic responsibility attribute to FIIPs * What Islamic finance is equal to? (Cross-Tabulation)**

| | | | What Islamic finance is Equal to? | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | Only Prohibition of *Riba* | Trade without interest | Socially Acceptable Just Financial System | Human oriented, environmental friendly financial system | All the above | Total |
| Socio-economic responsibility attribute to FIIPs | Strongly agree | Count | | 1 | 2 | 1 | 12 | 16 |
| | | % within Socio-economic responsibility attribute to FIIPs | | 6.3% | 12.5% | 6.3% | 75.0% | 100.0% |
| | Agree | Count | 1 | 2 | 6 | | 18 | 27 |
| | | % within Socio-economic responsibility attribute to FIIPs | 3.7% | 7.4% | 22.2% | | 66.7% | 100.0% |
| | Neutral | Count | | 1 | | 1 | 7 | 9 |
| | | % within Socio-economic responsibility attribute to FIIPs | | 11.1% | | 11.1% | 77.8% | 100.0% |
| | Disagree | Count | | | | | 2 | 2 |
| | | % within Socio-economic responsibility attribute to FIIPs | | | | | 100.0% | 100.0% |
| | Strongly disagree | Count | | | 1 | | | 1 |
| | | % within Socio-economic responsibility attribute to FIIPs | | | 100.0% | | | 100.0% |
| Total | | | 1 | 4 | 9 | 2 | 39 | 55 |
| | | | 1.8% | 7.3% | 16.4% | 3.6% | 70.9% | 100.0% |

To further confirm the responsibilities that respondents would assign to FIIPs, and in the light that CSR has been mainly associated with community involvement, philanthropy and social justice issues (Table 6.3), respondents were asked whether they would prefer social organisations, rather than FIIPs, to undertake morally-motivated economic and financial activities. It was noted from Table 6.10 that a larger percentage of 38.2% of the respondents disagreed or strongly disagreed with this statement, confirming the earlier high percentage of 78.2% (Table 6.8) who ascribed social responsibilities to FIIPs. As such, it could be asserted that the majority of the respondents believed in the attribution of a more integrated CSR role to FIIPs rather than shifting the responsibility to organisations involved in the third sector. The results from Table 6.10 thus showed that the respondents' opinion subscribed to Chapra's model rather than Ismail's model, which were described in Chapter 4. It is recalled that Chapra's model favoured an integral socio-economic role to be attributed to Islamic financial institutions while Ismail's model supported the allocation of social responsibilities to voluntary organisations.

It was, however, noted that an equally large percentage of 35.3% agreed or strongly agreed that social organisations could be assigned the responsibility of morally motivated economic and financial activities whilst 26.5% of the respondents remained neutral on the issue, indicating either uncertainty or mere unconcern about the issue (Table 6.10).

**Table 6.10 Should social organisations be responsible for morally motivated economic and financial activities?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Strongly agree | 3 | 5.5 | 8.8 | 8.8 |
| | Agree | 9 | 16.4 | 26.5 | 35.3 |
| | Neutral | 9 | 16.4 | 26.5 | 61.8 |
| | Disagree | 12 | 21.8 | 35.3 | 97.1 |
| | Strongly disagree | 1 | 1.8 | 2.9 | 100.0 |
| | Total | 34 | 61.8 | 100.0 | |
| Missing Values | | 21 | 38.2 | | |
| Total | | 55 | 100.0 | | |

It should be noted that 65.1% (28 out of 43) of those who agreed or strongly agreed to allocate a socio-economic responsibility attribute to FIIPs equally favoured the idea that FIIPs should adopt similar social, ethical, environmental (SEE) objectives which are propounded by SRI funds in the West (Table 6.12). This idea was initially advanced by Wilson (2002: 61) who believed that Islamic banks should promote their underlying ethical values and objectives as is commonly practiced by secular ethical institutions such as the Co-operative Bank in the UK. This, he argued, would increase their attractiveness to customers seeking ethical financial services who subscribe to these values. Overall, otherwise, 61.1% of Islamic financial practitioners agreed that FIIPs should adopt the SEE objectives of SRI funds; 24.1% remained neutral to the idea and 14.8% disagreed (Tables 6.11 and 6.12).

**Table 6.11 Should FIIPs adopt the SEE objectives propounded by SRI funds?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Strongly agree | 12 | 21.8 | 22.2 | 22.2 |
| | Agree | 21 | 38.2 | 38.9 | 61.1 |
| | Neutral | 13 | 23.6 | 24.1 | 85.2 |
| | Disagree | 8 | 14.5 | 14.8 | 100.0 |
| | Total | 54 | 98.2 | 100.0 | |
| Missing Values | | 1 | 1.8 | | |
| Total | | 55 | 100.0 | | |

**Table 6.12 Ascription of Socio-Economic Responsibility to FIIPs * FIIPs should adopt SEE Objectives propounded by SRI funds (Cross-Tabulation)**

| | | | FIIPs should adopt SEE Objectives propounded by SRI funds | | | | |
|---|---|---|---|---|---|---|---|
| | | | Strongly Agree | Agree | Neutral | Disagree | Total |
| Socio-Economic Responsibility attribute to FIIPs | Strongly agree | Count<br>% within Socio-Economic Responsibility attribute to FIIPs | 9<br>56.3% | 3<br>18.8% | 3<br>18.8% | 1<br>6.3% | 16<br>100.0% |
| | Agree | | 2<br>7.4% | 14<br>51.9% | 5<br>18.5% | 6<br>22.2% | 27<br>100.0% |
| | Neutral | | 1<br>12.5% | 3<br>37.5% | 4<br>50.0% | | 8<br>100.0% |
| | Disagree | | | 1<br>50.0% | 1<br>50.0% | | 2<br>100.0% |
| | Strongly disagree | | | | | 1<br>100.0% | 1<br>100.0% |
| Total | | | 12<br>22.2% | 21<br>38.9% | 13<br>24.1% | 8<br>14.8% | 54<br>100.0% |

Around 77.4% of the respondents also believed that FIIPs should not hesitate to spell out their ethical policies in their mission statements – a practice which is usually adopted by the ethics-guided SRFIs (Table 6.13). For instance, the Co-operative Bank, which is a widely-recognised ethical bank in the UK, proclaims its mission statement as: *"To be a growing, pioneering financial services business delivering benefits to customers, members and communities through commitment to value,*

*fairness and social responsibility"* (The Co-operative Bank Financial Statements, 2005: 5). The Co-operative Bank further elaborated on the underlying values of its business which are: social responsibility, openness and honesty, being successful, being customer focused and making work fun (The Co-operative Bank Financial Statements, 2005: 5).

To verify whether the above belief of the Islamic financial practitioners was reflected in the practice of their institutions, an examination of the contents of the mission and vision statements of the sampled FIIPs was effected. It was noted that almost half of the FIIPs (50.9%) did not make mention of the ethical values that guide their practices (Table 6.14).

**Table 6.13 Should FIIPs spell out their ethical policies like SRI funds? Response from the Questionnaire**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Strongly agree | 12 | 21.8 | 22.6 | 22.6 |
| | Agree | 29 | 52.7 | 54.7 | 77.4 |
| | Neutral | 9 | 16.4 | 17.0 | 94.3 |
| | Disagree | 3 | 5.5 | 5.7 | 100.0 |
| | Total | 53 | 96.4 | 100.0 | |
| Missing Values | | 2 | 3.6 | | |
| Total | | 55 | 100.0 | | |

**Table 6.14 Do the FIIPs proclaim their ethical goals in their vision and mission statements? Analysis based on an examination of company websites**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Yes | 24 | 43.6 | 43.6 | 43.6 |
| | No | 28 | 50.9 | 50.9 | 94.5 |
| | Not observed | 3 | 5.5 | 5.5 | 100.0 |
| | Total | 55 | 100.0 | 100.0 | |

To further analyse the value placed by the FIIPs on their ethical policies, the financial practitioners were asked whether their financial institutions publicize their ethical criteria for selecting investments. Positive responses were received from some 85.2% of the respondents, while only 14.5% answered negatively (Table 6.15). These results, to some extent, indicated that the belief of the respondents to publicize their ethical policies (reflected in Table 6.13) was reported to be translated into practice (Table 6.15).

Nonetheless, a content analysis of the websites of the FIIPs was carried out, where it was noted that only 25.9% of the FIIPs disseminated their ethical criteria for investment selection (Table 6.16). A possible explanation for this lower response (25.9%, Table 6.16) as compared with the statements made by the Islamic financial practitioners (85.2%, Table 6.15) could be that the ethical policies are instead publicized in the institutions' marketing materials and brochures, rather than on their websites.

**Table 6.15 Publicity of criteria for selection of investments according to the responses of the Islamic Financial Practitioners**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Yes | 46 | 83.6 | 85.2 | 85.2 |
| | No | 8 | 14.5 | 14.8 | 100.0 |
| | Total | 54 | 98.2 | 100.0 | |
| Missing Values | | 1 | 1.8 | | |
| Total | | 55 | 100.0 | | |

**Table 6.16 Did the FIIPs reveal their criteria of investment selection? Analysis based on examination of company websites**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Yes | 14 | 25.5 | 25.9 | 25.9 |
| | No | 40 | 72.7 | 74.1 | 100.0 |
| | Total | 54 | 98.2 | 100.0 | |
| Missing Values | | 1 | 1.8 | | |
| Total | | 55 | 100.0 | | |

An average of 47 of the 55 respondents (about 85.4%) revealed details on the criteria for investment selection for their institutions in the questionnaire. These screening criteria are summarised in Table 6.17, ranked in descending order from the highest frequency of positive responses.

**Table 6.17 The Institutions' Screening Criteria for Selecting Investments Based on the Questionnaire Response**

| | Yes | | No | |
|---|---|---|---|---|
| **Screening Criteria** | **Frequency** | **Valid Percent** | **Frequency** | **Valid Percent** |
| Not investing in impermissible activities | 47 | 97.9 | 1 | 2.1 |
| Not investing in *riba* | 45 | 93.8 | 3 | 6.3 |
| Not investing in the arms industry | 32 | 69.6 | 14 | 30.4 |
| Investing in profit and loss sharing arrangements | 31 | 63.3 | 18 | 36.7 |
| Not investing in forward currency transactions | 26 | 56.5 | 20 | 43.5 |
| Investing in companies that contribute positively to society | 19 | 41.3 | 27 | 58.7 |
| Not investing in environmentally polluting economic activities | 19 | 41.3 | 27 | 58.7 |
| Other screening criteria, e.g.,<br>• Not investing in conventional banking & insurance<br>• Not investing in companies that promote religions other than Islam<br>• Seeking high return investments<br>• Investing in care home for elderly people<br>• Investing in trade related transactions<br>• Investing in real transactions | 14 | 31.8 | 30 | 68.2 |
| Investing in environmentally friendly activities | 14 | 30.4 | 32 | 69.6 |

It is noticed from Table 6.17 that criteria like *'not investing in impermissible activities'*, *'not investing in riba'*, and *'not investing in the arms industry'* ranked the highest in the FIIPs' 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. This also reflects the fact that the movement of Islamic finance itself developed in response to the religious prohibitions which motivated the search for an alternative economic and financial system. 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, promoting thematic investment, shareholder advocacy, and community investment. The results could therefore be said to be reflecting the early stage – a 30-year old industry – that Islamic finance is at.

It should, however, be stated that the data could also indicate a progressing state of the Islamic financial practice since, as observed from Table 6.17, a significant percentage of 63.3% would choose investments in profit and loss sharing arrangements. It is noted that much of the criticisms on the practice of Islamic finance highlighted the neglect in the use of financing modes like *musharaka* (profit and loss sharing arrangement in a partnership) and the two-tier *mudaraba* model (passive partnership) as a result of informational asymmetry problems. The significant percentage of the respondents who selected the use of profit and loss sharing instruments would be suggestive of an increasing tendency to use these original modes of Islamic finance. About 41.3% of the respondents also pointed out that their institutions would invest in companies that contribute positively to society. This could be suggestive of a move in the understanding of financial practitioners towards inclusion of more positive screening or proactive investments within Islamic finance. A percentage of 43.5% would, however, still invest in forward currency transactions. A possible explanation could be the use of these instruments as hedging tools.

Environmental issues, however, appeared to be of minor concern to Islamic financial practitioners. As shown in Table 6.17, about 41.3% of the respondents confirmed that their financial institutions would not be investing in environmentally polluting economic activities, indicating that a larger percentage of 58.7% would share no concern about the environmental effects of their investments. Moreover, a higher percentage of about 69.6% of the respondents appeared not to be taking positive initiatives for investing in environmentally friendly activities. Thus, it was observed that, although *Shari'ah* prohibits waste and excessive exploitation of non-renewable resources and encourages the maintenance of environmental and ecological balance, the FIIPs examined in this study did not incorporate such essential values as a deliberate policy decision to be practised within the Islamic financial arena. This would compare with the practices of SRFIs (which are discussed in the following chapter) which were seen to exert considerable efforts in their screening against or in favour of a number of environmental issues. In fact, the environment was a leading screening criterion considered by the SRI funds (which is reflected in the terms 'social, ethical and *environmental*' which are used to categorise CSR issues). The

FIIPs, by contrast, could be said to focus primarily on the ethical and social factors, with the environment being recognised as an implicit screening criterion within the 'ethical' screen.

Again, the ranking order of the screening criteria, as given in Table 6.17, could be said to be reflective of the religious foundations upon which FIIPs have been established: to stay away from prohibitive *haram* activities and to spend best efforts towards implementing Islamically-acceptable *halal* operations. The environment, being related to financial firms' secondary area of concern rather than being one of their primary objectives (like the financial issues of *riba*, speculation, profit and loss sharing), thus captures implicit and lower interest from Islamic financial practitioners.

## 6.3 Assessing the Management of CSR Issues by FIIPs

On basis of the high percentage of respondents (78.2% from Table 6.8) who agreed to allocate social responsibilities to FIIPs, it was queried whether financial practitioners perceived the existence of a conflict between managing the profit-seeking and the social objectives of their institutions. To the question *'how does the financial institution rank financial gains vis-à-vis social objectives?'* it was found that the majority of the respondents (72.2%) attributed equal importance to both variables, implying that they perceived no conflict between the two objectives (Table 6.18). About 25.9%, however, viewed financial gain as more important; 5.6% ranked it as less important and 1.8% of the respondents were of the opinion that it was not important (Table 6.18).

**Table 6.18 Ranking of financial gain in comparison to social objectives of FIIPs**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Less important | 3 | 5.5 | 5.6 | 5.6 |
| | Equally important | 36 | 65.5 | 66.7 | 72.2 |
| | More important | 14 | 25.5 | 25.9 | 98.1 |
| | Not important | 1 | 1.8 | 1.9 | 100.0 |
| | Total | 54 | 98.2 | 100.0 | |
| Missing Values | | 1 | 1.8 | | |
| Total | | 55 | 100.0 | | |

Of those who provided equal rating to profitability and social objectives, 80.5% suggested that FIIPs should be socially oriented (Table 6.19). About 71.5% of those who viewed financial gain as more important still agreed or strongly agreed to the assertion that FIIPs should be socially geared (Table 6.19). On the one hand, this statement may appear paradoxical on the ground that socially or community-oriented projects may be less remunerative in comparison to commercial projects and thus, choosing a socially-geared project may adversely affect the profitability of the institution. On the other hand, a possible explanation could lie in the belief that involvement in CSR activities brings value to the institution and thus be profitable in the long term. Alternatively, some financial practitioners may view financial gain as the enabling factor which allows FIIPs to get involved in social activities, and hence would rank it above the social objectives of FIIPs.

In the light of the above, it was noticed that the attribution of social responsibility to FIIPs primed in the opinions of the Islamic financial practitioners.

**Table 6.19 Ranking of Financial Gain in comparison to Social Objectives of FIIPs * Assigning Socio-economic Responsibility Attribute to FIIPs (Cross-Tabulation)**

| | | | Socio-Economic Responsibility attribute to FIIPs | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | **Strongly Agree** | **Agree** | **Neutral** | **Disagree** | **Strongly Disagree** | **Total** |
| **Ranking of Financial Gain in comparison to Social Objectives of FIIPs** | Less Important | Count<br>% within Ranking of Financial Gain in comparison to Social Objectives of FIIPs | | 2<br>66.7% | 1<br>33.3% | | | 3<br>100.0% |
| | Equally Important | | 12<br>33.3% | 17<br>47.2% | 6<br>16.7% | 1<br>2.8% | | 36<br>100.0% |
| | More Important | | 4<br>28.6% | 6<br>42.9% | 2<br>14.3% | 1<br>7.1% | 1<br>7.1% | 14<br>100.0% |
| | Not Important | | | 1<br>100.0% | | | | 1<br>100.0% |
| Total | | | 16<br>29.6% | 26<br>48.1% | 9<br>16.7% | 2<br>3.7% | 1<br>1.9% | 54<br>100.0% |

To further ascertain the above-mentioned outcomes, it is recalled that the majority of the financial practitioners disagreed or strongly disagreed with the view that social organisations be made responsible for undertaking socially and morally oriented economic and financial activities (38.2% from Table 6.10). Instead, they preferred that FIIPs shoulder such responsibilities.

Cross-tabulating the respondents' views on the *'ranking of financial gains in comparison to the social objectives of FIIPs'* with the question relating *'social organisations versus financial institutions be made responsible for socially-oriented economic activities'*, it was observed that among those who considered financial gain as more important, the majority of 50% viewed social organisations as more suitable to carrying out socially-geared economic activities (agreed and strongly agreed) (Table 6.20). Although upon first perusal of the data, the respondents whose objective was high returns appeared to allocate a socio-economic responsibility to FIIPs (71.5% as reflected in Table 6.19), this group still seemed to prefer social organisations to take over this role (Table 6.20). Consistently, among those who allocated equal importance to profits and social objectives, some 52.1% disagreed or strongly disagreed with the statement that social organisations should be made responsible for morally-motivated economic transactions (Table 6.20).

**Table 6.20 Ranking of Financial Gain vis-à-vis social objectives * Whether social organisations should be responsible for undertaking morally motivated economic and financial activities (Cross-Tabulation)**

| | | | Whether social organisations should be responsible for undertaking morally motivated economic and financial activities | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | Strongly Agree | Agree | Neutral | Disagree | Strongly Disagree | Total |
| Ranking of Financial Gain vis-à-vis social objectives | Less Important | Count<br>% within Ranking of Financial Gain vis-à-vis social objectives | 1<br>50.0% | 1<br>50.0% | | | | 2<br>100.0% |
| | Equally Important | | 2<br>8.7% | 4<br>17.4% | 5<br>21.7% | 11<br>47.8% | 1<br>4.3% | 23<br>100.0% |
| | More Important | | | 4<br>50.0% | 3<br>37.5% | 1<br>12.5% | | 8<br>100.0% |
| | Not Important | | | | 1<br>100.0% | | | 1<br>100.0% |
| Total | | | 3<br>8.8% | 9<br>26.5% | 9<br>26.5% | 12<br>35.3% | 1<br>2.9% | 34<br>100.0% |

Cross-checking whether those who disagreed to attribute morally-motivated socio-economic responsibilities to social organisations (and rather preferred that FIIPs should shoulder these responsibilities) would indeed assign a socio-economic responsibility to FIIPs, it was observed that 66.7% agreed or strongly agreed to do so (Table 6.21).

**Table 6.21 Whether social organisations should be responsible for undertaking morally motivated economic and financial activities * Assigning a Social Responsibility Attribute to FIIPs (Cross-Tabulation)**

| | | | Assigning a Social Responsibility Attribute to FIIPs | | | | |
|---|---|---|---|---|---|---|---|
| | | | Strongly Agree | Agree | Neutral | Disagree | Total |
| **Whether social organisations should be responsible for morally motivated economic and financial activities** | Strongly agree | Count<br>% within Whether social organisations should be responsible for morally motivated economic and financial activities | | 3<br>100.0% | | | 3<br>100.0% |
| | Agree | | 3<br>33.3% | 5<br>55.6% | 1<br>11.1% | | 9<br>100.0% |
| | Neutral | | | 7<br>77.8% | 1<br>11.1% | 1<br>11.1% | 9<br>100.0% |
| | Disagree | | 6<br>50.0% | 2<br>16.7% | 3<br>25.% | 1<br>8.3% | 12<br>100.0% |
| | Strongly disagree | | | | 1<br>100.0% | | 1<br>100.0% |
| Total | | | 9<br>26.5% | 17<br>50.0% | 6<br>17.6% | 2<br>5.9% | 34<br>100.0% |

Above all, the opinion of the respondents was sought to find out how they perceived the contribution of FIIPs towards socio-economic welfare. As shown in Table 6.22, the majority of the respondents (79.4%) agreed or strongly agreed that FIIPs are contributing positively towards socio-economic welfare. This may be taken to explain the majority view of the respondents to maintain the attribution of a socio-economic responsibility to FIIPs.

**Table 6.22 Are FIIPs perceived as contributing positively towards socio-economic welfare?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Strongly agree | 10 | 18.2 | 29.4 | 29.4 |
| | Agree | 17 | 30.9 | 50.0 | 79.4 |
| | Neutral | 3 | 5.5 | 8.8 | 88.2 |
| | Disagree | 4 | 7.3 | 11.8 | 100.0 |
| | Total | 34 | 61.8 | 100.0 | |
| Missing Values | | 21 | 38.2 | | |
| Total | | 55 | 100.0 | | |

With a view to further evaluating how FIIPs manage CSR issues the question *'whether financial practitioners believe that acting in a socially responsible manner can create value for their organisation'* was posed. About 92.6% of the respondents agreed or strongly agreed, thus, establishing a strong business case for CSR. Nonetheless, 7.4% was neutral to the statement whilst nobody disagreed (Table 6.23).

**Table 6.23 Can CSR Create Value for FIIPs?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Strongly agree | 19 | 34.5 | 35.2 | 35.2 |
| | Agree | 31 | 56.4 | 57.4 | 92.6 |
| | Neutral | 4 | 7.3 | 7.4 | 100.0 |
| | Total | 54 | 98.2 | 100.0 | |
| Missing Values | | 1 | 1.8 | | |
| Total | | 55 | 100.0 | | |

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 FIIPs adopt the SEE objectives of SRI funds'*. It was noticed that 62.2% approved that FIIPs should assume such objectives (Table 6.24). Nonetheless, the results showed that a significant percentage of 24.5% was neutral to this question. This could imply that a number of financial practitioners may not perceive a link between SRI funds and FIIPs, and see the institutions as two different types of institutions, founded on two distinctive set of values and having different visions and objectives. They would not, therefore, suggest the sharing of objectives by the institutions. Alternatively, some of the respondents could be unaware of the SRI movement, thus stipulating a neutral answer.

**Table 6.24 Whether CSR can create value for FIIPs * FIIPs should adopt SEE objectives propounded by SRI funds (Cross-Tabulation)**

| | | | FIIPs should adopt SEE objectives propounded by SRI funds | | | | |
|---|---|---|---|---|---|---|---|
| | | | Strongly Agree | Agree | Neutral | Disagree | Total |
| **Whether CSR can create value for FIIPs** | Strongly agree | Count<br>% within Whether CSR can create value for FIIPs | 6<br>31.6% | 6<br>31.6% | 6<br>31.6% | 1<br>5.3% | 19<br>100.0% |
| | Agree | | 5<br>16.7% | 15<br>50.0% | 5<br>16.7% | 5<br>16.7% | 30<br>100.0% |
| | Neutral | | 1<br>25.0% | | 2<br>50.0% | 1<br>25.0% | 4<br>100.0% |
| Total | | | 12<br>22.6% | 21<br>39.6% | 13<br>24.5% | 7<br>13.2% | 53<br>100.0% |

In order to further evaluate the management of CSR issues by FIIPs, answers to the following two questions were sought through content analysis of the information provided on the websites of the institutions and in their literature.

- Does the financial institution have any policies that assist in the assessment of its environmental impact, fulfilment of its stakeholders' demands, or respond to changing conditions or new issues facing the institution?

- Does the financial institution publish a code of ethics?

With regard to the assessment of environmental impact, it was queried whether the institutions took into account the issue of sustainable environment in their financing activities. Among the 46 sampled FIIPs, it was noted that only four institutions (8.7%) showed concern for the environment. Emerging Markets Partnership, an international infrastructure fund in Bahrain with its headquarters in the USA, specifically mentioned investments in Greenfield ventures and Norton Rose, an international law firm with expertise in Islamic finance, highlighted its association with the 'Environmental Law Foundation' and the activities it engages in as part of its efforts to resolve environmental problems. Similarly, Maybank from Malaysia highlights its involvement in the protection of endangered species, cleanliness and landscaping activities as part of its community relations programmes to *"enhance the well being of all levels of our society"* (Maybank Annual Report, 2003: 104-109). The Islami Bank of Bangladesh was the single FIIP who had an 'environmental management policy' whereby *"the Bank makes investment keeping in view the environmental and ecological issues"* as it endeavours to achieve *"sustainable, economic, ecological and social infrastructure development"* of its surroundings (Islami Bank Bangladesh Limited Annual Report, 2003: 27).

The small number of FIIPs having a deliberate environmental policy indeed supports the earlier findings which showed that a low percentage of the FIIPs did not invest in environmentally pollutive activities or took initiatives to support environmentally friendly activities.

As regards the question whether the FIIP gave any importance to its stakeholders' interests, analysis of the websites of the FIIPs revealed that about 50.9% identified the community as a stakeholder group of the institution and about 18.2% of the FIIPs associated Islamic finance with the well-being of mankind or society in general (Tables 6.25 and 6.26 respectively). A number of the institutions reflected on the objective of *Shari'ah* which is to ensure general human well-being and socio-economic justice and thus perceived their institutions as responsive to the socio-economic needs of the people, irrespective of race or religion, and as a contributor to the economic development of the country (e.g. Muslim Community Cooperative Australia, Khyber Bank, AlBaraka Bank of South Africa, Bank Muamalat Malaysia, Islamic Bank of Britain, Shamil Bank).

**Table 6.25 Is the community highlighted as a stakeholder group of the FIIPs?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Yes | 28 | 50.9 | 100.0 | 100.0 |
| Missing Values | | 27 | 49.1 | | |
| Total | | 55 | 100.0 | | |

**Table 6.26 Do the FIIPs highlight the well-being of mankind or society?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Yes | 10 | 18.2 | 100.0 | 100.0 |
| Missing Values | | 45 | 81.8 | | |
| Total | | 55 | 100.0 | | |

Besides, the other stakeholder groups that the FIIPs seemed to focus on were mainly customers (80%), employees (65.5%), the community (50.9%), shareholders (43.6%), and investors (18.2%), as summarised below in Table 6.27.

**Table 6.27 The Stakeholders emphasised by the FIIPs**
**Analysis based on an examination of company websites**

| | Are customers highlighted as an important stakeholder group of the FIIP? | Are employees highlighted as an important stakeholder group of the FIIP? | Is the community highlighted as an important stakeholder group of the FIIP? | Are shareholders highlighted as an important stakeholder group of the FIIP? | Are investors highlighted as an important stakeholder group of the FIIP? |
|---|---|---|---|---|---|
| Valid | 44 (80%) | 36 (65.5%) | 28 (50.9%) | 24 (43.6%) | 10 (18.2%) |
| Missing Values | 11 (20%) | 19 (34.5%) | 27 (49.1%) | 31 (56.4%) | 45 (81.8%) |

It was noticed that the websites of the institutions did not reveal details on how the FIIPs responded to new issues they encounter. A minority of the FIIPs, however, referred to the roles they play in meeting their communities' changing financial needs (e.g. Muslim Community Cooperative Australia) indicating the adaptive capability of the organisation.

Moreover, most of the FIIPs did not appear to have published a code of ethics, except about 8 of the sampled FIIPs which clearly publicised the corporate values they endorsed. These FIIPs were namely Maybank[1] (Malaysia), Bank Syariah Mandiri[2] (Indonesia), ABN Amro[3] (Pakistan), Bank of Khyber[4] (Pakistan), Bank Alfalah[5] (Pakistan), HSBC Amanah[6] (Dubai), the Islamic International Arab Bank[7] (Jordan), and the Islamic Bank of Britain[8] (UK). A number of the banks, nonetheless, were observed to have stipulated their ethical goals in their vision and mission statements (about 24 FIIPs *i.e.* 43.6%, as was noted earlier in Table 6.14). Some of the FIIPs (6 in number) even made specific mention of 'corporate social responsibility' as one of their core values underlying their operations (Table 6.28). Dubai Islamic Bank, Bahrain Islamic Bank and Bank Syariah Mandiri, for instance, released information about how they fulfil their social responsibilities.[9] Similarly, HSBC Amanah included 'corporate citizenship' among its corporate values and highlighted the establishment of responsible business practices and investment in the community as important ethical standards maintained by the institution. Other values referred to by the FIIPs were integrity, respect, teamwork, professionalism, excellence, high quality of service, customer focus, innovation and utilization of latest technology – altogether representing various ethical standards which correspond to the different dimensions of CSR. Around 11 of the FIIPs also reported their endorsement of 'corporate governance' in the management of their businesses (Table 6.28).

[1] Maybank Annual Report (2003: 1)
[2] Bank Syariah Mandiri Annual Report (2004: 3)
[3] http://www.abnamro.com.pk/abnamropk.htm
[4] http://www.bok.com.pk/main.htm
[5] http://www.bankalfalah.com/
[6] http://www.amanahfinance.hsbc.com/hsbc/amanah
[7] Islamic International Arab Bank Annual Report (2003: 8)
[8] http://www.islamic-bank.com
[9] See http://www.alislami.co.ae/; Bahrain Islamic Bank Annual Report (2001: 34); and Bank Syariah Mandiri Annual Report (2004: 90-92).

**Table 6.28 Emphasis placed on Social Responsibility and Corporate Governance**

| | FIIPs which made specific mention of Corporate Social Responsibility | FIIPs which made specific mention of Corporate Governance |
|---|---|---|
| 1 | Bank of Khyber (Pakistan) | ABC International Bank (UK) |
| 2 | Bank Syariah Mandiri (Indonesia) | Islamic Bank of Britain (UK) |
| 3 | Bahrain Islamic Bank (Bahrain) | AlBaraka Bank (South Africa) |
| 4 | Dubai Islamic Bank (Dubai) | Bank Syariah Mandiri (Indonesia) |
| 5 | Islamic International Arab Bank (Jordan) | Bank of Khyber (Pakistan) |
| 6 | Islamic Bank of Britain (UK) | Muslim Commercial Bank (Pakistan) |
| 7 | | HSBC Amanah (UK) |
| 8 | | Islami Bank Bangladesh (Bangladesh) |
| 9 | | Islamic International Arab Bank (Jordan) |
| 10 | | Maybank (Malaysia) |
| 11 | | Shamil Bank (Bahrain) |

To compare the importance given by the FIIPs to issues like social responsibility relative to the efficiency and profitability of the institutions, the websites of the institutions were searched for the usage of such terms which are related to 'profits', 'efficiency', 'shareholder value', and the 'provision of modern products and services'. It was noticed that about 85.5% of the sample emphasised that they aim at increasing shareholder value (Table 6.29). Some of the institutions like Noriba Bank (Bahrain), Bank International Indonesia (Indonesia), ABC International Bank (UK) and Bank Al-Jazira (Saudi Arabia) even highlighted the exclusive provision of products and services to high net worth and affluent customers. Indeed, efficiency and profit maximisation are considered laudable goals in Islam, which according to Sadeq (2005: 490) are *"an Islamic and Shari'ah imperative, rather than being discouraged in Islam"*. After all, the definition of CSR comprises the fulfilment of economic and financial responsibilities which require of businesses to be foremost profitable, viable and efficient (Carroll, 1979: 499). The question which is more relevant with respect to the assessment of CSR is, however, more on whether this profit is shared with others?

**Table 6.29 Do the FIIPs place emphasis on efficiency, financial gain and the provision of modern financial services and products?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Yes | 47 | 85.5 | 100.0 | 100.0 |
| Missing Values | | 8 | 14.5 | | |
| Total | | 57 | 100.0 | | |

With respect to societal share, it is noted that Islam has assigned a minimum limit to social responsibility through the institution of *zakah*. As Sadeq (2005: 492) argues, no upper limit to social responsibility has been fixed. The 'extra' effort, besides meeting the compulsory *zakah* payments, would therefore determine the degree to which FIIPs pursue CSR. This could be assessed through the emphasis the FIIPs place on the welfare of the community and the well-being of the larger society.

As noted above, relatively lower emphasis appeared to be placed on the welfare of the community (50.9% from Table 6.25), the well-being of the larger society (18.2% from Table 6.26), and corporate social responsibility (6 FIIPs out of 46), compared to the focus of the FIIPs on 'efficiency' variables (85.5% from Table 6.29). It could therefore be inferred that the institutions were more 'efficiency/profitability oriented' rather than attempting to maximise social welfare. This finding contrasts with the earlier statement of the financial practitioners where it was found that the majority of the respondents attributed equal importance to the ranking of financial gains with the objectives of the FIIPs (66.7% from Table 6.18). It could therefore be said that the beliefs held by the financial practitioners were not necessarily observed in practice. Possible explanations could be related to operational difficulties faced by the FIIPs like competition, stakeholder pressures, and lack of the right organisational structure.

## 6.4 Evaluating the Corporate Social Responsiveness of the FIIPs

To verify how financial practitioners perceived the responsiveness of the FIIPs towards the endorsement of CSR issues, they were asked whether they viewed their organisations as being socially responsible. It was noted that about 81.1% of the respondents agreed or strongly agreed that their institutions could be classified as a socially responsible organisation (Table 6.30).

**Table 6.30 Do respondents perceive their institution as being socially responsible?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Strongly agree | 15 | 27.3 | 28.3 | 28.3 |
| | Agree | 28 | 50.9 | 52.8 | 81.1 |
| | Neutral | 8 | 14.5 | 15.1 | 96.2 |
| | Disagree | 2 | 3.6 | 3.8 | 100.0 |
| | Total | 53 | 96.4 | 100.0 | |
| Missing Values | | 2 | 3.6 | | |
| Total | | 55 | 100.0 | | |

This result can be compared with the practice of the FIIPs as demonstrated from the information disclosed on their websites. It was found that, although the financial practitioners categorised their institutions as being socially responsible, the practices of the institutions did not necessarily corroborate the beliefs held by the respondents. For instance, 77.4% of the respondents agreed or strongly agreed that FIIPs should publicize their ethical policies; a survey of the websites of the institutions however revealed that only about 43.6% proclaimed their ethical goals in their mission and vision statements (Tables 6.13 and 6.14). A comparison between the reports of the financial practitioners (85.2%, Table 6.15) and the analysis based on the website examination (25.9%, Table 6.16) about the publicity of the FIIPs' criteria for investment selection also indicated that the view of the respondents could not be confirmed with the practices of the FIIPs.

Moreover, the negative screening preferred by the financial institutions indicated that the notion of social responsibility was understood more in terms of 'not being socially irresponsible' rather than 'being socially responsible' (from Table 6.17, it was noted that the following were ranked among the first criteria of investment selection – *'not investing in impermissible activities'*, *'not investing in riba'*, and *'not investing in the arms industry'*). The FIIPs could therefore be said to be more 'reactive' towards CSR rather than being 'proactive'.

As further discussed in the following section where the social welfare activities of the FIIPs are examined (Section 6.5), the notion of social responsibility appeared to be associated with charitable activities, which do not necessarily contribute towards social capacity building and socio-economic empowerment. This finding was consistent with the belief held by the majority of the respondents when they defined social responsibility primarily in terms of corporate philanthropy and community services (43.9%, Table 6.3).

In addition, the understanding of social responsibility did not seem to give high importance to environmental issues which, according to Table 6.17, ranked least within the institutions' investment screening policies. It was noted that some 58.7% of the respondents highlighted that their institutions would not be concerned about investments in environmentally polluting economic activities and about 69.6% would not proactively search for environmentally friendly investments (Table 6.17). Through an examination of the websites and reports of the FIIPs, it was equally found that only four of the FIIPs showed an interest towards environmental protection. Similarly, it was noticed that 58.7% of the respondents did not necessarily invest in companies that contribute positively to society nor did 36.7% of the institutions invest in profit sharing arrangements which have long term beneficial effects on society (Table 6.17).

To substantiate to what extent the social responsibility affirmation of the financial institutions, as pointed out by the respondents, translated in an open or published declaration of socially responsible vision, objectives and activities by the FIIPs, the literature published on the websites of the institutions was again verified and their annual reports were consulted. In particular, Carroll's (1979) definition of the processes of the response to CSR issues which classified organisations as reactive, defensive, accommodative or proactive towards CSR was used to evaluate the corporate social responsiveness of the FIIPs.[10]

To this end, a content analysis was carried out to assess if the institutions were fulfilling their economic, legal, ethical and philanthropic responsibilities. It is recalled that within the Islamic perspective, ethical responsibilities can be said to be consisting of adherence to both *Shari'ah* textual rulings as well as the embracing of broader ethical values (like honesty, respect, transparency, teamwork,

[10] See Tables 5.1 ad 5.2 in Chapter 5 which define the Reactive-Defensive-Accommodative-Proactive (RDAP) scale of corporate social responsiveness.

professionalism, fairness, financial inclusion, and justice) which render the FIIPs to comply with the spirit of the *Shari'ah.* Therefore, through content analysis, such usage of words was looked for on the websites which indicated compliance of the FIIPs with 'ethical' values as well as fulfilment of their legal *Shari'ah* responsibilities. With regard to philanthropic responsibilities, again the two dimensions of community involvement and charitable activities were verified. In short, the determination of the RDAP scale for the FIIPs was based on the recognition and fulfilment of the responsibilities as per the pyramid shown in Figure 6.1.

**Figure 6.1 The RDAP Scale**

L → Reactive

L + Ec → Defensive

L + Ec + Eth + S → Accommodative

L + Ec + Eth + S + C + Ph → Proactive

(L = Legal responsibilities; Ec = Economic responsibilities; Eth = Ethical responsibilities; S = *Shari'ah* responsibilities; C = Community involvement; Ph = Philanthropy)

By definition, all the institutions have to comply with the legal financial rules of the country they operate in. A number of the institutions highlighted the date and country of 'incorporation' or some mentioned that they were granted license to operate by the Government or the Central Bank. Hence, all the FIIPs were implicitly classified as 'reactive' institutions that were aware of their legal obligations.

An analysis of the websites also indicated that all the FIIPs were concerned with financial gains, economic viability, and above all, operated in such a way as to stay in business. Some 85.5% of the institutions in fact clearly indicated their drive for financial performance, improved efficiency and profitability, increased shareholder value and the modern financial products and services they offer (Table 6.29 above). Key phrases like *"optimizing shareholders value"*, *"improving efficiency"*, *"aiming* *at superior financial performance"* and *"offer the best rate of return"* were used in the mission statements of these financial institutions to call attention to their pursuit of the profit motive, profit maximisation and economic efficiency. One of the institutions in Saudi Arabia particularly 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. Other FIIPs, especially in the Middle East region including Bahrain (e.g. Noriba Bank), have highlighted high net worth individuals as their targeted customers.

At this point, it is useful to note the nature of the institutionalisation of most of the FIIPs which has been based on the conventional banking set up, such that the Islamic banks aim to offer similar but alternative products and services, without contravening Islamic legal principles. It could be submitted that the purpose of most of the FIIPs is to operate like high street banks such as Barclays Bank and Natwest. The comments made by three of the FIIPs could, in this respect, be cited:

> *"Islamic banks would be financial intermediaries, like conventional commercial banks, only they would purge interest from all their operations, relying on partnership and profit-sharing instead."* (Dubai Islamic Bank, Dubai).
>
> *"At Meezan Bank, we strive to find commonalties with the conventional banking system with absolutely no compromise on Shariah rulings."* (Meezan Bank, Pakistan).
>
> *"Our goal is to provide our shareholders with a return on their investment that is comparable to that received by investors in conventional UK retail banks."* (Islamic Bank of Britain, UK).

A perusal of the financial products offered by the institutions also indicated that most of the FIIPs attempted to offer similar, yet *Shari'ah* compliant, products and services to conventional banking and financial firms. Common terms to mainstream banking like savings accounts, current accounts, investment accounts, foreign currency deposit schemes, credit card facilities, consumer finance, small business finance, ATM facilities, letter of credit, letter of guarantee, among others, figured among the services offered by the FIIPs.

At the same time, the FIIPs have to meet most of the legal financial requirements which conventional banks face and compete for market share in an environment where financial performance is viewed as a key determining factor of success. This could, hence, explain the orientation of the FIIPs towards superior financial performance and better rates of return.

Nevertheless, the emphasis placed by the institutions on the products they offer to serve the needs of society as well as the employment they create would infer that they are aware of their economic responsibilities. On basis of the economic purpose that the FIIPs serve, they were therefore ranked as 'defensive' towards CSR.

The third and fourth scales of corporate social responsiveness consisted of the ranking of the FIIPs within the 'accommodative' and 'proactive' categories. It was found that not all the FIIPs necessarily fulfilled all the components of the CSR responsibilities so that they fit distinctly within the 'accommodative' or 'proactive' classifications. For instance, some FIIPs would be highlighting their compliance to the *Shari'ah* without mentioning their ethical values; some others would highlight community involvement without supporting charitable activities; still others would be making charitable donations without highlighting their subscription to the *Shari'ah*. As such, a continuum of grading could be assigned to the FIIPs within each category. The pyramid given in Figure 6.1 above thus became more complex (see Figure 6.2 that follows).

**Figure 6.2 The Continuum within the RDAP Scale**

| | | | |
|---|---|---|---|
| **L** | | → | **Reactive** |
| **L + Ec** | | → | **Defensive** |
| L + Ec + Eth | **Accommodative** | → | Accommodating in terms of recognition of ethical principles only |
| L + Ec + S | **Accommodative** | → | Accommodating in terms of *Shari'ah* compliance only |
| **L + Ec + Eth + S** | **Accommodative** | → | Accommodating in terms of recognition of both ethical & *Shari'ah* compliance |
| L + Ec + Eth + C | **Proactive** | | The different levels within the **'proactive'** category, with some involved in community activities alone, others involved in philanthropy alone and some others involved in both community and philanthropy. |
| L + Ec + S + C | **Proactive** | | |
| L + Ec + Eth + S + C | **Proactive** | | |
| L + Ec + Eth + Ph | **Proactive** | | |
| L + Ec + S + Ph | **Proactive** | | The **'proactive'** ranking, being the highest level in the CSR ranking, also includes the different combinations within the 'accommodative' category. |
| L + Ec + Eth + S + Ph | **Proactive** | | |
| L + Ec + Eth + C + P | **Proactive** | | |
| L + Ec + S + C + P | **Proactive** | | |

(L = Legal responsibilities; Ec = Economic responsibilities; Eth = Ethical responsibilities; S = *Shari'ah* responsibilities; C = Community involvement; Ph = Philanthropy)

Based on the above continuum which has been used in categorising the FIIPs, the results from the content analysis were as shown in Table 6.31.

**Table 6.31 Is the Institution Reactive, Defensive, Accommodative or Proactive to CSR?**

| RDAP Scale | Levels within the RDAP Scale | CSR Responsibilities | Frequency | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Defensive | Fulfilling only the legal and economic responsibilities | L + Ec | 3 | 5.5 | 5.5 |
| Accommodative | Mentioning endorsement of ethical values only | L + Ec + Eth | 6 | 10.9 | 69.1 |
| | Mentioning *Shari'ah* compliance only | L + Ec + S | 20 | 36.4 | |
| | Fully accommodative, mentioning both ethics and *Shari'ah* compliance | L + Ec + Eth + S | 12 | 21.8 | |
| Proactive | Excluding ethics and community involvement | L + Ec + S + Ph | 4 | 7.3 | 25.4 |
| | Excluding philanthropy | L + Ec + S + Eth + C | 2 | 3.6 | |
| | Excluding community involvement | L + Ec + S + Eth + Ph | 5 | 9.1 | |
| | Fully proactive | L + Ec + S + Eth + C + Ph | 3 | 5.4 | |
| | | Total | 55 | 100.0 | 100.0 |

- As the operations of all the institutions were in accordance with the law, the FIIPs were implicitly accounted for as being 'reactive'.
- It was noted that three FIIPs *only* emphasised fulfilment of their legal and economic responsibilities, hence they were classified as being 'defensive'. In general, otherwise, most of the FIIPs appeared to be more than 'defensive', fulfilling other aspects of their CSR responsibilities, over and above the legal and economic responsibilities.
- L = Legal; Ec = Economic; Eth = Ethical; S = *Shari'ah*; C = Community; Ph = Philanthropy

From Table 6.31, it was noted that about 5.5% of the FIIPs were classified as adopting a 'defensive' approach to CSR as they referred exclusively to their economic and legal responsibilities. They did not appear to recognise the other CSR responsibilities that society commonly attributes to businesses like ethical responsibility, *Shari'ah* compliance, community services and philanthropy. In terms of Dusuki's (2005) continuum of CSR responsiveness of firms (described in Chapter 5, Table 5.4), these FIIPs could be described as adopting a 'minimalist' approach to CSR.

With regard to the meeting of the *Shari'ah* responsibilities, it was noted that the majority of 83.6% of the FIIPs made reference to their abidance by the *Shari'ah* law, signifying the fulfilment of their legal responsibilities under Islamic law (Table 6.32). A number of the institutions stated that they shun such unjust principles like *riba* and *gharar* and many specifically stated that they comply with the *Shari'ah* in their operating and financing activities. About 13 FIIPs, furthermore, made available some literature on Islamic economics, banking and finance on their websites in order to explain why their operating activities differ from conventional banking and finance and with most of the FIIPs describing the Islamic financing modes (Table 6.33). This information supplemented their company information and description of their financial products and services. Some of these institutions were the Dubai Islamic Bank, AlBaraka Bank of South Africa, the Bank of Khyber, Islami Bank Bangladesh Ltd and the Islamic Bank of Britain.

**Table 6.32 Do the FIIPs emphasise fulfilment of their *Shari'ah* responsibilities?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Yes | 46 | 83.6 | 100.0 | 100.0 |
| Missing Values | | 9 | 16.4 | | |
| Total | | 57 | 100.0 | | |

**Table 6.33 Whether the FIIPs publish literature on Islamic banking and finance on their websites?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Yes | 17 | 30.9 | 100.0 | 100.0 |
| | *ABC International Bank (UK)* | | | | |
| | *Al-Amanah Islamic Investment Bank of Philippines* | | | | |
| | *Al-Baraka Bank (Bahrain)* | | | | |
| | *Al-Baraka Bank (South Africa)* | | | | |
| | *Ansar Finance (UK)* | | | | |
| | *Bank of Khyber (Pakistan)* | | | | |
| | *Islamic Bank of Brunei* | | | | |
| | *Dubai Islamic Bank* | | | | |
| | *Islamic Bank of Britain (UK)* | | | | |
| | *Norton Rose (UK)* | | | | |
| | *Islami Bank Bangladesh Ltd.* | | | | |
| | *Muslim Community Cooperative Australia* | | | | |
| | *Takaful Malaysia* | | | | |
| Missing Values | | 38 | 69.1 | | |
| Total | | 55 | 100.0 | | |

Moreover, it was noticed that about 36.4% of the FIIPs laid special emphasis on their *Shari'ah* supervisory board – particularly on the establishment of this board to ensure compliance of the financial activities with Islamic law, the constituting members of the board and the eminent personalities of the members (Table 6.34). It is noted that, according to the accounting standards published by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI, 2004-05), Islamic financial institutions are required to publish the report of their *Shari'ah* supervisory board whose role is to ensure that the transactions and activities of the Islamic financial institutions are in compliance with Islamic *Shari'ah* rules and principles. As Gambling *et. al.* (1993: 198) argue, the prevalence of the *Shari'ah* supervisory board assures Muslim customers that their moral expectations are being fulfilled. The emphasis placed on this supervisory board is similar to the focus that SRFIs placed on their ethical policy unit which ascertains compliance with their ethical policies (to be discussed in the following chapter).

**Table 6.34 Do the FIIPs emphasise their *Shari'ah* supervisory board?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Yes | 20 | 36.4 | 100.0 | 100.0 |
| Missing Values | | 35 | 63.6 | | |
| Total | | 55 | 100.0 | | |

It may, however, be contended that being *Shari'ah* compliant does not necessarily imply being 'ethical'.[11] *Shari'ah* compliancy may, on the one hand, be met if the financial products are in conformity with Islamic legal principles, eliminating all dealings proscribed by *Shari'ah* and promoting Islamic exhortations. This can, however, be achieved if all the necessary adjustments are made to conventional financial products so that they become *Shari'ah* compliant – a process which is commonly termed as 'Islamic financial engineering'. While this would represent acting within the textual directive of Islamic law, *Shari'ah* consistency should also involve acting within the spirit of Islamic law (Badawi, 1997: 20). This would have

[11] Here the definition of ethical responsibility given by Carroll (1998: 594) is reiterated. It is said to *"embrace a response to the "spirit" of laws and regulations and help guide business actions in those decision arenas in which regulations are ill-defined or non-existent"*. Ethical responsibility would therefore imply acting over and above the legal requirements – in the Islamic case, rising above the search for *Shari'ah* compliance.

recourse to the broader objectives of the *Shari'ah* (*maqasid al-Shari'ah*) and would attribute a more holistic long term objective to Islamic banks – that of working towards the optimisation of human well-being. In this respect, Islamic banks would be expected to embrace broader concepts involving processes which, for example, build good relations between management and employees and take steps to have a positive impact on the environment and the larger society. The broader objective extended to FIIPs would also impact on the institutions' outlook, procedures, training of employees, financial products on offer and overall modus operandi (Hasan, 2005a: 22). In terms of financial products, for instance, the FIIPs would be concerned that these not only drive financial resources towards consumption channels but would work towards capital formation for long-run growth (Hasan, 2005a: 21).

It is certainly most difficult to evaluate the overall modus operandi of a financial institution merely by examining its websites and annual reports. As such, the fulfilment of the ethical responsibilities was attributed to those institutions which were noted to have clearly specified the endorsement of 'ethical' principles such as ensuring equity and justice in their economic activities, and their abidance by values like honesty, trust, integrity, accountability, fairness and transparency. This served as a proxy to label the FIIPs as acting over and above the textual directive of Islamic law.

On the basis of the above classification of the FIIPs, it was noted that some 50.9% of the institutions made mention of the ethical values their institutions subscribed to (Table 6.35). Yet, as pointed out earlier, only a small number of the respondents made allusion to issues like the environment as forming part of the ethical strategy adopted by their institution. Those who referred to their involvement in activities related to environmental protection or investment in Greenfield ventures were: Emerging Markets Partnership (Bahrain), Norton Rose (UK), Islami Bank Bangladesh Ltd. and Maybank (Malaysia).

**Table 6.35 Do the FIIPs emphasise fulfilment of its ethical responsibility?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Yes | 28 | 50.9 | 100.0 | 100.0 |
| Missing Values | | 27 | 49.1 | | |
| Total | | 55 | 100.0 | | |

In comparison to the percentage of the FIIPs which referred to the fulfilment of their *Shari'ah* responsibilities (83.6%, Table 6.32), the percentage of FIIPs which explicitly recognised the endorsement of ethical values was considerably lower (50.9%, Table 6.35). As such, those who specified *Shari'ah* compliance might not have necessarily indicated their support for ethical values. The lower percentage which reported their ethical responsibilities could probably be a result of the common belief that *Shari'ah* compliance encompasses ethical compliance. After all, Islamic financing is also often connoted with ethical financing. In the context of this statement, however, compliance with the *Shari'ah* would subject FIIPs to act in accordance with the spirit of the *Shari'ah*, where the *Shari'ah* is taken to offer a wider paradigm in defining the nature of ethicality. As it was unclear whether the FIIPs implied compliance with both the Islamic textual law as well as support for Islamic ethical values when they used the term '*Shari'ah* compliance', both definitions were searched for on their websites.

On this basis, three levels of the 'accommodative' scale were observed: (i) FIIPs which focused on ethical values only (10.9%, Table 6.31); (ii) those who mentioned *Shari'ah* compliancy only (36.4%, Table 6.31); and (iii) those who highlighted the observance of both ethical values and compliance with the *Shari'ah* within their operations (21.8%, Table 6.31). The overall percentage for those classified within the 'accommodative' rank was 69.1%.

In general, it was noticed from Table 6.31, that the majority of the FIIPs were seen as being accommodative to CSR issues (totalling 69.1%). Of this percentage, most of the institutions (about 36.4%) highlighted the fulfilment of their legal, economic, and *Shari'ah* responsibilities. It was noted that this group (36.4%) did not lay emphasis on the reporting of their ethical responsibilities. This result would indicate that the majority of the FIIPs were concerned with ensuring that their operations were in conformity with the Islamic legal principles. As such, it could be inferred that the FIIPs were *Shari'ah* compliant but not necessarily '*Shari'ah* based' where their overall operations are guided by broader Islamic-cum-ethical objectives. As a general observation, the CSR responsiveness of the FIIPs classified in this category could also be rated in the 'apathy' category (described by Dusuki, 2005 – as per Table 5.4

in Chapter 5) where, above all, the fulfilment of ethical responsibilities would be restricted to those that meet the mandatory legal (*Shari'ah*) requirements.

With regard to the classification of the FIIPs in the 'proactive' category, it was observed that a total of 25.4% met their economic, legal, *Shari'ah* (at times ethical) responsibilities and highlighted their roles in the community through charitable donations and participation in community projects (Table 6.31). Again, the total percentage of 25.4% could be broken down into different levels of 'proactivity' on the part of the institutions.

- The highest percentage of 9.1% (representing 5 respondents) in this category defined their adherence to the *Shari'ah*, endorsed ethical values and participated in mainly philanthropic activities. Participation in the community which devolved time, effort, the sharing of expertise and other resources were not part of the activities of this group.

- The second largest group of 7.3% (representing 4 respondents) was proactive to the extent that they supported philanthropic activities. However, this group did not define their ethical responsibilities, although they highlighted their compliance with the *Shari'ah*.

- The third group of 5.4% (representing 3 respondents) could be labelled as being 'fully proactive', where the FIIPs defined all their CSR responsibilities and allocated resources towards community projects as well as philanthropy.

- The remaining 3.6% of the FIIPs (representing 2 respondents) in the proactive category acknowledged *Shari'ah* compliance, defined their ethical principles, was involved in community projects but did not appear to support philanthropy.

Particularly, it was noted that 21.8% of the FIIPs emphasised their support for philanthropy which consisted mainly of financial donations to various charitable causes (Table 6.36). A lesser percentage of 7.3% focused on community development projects (Table 6.37).

**Table 6.36 Do the FIIPs emphasise fulfilment of their philanthropic responsibilities?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Yes | 12 | 21.8 | 100.0 | 100.0 |
| Missing Values | | 43 | 78.2 | | |
| Total | | 55 | 100.0 | | |

**Table 6.37 Do the FIIPs focus on development of the community or specify meeting the needs of the community?**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Yes | 4 | 7.3 | 100.0 | 100.0 |
| Missing Values | | 51 | 92.7 | | |
| Total | | 55 | 100.0 | | |

Some of the philanthropic activities described by the institutions were:

- The setting up of *qard hassan* funds for the provision of interest free loans to the needy (e.g. Al-Amanah Islamic Investment Bank, Islamic International Arab Bank, Bahrain Islamic Bank, Dubai Islamic Bank);
- Sponsorship and support for youth programmes (e.g. Muslim Community Cooperative Australia);
- Sponsorship of social events (e.g. Maybank, Dubai Islamic Bank);
- Establishment of *zakah* fund (e.g. Dubai Islamic Bank);
- Providing support for social, cultural, sports, educational, and health activities through financial aids and donations of equipments (e.g. Bahrain Islamic Bank, Maybank, National Commercial Bank); and
- Sponsorship of publications and banking conferences (e.g. ABC International Bank, Dubai Islamic Bank).

Some of the community activities that the FIIPs were engaged in were:

- Staff volunteering in schools by teaching children reading and IT; setting up of coaching schemes on sports; helping with career choices; assisting in fundraising (e.g. Norton Rose);

- Financing of community projects like hospitals, social service centres, vocational training institutes, rehabilitation centres for the disabled, and setting up of rural development schemes (e.g. Islami Bank Bangladesh Ltd.);
- Expanding the Muslim community economic strength by developing Muslim businesses (e.g. Muslim Community Cooperative Australia); and
- Support to grass root level development through micro-finance projects (e.g. Bank of Khyber; Islami Bank of Bangladesh Ltd.).

As stated earlier, it was found that within the 'proactive' category the two highest ranking achieved by the institutions were: (i) those who defined all their CSR responsibilities, included philanthropy, but excluded community involvement (5 respondents representing 9.1% from Table 6.31); and (ii) those who excluded ethics and community involvement in their definition of CSR but included philanthropy (4 respondents representing 7.3% from Table 6.31). It was observed that a fewer number of FIIPs acknowledged all their CSR responsibilities and was involved in both community projects and philanthropy (3 respondents representing 5.4% from Table 6.31). This group of 5.4% could be stated to be 'fully proactive'.

The FIIPs which were classified in the 'proactive' category are described in Table 6.38 that follows.

**Table 6.38 List of the FIIPs classified in the Proactive Category**

| Proactive | CSR Responsibilities | Frequency of Responses | Valid Percent | No. of FIIPs | Name of FIIPs |
|---|---|---|---|---|---|
| Excluding community involvement | L + Ec + S + Eth + Ph | 5 | 9.1 | 3 | • Dubai Islamic Bank<br>• Islamic International Arab Bank<br>• May Bank |
| Excluding ethics and community involvement | L + Ec + S + Ph | 4 | 7.3 | 3 | • ABC International Bank<br>• Bahrain Islamic Bank<br>• National Commercial Bank |
| Fully proactive | L + Ec + S + Eth + C + Ph | 3 | 5.4 | 3 | • Islami Bank Bangladesh Ltd.<br>• Muslim Community Cooperative Australia<br>• Norton Rose |
| Excluding philanthropy | L + Ec + S + Eth + C | 2 | 3.6 | 2 | • Bank of Khyber<br>• Islamic Bank of Britain |
| **Total** | | 14 | 25.4 | 11 | |

From Table 6.38 above, it was noticed that only 3 FIIPs were classified as being fully proactive in this study, on basis of their expressed social objectives. They were notably: (i) Islami Bank Bangladesh Ltd. (Bangladesh), (ii) Muslim Community Cooperative Australia (Australia), and (iii) Norton Rose (UK). Of these 3 FIIPs, it was observed that two of the institutions promoted their social welfare activities through the foundations that they have established. The 'Islami Bank Foundation' and the 'Norton Rose Charitable Foundation' are the two foundations which were stated to be responsible for coordinating the institutions' charitable donations and social welfare activities. It is noted that the setting up of foundations or trusts to undertake social activities is a common practice of big corporations like Toyota and Ford. The setting up of foundations to fulfil social responsibilities indicates that there is a strategic effort – a thought-out policy – on the part of the institutions to fulfil their social responsibilities.

It is remarked that Norton Rose operates as an international company with a network of offices in Europe, the Middle East and Asia. It claims to have 30 years of experience in Islamic finance with well-established offices in the UK, Bahrain, Dubai and Singapore. Thus, it appears to have the financial capacity to support the community work it involves it. With respect to the Islami Bank Bangladesh Ltd., it is remarked that the institutional set-up of the bank fully recognised its social orientation. Unlike other Islamic commercial banks, the Islami Bank Bangladesh at the outset delineated the developmental role it endeavoured to undertake. This clear social objective demarcates the bank from the other FIIPs which had profitability and financial performance as their key objectives. Similarly, the Muslim Community Cooperative Australia was established as a co-operative whose objective was to work for the welfare of the Australian Muslim community. This institutional structure and objective of the bank would explain its proactivism with regard to the social welfare agenda.

Table 6.39 provides the classification of all the FIIPs according to the RDAP ranking.

## Table 6.39 Are the Institutions Reactive, Defensive, Accommodative or Proactive to CSR?

| | Defensive | Accommodative | | | Proactive | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Name of Financial Institution** | **L+E** | **L+E+ Eth** | **L+E+ S** | **L+E+ Eth+S** | **L+E+ Eth+S+C** | **L+E+ S+P** | **L+E+ Eth+S+P** | **L+E+ Eth+S +C+P** | **Total** |
| ABC International Bank Ltd. | | | | | | 1 | | | 1 |
| ABN Amro Bank | | 1 | | | | | | | 1 |
| Al Baraka South Africa | | | | 1 | | | | | 1 |
| Al Baraka Turk | | 1 | | | | | | | 1 |
| Al Barakah Cooperative Society | | | 1 | | | | | | 1 |
| Al-Amanah Islamic Investment Bank of Philippines | | | | 1 | | | | | 1 |
| AlBaraka Banking Group | | | 1 | | | | | | 1 |
| ALEEF | | 1 | | | | | | | 1 |
| Ansar Finance | | | | 1 | | | | | 1 |
| Asya Finans Kurumu | | | 2 | | | | | | 2 |
| Bank Al Jazira | | | 1 | | | | | | 1 |
| Bank Alfalah | | 1 | | | | | | | 1 |
| Bank Bukopin | | | 1 | | | | | | 1 |
| Bank International Indonesia | | | 2 | | | | | | 2 |
| Bank Muamalat | | | 1 | | | | | | 1 |
| Bank of Khyber | | | | | 1 | | | | 1 |
| Bank Syariah Mandiri | | | | 1 | | | | | 1 |
| Bank Tejarat | 1 | | | | | | | | 1 |
| Barain Islamic Bank | | | | | | 2 | | | 2 |
| Brunei Islamic Bank | | | 3 | | | | | | 3 |
| Dawnay Day | 1 | | | | | | | | 1 |
| Dubai Islamic Bank | | | | | | | 3 | | 3 |
| Emerging Markets Partnership (Bahrain) E.C. | | | | 1 | | | | | 1 |
| Encore Management | 1 | | | | | | | | 1 |
| Family Finans Kurumu | | 1 | | | | | | | 1 |
| HSBC Amanah | | | | 1 | | | | | 1 |
| Hussein Aoueini & Co. Ltd. | | | 1 | | | | | | 1 |
| Islami Bank Bangladesh Ltd. | | | | | | | | 1 | 1 |
| Islamic Bank of Britain | | | | | 1 | | | | 1 |
| Islamic International Arab Bank | | | | | | | 1 | | 1 |
| Kuveyt Turk Evkaf Finans Kurumu | | | | 1 | | | | | 1 |
| Maybank | | | | | | | 1 | | 1 |
| MCB Ltd. Islamic Banking Division | | | | 2 | | | | | 2 |
| Meezan Bank | | | | 1 | | | | | 1 |
| Muslim Community Cooperative Australia | | | | | | | | 1 | 1 |
| National Commercial Bank | | | | | | 1 | | | 1 |
| Noriba Bank | | | 1 | | | | | | 1 |
| Norton Rose | | | | | | | | 1 | 1 |
| Qatar International Islamic Bank | | | 2 | | | | | | 2 |
| Shamil Bank | | | | 1 | | | | | 1 |
| Sudanese Islamic Bank | | | 1 | | | | | | 1 |
| Tadamon Islamic Bank | | | 1 | | | | | | 1 |
| Takaful Malaysia | | | 1 | | | | | | 1 |
| The International Investor | | | 1 | | | | | | 1 |
| Yasaar Ltd. | | | | 1 | | | | | 1 |
| Zarai Taraqiati Bank Limited | | 1 | | | | | | | 1 |
| **Total** | **3** | **6** | **20** | **12** | **2** | **4** | **5** | **3** | **55** |

Besides looking at the RDAP ranking of the FIIPs, the content analysis of the FIIPs may be taken further to question whether the institutions reported their SEE effects arising out of their economic and financial activities to particular interest groups or to society at large. In other words, it was asked whether corporate social reporting was a well-grounded policy within the practices of the FIIPs. It was found that, although some of the FIIPs mentioned their adherence to corporate governance and even recognised 'social responsibility' as one of their business values, no CSR report appeared to be published by the institutions. This would contrast with the practices of the SRFIs (to be discussed in the following chapter) which would be seen to spend effort and time into promoting their SEE policies as well as reporting their CSR activities on an annual basis.

## 6.5 Measuring the Outcomes of CSR Actions for FIIPs

The financial institutions' commitment of resources towards socially geared activities was examined in an attempt to measure the outcomes of CSR actions. On account of the non-prevalence of CSR reports published by FIIPs, it was deemed difficult to assess the effects that the CSR actions of the FIIPs have on society and their stakeholders. To this end, it was assumed that the spending of a percentage of the institutions retained profits on social projects or philanthropic activities would have positive impacts on the well-being of society members. The FIIPs' commitment of resources towards social welfare activities was, therefore, assessed instead.

Based on the responses to the questionnaire, this study endeavoured to find the activities that the FIIPs would participate in to add positively to the community, to establish responsible business practices, and to support the environment. At the same time, this study queried the percentage of profits the FIIPs would attribute to these activities.

It was found that the majority of the respondents (44.2%) confirmed that their institutions spent about 0-2% of the annual profits on activities which benefited the community (Table 6.40). The results equally revealed that 41.9% spent 2-5% of the annual profits; 9.3% spent 5-7%; and 4.7% spent 7-10%. Therefore, it was observed that most of the respondents chose the 0-2% and 2-5% range of profits directed towards social welfare activities. It was also noted that 21.8% of the financial practitioners chose not to disclose the percentage of profits their institutions spent on community welfare activities. This could be on account of either confidentiality issues relating to business practices where such information is not revealed to the public (as confirmed by one practitioner at the Islamic Bank of Britain) or lack of transparency within the FIIPs and towards the public such that the financial practitioners would not reveal such details.

**Table 6.40 Percentage of profits spent on community enhancing activities**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | 0-2 % | 19 | 34.5 | 44.2 | 44.2 |
| | 2-5 % | 18 | 32.7 | 41.9 | 86.0 |
| | 5-7 % | 4 | 7.3 | 9.3 | 95.3 |
| | 7-10 % | 2 | 3.6 | 4.7 | 100.0 |
| | Total | 43 | 78.2 | 100.0 | |
| Missing Values | | 12 | 21.8 | | |
| Total | | 55 | 100.0 | | |

It was further noticed that most of the respondents (78.9% as shown in Table 6.41) who believed that Islamic finance should be defined in broad terms incorporating a human-oriented socially-acceptable just financial system also stated that a range of 0-2% of the profit margin of their institutions was spent on socially oriented activities. The 0-2% range also corresponded with 78.9% of the respondents who agreed or strongly agreed that their organisations were socially responsible (Table 6.42).

**Table 6.41 What percentage of profits is spent on community enhancing activities * What Islamic finance is equal to? (Cross-Tabulation)**

| | | | What Islamic Finance is Equal to? | | | | |
|---|---|---|---|---|---|---|---|
| | | | Trade Without Interest | Socially Acceptable Just Financial System | Human Oriented Environmentally Friendly Financial System | All the Above | Total |
| Percentage of profits spent on community enhancing activities | 0-2% | Count<br>% within Percentage of profits spent on community enhancing activities | | 3<br>15.8% | 1<br>5.3% | 15<br>78.9% | 19<br>100.0% |
| | 2-5% | | 2<br>11.1% | 2<br>11.1% | | 14<br>77.8% | 18<br>100.0% |
| | 5-7% | | 1<br>25.0% | | 1<br>25.0% | 2<br>50.0% | 4<br>100.0% |
| | 7-10% | | | | | 2<br>100.0% | 2<br>100.0% |
| Total | | | 3<br>7.0% | 5<br>11.6% | 2<br>4.7% | 33<br>76.7% | 43<br>100.0% |

**Table 6.42 What percentage of profits is spent on community enhancing activities? * Whether the FIIP is socially responsible? (Cross-Tabulation)**

| | | | Whether the FIIP is Socially Responsible? | | | |
|---|---|---|---|---|---|---|
| | | | Strongly Agree | Agree | Neutral | Total |
| Percentage of profits spent on community enhancing activities | 0-2% | Count<br>% within Percentage of profits spent on community enhancing activities | 7<br>36.8% | 8<br>42.1% | 4<br>21.1% | 19<br>100.0% |
| | 2-5% | | 2<br>11.1% | 13<br>72.2% | 3<br>16.7% | 18<br>100.0% |
| | 5-7% | | 1<br>25.0% | 3<br>75.0% | | 4<br>100.0% |
| | 7-10% | | 1<br>50.0% | 1<br>50.0% | | 2<br>100.0% |
| Total | | | 11<br>25.6% | 25<br>58.1% | 7<br>16.3% | 43<br>100.0% |

The ranking of the different social welfare activities that the FIIPs were involved in is described at Table 6.43. As can be observed from the table, among the first rankings of the activities that the financial institutions participated in, those stated by the respondents were mainly related to donations-like activities. The first three rankings were donations to charities (ranked 1$^{st}$), loans and social welfare facilities to staff (ranked 2$^{nd}$), and donations for community causes (ranked 3$^{rd}$). The 6$^{th}$ and 7$^{th}$ ranking were also of a philanthropic nature: sponsorship of community events (ranked 6th), and provision of benevolent loans (ranked 7th). This list was consistent with some of the philanthropic activities that were posted on the websites of the institutions, outlined in Section 6.4 above.

It may be contended that the percentage of retained profits (0-2%) which was attributed to social welfare activities would be mainly used for donations-related activities or philanthropy. This view would align with the financial practitioners' earlier belief and understanding of social responsibility where CSR was defined in the first instance in terms of corporate philanthropy and community involvement (see Table 6.3). It would also be in line with the findings reported in Tables 6.36 and 6.37 above where it was observed that a higher percentage of 21.8% of the FIIPs would engage in charitable donations but only about 7.3% of the FIIPs would spend their resources towards their participation in community projects.

It may be noted that within the Islamic perspective, acts of benevolence are indeed encouraged. Besides the obligatory annual *zakah* payment of 2.5% which is enjoined on every financially-able Muslim and viable Muslim organisation, other voluntary spending (*sadaqa*) is encouraged as an expression of man's gratitude to God for His grace. God describes voluntary spending as a "goodly loan" which He will increase manifold (Qur'an, 2: 245). In this respect, Muslims dispense financial resources towards charitable causes and Islamic financial institutions advance interest-free loans (*qard hassan*) to deserving individuals facing exceptional financial difficulties. ever, it is worthwhile to note that philanthropic activities within the Islamic xt may not necessarily be undertaken on an entirely 'selfless' basis, for they be performed expecting a reward (*sawab*) from God. A show of greater nitment towards the Islamic cause would be more in terms of involvement of the in the community, which would require not only financial resources (which is vely easy to give away if available), but also entail dedication in terms of time, and expertise for probably a longer period.

## Table 6.43 Ranking of the Social Welfare Activities endorsed by the FIIPs

| Types of activities in which the financial institutions would get involved | Yes | Valid Percent | No | Valid Percent | Total Response | Missing Responses | CSR Classif-ication* |
|---|---|---|---|---|---|---|---|
| 1. Donations to charities | 42 | 91.3 | 4 | 8.7 | 46 | 9 | Ph |
| 2. Staff welfare (loans, health schemes, etc.) | 39 | 97.5 | 1 | 2.5 | 40 | 15 | Ph |
| 3. Donations to community causes | 37 | 88.1 | 5 | 11.9 | 42 | 13 | Ph |
| 4. Promoting ethical values among staff (e.g. against-bribery, corruption, conflict; pro-honesty, trust, brotherhood, justice) | 36 | 100 | - | - | 36 | 19 | Eth |
| 5. Abstaining from false advertising | 35 | 97.2 | 1 | 2.8 | 36 | 19 | Eth |
| 6. Sponsorship of community events | 31 | 77.5 | 9 | 22.5 | 40 | 15 | Ph |
| 7. Provision of benevolent loans (*qard hassan*) | 29 | 78.4 | 8 | 21.6 | 37 | 18 | Ph |
| 8. Sharing best practice on social, ethical and environmental responsibility with other organisations | 29 | 90.6 | 3 | 9.4 | 32 | 23 | Eth |
| 9. Working with local schools, colleges, universities | 29 | 76.3 | 9 | 23.7 | 38 | 17 | C |
| 10. Investing according to ethical guidelines | 25 | 83.3 | 5 | 16.7 | 30 | 25 | Eth, Ec |
| 11. Investment in Research & Development | 24 | 75.0 | 8 | 25.0 | 32 | 23 | Ec |
| 12. Scholarship to students | 22 | 68.8 | 10 | 31.3 | 32 | 23 | Ph |
| 13. Establishing fair recruitment practices, including engaging people traditionally excluded from the labour market e.g. disabled, homeless, ethnically discriminated | 18 | 69.2 | 8 | 30.8 | 26 | 29 | Eth |
| 14. Commitment to sustainable development | 17 | 70.8 | 7 | 29.2 | 24 | 31 | Eth, Ec |
| 15. Supporting employee involvement with community causes | 15 | 60.0 | 10 | 40.0 | 25 | 30 | C |
| 16. *Zakah* collection and distribution | 15 | 55.6 | 12 | 44.4 | 27 | 28 | C |
| 17. Investing or encouraging investment in deprived areas | 13 | 54.2 | 11 | 45.8 | 24 | 31 | Ec, C |
| 18. Taking initiatives to protect the environment (e.g. recycling) or enhance environmental management | 13 | 54.2 | 11 | 45.8 | 24 | 31 | Eth |
| 19. Working with NGOs for sustainable development | 13 | 52.0 | 12 | 48.0 | 25 | 30 | C |
| 20. Lobbying for a particular social, ethical or environmental cause | 9 | 36.0 | 16 | 64.0 | 25 | 30 | Eth |

* Ph = Philanthropic, Eth = Ethical, Ec = Economic, C = Community involvement

From the last column of Table 6.43 where the types of activities the institutions would get involved in were classified as an ethical, economic, philanthropic or community activity, it was noticed that 6 out of the 20 activities (30%) were of a philanthropic nature, 8 out of 20 (40%) were of an ethical dimension, 5 out of 20 (25%) related to community involvement, and 4 out of 20 (20%) were of an economic dimension.[12] It was further observed that, while the economic, ethical and community issues varied in ranking, the philanthropic activities ranked among the first choice of activities of the FIIPs.

Nonetheless, the fact that CSR issues like *'promotion of ethical values among staff'* and *'abstention from false advertising'* were ranked fourth and fifth respectively in the analysis could be taken to indicate a tendency for the financial institutions to build a positive banking culture – an Islamic banking culture – where Islamic-cum-ethical values like brotherhood, trust, transparency, cooperation, honesty, and reliable customer service are likely to reign.

Again, from Table 6.43, it was noted that environmental causes ranked among the last observations in the list of activities subscribed by FIIPs: commitment to sustainable development (ranked 14$^{th}$); taking initiatives to protect the environment (e.g. recycling) or enhance environmental management (ranked 18$^{th}$); working with NGOs for sustainable development (ranked 19$^{th}$); and lobbying for a particular social, ethical or environmental cause (ranked 20$^{th}$). Equally, of relatively minor importance to the respondents were the support to employees for their involvement in community causes (ranked 15$^{th}$), investments in deprived areas (ranked 16$^{th}$), and community work like *zakah* collection and distribution (ranked 17$^{th}$). As it may be noticed, these activities could be seen to be of a 'proactive' nature, which would require positive effort, engagement, dedication and commitment on the part of the FIIPs. They could be said to be different from philanthropy, which could be perceived as an 'easier' act to embrace if one has the financial means. The FIIPs did not appear to be much involved in such activities.

[12] It is noted that some of the activities were classified within two categories e.g. investing according to ethical guidelines was viewed as both an economic and an ethical activity.

Based on the empirical findings, the ensuing question may finally be posed: Does CSR seem to constitute a peripheral or minimalist activity of the sampled financial institutions? Or does CSR appear to form part of an integral management strategy of the FIIPs? It is recalled that an integral policy approach towards CSR would constitute assigning explicit social objectives to FIIPs over and above their economic, legal, *Shari'ah,* and ethical responsibilities. This approach will be consistent with the European view of CSR, where CSR is adopted on a voluntary, explicit basis and forms part of the business strategy as a decisive policy of management (Matten and Moon, 2005: 350). CSR, in this case, could be said to take the form of a 'proactive' strategy of the firm where time, effort and resources are allocated for its development, management and implementation. Alternatively, the task of undertaking socially oriented projects and adopting CSR policies could be viewed as an optional business activity – a discretionary policy of FIIPs – with the objective of CSR being sought merely as a peripheral practice, with little and implicit attention being given to it. This, on the other hand, would be consistent with the American view of CSR where CSR is adopted as a voluntary, implicit approach, made peripheral to the way the business is run, and with CSR mostly defined in terms of philanthropic activities and charitable donations.

In the first instance, the inferences drawn from the empirical analysis of the FIIPs are reiterated below:

- Social welfare activities of the financial institutions were mainly related to philanthropic activities (Tables 6.31 and 6.43). This reflected in the respondents' beliefs whereby they associated CSR with primarily philanthropy (Table 6.3).
- More 'proactive' activities like involvement with other organisations to promote sustainable development, campaigning against unethical issues, taking initiatives to encourage protection of the environment, engaging with companies to encourage *riba* elimination and promote positive CSR issues were not highly ranked by the FIIPs (Table 6.43).

- Social welfare activities were ascribed about 0-2% of the annual profits of the FIIPs by the majority of the respondents (Table 6.40). This showed a limited commitment of resources towards community welfare activities.
- The majority of the FIIPs were seen to be concerned with meeting their legal, economic and *Shari'ah* responsibilities (Table 6.31). CSR was therefore more linked with achieving legal *Shari'ah* compliance in practice.
- The FIIPs did not appear to publish CSR reports to publicise their CSR activities to the various stakeholder groups. In fact, the terms 'corporate social responsibility' and 'corporate governance' figured on only a few of the websites and annual reports examined. The limited acknowledgement of CSR by the FIIPs may, thus, be taken to indicate its low degree of importance attributed by the institutions.

The above inferences could be suggestive that CSR represented a peripheral practice for the FIIPs. In general, it was observed that CSR issues, especially a social objective of the institutions, were not considered part of a deliberate management strategic policy decision but were practised merely as one of the activities by the institutions which took the form of mainly charitable donations.

The lack of strategic effort on the part of the FIIPs (except for a few like Norton Rose, Islami Bank Bangladesh, MCCA), the association of CSR with mandatory *Shari'ah* legal compliance, and the engagement of the FIIPs in voluntary, piecemeal, philanthropic activities – would all suggest that the majority of the FIIPs could generally be classified in Dusuki's (2005) CSR category labelled as 'apathy'.

If the rating of firms as devised by Henderson Global Investors were used to classify the FIIPs (described in Table 5.3, Chapter 5), the following could generally be perceived in the behaviour of the FIIPs: (i) little or no reporting on CSR; (ii) focus on *Shari'ah* compliance; and (iii) CSR being largely perceived as a matter for the internal controls of the FIIPs. On this basis, a generic rating of the FIIPs – using Henderson's classification – would be under the category 'reactive'.

## 6.6 A Brief Overview of the CSR Practices of some FIIPs which did not respond to the Self-Completion Questionnaire

It was noted in section 6.1 that the response rate to the self-completion questionnaire used in this study was about 22% representing 55 respondents or 46 FIIPs from a wide number of countries. It could be objected that this sample size is relatively small and could limit the inferences drawn from the findings of this study. Therefore, in an attempt to verify the findings of this study and confirm whether they corroborate with the practices of other FIIPs, an analysis of some of the websites of a number of FIIPs which did not return the questionnaire sent out to them was made. This second sample was selected on a random basis and it comprised 24 FIIPs from some 19 countries, as follows:

1. Social Investment Bank Limited, Bangladesh
2. Gulf Finance House, Bahrain
3. Al-Amin Bank, Bahrain
4. Citi Islamic Investment Bank, Bahrain
5. Jordan Islamic Bank, Jordan
6. Kuwait Finance House, Kuwait
7. Qatar Islamic Bank, Qatar
8. Abu Dhabi Islamic Bank, Abu Dhabi
9. Emirates Islamic Bank, Dubai
10. Albaraka Bank, Lebanon
11. Albaraka Bank of Algeria, Algeria
12. Omdurman National Bank, Sudan
13. Standard Chartered Modaraba (SCM), Pakistan
14. Al Tawfeek Co For Investment Funds, Cayman Islands
15. Faisal Finance (Switzerland) SA, Switzerland
16. ihilal Financial Services, Dubai and UK
17. Islamic Development Bank of Brunei Berhad, Brunei
18. Bank Islam Malaysia Berhad, Malaysia
19. Seyad Shariat Finance Ltd., India
20. Al-Ameen Islamic Financial & Investment Corporation (India) Limited, India

21. Bank Sepah, Iran
22. Parsian Bank, Iran
23. Lariba American Finance House, USA
24. Amanah Mutual Fund Trust, USA

An examination of the websites of the above 24 institutions revealed similar trends in the CSR practices of this group of FIIPs with the earlier group of 46 FIIPs whose findings have been discussed in the earlier sections. A summary of the analysis is provided below.

(i) Most of the FIIPs emphasised customers and employees as key stakeholders. This supported the similar evidences found with regard to the group of 55 respondents.

(ii) The majority of the FIIPs pointed to the eminent members of their *Shari'ah* supervisory board who ensure the *Shari'ah* compliance of their financing operations. This substantiates the earlier findings of this study. Lariba American Finance House, however, was one of the FIIPs which clearly specified that it does not seek to "market" or "sell" its products by using the eminence and scholarly stature of its scholars.

(iii) Of the 24 FIIPs, only two of the financial institutions published their ethical criteria of investment selection. They were ihilal Financial Services (Dubai and UK) and Lariba American Finance House (USA). ihilal Financial Services released information on both its qualitative as well as quantitative screens. Lariba American Finance House published its ethical screening criteria whilst stipulating its business ethics and business policies. Lariba, in fact, provided extensive information on its website on the way it operates its business.

(iv) A considerable number of the FIIPs made available some literature on Islamic banking and finance on their websites as a way to educate the customer about the Islamic financial products as well as on the way their institutions operate.

(v) The majority of the FIIPs placed high emphasis on financial return, shareholder value, efficiency and the provision of modern financial products. This confirmed the earlier findings that viability of the business as well as financial gain was considered important for the FIIPs.

(vi) In support to the earlier findings which revealed a low emphasis placed on CSR reporting, it was noted that only two of the FIIPs endorsed CSR as one of their core ethical values. The institutions were Standard Chartered Modaraba (Pakistan) and Bank Islam Malaysia Berhad (Malaysia). Standard Chartered Modaraba, especially, recognised the various CSR components, including responsible business practices, responsibility vis-à-vis the different stakeholders, corporate philanthropy and sustainable enterprise. Moreover, it recognised the SEE aspects of CSR as well as subscribed to Carroll's (1979) four-part definition of CSR. In fact, Standard Chartered Modaraba was the only FIIP in the list of 24 FIIPs which recognised the importance to care for the environment. Bank Islam Malaysia Berhad, on the other hand, mentioned CSR in less explicit terms by stating that it was *"always conscious of its responsibilities and duties as an Islamic corporate citizen"* as one of its corporate objectives. One aspect which was particular to Bank Islam Malaysia Berhad was its statement on Anti-Money Laundering. Under this statement the Bank described how it conforms to high ethical business standards as well as adheres to the *Shari'ah* and legal regulations governing financial institutions.

(vii) Similarly, it was observed that only one of the FIIPs – namely Faisal Finance (Switzerland) SA – highlighted its corporate governance philosophy. This institution was also among some other FIIPs (about 6 FIIPs) which emphasised the endorsement of ethical values in their mission statements. This showed that, in general, it was not a common practice of the FIIPs to draw attention to the ethical values which underlie their business operations. Instead, it was observed that about 87.5% of the FIIPs iterated that they operate in conformity with the *Shari'ah.*

(viii) In view of the high percentage of FIIPs which were noted to have pointed to the fulfilment of their *Shari'ah* responsibilities, it was observed that the majority of the FIIPs were classified as 'accommodative' towards CSR to the extent that they recognised their legal, economic and *Shari'ah* responsibilities. This finding corroborated the results for the other group of 55 respondents to the questionnaire which revealed that the FIIPs were primarily *Shari'ah* compliance focused.

(ix) Most of the FIIPs did not reveal the philanthropic activities they endorsed, either in the form of charitable donations or their community involvements. Only two FIIPs – namely Jordan Islamic Bank and Standard Chartered Modaraba – pinpointed to their charitable donations for uplifting social welfare. With regard to community involvement, two other FIIPs drew attention to the efforts they made towards caring for the society. Al-Ameen Islamic Financial & Investment Corporation (India) underlined its contribution towards the financing of small and medium scale entrepreneurs and its support to the poor and needy in the education sector. The Social Investment Bank Limited (Bangladesh) mentioned its contribution in the development and management of *waqf* and mosque properties. The institutional structure of the Social Investment Bank Limited was particularly noted as interesting and valuable. The Bank stated that it developed a three sector banking model: (i) the formal sector which aimed at providing commercial banking with the latest technology; (ii) the non-formal sector which provided family empowerment micro-credit and micro-enterprise financing; and (iii) the voluntary sector which sought social capital mobilisation through the management of cash *waqf* and trust funds. In this respect, the bank was seen to pursue its social as well as commercial objectives.

(x) None of the FIIPs were observed to be fully proactive, fulfilling all their CSR responsibilities. Thus, in support to the earlier findings, it could be said that the practice of CSR did not appear to be a deliberate policy decision of FIIPs.

## 6.7 How Socially Responsible is Islamic Finance? Comparing the Theory and Practice of Islamic Banking and Finance

This section compares the theory and practice of Islamic banking and finance based on the findings from the 55 respondents drawn from the analysis of the questionnaire they responded and the examination of the websites and financial reports of the same financial institutions.

It is recalled that the early promoters of Islamic economics (e.g. Siddiqi, 1980, 1983; Ahmad, 1980; Chapra, 1985) envisioned the discipline as an advocate of economic and social justice, equity and human well-being, and developed Islamic banking as a concept which, guided by the Islamic ethos, is expected to further the socio-economic aspirations of an Islamic economy. According to the data gathered from the questionnaire circulated to the financial practitioners, it was found that the theoretical understanding and ethical implications of Islamic finance by the respondents were consistent with the emphasis placed on social responsibility by the Islamic economics literature.

The respondents' definition of Islamic finance revealed a broad understanding of the discipline, embracing *riba* elimination, trade encouragement and efficiency as well as including social objectives such as social justice and environmentally friendly financial policies thus advancing a human oriented approach and a socially just financial system (Table 6.4). The majority of the respondents also perceived the practice of Islamic finance as an integrated system of affairs, encouraging the participation of the civil society, the state and the private sector (Tables 6.6 and 6.7). Thus defined, most of the respondents stipulated that they would attribute a social objective to FIIPs, in addition to their economic, financial, legal, ethical, and *Shari'ah* responsibilities (Table 6.8). This argument was in line with the respondents' definition of CSR, where the majority related the concept to the role played by FIIPs in community development and corporate philanthropy (Table 6.3). This view could be associated to the modern roots of CSR when the concept first developed in the 19$^{th}$ century in the form of business philanthropy (Moon, 2005: 51). Eventually the implications of CSR have progressed to include a number of other issues besides philanthropy: consumer responsibility, responsible business practices, sustainable enterprise, community involvement, as well as economic, legal and ethical responsibilities. Some of these have been recognised by the respondents as they have linked CSR to (i) corporate philanthropy and community involvement, (ii) social justice, (iii) ethics, (iv) the environment and sustainable enterprise; and (v) overall responsible business practices, *Shari'ah* obligations, and legal compliance (Table 6.3, ranked in order of priority).

Furthermore, being profitable was viewed by the majority of the respondents as being of equal importance to the social objectives of the institutions (Table 6.17). This view is consistent to Chapra's (1985: 154) argument that Islamic banks *"should play a goal-oriented rather than merely a profit-maximising role"* which may be extended to considering CSR within a holistic perspective to realise both the profit objective and achieve the socio-economic goals of Islam. In this respect, acting in a socially responsible manner is deemed to create value for the institutions – a perception strongly agreed upon by the majority of the respondents (Table 6.23). Accordingly, the popular view among the respondents was that FIIPs should be attributed the task of pursuing socially-oriented economic and financial policies as opposed to relegating this objective to social organisations (Table 6.10). The majority of the respondents tend to further believe that FIIPs are contributing positively towards socio-economic welfare (Table 6.22) and this would explain their view of assigning socio-economic objectives to FIIPs.

In any case, the argument of shifting the responsibility of undertaking socio-economic financing activities to social organisations has raised some criticisms. Siddiqi (2004b) in particular stated in an interview conducted by the researcher 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 thus called for an internalisation of Islamic moral and social values by the individual members of society, which if extended to financial practitioners, should reflect in the policy decisions of financial institutions. Yet, the fact that faith can act as a sufficient impetus to motivate individuals' behaviour to comply with the ideals of social justice or work for the collective good of society has been criticised in the literature (e.g. Kuran 1983, 1995). Naqvi (2003: 202-203) therefore recommends the building of an "explicit social contract" with people, where the religious moral values are clearly stipulated, so that there is a difference on individuals' behaviour. In the context of FIIPs, the idea of making the CSR objective more explicit could assist in translating the faith-based beliefs into faith-backed actions which would work towards the achievement of human well-being.

As institutions endorsing a social and ethical objective, most of the respondents further agreed that the institutions should emulate the SEE objectives of SRI funds, which share similar socially responsible values with FIIPs (Table 6.11) and should not hesitate to spell out their ethical policies in their mission statements (Table 6.13). As has been advanced by Wilson (2002), FIIPs often do not establish a link between the specific methods of offering Islamic financial products and services and the ethicality of the transactions. Wilson (2002) states *"ethical is used as a label and equated with Islamic"*. Indeed a survey of the websites of the sampled FIIPs found that about 7 of the 46 institutions used the word 'ethical' on their websites, associating it with mostly their underlying ethical values of management but not necessarily to the unique ethical concept that the Islamic financial products and services represent. An explanation of the underlying ethical principles, revealing details of the areas of involvement or disengagement of the institution, is proposed to be necessary to express Islam's concern for a socially just financial system. This is deemed important in the advancing of cooperation between people of other faiths and Muslims who both advocate this goal.

Below are some examples of the statements made by the FIIPs which clarify the context in which the term 'ethical' was used.

| | |
|---|---|
| Shamil Bank (Bahrain) | *"Our commitment to the teachings of the glorious Sharia requires that everything we do is consistent with the highest ethical standards."* |
| Kuveyt Turk (Turkey) | *"To be an institution that commits to the principles of interest-free financial products and services, with ethical values, and focuses on customers' perspective."* |
| Noriba Bank (Bahrain) | *"The financial professionals at Noriba...provide clients with...a range of exceptional Sharia-compliant investment opportunities that provide maximum benefit even as the associated risks and ethical dimensions are rigorously controlled."* |
| HSBC Amanah (Dubai) | *We maintain high ethical standards in our business relationships and invest in the future of our communities.* |
| Dubai Islamic Bank (Dubai) | *Today, Islamic banking is increasingly recognised as a fairer alternative to traditional commercial banking and is consequently attracting many non-Islamic customers – motivated by the system's inherent commitment to transparency and ethical values.* |

| | |
|---|---|
| Bank of Khyber (Pakistan) | *Islamic banking...is based on the <u>ethical</u> and moral code of conduct, enshrined in the Shariah...; When the concept of Islamic banking with its <u>ethical</u> values was propagated...; Today, not only Muslims but others also look for <u>ethical</u> values in their financial dealings and as a result we see many financial organizations moving towards <u>ethical</u> operations.* |
| Islamic Bank of Britain (UK) | *"We will aim to attain our business and customer service objectives whilst adhering rigorously both to Sharia'a and to the highest standards of professional conduct, corporate governance and <u>ethics.</u>"* <br> *"Our policy of <u>ethical</u> investment means that we hope and expect to attract a wider range of customers, based on the values within our business and attractiveness of the proposition."* |

Further comparisons of the socially responsible views of the respondents on the practice of their financial institutions now ensue. The following are some observations based on the analysis made in the earlier paragraphs.

First, with regard to the screening criteria disclosed by the respondents, it was observed that negative criteria like the prohibition of *riba* 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 FIIPs (Table 6.17). Issues such as the avoidance of *riba* would certainly contribute to building a socially responsible financial system: in the long term, its avoidance is believed to provide a major boost to ensuring social justice and removing exploitation. However, in practice, it is observed that FIIPs, by banning interest, have introduced other similar benchmarks and mark-ups in their attempt to make their services comparable with the non-Islamic conventional financial sector. As a result, the cost of borrowing is for instance raised to levels similar to the conventional sector. This explains, to some extent, the criticisms in the literature for the extensive use of the debt-based modes of Islamic finance in the practical field.

Moreover, as reported by the activities in which the institutions participated, popular secularist ethical concerns which are of importance within the Islamic ethos – like sustainability of the environment or lobbying for an ethical cause – were nonetheless of little concern to FIIPs (Tables 6.17 and 6.43). With regard to environmental issues, it was noticed that only four of the institutions made mention of the environment on their websites (e.g. Islami Bank Bangladesh, Norton Rose, Maybank and Emerging Markets Partnership). The FIIPs were thus observed to be restrictive in taking more positive or proactive measures towards CSR issues. To this end, their actions could be commented to have been more towards not acting 'irresponsibly' rather than endeavouring to act 'responsibly'.

One may, however, argue that from a *Shari'ah* point of view some socially responsible actions would be classified as a 'must' (*wajib*) and others 'preferred' (*mustahab*) (Abou-Ali, 2005: 476). On this basis Abou-Ali (2005: 476) stated that, particularly for the actions which corporations are only encouraged to observe, *"their violation does not justify condemning Islamic financial institutions of breaching the principles of Islam"*. While this argument certainly stands when the actions of FIIPs are examined within the limelight of abidance with the 'textual directive' of the *Shari'ah* law, it fails to meet the expectations of acting within the 'spirit' of the *Shari'ah* which promotes a larger vision of promoting human well-being – a vision endorsed by the early founders of the Islamic economics discipline.

Second, the reported practices even showed little commitment of the institutions towards establishing ethical employment policies and involving in community projects, except for making donations to charities, community causes and staff welfare (Table 6.43). However, paradoxically, the websites of the institutions did appear to lay high emphasis on the value of their employees as a major stakeholder group (65.5%, Table 6.27). Customers were nonetheless ranked as the most important stakeholder groups for the FIIPs with 80% focusing on this group as reported in Table 6.27. The importance of the community acquired a third ranking among the FIIPs (50.9%, Table 6.27).

Third, with regard to social welfare activities in which the FIIPs participated, it was noted that the activities obtaining a higher ranking by the respondents were of a charitable or philanthropic nature (Table 6.43). This choice was in line with the understanding of social responsibility by the respondents whereby they associated CSR with the notion of corporate philanthropy. Given that the respondents also perceived the subscription to CSR by FIIPs as a value-added activity, it would have been thought that CSR would be better seen as an integral business policy of responsible practices, where time and effort is spent on establishing a management strategy of CSR practices instead of merely relegating it to the philanthropic dimension. Nonetheless, the practices of the FIIPs indicated that such CSR management strategy was not endorsed. In fact, no CSR reporting appeared to be practised by most of the institutions. By contrast, it may be contended that a business can behave responsibly without necessarily reporting its CSR activities. However, since corporate reporting and accountability are seen as key constituents of contemporary CSR practices, it is expected that FIIPs would equally report their CSR activities which would indeed indicate the value they place on this practice (Chambers *et. al.*, 2003: 8). Instead, it was observed that only about 6 FIIPs made specific mention of the tem 'corporate social responsibility' (on their websites and annual reports), while 'corporate governance' was recognised by about 11 FIIPs (Table 6.28).

In comparison, an examination of the websites of the FIIPs revealed that 85.5% emphasised efficiency, financial gain, improvement of shareholder value and the provision of modern financial products and services (Table 6.29). This shows that the FIIPs placed greater focus on financial performance rather than social performance – thus lending support to El-Gamal's (2000) hypothesis that the preferences of financial practitioners tend to be biased towards the considerations of profits and efficiency rather than towards the social considerations of social justice and equity. This finding is also supported by another study by a group of researches from the International Institute of Islamic Thoughts (1996) (cited in Maali *et. al.* 2003: 5) where an examination of 32 Islamic Banks revealed that their economic objectives overrode their social objectives. The study further concluded that economic criteria of investment selection were given priority over social criteria, despite the fact that the banks laid much emphasis on their social roles and objectives (cited in Maali *et. al.* 2003: 5).

Nevertheless, it should be stated that philanthropy is held in high esteem within the Islamic tradition, especially if it is performed for seeking God's pleasure and not merely as a way to seeking reward from God. The fact that philanthropic activities are ranked relatively high within the practices of the FIIPs is indeed in line with the teachings of Islam which promote spending on the poor and the needy, stipulating both a minimum level through *zakah* and encouraging extra spending (*nafl*) beyond the compulsory (*fard*) *zakah* payments.

Fourth, it was reported that the amount the FIIPs spent on community causes ranged mostly between 0-2% of their profits despite the fact that the financial practitioners labelled their institutions as being 'socially responsible' (Table 6.40). This can be compared with the statement of a UK company offering financial advice on SRI, which reported a high distribution of the company profits. It was said: *"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"* (Coates, 2005).

It may, however, be equally highlighted that about 21.8% of the respondents failed to allocate a percentage of profits to the community activities their institutions participate in (Table 6.40). From the questionnaire response, it was noted that a much larger number of the respondents (more than 95%) could not state the percentage of expenditure on the individual activities of their institutions. This may be argued to be the result of a lack of transparency of data reporting by the FIIPs. This would be confirmed by the study of Maali *et. al.* (2003) who found that Islamic banks disclose far lesser information than the expected level. This lower level of transparency could also have led to a lower reported amount of profits being spent on community enhancing activities. The underlying belief could be that it is best to keep charitable donations undisclosed or to conceal charitable and good social deeds (Abou-Ali, 2005: 475). This practice would be in line with acting according to the Qur'anic teaching which states: *"If you dispense your charity publicly, it is well; but if you conceal it and pay it to the needy in secret, it will be even better for you"* (Qur'an, 2: 271). If this assessment were correct, it would to some extent lend further support to the claim that CSR is considered only as a peripheral practice of FIIPs. 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, it can be argued that FIIPs should opt for greater transparency in their activities – a practice that would certainly enhance confidence and trust among users and the public at large. In fact, in view of the institutionalisation of the practice of Islamic finance, it can be asserted that FIIPs should see a commitment towards CSR as an act that brings benefit to the institution. As further mentioned by Abou-Ali (2005: 476), an integral policy of CSR would add value to the institution by acting as *"non-price competition"*. This practice would be noticed in the policies of SRFIs, to be discussed in the following chapter, where for instance the Co-operative Bank in the UK especially launched its ethical policy in 1992 as it represented a *"competitive strategy"* to be taken advantage of (The Co-operative Bank, Banking on an Ethical Stance, 1997: 31).

Fifth, some divergence was noticed to prevail between the beliefs held by the financial practitioners and what was observed to be the practice of the FIIPs through an examination of the websites of the institutions. The following were some of the discrepancies noted:

- The majority of 77.4% indicated that FIIPs should spell out their ethical policies in their mission statements (Table 6.13). Instead, it was observed through a survey of the websites that about 43.6% of the FIIPs proclaimed their ethical goals (Table 6.14).
- According to the responses of the financial practitioners, some 85.2% indicated that their institutions published their criteria of investment selection (Table 6.15). It was noticed that about 25.9% revealed this information on their websites (Table 6.16). However, this low percentage could be on account of the fact that FIIPs are instead publicizing this information through other publicity modes and not necessarily on their websites.

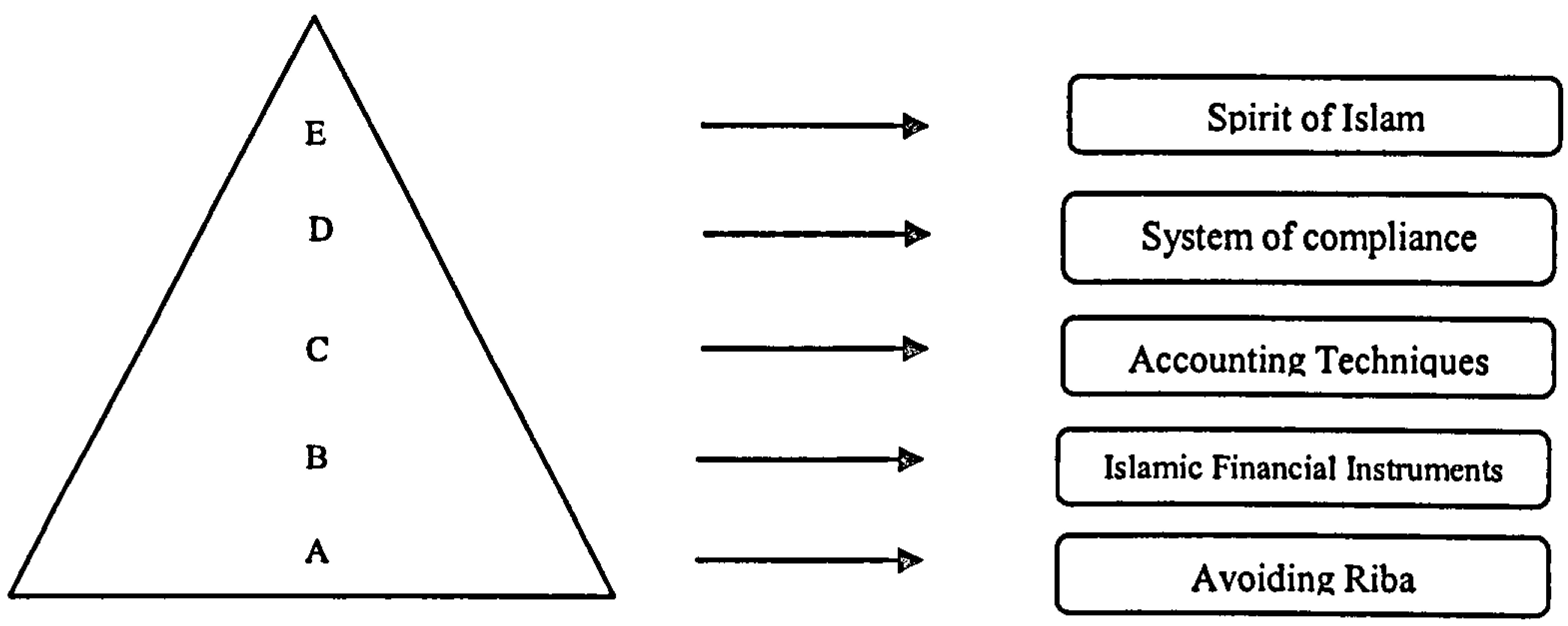
Sixth, an analysis of the information disclosed by the FIIPs further classified the majority of the institutions (69.1%) as embracing an 'accommodative' approach to

CSR, fulfilling primarily their economic, legal and ethical (*Shari'ah*) responsibilities (Table 6.31). Of this percentage, it was noted that about 36.4% of the FIIPs focused more on being *Shari'ah* compliant rather than emphasising the endorsement of both ethics and *Shari'ah* compliance. A lesser percentage of 25.4% was nonetheless seen to be proactive in their practice of CSR (Table 6.31). Of this percentage, only 5.4% could be considered fully proactive. The majority of 9.1% within the proactive category, otherwise, did not engage in community involvement although they supported philanthropic activities. The overall lower percentage of FIIPs which were being classified as proactive can be said to correspond with Parker's (2005: 2) observation that FIIPs, in general, 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.

Overall, the above findings could be said to be indicative of a peripheral approach assumed by FIIPs towards CSR issues as opposed to a more integral and deliberate CSR policy put in place by management. It was observed that the beliefs held by the financial practitioners could indeed be perceived as being 'socially responsible'. In contrast, the practices of the FIIPs were seen to be more in terms of being 'not socially irresponsible' rather than being proactive to be 'socially responsible'. Indeed, the FIIPs tend to provide assurance that their dealings are *Shari'ah* compliant. They also emphasised efficiency gains while some others publicised the ethical values they endorsed. Yet, a more holistic approach to integrating CSR as part of the comprehensive objective of pursuing human well-being appeared lacking in the practices of the institutions, on the grounds that: (i) there was little or no reporting on CSR at the level of the FIIPs; (ii) the FIIPs were mostly compliance focused especially with regard to the *Shari'ah* legal rulings; and (iii) CSR was mainly a matter for the internal controls of the FIIPs. These seem to confirm Wilson's (2002) statement that the term *"ethical is used as a label and equated with Islamic"*. For, to be ethical is also about acting within the 'spirit' of Islam and is not only about *"making all the adjustments necessary so as to ensure that financing operations comply with Islamic Shari'ah"* (Iqbal and Wilson, 2005: 2).

The shortfall in the observance of the CSR practices could, by contrast, be explained to be a result of lack of transparency and accountability on the part of the FIIPs, as it was mentioned earlier. Alternatively, the early stage of development that Islamic banks – as a group or on an individual basis – are situated in could explain this state of affairs. The model of corporate governance proposed by Banaga *et. al.* (1994: 188-9) could be useful in this respect. The authors considered the different stages of development that management of Islamic banks concentrate on: from (i) avoidance of *riba*, moving onto (ii) the development of appropriate Islamic financial instruments with (iii) appropriate accounting techniques and (iv) ensuring the development of an appropriate system of compliance and finally (v) acting within the spirit of Islam which should imbue all aspects of business transactions and business life.

**Figure 6.3 "Pyramid of developing corporate governance towards dependence on the spirit of Islam"**




Source: Banaga *et. al.* (1994: 189)

Thus, based on Banaga *et. al.* (1994: 189) model of corporate performance, it can be suggested that Islamic banks have thus far concentrated on the elimination of interest in their transactions and the development of Islamic financial instruments with appropriate accounting techniques. Development of an appropriate system of compliance and imbuing all aspects of the business within the spirit of Islam are still in the making. However, as Ahmad, K. (2005) emphatically stated, care should be taken so that the practices of the transition period should not become the model for the future. To this end, it is proposed that frequent revisits be made by Islamic financial practitioners to the socially responsible vision and objectives of Islamic economics as held by the early Islamic economists when the discipline was first developed in the 1970s. Finding a balance between this socially laudable vision and the challenges faced in reality is deemed necessary in order to bring about the socio-economic development and advancement of Muslim communities.

Alternatively, a bigger question may be posed: why should Islamic banks have to be modelled based on the functions and structure of conventional profit-seeking commercial banks? Do they have to be equal to the large high street commercial banks like Barclays and Natwest? As Hasan (2005a: 22) noted, the institutional set up of commercial banks has been based on the objective to meet the short term liquidity needs of trade and commerce. Designing FIIPs using the model of commercial banks inevitably affects their *"outlook, objectives, procedures, training and modus operandi"* (Hasan 2005a: 22). Conceived as such, they are unable to cater for the medium and long term financial needs and meet the social aspirations for development and wealth creation. For this purpose, Hasan (2005a, 2005b) suggests, there is need for specialised financial institutions like industrial banks, agricultural credit societies, housing development corporations, investment houses, and import-export banks.

Indeed, it is noted that in the West, mostly in Europe and the United States, new forms of financial intermediaries have emerged since the 1990s – classified under the label of 'social banking'. These institutions are driven by financial returns while at the same time take a positive interest in the social outcomes and effects of their activities (Mayo and Guene, 2001: 1). One of such financial intermediaries is the Community Development Financial Institutions (CDFIs) which are defined as "private sector" "locally controlled" "market driven" "specialised financial institutions" "with community development as their primary mission" (Dewees, 2004; Coalition of CDFIs (a)). If the welfare of Muslim communities and general human well-being are to be promoted by Islamic banks – in line with the *maqasid al Shari'ah* – it is asked, as to whether or not, the organisational structure of FIIPs should be conceived in such a way whereby the economic/financial, ethical, social and philanthropic motives are held as key objectives to financial managers and practitioners?

To this end, this research seeks to learn from the socially responsible movement which has developed in the West by especially examining the practices of SRFIs in the UK. The findings of the analysis conducted on the British SRFIs are elicited in the next chapter.

# CHAPTER 7

# Examining the Social Responsibility of SRFIs: The UK Experience

## 7.0 Introduction

The United Kingdom (UK) has been projected as one of the countries in Europe with the most developed, progressive and explicit system of CSR and with an expanding market for SRI (Eurosif Report, 2003; Moon, 2005: 51). CSR and SRI agendas are being supported by government initiatives and CSR umbrella organisations like the UK Social Investment Forum (UKSIF), Ethical Investment Research Service (EIRIS) and Business in the Community (BITC). A growing number of companies, businesses, investment funds and banks are reorienting their management strategies to consider corporate governance issues along with SEE factors. Thus, CSR and SRI are seen to be increasingly crossing over from the periphery into the mainstream.

In the 1980s, a number of ethical funds were set up in the UK: the Ecology Building Society (1981), Friends Provident Stewardship Fund (1984), Merlin Ecology Fund (now known as the Jupiter Ecology Fund) (1988). The launch of the Co-operative Bank's ethical policy in 1992 gave an added boost to ethical banking. Since then, a number of the mainstream banks like HSBC, Lloyds TSB and Barclays have embraced an ethical stance in their operations.[1] More SRI funds have also been set up. These funds are certainly diverse in their approach to SRI and in the inclusion of SEE issues in their screening criteria. To reflect this diversity in opinions and encourage transparency in the way SRI funds operate, the European Social Investment Forum (Eurosif) initiated a *"transparency guidelines for the retail SRI fund sector"* to which eight of the leading SRI funds in the UK subscribed.[2] This guideline covered six key areas on which the funds were to disseminate information.

[1] The HSBC Group has launched HSBC *Amanah* since 1998 to offer Islamic financial products and services (www.hsbc.com). Lloyds TSB also offers bank accounts compatible with the *shari'ah* since 2005 in the UK (www.lloydstsb.co.uk). EIRIS (2003b) further reports that banks like Barclays Bank, Lloyds TSB, the Royal Bank of Scotland along with the Co-operative Bank were ranked among the best performers in terms of their SEE screening.

[2] www.eurosif.org/publications/retail_transparency_guidelines/signatories_responses/unitedkingdom

It included: (i) background details of the funds, (ii) their SRI investment criteria, (iii) their SRI research processes, (iv) the evaluation and implementation of their research processes, (v) the engagement approach of the funds, and (vi) their voting policy.

The eight leading British SRI funds which subscribed to the guidelines were: the Co-operative Insurance Society (CIS) Sustainable Leaders Trust; F&C Asset Management; Friends Provident; Henderson Global Investors; Insight Investment; Jupiter Asset Management; Morley Fund Management; and Standard Life Investments. For the purpose of this research, these eight SRI funds were used as case studies to examine their approach and practices towards CSR and SRI. Moreover, the CSR initiatives of four additional SRFIs which are recognised for their leadership towards SEE issues – namely Triodos Bank, the Ecology Building Society, Unity Trust Bank and the Co-operative Bank – were studied in this chapter.

As mentioned in Chapter 5, the method used in examining these case studies was based on information drawn from their corporate websites. A textual analysis of the information disseminated on their websites, including the literature they have published, has been undertaken to analyse the views held by the SRFIs and evaluate their practices on CSR and SRI. This involved undertaking a discourse analysis of the published texts and documents as well as making use of the method of interpretivism to give meaning to the texts. In this way, the CSP of the twelve British SRFIs based on the four-stage process of CSP measurement (given in Figure 5.1, Chapter 5) was examined.

## 7.1 The British SRFIs: Some General Information

One of the common characteristics between these financial institutions is their self-designation as being 'socially responsible' in their approach to doing business. They specifically tend to highlight their GSEE policies, screening criteria and distinct products and services to differentiate themselves from other conventional financial institutions. The philosophical foundations behind the socially responsible approach of the institutions are usually derived from such sources like humanism, socialism, secularism, or environmentalism. Alternatively, a socially responsible approach can be adopted in order to abide by legal requirements or simply to meet investors' preferences. Unlike their counterparts, the FIIPs, the SRFIs do not tend to promote a religious message nor does the motivation behind the promotion of CSR and SRI practices necessarily stem from a religious worldview, as it is in the case of FIIPs.

Some background details of these SRFIs, obtained from an examination of their websites and published literature, are given in Table 7.1.

**Table 7.1 Background Details of the Sampled SRFIs**

| SRFI | Type of Institution | Assets | Market Spread | Launch Date | Brief Description |
|---|---|---|---|---|---|
| **The Co-operative Bank Plc** | Bank | £11.9 billion (as at 2005)[3] | UK | 1971 | The Co-operative Bank, set up by the Co-operative Wholesale Society in 1971, was the first high street bank to have announced a customer-derived ethical stance in 1992. It describes its mission *"to be a growing, pioneering financial services business delivering benefits to customers, members and communities through commitment to value, fairness and social responsibility"*.[4] Its parent company, the Co-operative Financial Services (CFS), was set up in 2002. Currently, the Bank has about 2 million customers.[5] |
| **Triodos Bank** | Bank | Euro 1,806 million (for the Triodos Group, as at 2004). UK assets represent Euro 281 million.[6] | Europe | 1980 | The Bank is officially registered in the Netherlands (1980), with branches in Belgium (1993), the UK (1995), and Spain (2004). Its mission is to promote sustainable banking by financing socially worthwhile projects as well as lending to social businesses, charities and organisations pursuing positive social, environmental and cultural goals. The bank has over 100,000 customers. |

[3] *Co-operative Financial Services Capital Market Presentation 28 April 2006*, www.co-operativebank.co.uk/images/pdf/Capital_Markets_Presentation_270406.pdf

[4] *The Co-operative Bank Plc Financial Statements 2005*, www.co-operativebank.co.uk/images/pdf/BankReport2005.pdf

[5] *Co-operative Financial Services Capital Market Presentation 28 April 2006*, www.co-operativebank.co.uk/images/pdf/Capital_Markets_Presentation_270406.pdf

[6] *Triodos Bank Annual Review 2004*, www.triodos.co.uk/uk/static/pdf/uken_ar_2004.pdf?lang=

Table 7.1 (Continued)

| SRFI | Type of Institution | Assets | Market Spread | Launch Date | Brief Description |
|---|---|---|---|---|---|
| **Ecology Building Society** | Mutual Building Society | £60 million[7] | UK | 1981 | It is the first SRFI set up in the UK to finance ecology-friendly properties. It is a mutual building society which aims at providing loans to promote sustainable housing and sustainable communities.[8] Currently, it has over 10,000 account holders. |
| **Unity Trust Bank** | Bank | £466.2 million (as at 31 December 2005)[9] | UK | 1984 | Unity Trust Bank describes itself as a specialist bank offering banking services to charities, trade unions, credit unions, voluntary organisations and social enterprises. It has its roots in the co-operative and trade union movements and focuses on customers in the third sector.[10] |
| **CIS Sustainable Leaders Trust** | Ethical Unit Trust | £102 million (as at 28 April 2005) [11] | UK | 1990 | The CIS Sustainable Leaders Trust was formerly known as the CIS Environ Trust. It is an ethically screened unit trust set up by the Co-operative Insurance Society (CIS) which shares common leadership with the Co-operative Bank under the Co-operative Financial Services (CFS). |
| **Insight Investment Management** | Investment Management Company | £95.5 billion under management (as at 31 March 2006)[12] | International | Formerly known as Clerical Medical Investment Management Ltd. Renamed as Insight Investment in 2002.[13] | Insight Investment is one of the leading UK investment managers. It offers a full range of asset types from equities to bonds, property, hedge funds, and private equity. In addition to its mainstream funds, Insight Investment has two ethical funds: Insight European Ethical Fund and Insight Evergreen Fund. |

[7] *Ecology in Profile: What Makes Us Different*, www.ecology.co.uk/downloads/literature/profile.pdf
[8] www.ecology.co.uk
[9] *Unity Trust Bank, Report and Accounts 2005*, www.unity.uk.com/downloads/R&A2005edited.pdf
[10] *Banking Solutions Designed for You*, www.unity.uk.com/downloads/SEbrochure_230805.pdf
[11] *CIS Sustainable Leaders Trust: Eurosif Transparency Document*, www.cis.co.uk/images/pdf/eurosif_transparancy.pdf
[12] www.insightinvestment.com/
[13] *Insight Investment Management Limited Annual Report and Accounts*, www.insightinvestment.com/Documents/other_documents/Insight_Report_and_Accounts_2005.pdf

*Table 7.1 (Continued)*

| SRFI | Type of Institution | Assets | Market Spread | Launch Date | Brief Description |
|---|---|---|---|---|---|
| **F&C Asset Management** | Investment Management Company | £112 billion funds under management (as at 31 March 2006, of which £2.2 billion is under ethical investment).[14] | International | 2004 | F&C Asset Management manages funds totalling £112 billion as at 31 March 2006 for a diverse range of institutional, insurance and retail clients. It has offices in seven countries: France, Germany, Ireland, Netherlands, Portugal, UK and the USA. Its ethically screened funds include the (i) Stewardship family of Funds (Stewardship Growth OEIC; Stewardship Income OEIC; and Stewardship International OEIC); (ii) F&C UK Ethical Fund; (iii) Balanced Socially Responsible Investment Fund; (iv) Social Awareness Fund; (v) Environment Fund; and (vi) other ethical funds customised for clients with specific needs. The size of the ethically screened funds totals around £2.2 billion.[15] |
| **Friends Provident plc** | Ethical Unit Trust | £1.9 billion under management (as at 28 February 2005)[16] | International | 1984 | Friends Provident is a financial services group (founded in 1832 by the Quakers) with three distinct business segments: UK Life and Pensions; International Life and Pensions; and Asset Management.[17] The Friends Provident Group set up the first ethical unit trust in the UK in 1984 – the Stewardship family of funds. These are managed by F&C on behalf of Friends Provident Life and Pensions. The funds that fall under the Stewardship family of funds are: (i) Life: Stewardship, Stewardship Managed, Stewardship International, Stewardship Safeguard Optimiser; and (ii) Pensions: Stewardship, Stewardship Managed. |

[14] www.fandc.com/

[15] www.fandc.com/

[16] *Friends Provident Eurosif Transparency Guidelines*, www.friendsprovident.co.uk/doclib/eurosiftransparency.pdf

[17] *Friends Provident Annual Report and Accounts 2005*, www.friendsprovident.co.uk/doclib/full_annual_report.pdf

*Table 7.1 (Continued)*

| SRFI | Type of Institution | Assets | Market Spread | Launch Date | Brief Description |
|---|---|---|---|---|---|
| **Henderson Global Investors** | Investment Management Company | £67.7 billion (as at 31 Dec 2005, of which £1.1 billion is in SRI portfolios)[18] | International | 1934 | Henderson Global Investors provides a wide range of products and services to institutional and retail investors in Asia, Europe and North America. It is said to be managing £1.1 billion (as at 30 June 2005) in pooled and segregated SRI portfolios. Some of its pooled funds are as follows: (i) Henderson Global Care Growth; (ii) Henderson Global Care Income; (iii) Henderson Global Care Managed; (iv) Henderson Ethical; (v) Horizon Global Sustainable Investments; and (vi) Henderson Industries of the Future. |
| **Jupiter Asset Management** | Investment Management Company | £538.2 million | International | 1985 | Jupiter Asset Management is a subsidiary of Commerzbank Group. It manages segregated and pooled pension funds, charities and investment trusts, and acts as Investment Adviser for its range of unit trusts including SRI funds. The Jupiter SRI funds are: (i) Jupiter Ecology Fund; (ii) Jupiter Environmental Opportunities Fund; and (iii) Jupiter Global Green Investment Trust. |
| **Standard Life Investments** | Investment Management Company | £118.8 billion (as at 31 December 2005)[19] | International | In operation for about 180 years[20] | Standard Life Investment has a global investment network and has offices in several international markets. It aims to meet its clients' expectations and offers a range of products and services. Three of its SRI funds are: UK Ethical Fund; Life Ethical Fund; and Pension Ethical Fund. |

[18] www.henderson.com/home/

[19] http://uk.standardlifeinvestments.com/content/press/press_faq/press_faq_index.html

[20] http://uk.standardlifeinvestments.com/content/profile/profile_index.html

*Table 7.1 (Continued)*

| SRFI | Type of Institution | Assets | Market Spread | Launch Date | Brief Description |
|---|---|---|---|---|---|
| **Morley Fund Management** | Investment Management Company | £156.7 billion (as at 31 March 2006)[21] (of which £750 million is under SRI as at 31 March 2005)[22] | International | Some 30 years ago | Morley Fund Management is the largest fund management company of Aviva plc. It is also one of UK's largest fund management companies, catering for both retail and institutional investors. Two of its SRI funds are the Morley Sustainable Future Funds and the Norwich UK Ethical Fund. |

The ensuing sections examine the CSR and SRI practices of the sampled SRFIs.

## 7.2 Examining the CSR Principles Endorsed by the British SRFIs

The understanding of CSR by the financial institutions was gauged by examining how the SRFIs defined their 'social responsibility' function. In the first instance, key concepts such as 'social responsibility', 'corporate social responsibility', 'corporate responsibility', 'ethics', 'sustainability', 'sustainable banking' were used by majority of the institutions to indicate their incorporation of SEE values within company decisions and show their commitment towards CSR. The Co-operative Bank, for example, clearly points out its long term "*commitment to social responsibility*" drawn from "*the values that have been passed through the Co-operative Movement since its creation in 1844*" and accordingly provides details on the implementation of its ethical policy under its heading "*ethics in action*" on its website.[23] Triodos Bank stipulates its "*aim to be a pioneering force in the world of sustainable banking*".[24] The Unity Trust Bank puts across its message of social responsibility by describing itself as a "*socially responsible and innovative bank, committed to working in partnership with all our stakeholders, delivering high quality services and*

[21] www.morleyfm.com/uk/

[22] *Eurosif Retail SRI Fund Transparency Guidelines, Morley Fund Management Statement of Commitment*, www.eurosif.org/pub2/lib/2005/3rdparty/EurosifRetailTGL_MorleyFM.pdf

[23] www.co-operative.co.uk

[24] www.triodos.co.uk

*reinvesting in the wider community".*[25] The Ecology Building Society, on its part, promotes itself as *"a mutual building society dedicated to improving the environment by promoting sustainable housing and sustainable communities".*[26] Hence, the mission and value statements of the SRFIs were often seen to incorporate and highlight the SEE values endorsed by the institutions.

At times, it was noticed that the names of the SRFIs were utilised as a marketing tool to promote their socially responsible objectives. Friends Provident uses the title *"stewardship"* within its funds' names to reflect its policy of *"wise 'stewardship' over the companies [it] invests".*[27] Triodos Bank banks on its name 'Triodos' which it explains means *"three fold way"* to substantiate its three-fold approach of including financial, ethical and social criteria in its business practices and of lending to businesses pursuing positive social, environmental and cultural goals. The Ecology Building Society is another financial institution whose name indicates its ethical purpose of providing mortgage loans for properties which are ecology-friendly. This is recognised by the institution itself which states *"The very name of the Ecology and its presence in the market are a testament to its standpoint on environmental and ecological issues."* (Ecology Building Society, 2005: 2).

It was observed that CSR was defined by some of the institutions at both a managerial and financial services front. At the managerial level, CSR was associated with professional ethics, high business standards, fair recruitment practices, and good corporate governance. Within the financial services perspective, CSR was addressed by examining the impact it has on stakeholders in the marketplace and workplace, on consumers and the environment. CSR was also reflected in the financial products on offer, the screening criteria of the SRFIs, and the GSEE approach adopted in SRI by the institutions.

Examples of some of the ways in which CSR has been described by the British SRFIs, which indicate the attention placed on corporate governance and socially responsible finance, are as follows:

[25] *Unity Trust Bank Report and Accounts 2005*, www.unity.uk.com/downloads/R&A2005edited.pdf
[26] www.ecology.co.uk
[27] www.friendsprovident.com

- The Co-operative Financial Services, which provides leadership to the Co-operative Bank and CIS Sustainable Leaders Trust Fund, states: *"governance, management, reporting and assurance systems underpin the CFS' commitment to develop its business in a sustainable manner"* (Co-operative Financial Services, 2004: 12). Especially, CSR was regarded by the Co-operative Bank as an important *"safeguard to the business"* for its sustainable development.[28]

- Friends Provident describes CSR in a positive way, stating *"Corporate Responsibility is all about the positive things Friends Provident does to meet our responsibilities to people and to the world in which we live."*[29] To this end, it describes its governance structure and management system; examines CSR in terms of its impact on the marketplace, environmental management, labour practices and community investment; and defines its socially responsible investments.

- Morley Fund Management takes pride in being a *"responsible investor"* by *"demanding ethical and sustainable practices from companies we invest in"* and *"applying these same high standards to our own business – to ensure that we continue to operate in a responsible and ethical manner and meet the expectations of all our stakeholder groups"*.[30] In this way, it explains, CSR is embedded at the heart of its business.

- Henderson Group Plc promotes a 'code of conduct' specifying the standards of behaviour expected of its employees.[31] Its *'Sustainable and Responsible Investment Annual Review 2004'* provides guidelines on the fund's SRI approach and screening criteria.[32]

- Insight Investment sees corporate responsibility as an important aspect for long term value creation and regards this as a key rationale for instilling high

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[28] *The Co-operative Bank plc Financial Statements 2005*, p. 23, www.co-operativebank.co.uk/images/pdf/BankReport2005.pdf
[29] www.friendsprovident.co.uk
[30] *Morley Fund Management 2005 CSR Report*, www.morleyfm.com/uk/morley/groups/internet/documents/webattachment/pdf_000558.pdf
[31] www.henderson.com/home/sri/document_library/
[32] www.henderson.com/global_includes/pdf/sri/SRIAnnualReport2004.pdf

standards with regard to corporate governance and CSR.[33] At the same time, it recognises that there are pressures that can lead businesses to breach corporate responsibility standards and, in this respect, highlights the role of boards of directors to take necessary actions.[34]

- Jupiter Asset Management acknowledges both corporate responsibility and the SEE goals governing its SRI funds.[35] It defines CSR in terms of the responsible management of a company so as to *"maximise its positive impact and minimise any negative impact on the environment, society and the economy"*.[36]
- Standard Life Investments emphasises its corporate governance principles and policies in its *'UK Corporate Governance Guidelines'* booklet and provides details about its negative, positive and engagement policies in the Eurosif Transparency Guidelines.[37] Like the Co-operative Bank, Standard Life Investments perceives CSR as a powerful tool to protect businesses against the risk of damage to their reputation and image that can directly affect their financial performance.[38]

CSR was further taken to cover the four dimensions of responsible business practices, consumer responsibility, sustainable business enterprises, and corporate philanthropy and involvement with the community. The four dimensions of CSR were most apparent in the practices of the Co-operative Bank and Friends Provident. Friends Provident, for instance, was seen to emphasise its CSR effects in four key areas: the market place, work place, environment and community. The Co-operative Bank, on its part, iterates the values it believes in, which in turn reflect on the four

[33] *Corporate Governance & Corporate Responsibility Statement of Policy*, www.insightinvestment.com/documents/responsibility/00292_SRI_Policy.pdf

[34] *Rewarding Virtue: Effective Board Action on Corporate Responsibility*, www.insightinvestment.com/Documents/responsibility/Rewarding%20Virute%20Executive%20Summary.pdf

[35] *A Guide to Jupiter's Socially Responsible Investment Funds*, www.jupiteronline.co.uk

[36] www.jupiteronline.co.uk

[37] http://uk.standardlifeinvestments.com/content/pdf/sli/corporate_governence_booklet.pdf; http://retail.standardlifeinvestments.com/content/pdf/sli/ETHICAL%20GUIDE.pdf?show=true

[38] http://uk.standardlifeinvestments.com/content/press/press_faq/press_faq_index.html

dimensions of CSR. The values were: social responsibility, openness and honesty, being successful, being customer-focused, and making work fun.[39]

With regard to corporate philanthropy and community involvement, it was observed that it was undertaken by most of the SRFIs as part of their CSR policies. The charitable donations have sometimes been referred to result from the foundations that the financial institutions have established – like the Friends Provident Charitable Foundation and the Triodos Foundation. Efforts to support charitable donations were at times undertaken through the financial products of the SRFIs. The Co-operative Bank for example makes donations to charities nominated by its customers for every £100 spent by the customers on their visa debit and credit cards. Through this campaign – entitled "*customers who care campaigns*" – the Co-operative Bank not only encourages expenditure on its debit and credit cards (also known as 'affinity cards'), but also involves the participation of its customers in its campaigns for socially responsible causes like combating climate change and promoting trade justice and fair trade.

The Unity Trust Bank was observed to undertake its charitable activities differently. In the first instance, in keeping with its mission, it provides support to charities by funding their projects and assisting them to in turn contribute to the development of their local communities. Moreover, the bank encourages and supports staff participation in charity events and community projects. Staff members thus spend money and time and volunteer their expertise in different charitable activities. In 2005 the Bank reported that an average of 100 hours was spent by its managers for such purposes.[40] Similarly, Morley Fund Management reports on its staff volunteering activities and its fund raising activities for charities.[41]

Some of the SRI funds however quote that *"the funds do not make donations to charities"* in their Eurosif Transparency Guidelines reports. Henderson Global

[39] *The Co-operative Bank plc Financial Statements 2005*, www.co-operativebank.co.uk/images/pdf/BankReport2005.pdf
[40] *Unity Trust Bank Report and Accounts 2005*, www.unity.uk.com/downloads/R&A2005edited.pdf
[41] See *Morley Fund Management 2005 CSR Report*, www.morleyfm.com/uk/morley/groups/internet/documents/webattachment/pdf_000558.pdf

Investors and Standard Life Investments, for instance, did not appear to support corporate donations.

Moreover, it was noted that the CSR issues endorsed by the SRFIs were quite comprehensive. A wide range of areas were associated with CSR, like – ethical consumerism, trade justice, climate change (The Co-operative Bank); the environment, sustainable housing and communities (The Ecology Building Society); environmental management, labour practices, community investment (Friends Provident; F&C Asset Management; Jupiter Asset Management); sustainability, responsibility, ethics (Henderson Global Investors); high standards of responsibility, accountability and transparency (Insight Investment; Standard Life Investments); standards of business conduct, human rights, health and safety (Morley Fund Management); fair trade and micro credit (Triodos Bank); and social justice, combating financial exclusion, sustainable employment (Unity Trust Bank).

The CSR issues that the SRFIs endorsed were inevitably reflected in the financial products offered by the institutions. Socially responsible financial products were therefore offered: ethical mortgages (Ecology Building Society); investments in industries of the future (Henderson Global Investors); financing of micro enterprises and fair trade (Triodos Bank); socially responsible pensions (Friends Provident); affinity credit and debit cards (The Co-operative Bank); and credit union banking, charity and voluntary organisations banking (Unity Trust Bank).

Within the CSR discussion, it was noticed that the SRFIs also recognised a number of stakeholder groups in their operations – like shareholders, customers, employees, society, and the environment. Customers were especially noted to be one of the stakeholder groups who were given high priority ranking by the sampled financial institutions. This was shown by the statements that some of the SRFIs made which reflect the key position held by customers in influencing their decision policies.

- The Co-operative Bank states in the context of the introduction of its ethical policy in 1992: *"The bank chose to base its Ethical Policy on the concerns of its customers, on the basis that it is generally their money that is being used,* *and they should have a say in how it is used...More than a decade later, the bank continues to be the only high street bank that gives customers a say in how their money is used and which encourages their input into the ongoing development of its Ethical Policy."* [42] The high value placed on customers is also reflected in the *"Customers Who Care Campaigns"* run by the Bank wherein the participation of customers in the nomination of charities is encouraged. Furthermore, the Bank reports on its annual 'satisfaction research' undertaken amongst a sample of its personal, corporate and business customers, gauging their level of satisfaction with respect to service, relationship, ethics and sustainability, complaints, and network developments (Co-operative Financial Services, 2004: 29-35).

- Triodos Bank makes available on an annual basis a list of its projects to its customers to show *"exactly where Triodos Bank's customers' money is working"* (see Triodos Bank, Inspiring Change Project Lists 2003, 2004, and 2005). The Bank further disseminates details on its *"internal complaints procedure"* to indicate how *"fairly, consistently and promptly"* it deals with an expression of customer dissatisfaction.[43]

- Morley Fund Management has a specific section dedicated to 'client service and marketing' in its CSR Report 2005 wherein it describes its efforts to *"raise client satisfaction, improve retention, grow our external profile and win new business"*.[44]

- To highlight the special group of customers it targets and to indicate their special needs, Unity Trust Bank states *"At Unity Trust we embrace the fact that our customers are different"*.[45]

Besides defining CSR and its impact on the various stakeholders, it was noticed that all the institutions explicitly referred to their SRI approach to investments and they,

[42] www.co-operativebank.co.uk
[43] www.triodos.co.uk
[44] www.morleyfm.com/uk/morley/groups/internet/documents/webattachment/pdf_000558.pdf
[45] *Banking Solutions Designed for You*, www.unity.uk.com/downloads/SEbrochure_230805.pdf

accordingly, provided details about their screening criteria of investment selection. Most of the institutions adopted negative and positive screening as well as engagement policies within their SRI strategies. Some of the SRFIs even published details on their voting policies to influence company decisions.[46] While the screening criteria included a number of themes which ruled out or incorporated companies in investment portfolios, it was noted that dealings in interest, which is a major prohibition for FIIPs, was not considered one of the negative screening criteria of the SRFIs. Instead, secular values – as detailed in Table 7.2 below – were endorsed by the SRFIs.

From the listing in Table 7.2, it was observed that the screening criteria of the SRFIs comprised a large number of issues, from the environment to organic and intensive farming and from economic issues like fair trade and third world debt to social issues like gambling, tobacco, and corruption. The different positive criteria endorsed by the SRFIs – like the promotion of social enterprises and financial and social inclusion – can especially be viewed as a commendable effort made by the institutions to contribute towards socio-economic development. This can be compared to the practices of the FIIPs delineated in the last chapter, where it was noticed that the screening criteria of the FIIPs was hardly communicated by the institutions.

With respect to the screening of environmental issues, the policies of some of the SRI funds, such as Insight Evergreen Fund and Morley Fund Management, were very detailed and extensive.[47] Negative environmental screening criteria included such issues like climate change, deforestation, ozone depleting substances, exclusion of oil and gas companies, harmful pesticides, and unsustainable timber or timber products. Positive environmental screening criteria comprised the encouragement of large scale infrastructure projects to take into account their environmental impacts, air quality and emissions control, drinking water purification, energy conservation,

[46] See *Jupiter's Approach to Responsible Shareholding: Voting and Engagement Report*, www.jupiteronline.co.uk/ApplicationFiles/GetFile.pdf?docId=74
[47] See *Insight's Ethical Funds*, www.insightinvestment.com/documents/TheChildrensMutual/literature/02710%20-%20TCM%20Ethical%20Funds_d12.pdf; and
*Morley Fund Socially Responsible Investment Process*, www.morleyfm.com/uk/morley/groups/internet/documents/salessupportmaterial/pdf_002337.pdf

environmental assessment, pollution analysis, geothermal energy, natural gas, recycling, site remediation, waste reduction and disposal, waste water treatment, and wind power. This practice can be compared with that of FIIPs which barely accounted for environmental issues in their screening criteria of investment selection.

One of the screening strategies promoted by Henderson Fund Management was inclusion of 'industries of the future'. The Henderson Industries of the Future Fund screens its investments to allow for the following themes – cleaner energy, efficiency, environmental services, health, knowledge, quality of life, safety, social property and finance, sustainable transport, and water management.[48] Jupiter Asset Management uses 'best of class' screening methodology in its investment selection and performs 'quality assurance' checks to ensure that the holdings of the funds it invests in continue to comply with its SRI screening criteria.[49]

[48] www.henderson.com/global_includes/pdf/sri/IndustriesFutureCriteria.pdf

[49] *A Guide to Jupiter's Socially Responsible Investment funds*, www.jupiteronline.co.uk

## Table 7.2 Screening Criteria of the Sampled SRFIs

| | Alcoholic drinks | Armaments/Military | Animal Testing/Welfare | Gambling | Pornography | Nuclear Power | Tobacco | Environment | Public Donations | Genetic Engineering | Third World Debt | Oppressive Regimes | Human Rights | Currency Speculation | Irresponsible Marketing Practices | Fair-trade | Labour Rights/Employment Practices | Social Enterprise | Customer Consultation |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| The Co-operative Bank | | • | • | | | | • | • | | • | | • | • | • | • | • | • | • | • |
| Triodos Bank | | • | • | • | • | • | • | • | | • | | • | | | | • | • | • | |
| Unity Trust Bank | | | | | | | | | | | | | | | | | | • | |
| Ecology Building Society | | | | | | | | • | | | | | | | | | | | |
| CIS Sustainable Leaders Trust Fund | | | | | | | | • | | | | | | | | | | | |
| F&C Asset Management | • | • | • | • | • | • | • | • | | | | • | | | • | | • | | |
| Friends Provident | • | • | • | • | • | • | • | • | | | • | • | | | • | | | | |
| Henderson Global Investors | • | • | • | • | • | • | • | • | | • | | | | | | | | • | |
| Insight Investment | | | | | | | | | | | | | | | | | | | |
| *Insight European Ethical Fund* | | • | • | • | • | • | • | • | | | | | • | | | | | | |
| *Insight Evergreen Fund* | | • | • | • | • | | • | • | | | | | • | | | | | | |

| | Organic Farming | Culture & Society | Fur Industry | Corruption | Breach of Legislation, Code of Conduct or Conventions | Financial/Social Exclusion | Child Poverty | Sustainable Employment | Higher Standards of Living | Community Involvement/Positive Contribution to Society | Basic Necessities of Life | Training and Education | Openness about company activities | Good relations with customers and suppliers | Meat and dairy production | Road Building | Industries of the Future | Intensive Farming |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| The Co-operative Bank | | | | | | | | | | | | | | | | | | |
| Triodos Bank | • | • | • | • | • | | | | | | | | | | | | | |
| Unity Trust Bank | | | | | | • | • | • | | | | | | | | | | |
| Ecology Building Society | | | | | | | | | | | | | | | | | | |
| CIS Sustainable Leaders Trust Fund | | | | | | | | | • | • | | | | | | | | |
| F&C Asset Management | | | | | | | | | | • | • | • | • | • | | | | |
| Friends Provident | | | | | | | | | | | | | | | | | | |
| Henderson Global Investors | | | • | | | | | | • | | | | | | • | • | • | |
| Insight Investment | | | | | | | | | | | | | | | | | | |
| *Insight European Ethical Fund* | | | • | | | | | | | | | | | | | | | |
| *Insight Evergreen Fund* | | | • | | | | | | | | | | | | • | | | |

| | Alcoholic drinks | Armaments/Military | Animal Testing/Welfare | Gambling | Pornography | Nuclear Power | Tobacco | Environment | Public Donations | Genetic Engineering | Third World Debt | Oppressive Regimes | Human Rights | Currency Speculation | Irresponsible Marketing Practices | Fairtrade | Labour Rights/Employment Practices | Social Enterprise | Customer Consultation | Organic Farming | Culture & Society | Fur Industry | Corruption | Breach of Legislation, Code of Conduct or Conventions | Financial/Social Exclusion | Child Poverty | Sustainable Employment | Higher Standards of Living | Community Involvement/Positive Contribution to Society | Basic Necessities of Life | Training and Education | Openness about company activities | Good relations with customers and suppliers | Meat and dairy production | Road Building | Industries of the Future | Intensive Farming |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Jupiter Asset Management | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| *Jupiter Ecology Fund* | • | • | • | • | • | • | • | • | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| *Jupiter Environmental Opportunities Fund* | | • | • | | | • | • | • | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| *Jupiter Global Green Investment Trust* | | • | • | | | • | • | • | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Morley Fund Management | • | • | • | • | • | • | • | • | | • | | | • | | | | | | | | | • | | | | | | | • | | • | • | • | | | | • |
| Standard Life Investment | • | • | • | • | • | • | • | • | • | • | | • | • | | | | • | | | | | | • | • | | | | | • | | • | | | | | | • |

Source: Author's Own

It was remarked that most of the SRFIs published their screening criteria in great details, in the form of special reports to explain how they select their investments. In addition, the 8 SRI funds have subscribed to the Eurosif Transparency Guidelines wherein they – defined SRI, presented details on their SRI screening criteria, stated how frequently and by whom the SRI criteria were reviewed, and reported on how changes in the criteria were communicated to investors.

Some of the reports published by the SRFIs were as entitled below:

- Triodos Bank – *How We Do What We Do, Triodos Bank's Approach to Lending*;[50]
- CIS Sustainable Leaders Trust Fund and The Co-operative Bank – *Co-operative Financial Services Sustainability Report 2004* (which includes CIS Ethical Engagement Policy and The Co-operative Bank's Ethical Policy);[51]
- Ecology Building Society – (i) *Environment Policy;* (ii) *Environment Policy: Evaluation Report 2005*;[52]
- Unity Trust Bank – (i) *Banking Solutions Designed for You*; (ii) *Unity Trust Bank: 21 Years of Social Responsibility.*[53]
- Friends Provident – (i) *Stewardship Approach*; (ii) *Stewardship Philosophy*; (iii) *Stewardship Ethical Policy*; (iv) *Stewardship Social Policy*; (v) *Stewardship Environmental Policy*; (vi) *Corporate Responsibility Report 2005*;[54]

[50] www.triodos.co.uk/uk/static/pdf/uken_lendingapproach.pdf?lang=
[51] www.co-operativebank.co.uk/images/pdf/cfssustainabilityreport2004.pdf
[52] www.ecology.co.uk/
[53] (i) www.unity.uk.com/downloads/SEbrochure_230805.pdf;
(ii) http://www.unity.uk.com/downloads/21st_birthday_brochure_for_the_website.pdf
[54] (i) http://www.friendsprovident.co.uk/doclib/xsad314.pdf;
(ii) http://www.friendsprovident.co.uk/doclib/xsad313.pdf;
(iii) http://www.friendsprovident.co.uk/doclib/xsad317.pdf;
(iv) http://www.friendsprovident.co.uk/doclib/xsad315.pdf;
(v) http://www.friendsprovident.co.uk/doclib/xsad316.pdf;
(vi) http://www.friendsprovident.co.uk/doclib/corp_resp_report.pdf

- Henderson Global Investors – *Sustainable and Responsible Investment Annual Review 2004*;[55]

- F&C Asset Management – (i) *F&C Corporate Governance Operational Guidelines* (General and in the UK); (ii) *Quarterly public reo® reports*; (iii) *Annual Voting and Governance Reports*;[56]

- Insight Investment – (i) *Detailed Criteria for Implementing the Ethical Policies of Insight Investment's European Ethical and Evergreen Funds*; (ii) *Insight's Ethical Funds*;[57]

- Jupiter Asset Management – (i) *Jupiter's Socially Responsible Investment Bulletin;* (ii) *Jupiter's Approach to Responsible Shareholding Voting and Engagement Report;* (iii) *Jupiter's Corporate Governance and Voting Policy*; [58] and

- Morley Fund Management – (i) *Socially Responsible Investment Process*; (ii) *SRI Brochure: Passionate about a Sustainable Future for All.*[59]

Insight Investment, in its document 'Detailed Criteria for Implementing the Ethical Policies of Insight Investment's European Ethical and Evergreen Funds', specifically provides explicit details on the interpretation of its screening criteria and how it implements its ethical policies in practice.[60] For example, Insight Investment allocates quantitative percentages to rate the performance of companies, on basis of

[55] www.henderson.com/global_includes/pdf/sri/SRIAnnualReport2004.pdf
[56] www.fandc.com/uploadfiles/co_gsri_cgo_guidelines_general.pdf; and www.fandc.com/uploadfiles/co_gsri_cgo_guidelines_uk.pdf
[57] (i) www.insightinvestment.com/Documents/responsibility/Detailed%20Criteria%20Document _for%20Website_Revised%20July%202005.doc;
(ii) http://www.insightinvestment.com/documents/TheChildrensMutual/literature/02710%20-%20TCM%20Ethical%20Funds_d12.pdf
[58] (i) www.jupiteronline.co.uk/ApplicationFiles/GetFile.pdf?docId=76;
(ii) www.jupiteronline.co.uk/ApplicationFiles/GetFile.pdf?docId=74;
(iii) www.jupiteronline.co.uk/ApplicationFiles/GetFile.pdf?docId=78.
[59] (i) www.morleyfm.com/uk/morley/groups/internet/documents/salessupportmaterial/pdf_002337. pdf; (ii) www.morleyfm.com/uk/morley/groups/internet/documents/webattachment/pdf_002940.pdf
[60] www.insightinvestment.com/Documents/responsibility/Detailed%20Criteria%20Document _for%20Website_Revised%20July%202005.doc

which a decision is made as to whether investment in a company is accepted or rejected.

In general, it was observed that all the sampled financial institutions recognised corporate responsibility within their business operations and the way CSR was mostly projected in the mission and value statements of the SRFIs indicated that CSR tend to be an embedded activity of the institutions as part of their company decisions. This was confirmed by the study of Strandberg (2005: 7) which examined the best practices of 21 SRFIs. Most of the institutions were further seen to endorse a number of GSEE issues whilst others seemed to focus on only a few. The Ecology Building Society, for instance, emphasised only environmental issues. The Unity Trust Bank, on the other hand, focused on social issues like social enterprise, sustainable employment, child poverty, and social exclusion. The CSR policies of the institutions appeared to be in principle consistent with Carroll's (1979) four-part definition. However, they did not always include philanthropic activities, for some of the SRI funds did not account for charitable activities in their business policies. Overall, it can be said that, the SRFIs adopted a transparent and consistent SRI policy which was well-communicated to the different stakeholder groups of the firms through the literature they published. The impact that business policies have on the various stakeholder groups has also been duly recognised by the SRFIs.

## 7.3 Assessing the Management of CSR Issues by the SRFIs

While corporate responsibility was explicitly recognised by the SRFIs as an important aspect of their business policies, the discussion raised in this section relates to how the financial institutions managed their CSR policies. More specifically, the following questions were posed: Do the SRFIs perceive the existence of a conflict between profitability and their SEE objectives? Do they view CSR as a policy which creates value for their organisation? Do they have a system in place which ensures that their SRI policies are put into practice? Do they have an established system which assesses the environmental impact of their policies and evaluates the impact of their policies on the different stakeholder groups? How well do the SRFIs respond to changing conditions or new issues facing the institutions?

With regard to the relative importance attributed to the pursuit of profits and the SEE objectives of the financial institutions, some of the approaches mentioned in the literature of the SRFIs that indicate the way these two objectives were managed were through adoption of a (i) balanced approach (e.g. The Co-operative Bank and Friends Provident), (ii) twin track approach (e.g. Jupiter Asset Management), (iii) three-way approach (Triodos Bank), and (iv) multi-disciplinary approach (Morley Fund Management). The Co-operative Bank states: *"Can an organisation that conducts its business in a socially and environmentally responsible manner also be consistently profitable? We believe it can. In fact we believe that, in the years to come, the only truly successful businesses will be those that achieve a sustainable balance between their own interests, and those of society and the natural world."* [61] The Co-operative Bank further perceives CSR as a 'safeguard' of its business against potential risks to the short and long term value of its business.[62] Triodos Bank, on its part, emphasised its three-way approach by confirming that it uses *"a social and ethical – as well as financial – approach in all its business activity."*[63] The twin track approach embraced by the Jupiter funds in the selection of profitable investments requires that the investments meet social/environmental approval as well as the financial approval of the SRI fund managers.[64] The multi-disciplinary approach used by Morley Fund in assessing viable investment opportunities, on the other hand, takes into account analyses based on a number of research disciplines like Strategy and Economics, Corporate Credit, SRI, and Corporate Governance.

Overall, it was noticed that all the SRFIs emphasised the maximisation of 'value', 'financial performance', 'returns', 'financial security', and 'investment performance' while at the same time highlighting their goal of conducting their business transactions in a socially responsible manner. No conflict between the institutions' SEE objectives and profitability was therefore noted to prevail. The statement made by Friends Provident can be used to sum up the general stance taken by the majority

[61] www.co-operativebank.co.uk

[62] *The Co-operative Bank plc Financial Statements 2005*, p. 23, www.co-operativebank.co.uk/images/pdf/BankReport2005.pdf

[63] www.triodos.co.uk

[64] *A Guide to Jupiter's Socially Responsible Investment*, p. 4, www.jupiteronline.co.uk

of the institutions on this issue: *"Stewardship's track record has disproved the myth that profit and ethics don't mix".*[65] This confirmed the assertion made by Sparkes (2002: 22) that the SRFIs are profit-seeking institutions and are not conceived as charities.

The incorporation of CSR and sustainability objectives within company policy has instead been viewed by some of the institutions as a value enhancing activity. In fact, the high emphasis placed by the institutions on their social responsibility function to indicate their distinctive approach in conducting their businesses could be suggestive of the viable strategy the adoption of CSR represents to them. This was best illustrated by the case of the Co-operative Bank when it launched its ethical policy in 1992. Through the bank's survey of its 30,000 customers in 1991, it found that more than 80% of its customers favoured the institutionalisation of a clear ethical policy by the Bank. This was seen by the Bank as representing a *"competitive strategy"* to be taken advantage of. It regarded the response as an opportunity to *"offer a unique mix of value"* while remaining distinct from the activities of other financial institutions (The Co-operative Bank, 1997: 31). Thus, since its institutionalisation, CSR was considered a profitable mandate that the Co-operative Bank pursued.

The positive link between financial performance and CSR has also been recognised by Insight Investment in the following terms, *"we believe that investment returns can be enhanced if the companies we invest in maintain high standards of corporate governance and corporate responsibility".*[66] Insight Investment further endorses the statement made by The World Business Council for Sustainable Development *"We are convinced that investment managers stand a good chance of improving their portfolio performance and reducing their risks if they pay closer attention to the environmental performance of the companies in which they plan to invest".*[67] Similarly, Friends Provident emphasises the value creating potential of CSR

[65] *Stewardship An Introduction: The World's a Better Place with Friends*, www.friendsprovident.co.uk
[66] www.insightinvestment.com/Responsibility/policy/rationale.asp
[67] *Insight's Ethical Funds*, www.insightinvestment.com/documents/TheChildrensMutual/literature/02710%20-%20TCM%20Ethical%20Funds_d12.pdf

initiatives by enumerating the various benefits a company can possibly derive by addressing SEE issues. It illustrates its viewpoints through empirical case studies to substantiate the positive results that the adoption of SEE issues entails.[68]

In order to ensure efficiency, consistency and transparency in the application of their SRI policies, it was noticed that most of the SRFIs had in place an explicit SRI compliance system. The process for ensuring compliance at the Co-operative Bank starts with the completion of an 'Ethical Policy Questionnaire' by its business customers which is thereafter assessed against the Bank's ethical policies by the Business Relationship Manager. Moreover, the Bank has an 'Ethical Policy Unit' for assessment of any conflict identified in the customer's application and for deciding if the business is to be offered banking facilities. An independent external auditor is further invited to review the implementation of the Bank's ethical policy, with the findings published in the Bank's 'Partnership Report'. Triodos Bank, on its part, briefly mentions that it has a *"special share-holding trust which protects the social and environmental aims of the bank"* without giving details as to 'how' its lending policies are implemented.[69] Nonetheless, Triodos Bank provides extensive details on its screening criteria for its lending policies and publishes an annual list of its projects as part of its commitment to transparency regarding who it finances.[70]

The prevalence of the following processes may be regarded as plausible ways which assisted the institutions in ensuring compliance of their CSR/SRI policies:

- Having CSR values embedded in their mission, vision and value statements such that awareness about CSR is created at the company level, among the staff and management. The CSR 'image' beheld by the company is thus projected onto society;
- Establishment of a published code of conduct to guide staff behaviour (e.g. Henderson Investors' *Code of Conduct*);

[68] See Friends Provident, *The Responsible Approach to Investment: Friends Use Their Influence Wisely.*
[69] www.triodos.co.uk
[70] See Triodos Bank, *Inspiring Change Project Lists* 2003, 2004, and 2005.

- Setting clear corporate governance policies which assist management and staff in managing the institution's CSR/SRI policies (e.g. Insight Investment's *Statement of Policy on Corporate Governance and Corporate Responsibility*; Jupiter's *Corporate Governance and Voting Policy;* Ecology Building Society's *Environmental Policy*);
- Appointment of CSR staff; designation of senior management positions for CSR; setting up CSR units; carrying out research on CSR by staff;
- Having in place external and internal committee boards to undertake the responsibilities involved in portfolio construction and ensure compliance with fund policies (e.g. F&C Asset Management's Committee of Reference and Governance and SRI Team; Morley Fund's Corporate Responsibility Committee; Jupiter's SRI and Governance Team; CIS's Socially Responsible Investment Advisory Committee);
- Abidance by legal rules that govern the industry (e.g. Insight Investment highlighting its abidance by the 'Combined code of the Committee on Corporate Governance' for UK listing companies; and all the SRFIs mentioning their adherence to the regulations of the Financial Services Authority (FSA));
- Abidance by global ethical standards (e.g. Insight Investment adhering to the Universal Declaration of Human Rights, the OECD Guidelines for Multinational Enterprises, and the International Labour Organisation's Tripartite Declaration of Principles).[71]

To adhere to the Eurosif Transparency Guidelines, the 8 SRI funds also had to report on a number of issues which relate to the management of their CSR and SRI policies. To this end, they published details on the following: (i) their SRI research methodology and process, which include description of their ethical policies, company selection, company research, company approval and company monitoring; (ii) the research team used by the fund; (iii) if the research process includes

[71] *Corporate Governance and Corporate Responsibility: Statement of Policy,* http://www.insightinvestment.com/documents/responsibility/00292_SRI_Policy.pdf

stakeholder consultation; (iv) frequency of the review of the research process; (v) how the research results are integrated into the investment process; and (vi) the existence of any internal or external measures to ensure that portfolio holdings comply with the SRI investment criteria.

It was found that most of the SRI funds had set out an extensive SRI research methodology and process as well as an investment process, which explained how the companies/stocks were screened, rated, selected, monitored and reviewed. The prevalence of a review policy within the SRI process indicated that upcoming SRI issues and changing conditions of companies were taken into account in the portfolio construction by the SRI funds. F&C Asset Management, for instance, states that its approved company list is reviewed every three years to take on board the changing policies of companies. Insight Investment equally informs that the screening criteria of its funds are reviewed and updated periodically, including when the *"understanding of a particular social, ethical or environmental issue has developed"*.[72] This allows for the funds to consider upcoming issues into their SRI screening criteria.

These working procedures of the SRI funds have been made available to the public and all stakeholder groups in the form of funds literature. Details on the engagement process and voting policies of the SRI funds have moreover been communicated through funds literature – an indication of transparency, well-thought-out company policy and good management.

Management of CSR/SRI issues also involved an acknowledgement that the policies of the funds have an impact on the stakeholders. To this end, the assessment undertaken on stakeholders by Friends Provident was observed to be of high standard. On its website, Friends Provident disseminates (i) its approach to corporate responsibility vis-à-vis customers, shareholders, business partners, suppliers, staff, the environment, the community, and the wider society; (ii) its activities in the marketplace, workplace, community and on the environment; and (iii) the indicators

[72] *Insight Investment's Eurosif Transparency Guidelines*,
www.insightinvestment.com/Responsibility/product/eurosif_transparency_guidelines.pdf

it has developed to measure progress in the marketplace, workplace, the environment and the community. In recognition of the successful implementation of its CSR policies, Friends Provident was ranked 22nd in the list of the top 100 *"companies that count"* published by the Business in the Community (BITC) in the context of its 2004 Corporate Responsibility Index. In the construction of the BITC's CSR Index, companies were evaluated on the basis of their performance in five areas: (i) corporate responsibility strategy; (ii) integration of corporate responsibility issues; (iii) corporate responsibility management at the community, environment, marketplace and workplace levels; (iv) social and environmental performance and impact areas; and (v) corporate responsibility assurance and disclosure.[73]

Among the sampled SRFIs, three institutions participated in the BITC's CSR Index 2004, notably, the Co-operative Bank, CIS Sustainable Leaders Trust Fund, and Friends Provident. As compared with Friends Provident, the CSR policies of the Co-operative Bank were reported to be more outstanding. The Co-operative Bank ranked third in the index while CIS Sustainable Leaders Trust Fund ranked in a similar position with Friends Provident at 22. The BITC reported that both the Co-operative Bank and CIS scored the highest in the area of corporate strategy (designated as **** in Table 7.3 below). The Co-operative Bank was moreover perceived as an institution which has effectively integrated CSR into *"the mainstream of its management systems"* (represented by ♦♦♦♦ in Table 7.3). Friends Provident and CIS, on the other hand, were found to be demonstrating increasing levels of CSR integration within their businesses. With regard to the identification and management of CSR issues related to the community, environment, marketplace and workplace, the Co-operative Bank and CIS performed well in all the four areas while Friends Provident registered outstanding performance only within the marketplace and workplace. Furthermore, BITC highlighted the 'full disclosure' practices of the institutions with regard to their CSR policies. It can thus be inferred that corporate social reporting was well established at the level of these SRFIs. A summary of the results for the three financial institutions is as shown in Table 7.3.

[73] www.bitc.org.uk

**Table 7.3 Ranking of the Institutions as per the CSR Index 2004 of Business in the Community (BITC)**

| Ranking 2004 | Financial Institution | Outstanding Performance | | | | | | | | Disclosure |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Corporate Strategy | Integration | Community | Environment | Marketplace | Workplace | Social Impact Area | Environmental Impact Area | |
| 3 | The Co-operative Bank | **** | ♦♦♦♦ | √ | √ | √ | √ | • | • | Full |
| 22 | CIS Sustainable Leaders Trust | **** | ♦♦♦ | √ | √ | √ | √ | | | Full |
| 22 | Friends Provident | *** | ♦♦♦ | | | √ | √ | | | Full |

The sign **** in the Corporate Strategy category is taken to mean that the institution *"understands what corporate responsibility means for its business, communicates this well, has assigned responsibility at a senior level, has policies and has incorporated social and environmental considerations into the risk management process"*. *** is said to demonstrate increasingly high level of corporate strategy.

The sign ♦♦♦♦ in the Integration category is said to demonstrate that a *"company has effectively built corporate responsibility into the mainstream of its management systems, which in turn affects business decisions, the behaviour of its staff and is reflected in a transparent business culture"*. A lower ranking of ♦♦♦ is equated with increasing levels of integration within the business.

The symbol √ is taken to mean *"the company has robust systems to identify what its key Community, Environment, Marketplace and Workplace issues are and has well established and audited management system in place to manage them"*.

The sign • indicates that *"the company has taken action to reduce negative impacts and is able to show performance improvement over a number of years"*.

Source: Adapted from Business in the Community (www.bitc.org.uk/crindex)

The basis for assessing the successful or unsuccessful management of the CSR issues by the SRFIs may finally be made by using the management model developed by the Ashridge Centre for Business and Society (quoted in the 'BITC Winning with integrity summary'). This model sets out the steps for putting any management policy into action, as follows:

1. Secure commitment of senior management and allocate resources;
2. Identify external concerns and relate to business interests;
3. Review current policies, processes and performance;

4. Define strategy, plans and targets and allocate resources to turn ideas into reality;
5. Put into practice;
6. Measure performance in order to evaluate actions and seek continuous improvement;
7. Report and communicate so that strategies, actions and impacts can be assessed; and
8. Interact with external parties for meaningful review of progress.

Relating the above steps to the implementation of the CSR/SRI policies by the British SRFIs and on the basis of information made available by the SRFIs, , it can be said that most of the institutions, and especially the 8 SRI Funds and the Co-operative Bank, considered CSR/SRI a deliberate policy decision adopted by management for which – management's approval was secured, resources were allocated, stakeholders' interests were considered, plans and targets were set, performance indicators were prepared, review policies were institutionalised, reporting measures were taken, and engagement with external parties was effected. These points were partly recognised by the Co-operative Bank as it developed its biography into a 'Management Case Study' to serve as a model of a socially responsible business.[74] In this publication, the authors looked into the relationship between business, society and other stakeholders, and especially related the Bank's CSR policies as a *"deeply embedded commitment to action"*.[75] It was further noted that performance indicators were used by the Co-operative Bank and CIS Sustainable Leaders Trust to assess if the targets set were achieved. The CFS report (2004: 20) asserts: *"In pursuit of sustainable development, CFS uses indicators to chart its progress against the triple bottom lines of value, ethics and ecology."*

[74] The biography of the Co-operative Bank was stated to be the result of a joint venture between the Bank, the University of Lincoln and an independent business ethicist. The introduction of external parties, besides the involvement of the Bank, in the preparation of this management case study to some extent indicate the Bank's attempt in projecting an 'objective' image to the study conducted.

[75] *Management Case Study: Biography of the Co-operative Bank*, www.co-operativebankcasestudy.org.uk/managementcasestudy2.pdf

As regards the assessment of the other institutions like Triodos Bank, Unity Trust Bank and the Ecology Building Society, it was noted that little information was disseminated regarding the management of their CSR/SRI policies. Nonetheless, through their mission and vision statements, it can be stated that their CSR/SRI policies appear to be a result of a deliberate management decision for which resources are allocated to turn the ideas into action.

## 7.4 Evaluating the Corporate Social Responsiveness of the SRFIs

In an attempt to appraise the institutions' corporate responsiveness towards CSR (namely $CSR_2$), the four-part definition of CSR by Carroll (1979) was utilised. This implied evaluating the performance of the SRFIs in terms of how well they shouldered the economic, legal, ethical and discretionary responsibilities that society attributes to them.

As discussed earlier, it was found that all the SRFIs placed high emphasis on their economic and financial objectives, as reflected by the statement of Standard Life Investments: *"What is important to Standard Life is that we deliver investment performance. Our owners want performance, our clients want performance, we want performance, we are completely aligned, there is no conflict of interest."*[76] The SRFIs also emphasised their social and ethical aims. The ethical objectives of the institutions were to a large extent inclusive of environmental, governance and other socially responsible issues like fraud, financial inclusion, and human rights. The discretionary responsibilities within CSR mostly comprised the social purpose of the institutions which in turn consisted of community projects and investments as well as philanthropic activities. It was further noted that the SRFIs were, in principle, law abiding firms and were therefore assumed to be fulfilling their legal responsibilities, including meeting any SEE regulations. Several of the SRFIs in fact highlighted their legal status by, for example, emphasising adherence to the regulations of the FSA, indicating their membership with the Financial Ombudsman Service, and mentioning

[76] http://uk.standardlifeinvestments.com/content/profile/profile_index.html

their abidance to the banking code (e.g. Ecology Building Society, Co-operative Bank).

The classification of the SRFIs in terms of Carroll's four-part definition of CSR is shown in Table 7.4. This table was constructed based on the content analysis of the web literature published by the SRFIs. To determine whether the SRFI in question responded to its CSR responsibilities, key terms used by the institution to refer to the CSR responsibilities, the institution's screening criteria, and the social and philanthropic activities of the institutions were particularly noted. Fulfilment of the CSR responsibilities was indicated by the sign • in Table 7.4.

**Table 7.4 Classification of the SRFIs according to the Four-Part CSR Responsibilities of Carroll (1979)**

| Financial Institution | Economic/ Financial Responsibilities | Legal Responsibilities | Ethical Responsibilities | | | Discretionary/ Social Responsibilities | |
|---|---|---|---|---|---|---|---|
| | | | Env | G | Eth | C | Ph |
| The Co-operative Bank Plc | • | • | • | • | • | • | • |
| Triodos Bank | • | • | • | | • | • | • |
| Unity Trust Bank | • | • | | | • | • | • |
| Ecology Building Society | • | • | • | | | • | |
| CIS Sustainable Leaders Trust Fund | • | • | • | | • | • | • |
| F&C Asset Management | • | • | • | • | • | • | • |
| Friends Provident | • | • | • | • | • | • | • |
| Henderson Global Investors | • | • | • | • | • | • | |
| Insight Investment | • | • | • | • | • | • | • |
| Jupiter Asset Management | • | • | • | • | • | • | • |
| Morley Fund Management | • | • | • | • | • | • | • |
| Standard Life Investments | • | • | • | • | • | • | |

Env = Environmental, G = Governance, Eth = Ethical, C = Community, Ph = Philanthropy

Source: Author's Own

From Table 7.4, it is noted that all the SRFIs were concerned about environmental policies, with the exception of Unity Trust Bank whose objective is specifically geared towards meeting the needs of third sector organisations like trade unions, charities, credit unions and not-for-profit organisations. The Ecology Building Society, in particular, focuses primarily on ecological and environmental issues. This is reflected in its range of products such as 'green' mortgages to fund sustainable housing and communities, and its support for other ecologically positive projects like sustainable education, small scale businesses with the potential to generate local employment, and ecological enterprises. Overall, it was noticed that 8 of the SRFIs considered ethical, governance and environmental issues within their CSR policies. As regards, fulfilment of the social/discretionary responsibilities, it was noted that all the institutions were involved in community investment and community project funding. This formed part of their business policies which generally sought the welfare of the local community and the general society. However, only 9 of the SRFIs have mentioned their philanthropic activities or donations they made.

Adopting the classification stipulated in Table 5.1 from Chapter 5, where organisations can be categorised in terms of their 'reaction', 'defense', 'accommodation' or 'proaction' vis-à-vis CSR, it could be stated that all the institutions included in this study have so far 'accepted' their CSR responsibilities (Clarkson, 1995) and are *"progressive and adaptive to society's expectations"* (McAdam, 1973), thus suggesting that they are 'accommodative' to CSR issues. This submission is based on the fulfilment of most of the CSR responsibilities assigned to the institutions by Carroll – with the exception of philanthropic responsibilities which were not undertaken by all the institutions and environmental and governance issues which were not relevant to all the SRFIs.

Some of the institutions could nonetheless be perceived as *"doing more than what is required"* based on their involvement in philanthropic activities (Clarkson, 1995). This goes beyond the participation in community investment projects and the provision of facilities to the local community. Philanthropic activities can, for instance, include charitable donations in terms of money, time and expertise for social causes. According to the above analysis, the institutions which met their philanthropic responsibilities were the Co-operative Bank, Triodos Bank, Unity Trust Bank, the CIS Sustainable Trust Fund, F&C Asset Management, Friends Provident, Jupiter Asset Management, Insight Investment and Morley Fund Management. The CSR policies of these 9 institutions can be described as 'proactive'. Two of the institutions – Friends Provident and Triodos Bank – have also established foundations through which they undertake their charitable activities, thus maintaining business policies separate from philanthropy. Similarly, Insight Investment receives funds from the HBOS Foundation to distribute to charities for community projects.[77]

Moreover, subscription of the funds and their policies to the *Eurosif Retail Fund Transparency Guidelines* can be said to be indicative of the funds' concern to be transparent about their investment approaches. It also shows their proactive steps in *"leading the industry"* by disseminating details and approaches of the funds towards the different stakeholders (McAdam, 1973). The Co-operative Bank and Friends Provident furthermore participated in the BITC's CSR index (as mentioned in the last section) which again counts in favour of their proactive approach to CSR reporting.

It is here worth calling attention to the CSR grading table that Henderson Global Investors has developed and uses in analysing the CSR performance of companies in which it chooses to invest. Through this model, which provides clear guidelines on which to base the rating assessment, Henderson Global Investors classifies the companies it examines as 'leaders', 'integrating', 'developing', 'reacting' or 'resisting' in their approaches towards CSR. It is suggested that this rating model is applied to the sample list of SRFIs to determine their responsiveness towards CSR. The rating model advanced by Henderson was described in Chapter 5 as Table 5.3.

On basis of the published information of the SRFIs, the observed practices of the institutions are summarised in Table 7.5. According to this summary, it can be inferred that most of the SRFIs can be generally categorised as 'integrating' and 'leaders', on account of the following reasons:

- Their observance of CSR as an integrated business practice;
- Their establishment of a formal system to manage CSR responsibilities;

[77] *Insight Investment Annual Report and Accounts 2005*, www.insightinvestment.com/Documents/other_documents/Insight_Report_and_Accounts_2005.pdf

- Their engagement in stakeholder dialogue and involvement, and the clear definition of their engagement and voting policies;
- The good disclosure track record of their CSR approaches, monitoring and review policies;
- The development of CSR performance indicators to assess their impact in the workplace, marketplace, on the environment and in the community;
- Their endeavour to improve the sustainability agenda through their environmental policies.

Some of the institutions, like the Unity Trust Bank, the Ecology Building Society and Standard Life Investments, however, have not released sufficient details of their practices, thus limiting the accuracy of their grading. Their literature was mostly found to be descriptive and the institutions certainly focused on one key CSR area, such as social enterprises and ecology. Their CSR policies could thus be suggested as being still at the 'developing' stage.

**Table 7.5 Summary of the Observed Practices of the SRFIs**

| SRFIs | Observed Practices |
|---|---|
| **The Co-operative Bank Plc** | • Corporate responsibility is integrated into business practices.<br>• Corporate responsibility is seen as a safeguarding measure for the business.<br>• A wide range of CSR values is endorsed, including governance, social, ethical and environmental issues.<br>• Processes for stakeholder dialogue are in place.<br>• There is special involvement of customers in the development of the Bank's ethical policy.<br>• Transparency is endorsed and full disclosure on CSR is adopted. The bank's good track record on corporate social reporting is reflected through the publication of its Partnership reports, Sustainability reports, Ethical Consumerism Report. CSR is also discussed in the Bank's Financial Statements. The Bank further publishes a monthly magazine called 'Advantage' for the business banking sector.<br>• The Bank has developed *"specific, measurable, achievable, realistic and timely"* indicators to measure its progress against the triple bottom lines of delivery of value, social responsibility and ecological sustainability. This shows the Bank's efforts in quantifying the reporting of its performance.<br>• The Bank has a sustainable development policy and is proactive in pursuing the sustainability agenda.<br>• It can be rated as a 'leader' in its approach towards CSR. |

Table 7.5 (Continued)

| SRFIs | Observed Practices |
|---|---|
| **Triodos Bank** | • Triodos Bank recognises CSR as part of its business policy.<br>• CSR is taken to incorporate social, ethical, environmental and cultural values. The Bank endorses policies like micro-credit and fair trade financing in developing countries. It lends to organisations like charities, social businesses and supports the financing of community projects and environmental initiatives.<br>• The Bank pursues sustainable banking which takes account of people, the planet and profit.<br>• It believes in taking positive action in order to contribute towards sustainability and in instilling socially responsible businesses.<br>• It believes in taking a more active role in the engagement of companies it invests in.<br>• The bank publishes its approach to lending and an annual list of projects which it finances. No quantitative social reporting or indicators have been developed. Its reporting system is still of a descriptive nature.<br>• On basis of the above, its CSR approach can be described as being at the 'integrating' stage. |
| **Unity Trust Bank** | • Unity Trust Bank acknowledges that social responsibility is integrated within its business practices. It states *"Social responsibility and innovation are not just words in our Mission Statement, they are at the heart of everything we do"*.[78]<br>• It focuses its policies on the third sector – trade unions, charities, voluntary organisations, credit unions and social enterprises – which is taken as a key sector for the bank's financing.<br>• Its reporting policies are still descriptive. It describes its customers, shareholders, products, history and challenges. The Bank does not report on the management of its CSR responsibilities. Nonetheless, it publishes a quarterly bulletin to provide information on developments in the social economy. It also reported on the many activities the Bank has been involved in and its growth and progress in its special report: *1984-2005 Celebrating 21 years of social responsibility*.<br>• No engagement in stakeholder dialogue has been mentioned, except that special efforts appear to be made by the bank to know the organisation it finances. It works closely with its customers in an attempt to understand their needs, aims and future plans. The bank's customers seem appreciative of the bank's service, as reflected by several quotes mentioned in its report celebrating the 21st birthday of the Unity Trust Bank.<br>• CSR performance can be said to be in a 'developing' stage. |

[78] *Banking Solutions Designed for You*, www.unity.uk.com/downloads/SEbrochure_230805.pdf

*Table 7.5 (Continued)*

| SRFIs | Observed Practices |
|---|---|
| **Ecology Building Society** | • The Ecology Building Society considers the environment its key sector of focus. Environmental policies are embedded within the business.<br>• It practises what it believes in – which is commitment to ecological and sustainable living. This is reflected through the construction of its ecologically sustainable straw bale meeting room. Its own members have assisted in the construction of this building, which again reflects on its mutuality status.<br>• It provides details on the projects it finances (e.g. case studies of ethical mortgages) in its newsletter entitled 'Ecology Building Society News'. However, its reporting is still of a descriptive nature.<br>• It publishes its environmental policy which represents the building society's ethical policy. This includes details on its lending policies as well as the management details with regard to its property and facilities.<br>• It does not seem to be involved in engagement processes to change the policies of other organisations. Instead it states: *"you do not have to be 'green' to get an Ecology mortgage."* (www.ecology.co.uk).<br>• Its CSR policy can be described as 'developing'. |
| **CIS Sustainable Leaders Trust Fund** | • Just like its sister organisation the Co-operative Bank, CIS recognises the need to develop its business in a sustainable manner. It incorporates a sustainable agenda within its SRI policies and corporate responsibility is an embedded business practice.<br>• It defines its CSR areas of concern, SRI criteria, SRI research methodology and process, SRI review policies.<br>• CIS adopts the engagement approach in its SRI policies and has in place processes for stakeholder dialogue and involvement. In 2006, it was noted that the CFS (the holding company of CIS) was rated against 100 world's largest companies about *"the degree to which businesses respond to stakeholder expectations in their corporate strategy"* (CIS Financial Statements, 2005: 24). The CFS scored 87 percent with regard to the degree of satisfaction of its stakeholders.<br>• There is special involvement of its customers in the development of its SRI policy. CIS has launched a customer-led ethical policy where in 2005 it held an extensive consultation with its 5 million policy holders about the CIS's responsible policy shareholding policies (CIS Financial Statements, 2005: 7).<br>• Like the Co-operative Bank, it measures its delivery of value, social responsibility and ecological sustainability through a number of indicators.<br>• CIS has a well-grounded corporate reporting policy, which includes publication of sustainability reports, financial statements (which includes information on its CSR performance and a corporate governance report from the Board of Directors) and the Eurosif Transparency Guidelines.<br>• The CSR policy of CIS can be situated within the 'leader' category. |

*Table 7.5 (Continued)*

| SRFIs | Observed Practices |
|---|---|
| **F&C Asset Management** | • CSR is integrated into business practices.<br>• Its CSR policy is widely defined, incorporating various GSEE issues. The company subscribes to the sustainability agenda and takes account of environmental issues within its SRI criteria.<br>• It details out its ethical policies, company selection, company research, company approval and company monitoring procedure.<br>• It describes itself as a *"market leader in the field of Governance & Socially Responsible Investment"* and through its engagement policy (called *reo*®) it promotes its governance and SRI values with companies, government, regulators and the wider community.[79]<br>• There is transparency in reporting. It publishes quarterly reports on its shareholder engagement and annual voting and governance reports. It also conducts and publishes surveys and research studies relating to SEE issues. No quantified reporting was noted.<br>• The CSR policy of F&C can be viewed as 'integrating'. |
| **Friends Provident** | • Corporate responsibility is well integrated into business practices.<br>• A number of GSEE issues are endorsed. CSR embraces community as well as philanthropic activities.<br>• Friends Provident recognises the impact of CSR on different stakeholders including the workplace, marketplace, the environment and the community. Descriptive reports are published to indicate performance in these areas of influence.<br>• It has a well grounded CSR reporting policy. The following reports are published: (i) CSR reports, (ii) various fund literatures to explain what the company does, what are its ethical and social policies, how it executes its CSR policies, which companies it invests in and how it engages with other companies (the *reo*® approach), (iii) Eurosif Transparency Guidelines, (iv) a newsletter entitled "Principles", (v) remuneration reports, (vi) annual financial reports.<br>• It has a detailed engagement process in place.<br>• It has a sustainable development policy and is proactive in pursuing the sustainability agenda.<br>• In the absence of quantified reporting, its CSR strategy can be described as 'integrating'. |

[79] www.fandc.com

*Table 7.5 (Continued)*

| SRFIs | Observed Practices |
|---|---|
| **Henderson Global Investors** | • It recognises its CSR responsibilities towards its different stakeholders and incorporates CSR within its business practices.<br>• This is reflected in its SRI criteria and through the good governance policies adopted by its funds. Its SRI fund process was given AAA rating by Novethic in 2004.[80]<br>• Among its positive screening criteria is its endeavour to invest in industries of the future.<br>• It subscribes to and proactively pursues the sustainability agenda.<br>• It promotes an engagement policy with clearly defined aims – e.g. holding regular dialogues with companies to review their CSR performance; selecting a number of sectors for particular investigation; and pursuing company specific issues.<br>• Transparency is promoted through its reporting mechanisms. It publishes (i) a Sustainable and Responsible Investment Annual Review, (ii) a Code of conduct for its employees, (iii) the Eurosif Transparency Guidelines, (iv) the SRI criteria for each of its funds, (v) its financial reports. However, although it recognises the different aspects of CSR, there is no quantified reporting on its CSR performance.<br>• Henderson's CSR approach can be described as 'integrating'. |
| **Insight Investment** | • Corporate responsibility is integrated into business practices. Insight Investment pursues a high standard of corporate responsibility and corporate governance as part of its aims to improve financial performance. It also considers CSR as part of its responsibility towards investors.<br>• It defines its CSR/SRI policies as well as its engagement strategies. It also clearly stipulates its ways of achieving its objective of high standards of corporate governance and corporate responsibility: (i) company monitoring; (ii) dialogue; (iii) voting; (iv) policy research; (v) public statements; (vi) sponsoring debates; (vii) working with others.[81]<br>• It subscribes to the sustainability agenda and proactively pursues it.<br>• It has formal policies and systems in place to manage its CSR responsibilities.<br>• The company is transparent in its reporting. It publishes (i) a statement of policy with regard to corporate responsibility and corporate governance, (ii) various funds literature to explain what its aims are and how it achieves them, (iii) the Eurosif Transparency Guidelines, (iv) a detailed report on the criteria for implementing its ethical policies, and (v) general literature on SRI and global business principles.<br>• Its CSR approach can be classified within the 'integrating' category. |

[80] www.henderson.com/global_includes/pdf/sri/SRIAnnualReport2004.pdf
[81] *Corporate Governance & Corporate Responsibility: Statement of Policy.* www.insightinvestment.com/documents/responsibility/00292_SRI_Policy.pdf

*Table 7.5 (Continued)*

| SRFIs | Observed Practices |
|---|---|
| Jupiter Asset Management | • Corporate responsibility is incorporated into business practices. Its CSR policies also include charitable activities in the form of a matched employee giving scheme, charitable fund raising, sponsoring of arts.<br>• The SRI & Governance Team manages its CSR/SRI policies and it has in place an external Advisory Committee Board to determine any review of policies. The Compliance Department ensures the funds' holdings remain compliant with its policies.<br>• It engages in positive and ongoing dialogue with senior management of companies to encourage the addressing of environmental and social impacts on their businesses.<br>• It subscribes to the sustainability agenda and proactively pursues it through the management of its three environmentally-geared funds.<br>• It has a well grounded reporting policy. Publishes the following reports: (i) a number of fund's literature to explain SRI at Jupiter, its negative and positive criteria of investment, its fund facts and products, its performance in companies that address environmental concerns; (ii) Eurosif Transparency Guidelines, (iii) Jupiter's approach to responsible shareholder – Voting and Engagement Report; (iv) Jupiter's Corporate Governance and Voting Policy 2005; and (v) an SRI Bulletin to inform its stakeholders of any latest developments in the SRI sector.<br>• Its CSR approach can be viewed as 'integrating'. |
| Morley Fund Management | • Morley Fund states that *"corporate responsibility is fully integrated into the way we run our own business"*.[82] In its CSR Report 2005, it describes CSR as being at its heart of its business. It sets annual targets and objectives on its CSR-related policies which are tracked by its Corporate Responsibility committee.<br>• It has established a system for the development, management, implementation, monitoring and review of its CSR/SRI policies.<br>• The fund commits itself to a sustainable development agenda. It states: *"At Morley we believe companies most likely to grow consistently in the future will be those that are promoting, or benefiting from, sustainable economic development."*[83]<br>• It recognises its impacts on the various stakeholder groups. In its CSR report 2005, Morley Fund reports on its key successes in the different stakeholder areas like workforce, client service, standards of business conduct, supplier management, the environment, and the community.<br>• It has a transparent reporting policy. Publishes a CSR Report, its SRI process, its engagement process, the Eurosif Transparency Guidelines, and various fund literature.<br>• Morley Fund's CSR approach can be classified as 'integrating'. |

[82] www.morleyfm.com/uk/
[83] www.morleyfm.com/uk/

*Table 7.5 (Continued)*

| SRFIs | Observed Practices |
|---|---|
| **Standard Life Investments** | • Management is committed to include corporate responsibility within its business practices. It states: *"We apply our corporate governance policies in a professional and flexible manner taking account of a company's particular circumstances."*[84]<br>• It considers environmental effects when examining companies' policies and practices for SRI.<br>• It further commits itself to an engagement approach to encourage best practices in SEE and governance issues.<br>• Some of its publications are: (i) an annual newsletter, (ii) a corporate governance guidelines booklet, (iii) its Eurosif Transparency Guidelines, (iv) funds literature relating to SRI, financial returns, rules of engagement. Occasional research articles on CSR issues are published on its websites (e.g. Ethical Fund Investing, dated 23/03/05; Get Serious about Sustainable Governance, dated 14/02/05).[85]<br>• No CSR reports are published. No CSR performance indicators have been developed to assess the fund's impacts on its various stakeholder groups. Its reporting measures can be said to be of a descriptive nature.<br>• The fund's CSR approach appears to be at a 'developing' stage. |

Source: Author's Own

## 7.5 Measuring the Outcomes of CSR Actions for the SRFIs

Similar to the assessment made on the outcomes of CSR actions for FIIPs in Chapter 6, this section endeavours to examine the commitment of the resources of the SRFIs towards socially geared activities in an attempt to measure the plausible outcomes of their CSR actions. The underlying assumption, as iterated in Chapter 6, is that CSR actions – either in the form of the products and services of the institutions or in the form of community oriented activities – are expected to have a positive impact on the larger society and the various stakeholder groups. As it is difficult to evaluate the impact of such actions, the institutions' commitment of resources to generate this impact is instead assessed.

It is recalled that a list of activities geared towards the betterment of the community was included in the questionnaire circulated to FIIPs to determine the types of

[84] http://uk.standardlifeinvestments.com

[85] http://uk.standardlifeinvestments.com/content/press/press_articles/investment_week_23_03_2005.html;
http://uk.standardlifeinvestments.com/content/press/press_articles/get_serious_about_sustainable_governance.html

community involvements of the FIIPs (see Section C of the Questionnaire at Appendix A). From the responses to the questionnaire survey, it was observed that the majority of the FIIPs were involved in mainly donations-related activities, with little efforts being spent on environmental protection, on campaigns for SEE issues, or cooperation with other organisations to promote sustainable development. The same list of activities was used to examine and compare the extent of community involvement of the SRFIs included in this study. The results of the analysis, which are depicted in Table 7.6, were based on the content analysis of the web-literature disseminated by the SRFIs.

According to the information disseminated by the SRFIs, it was noticed that all the institutions publicised the fact that they operate their businesses in a socially responsible manner and that their financial products and services take account of SEE or ESG values. The institutions were also found to be highly committed to the goal of sustainable development and this was often emphasised in their literature under the guise of the following statements: *"Co-operative Financial Services (CFS) recognises the need to develop its business in a sustainable manner - business development that meets the needs of the present without compromising the ability of future generations to meet their own needs."* (CIS Sustainable Leaders Trust, Eurosif Transparency Document); *"Triodos bank is an advocate of sustainable banking"* (Triodos Bank); *"Passionate about a sustainable future for all"* (Morley Fund Management); *"...we believe that there is increasing evidence that failure to embrace issues relating to the concepts of sustainable development and corporate responsibility can have a negative impact on companies' financial performance."* (Jupiter, A Guide to Jupiter's Socially Responsible Investment Funds: 2); *"The Memorandum of the Society contains a requirement "to promote...ecological policies designed to promote or enhance the environment in accordance with the principles of sustainable development"* (Ecology Building Society, Environment Policy, 2004: 2-3); *"By supporting job creation and sustainability, equality of opportunity and urban regeneration, we are helping our customers make a positive and long lasting contribution to society"* (Unity Trust Bank, Banking Solutions Designed for you).

## Table 7.6 The Community Welfare Activities Endorsed by the SRFIs

| **Types of activities in which the financial institutions would get involved** | **The Co-operative Bank** | **Triodos Bank** | **Unity Trust Bank** | **Ecology Building Society** | **CIS Sustainable Leaders Trust Fund** | **F&C Asset Management** | **Friends Provident** | **Henderson Global Investors** | **Insight Investment** | **Jupiter Asset Management** | **Morley Fund Management** | **Standard Life Investment** | **Total no. of institutions (out of 12)** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Investing according to ethical guidelines | • | • | • | • | • | • | • | • | • | • | • | • | 12 |
| Commitment to sustainable development | • | • | • | • | • | • | • | • | • | • | • | • | 12 |
| Taking initiatives to protect the environment (e.g. recycling) or enhance environmental management | • | • | | • | • | • | • | • | • | • | • | • | 11 |
| Sharing best practice on social, ethical and environmental responsibility with other organisations (Engagement dialogue) | • | • | | | • | • | • | • | • | • | • | • | 10 |
| Establishing fair recruitment practices, including engaging people traditionally excluded from the labour market e.g. disabled, homeless, ethnically discriminated | • | | • | | • | | • | • | | • | • | • | 8 |
| Campaigning for a particular social, ethical or environmental cause | • | | • | | • | • | • | • | • | | • | | 8 |
| Donations to charities | • | • | | | • | • | • | | • | • | | | 7 |
| Staff health, safety and welfare | • | | | | • | | | • | • | • | • | | 6 |
| Donations to community causes | • | • | | | • | | • | | | • | • | | 6 |
| Supporting employee involvement with community causes | • | | • | • | • | | • | | | | • | | 6 |
| Working with NGOs for sustainable development | • | • | | • | • | | • | | • | | | | 6 |
| Sponsorship of community events | | | • | • | | | • | | • | • | | | 5 |
| Working with local schools, colleges, universities | • | | • | | • | | • | | | | • | | 5 |
| Promoting ethical values among staff (e.g. against-bribery, corruption, conflict; pro-honesty, trust, brotherhood, justice) | | | | | | | • | • | | | • | | 3 |
| Investment in Research & Development | | | | | | | | | • | | • | | 2 |
| Abstaining from false advertising | | | | | | | | | | | | | - |
| Provision of benevolent loans | | | | | | | | | | | | | - |
| Scholarship to students | | | | | | | | | | | | | - |
| Investing or encouraging investment in deprived areas | | | | | | | | | | | | | - |
| *Zakah* collection and distribution | NA | NA | NA | NA | NA | NA | NA | NA | NA | NA | NA | NA | NA |

NA = Not Applicable. It is highlighted that only those activities which have been specifically mentioned by the SRFIs in their web-literature have been noted in this table.

Source: Author's Own

From Table 7.6, it was further noted that issues relating to the protection and enhancement of the environment were given high priority by the SRFIs. In fact, apart from the Unity Trust Bank which focuses on banking for the voluntary sector, all the other institutions were seen to have taken positive initiatives to protect the environment. This was additional to the negative and positive screening criteria they adopt in their investment decisions with respect to the environment. Morley fund, for example, informs that it is continuously considering ways to reduce its impacts on the environment and accordingly encourages its staff to reduce energy consumption, undertakes recycling initiatives, and has reduced paper usage by initiating a clear desk policy.[86] Triodos Bank, on the other hand, iterates that it has an internal environmental management system in place to help reduce the impact of its activities on the environment. Friends Provident offers a 'green travel policy' as well as offsets some of its environmental impact by adopting climate friendly technology and through tree planting (Friends Provident, CSR Report 2003: 2). Moreover, Friends Provident has a mobile phone recycling programme whose revenue is used to finance a reforestation programme in Scotland. The Co-operative Bank highlights its encouragement for sustainable procurement with suppliers.

The SRFIs were further noted to be very active in their engagement approach with other companies and organisations to encourage a shift towards more responsible and sustainable development. They cooperate with other organisations to campaign against SEE issues of shared interest. The Co-operative Bank, for example, campaigned with Friends of the Earth for combating climate change and with Christian Aid for promoting trade justice.[87] The Unity Trust Fund campaigned on issues like *Make Poverty History* and *End Child Poverty*.[88] Similarly, a number of the institutions ensured that their employment policies were perceived as being fair and socially responsible by stating that they employed people of different ethnicities, were an equal-opportunity employer and adhered to human rights conventions. Eight

[86] www.morleyfm.com/uk/

[87] www.co-operativebank.co.uk

[88] *Unity Trust Bank Report and Accounts 2005*, www.unity.uk.com/downloads/R&A2005edited.pdf

of the SRFIs examined in this study highlighted the establishment of fair recruitment policies in their institutions.

With regard to the promotion of community services, it was noted that some of the institutions offered special financial products and services which target the welfare of the larger community. The Co-operative Bank offers special community accounts called *Community Directplus* and *Co-operatives Directplus* for social organisations and co-operatives respectively. Besides, the SRFIs also supported those involved in the social enterprise sector, made donations to charities, and encouraged staff involvement in community causes. The following were some additional activities endorsed by the SRFIs:

- Supporting charities and other organisations (e.g. cooperatives, credit unions) involved in the social enterprise sector (The Co-operative Bank, Triodos Bank, Unity Trust Bank);
- Operating a customer donation fund for community investment purposes (The Co-operative Bank);
- Operating special community accounts for groups which trade with a social purpose such as charities, credit unions, voluntary organisations, parish councils and social enterprises (The Co-operative Bank);
- Giving option to depositors to donate part or all of the interest on their savings account to an NGO for a good cause (Triodos Bank);
- Encouraging payroll giving such that staff members donate to their favourite charities, with the SRFI matching their donations (e.g. Friends Provident, Jupiter Asset Management, and Morley Fund);
- Contributing to the development of young people, providing support to medical research and charities and provision of employee volunteering opportunities that benefit employees and local communities (Co-operative Financial Services, 2004: 71);

- Encouraging staff participation in charity events and community projects by supporting them in offering their time, money and expertise (e.g. Unity Trust Bank, Friends Provident).

Friends Provident, CIS Sustainable Leaders Trust, the Co-operative Bank, Morley Fund, and Insight Investment, moreover, released the ensuing data depicted in Table 7.7, regarding the donations they have made in the past years. It was noted from the BITC 2005 Percent Standard Results – which is a voluntary benchmark, measuring the contributions made by companies through cash donations, staff time, gifts in kind and management time, shown as a percentage of pre-tax profits – that the Co-operative Group was ranked among the '2004 Top Ten UK Givers' list.[89] However, it was observed that charitable donations were not generally considered part of the CSR policies of the businesses of the following two SRI funds: Henderson Global Investors and Standard Life Investments.

**Table 7.7 Charitable Donations of the SRFIs**

| **Charitable Donations** | **Friends Provident** | **The Co-operative Bank** | **CIS Sustainable Leaders Trust** | **Morley Fund Management** | **Insight Investment** |
|---|---|---|---|---|---|
| Total community giving in 2003 | £710,000 | | | | |
| Charitable donations in 2003 | £324,000 | | | | |
| Commercial initiatives in the Community in 2004 | | £2,168,179 | £196,282 | | |
| Community investment to address social issues 2004 | | £326,227 | £319,700 | | |
| Charitable gifts 2004 | | £166,868 | £219,544 | | |
| Total contribution 2004 | | £2,759,410 | £963,376 | | |
| % of pre-tax profit 2004 | | 2.1% | 3% | | |
| Cash Support 2004 | | | | £32,000 | |
| Gifts in kind 2004 | | | | £2,070 | |
| Staff Volunteering 2004 | | | | £74,679 | |
| Total charitable giving 2005 (amount received from HBOS Foundation) | | | | | £30,000 |

Source: Various sources disseminated on the institutions' websites

[89] www.bitc.co.uk

With regard to the performance and outcomes measurement, it was further noted that the Co-operative Financial Services (CFS) has developed extensive benchmarks for measuring how well the Co-operative Bank and the CIS Sustainable Leaders Trust are performing in terms of their achievement against the broader objectives of sustainable development. It has developed a number of performance indicators in line with conventional criteria, referred to as SMART: Specific, Measurable, Achievable, Realistic, Timely (Co-operative Financial Services, 2004: 21). These indicators aim at assessing the 'delivery of value', 'social responsibility' and 'ecological sustainability' with further breakdowns sought under each category and corresponding qualitative and/or quantitative indicators derived (see Co-operative Financial Services, 2004: 22-23). For instance, to assess the institutions' performance with respect to community involvement, progress was determined through indicators which assessed the impact on society, financial support, customer involvement, and staff involvement (Co-operative Financial Services, 2004: 23). Table 7.8, which reproduces the list of indicators developed by the CFS, provides details on the themes used to assess social performance.

This method of assessing the social performance of the Co-operative Bank and CIS is deemed to be quite sophisticated and useful in determining the success of CSR actions of these institutions. It is a commendable practice to be encouraged by other SRFIs and FIIPs. The quantified reporting method adopted by CIS and the Co-operative Bank indeed makes the institutions 'leaders' in their CSR approach.

## Table 7.8 The Co-operative Financial Services' List of Indicators

| No. | Section | Indicator |
|---|---|---|
| | **Delivering value** | |
| 1 | Financial performance | Profit (Bank/CIS) |
| 2 | | Income (Bank/CIS) |
| 3 | | Cost/Income ratio (Bank) |
| 4 | | Average retail balances (Bank) |
| 5 | | Return on equity (Bank) |
| 6 | | Insurance funds under management (CIS) |
| 7 | | Sustainability Value Analysis (Bank) |
| 8 | | Wealth Creation (Bank/CIS) |
| 9 | Personal Customers | Satisfaction with service |
| 10 | | Satisfaction with relationship |
| 11 | | Satisfaction with Financial Adviser (CIS) |
| 12 | | Satisfaction with ethics and sustainability |
| 13 | | Complaints |
| 14 | | Network Developments |
| 15 | Corporate and Business Customers | Satisfaction with service |
| 16 | | Satisfaction with relationship |
| 17 | | Satisfaction with ethics and sustainability |
| 18 | | Complaints |
| 19 | | Network Developments |
| 20 | Staff | Salary package |
| 21 | | Staff turnover |
| 22 | | Trades union recognition |
| 23 | | Personal development and career opportunities |
| 24 | | Working environment |
| 25 | | Job security |
| 26 | | Work/life balance |
| 27 | | Communication |
| 28 | | Co-operative culture and ethical conduct |
| 29 | Suppliers | Prompt payment |
| 30 | | Satisfaction with relationship |
| 31 | | Fair treatment |
| 32 | | Effective communication |
| 33 | | Long-term relationship |
| 34 | Co-operative movement | Member economic involvement |
| 35 | | Member training |
| 36 | | Co-operative involvement |
| 37 | | Satisfaction with ethics and sustainability |

*Table 7.8 (Continued)*

| | | |
|---|---|---|
| | **Social Responsibility** | |
| 38 | Ethical finance | Socially responsible investment (Bank) |
| 39 | | Socially responsible investment (CIS) |
| 40 | | Anti-money laundering and financial crime prevention |
| 41 | Financial inclusion | Financial inclusion |
| 42 | | Small business support in deprived areas |
| 43 | Human rights | Oppression |
| 44 | | Armaments |
| 45 | | Labour standards |
| 46 | | Trade and development |
| 47 | Animal welfare | Animal testing |
| 48 | | Intensive farming |
| 49 | | Blood sports |
| 50 | | Fur trade |
| 51 | Sustainable procurement | Supplier screening and engagement |
| 52 | | Suppliers' attitudes toward ethics and sustainability |
| 53 | Health, safety and welfare | Accidents/incidents |
| 54 | | Absence |
| 55 | | Wellbeing |
| 56 | Diversity and equality | Workforce composition |
| 57 | | Accessibility of products and services |
| 58 | Community involvement | Impact on society |
| 59 | | Financial support |
| 60 | | Customer involvement |
| 61 | | Staff involvement |
| | **Ecological Sustainability** | |
| 62 | Energy | Carbon dioxide emissions |
| 63 | | Sulphur dioxide emissions |
| 64 | | Nitrogen oxide emissions |
| 65 | | Particulate emissions |
| 66 | | Volatile organic compound emissions |
| 67 | | Energy usage |
| 68 | Water | Water consumption and discharge |
| 69 | Chemicals | Toxins |
| 70 | | PVC |
| 71 | | CFCs/HCFCs/HFCs |
| 72 | Transport | Business mileage |
| 73 | | Carbon dioxide emissions |
| 74 | | Sulphur dioxide emissions |
| 75 | | Nitrogen oxide emissions |
| 76 | | Particulate emissions |
| 77 | | Volatile organic compound emissions |
| 78 | Reduce, reuse, repair and recycle | Waste minimisation |
| 79 | | Reuse and recycling |
| 80 | Paper and printing | Paper, by type |
| 81 | | Printing, by type |
| 82 | Biodiversity | Biodiversity enhancement |
| 83 | | Land occupied |

Source: Co-operative Financial Services (2004), *A Year in Focus: Co-operative Financial Services Sustainability Report 2004*, Available at <URL: http://www.co-operativebank.co.uk/images/pdf/cfssustainabilityreport2004.pdf> Pages 22-23.

## 7.6 Conclusion

In general, according to the data disseminated on the websites of the SRFIs studied in this chapter, it can be said that the institutions have taken a deliberate policy decision to promote CSR and SRI. They have highlighted in various ways the provision of their distinctive financial services and their ethical and socially responsible stance. With a lesser focus placed on charitable donations and more emphasis given to activities which enhance their contribution to capacity building and community well-being – such as community investments, support to social enterprises, generation of sustainable local employment, removal of social and financial exclusion, campaigning on SEE issues, engagement with companies to improve their SEE performance, and initiatives to protect the environment – it can be inferred that CSR and SRI as practised by the SRFIs form part of an integral management strategy of the institutions. The institutions' CSR and SRI practices do not appear to represent a mere peripheral activity of the organisations whereby CSR is practised in the form of ad hoc charitable activities or donations for community causes. In cases where the institutions practised charitable donations, these were viewed as additional activities over and above those meeting the economic, legal, social, and ethical responsibilities. In this way, these institutions could be classified within the category of *"doing more than what is required"* of them with respect to CSR.

It was noticed that most of the SRFIs examined in this study have established a formal system for developing, institutionalising and managing CSR, which is suggestive that CSR is taken seriously by the institutions. Separate CSR/SRI units have been set up at the SRFIs to undertake research, analysis and review of their CSR/SRI policies (e.g. the Ethical policy unit of the Co-operative Bank and Jupiter's Environmental Research Unit). A team of SRI and CSR specialists is also employed to carry out the CSR responsibilities of the institutions.

Furthermore, the numerous efforts made by the institutions in being transparent about their businesses – through corporate social and financial reporting, publication of funds' literature, dissemination of industry news through newsletters, and the posting of updated information on their websites – demonstrated the proactive approach of the SRFIs in projecting their social responsibility function and in enhancing the credibility of their institutions and practices. Social responsibility was itself perceived by the institutions as encompassing a wide array of GSEE issues which in turn resulted in a number of screening criteria being endorsed by the SRFIs. The institutions' engagement approach, best of sector investment and support given to investments in industries of the future further showed the advanced SRI practices of the sampled institutions.

It may be said that the SRFIs were partakers in the SRI industry for both the financial and 'social responsibility' reasons. Issues like efficiency, profits, sustainability were as important for their survival as the balance they sought to achieve in their social responsibility functions. Finally, despite the fact that their CSR and SRI practices were not backed by a religious philosophy or any Godly enforcing power, such as the *Shari'ah* – unlike the case for FIIPs – the SRFIs were observed to be involved in proactive activities which reflected on their level of commitment, their degree of transparency and their aim to contribute towards human well-being. These are seen as important lessons to be learnt by the FIIPs.

# CHAPTER 8

# Comparison of the CSR practices of FIIPs and SRFIs: Lessons Learnt from their Experiences

## 8.0 Introduction

The last two chapters examined the CSP of a sample of FIIPs from across a number of countries worldwide and the CSR and SRI practices of some leading SRFIs located in the UK. Both groups of institutions share the common objective of pursuing social responsibility in their businesses – albeit with a difference in the source guiding their CSR and SRI policies. Despite the importance attributed to corporate responsibility by both FIIPs and SRFIs, the analyses of their practices in Chapters 6 and 7 indicated a marked distinction between the two groups of institutions in their: perception of what CSR represents; management of CSR policies; corporate responsiveness of the institutions towards CSR issues; and commitment of resources towards CSR initiatives. Differences were particularly noted with regard to their level of transparency, information disclosure, corporate social reporting, engagement policies, marketing skills, approach to and involvement of the stakeholders, management process of CSR and the variation in the CSR issues considered by the institutions.

This chapter endeavours to make a comparison of the practices of the two types of institutions. Moreover, it seeks to delineate some lessons that can be learnt from the SRF industry, which are believed to be relevant for consideration by FIIPs.

## 8.1 Comparing the CSR and SRI Practices of the FIIPs and SRFIs

Both the FIIPs and SRFIs target a niche market, particularly those who wish to place their investments in line with their moral values or religious beliefs. To attract these customers, the FIIPs and SRFIs were observed to emphasise their distinctive ways of doing business: they tend to highlight their socially responsible approach in the provision of financial services. In this respect, it was noted that about 81.1% of the respondents to the questionnaire sent to FIIPs classified their institutions as being 'socially responsible' (Table 6.30, Chapter 6). Similarly, it was noted in Chapter 7 that the SRFIs used key terms such as 'social responsibility', 'corporate social responsibility', 'ethics', and 'sustainability' to reflect their socially responsible function. The term CSR was not necessarily used by FIIPs to the same extent as the SRFIs. It was observed that only 6 FIIPs used the term CSR on their websites and about 11 FIIPs referred to corporate governance (Table 6.28, Chapter 6). The FIIPs were instead seen to emphasise their conformity with the *Shari'ah* to point to their ethical credentials. It was observed that 83.6% of the FIIPs indicated that they were *Shari'ah* compliant on their websites (Table 6.32, Chapter 6). Moreover, out of the 46 FIIPs, 10 of the institutions included the title 'Islamic' in their names; others made use of terms with Islamic connotations (such as, Muslim, NoRiba, Al-Baraka, Al-Amanah, Syariah, Muamalat, Alfalah, Meezan) to reflect their Islamic nature. It was Wilson (2002) who pointed out that the use of the Islamic label is often associated by FIIPs with being 'ethical'. At the outset, therefore, a difference in the institutions' projection of social responsibility seemed to prevail.

On the part of the Islamic financial practitioners, their understanding of social responsibility was linked to the objectives of Islamic finance which seek *riba* elimination, trade encouragement, establishment of a socially-acceptable, just, human-oriented, and environmentally-friendly financial system. The corporate responsibility of FIIPs was therefore understood as mostly related to the ethical and philanthropic aspects of CSR through the (i) undertaking of corporate philanthropy and community involvement, (ii) establishment of social justice, and (iii) promotion of ethical issues like the shunning of *riba*, speculation, *gharar*. In particular, it was noted that corporate philanthropy as a component of CSR was given the highest ranking by the practitioners while issues like consumer and economic responsibility were not mentioned as forming part of the CSR of the FIIPs (Table 6.3, Chapter 6). This was reflected also in the type of welfare activities that the FIIPs participated in, which were mostly donations-related (Table 6.43, Chapter 6). In contrast, the SRFIs did not perceive corporate philanthropy as the main objective of CSR. CSR was instead viewed as an embedded activity of the business, integrating the four dimensions of responsible business practices, consumer responsibility, sustainable business enterprises and corporate involvement with the community as well as incorporating a comprehensive number of GSEE issues. The welfare activities that the SRFIs participated in furthermore had a more proactive tendency, involving engagement in dialogue with other organisations on SEE issues, campaigning for SEE causes, and taking initiatives towards environmental protection and management (Table 7.7, Chapter 7). Donations-related activities were not situated among the first rankings of the SRFIs (Table 7.7, Chapter 7).

The respondents from the FIIPs further believed in attributing an integrated social role to FIIPs – comparable to Chapra's idea of universal banks – rather than shifting these socio-economic responsibilities to organisations in the third sector. Despite this apparent holistic view embraced by Islamic financial practitioners regarding the pursuit of corporate responsibility by FIIPs, the practices of the FIIPs reflected a more limited approach to CSR. On basis of what the respondents stated were the practices of their institutions (from the questionnaire responses) and following an analysis of the websites of the same FIIPs, the following inferences were made about the institutions. These were in turn compared with the practices of the sampled SRFIs.

- The screening criteria of the FIIPs were observed to be biased towards the negative screening of Islamic prohibitions rather than proactively seeking positive screening and engagement with companies for improvement of their policies. In contrast to SRFIs, the engagement method in the form of shareholder advocacy and voting was not promoted, either in the literature or in practice, to be part of the Islamic financing approach. The FIIPs were therefore observed to uphold a limited view of social responsibility in comparison with the SRFIs. The concept of social responsibility within the Islamic perspective was more perceived as being associated with 'not being socially irresponsible' rather than with making an effort for 'being socially responsible'.

  Here, it is worth noting that the concept of ethicality, within the Islamic perspective, is based on a God-given concept, derived from the Islamic sources and interpreted by Islamic scholars. While all prohibitions have to be shunned, the exhortations are mostly encouraged to be practised to the best level of one's abilities (except for compulsory ordinances like *zakah* payments). In the case of the SRFIs, the concept of ethicality is based on social concerns which evolve over time and experience. Rather than being a 'received' 'God-given' concept, the ethical values are subjected to the changing norms of society which are endorsed on a voluntary basis. Inherent within the understanding of ethicality in the secular perspective, therefore, is the notion of 'proactivism' where voluntary efforts are made to promote the ethical values. This could, in some respects, explain the endeavours of the SRFIs in using the engagement and best of sector approaches to have an impact on the ethical policies of other companies.

- The screening criteria or CSR issues considered by the FIIPs were also seen to be more limited as compared to the wide range of GSEE issues which determined the screening criteria of SRI. The SRFIs were noted to be considering a broad variety of values – from human rights to animal welfare, ecology and environment, fair trade and organic farming, community involvement, financial inclusion and support to social enterprises – thus endorsing the four dimensions of CSR in their policies. The SRFIs were also seen to consider a number of investment styles to cater for the diverse ideological beliefs of the ethical investor and customer. As Baue (2004) confirmed, some of the investors would favour greater *"social progressivism"* in their screening of investments, others would prefer more *"cultural conservatism"* and still others would have *"a wide range of tolerance for the degree of stringency or screening"* of investments. This explains the vast number of CSR issues as well as the various SRI approaches adopted by the SRFIs which include negative and positive screening, best of class investment, shareholder advocacy, community investment, and investment in industries of the future. Hence, a sophisticated and complex understanding of CSR and SRI shapes the culture of SRFIs.

- The ethical screening criteria of the FIIPs, as stated above, are drawn from the teachings of Islam rather than relying on secular moral values. With regard to the CSR issues, therefore, secular concerns like fair trade, human rights, animal testing, the fur industry, the environment and armaments were observed to be important for the SRFIs (Table 7.2, Chapter 7). On the part of the FIIPs, higher emphasis was placed on the Islamic prohibition of *riba*, *gharar*, speculation, the shunning of forward currency transactions and the seeking of investments in real transactions. Ideally, it is believed that the Islamic financial prohibitions and the profit sharing approach represent strategic tools in achieving the Islamic vision of socio-economic justice and welfare. The positive contribution of *riba* elimination, in particular, has been described in socially laudable terms to be: the establishment of socio-economic justice and fairness, elimination of corruption, proper usage of other people's property, uplift of the human personality, and achievement of economic growth (Iqbal and Molyneux, 2005: 10). This surely might be the case in the idealised world where the practice accords with the theoretical teachings. Current Islamic finance practices, however, reveal that the banning of interest has been replaced with the use of other benchmarks and mark-ups, which – although being altogether in compliance with the *Shari'ah* – have the same effect as *riba*. To quote LaRiba American Finance House (USA), the interest rate of the day is used and called 'rent' by HSBC, 'service charge' by banks from the South East and Gulf regions, or 'Index' by HSBC and some banks in the Gulf.[1] Thus, the cost of 'borrowing' under Islamic finance is raised to the same level as under the case of conventional financing. The mere emphasis on the compliance of the financing contract with Islamic legal rulings, therefore, is not deemed to bring about the socially laudable objectives mentioned above. The nature of the business being financed as well as the way the financing is provided is believed to be crucial in deriving a socially responsible outcome from the financing deal.

- Regarding the CSR issues, it was moreover noticed that environmental concerns were given lesser priority by the FIIPs as compared with the practice of SRFIs. Some of the SRFIs even had a detailed and extensive screening list pertaining to issues on the environment and ecology (e.g. Insight Evergreen Fund and Morley Fund Management). SRI funds like Jupiter Asset

[1] http://www.americanfinance.com

Management and Insight Investment furthermore managed some special funds which focused on the environment (e.g. Jupiter Ecology Fund, Jupiter Environmental Opportunities Fund, Jupiter Global Green Investment Trust and Insight Evergreen Fund). The Ecology Building Society also focuses solely on the promotion of environmentally-friendly financing. The ecological sustainability analysis conducted by the Co-operative Financial Services (CFS) for the Co-operative Bank and CIS was indeed seen to be quite sophisticated. It included the development of indicators on various ecological issues (e.g. energy, water, chemicals, transport, recycling, paper and printing, biodiversity) and measured performance against the targets set.[2] The extensive efforts made by the SRFIs on environmental sustainability certainly showed their higher degree of concern for environmental issues.

With regard to the practices of the FIIPs, on the other hand, environmental causes were observed to rank among the last activities subscribed by the institutions (Table 6.43, Chapter 6). Environmental screening was also least endorsed by the FIIPs (Table 6.17, Chapter 6). Only four of the FIIPs were seen to show some concern about the environment in their reports and websites. Hence, a minimal engagement with environmental issues was observed on the part of the FIIPs, despite the fact that environmentally friendly practices are highly encouraged in Islam. A possible explanation for this practice could be that the FIIPs considered environmental protection merely as a secondary area of business interest and involvement. Rather, the FIIPs would be more interested in relieving their primary and immediate negative impacts caused by, for example, their involvement in *riba* and *gharar*.

In their management of CSR, it was observed that at least the 8 sampled SRI funds had a system in place whereby they not only defined their CSR policies and SRI screening criteria but also ensured a systematic management of their CSR/SRI policies through:

[2] *Co-operative Financial Services Sustainability Report 2004*, www.co-operativebank.co.uk/images/pdf/ cfssustainabilityreport2004.pdf

(i) Development of guidelines on how to implement these policies and screening criteria (e.g. publication of the research methodology and research process procedures which assist in company selection, research, approval and monitoring);

(ii) Setting up of a committee of reference or internal SRI compliance team which is attributed the power to check compliance of portfolio holdings and/or review the policies to account for new data;

(iii) Having in place an external verification process for the research process;

(iv) Inclusion of stakeholder consultation in setting the research process; and

(v) Establishment of transparency in all procedures by disseminating information through websites and publications of brochures, newsletters, CSR and sustainability reports.

Indeed all the SRFIs (including the four banks and building society) were transparent about their ethical policies, to whom they lend and their ethical lending or screening criteria. However, it was noticed that some of the institutions provided more details on their policies and activities than others.

Based on the management model developed by the Ashridge Centre for Business and Society, it was further inferred in Chapter 7 from an examination of the websites of the SRFIs, that most of the SRFIs (and especially the 8 SRI Funds and the Co-operative Bank) adopted CSR and SRI as a deliberate policy decision by management, for which – management's approval was secured, resources were allocated, stakeholders' interests were considered, plans and targets were set, performance indicators were prepared, review policies were institutionalised, reporting measures were taken, and engagement with external parties was effected.

This compares with the practices of the FIIPs which did not have a clear management system with respect to CSR policies. In the first instance, an examination of the mission and vision statements of the FIIPs showed that the FIIPs had a tendency to highlight *Shari'ah* compliancy as the essence of their financial businesses instead of focusing on the Islamic-cum-ethical objectives of the institutions (Table 6.32 compared with Table 6.14). It was further noted that ethical screening criteria were publicised by only 25.9% of the FIIPs on their websites (Table 6.16, Chapter 6). Hardly any detailed published reports prevailed which provided information on company/investment selection, approval, monitoring and review. With regard to an assessment of the managerial impact of the FIIPs on the various stakeholder groups, this did not appear to be a practice undertaken by the FIIPs (e.g. compare with the practice of the Co-operative Bank in Table 7.3, Chapter 7, where the Business in the Community reported that the Bank has been taking action to reduce its negative impacts on society and the environment). Generally, however, the FIIPs recognised the purpose of creating value for their key stakeholders like customers, employees and shareholders (Table 6.27, Chapter 6).

Equally, customer consultation – as practised by the Co-operative Bank and CIS in the determination of their ethical policies – was not seen to feature among the practices of the FIIPs. This could be explained by the fact that the ethical policies of the FIIPs are derived from Islamic law and the Islamic values should in principle be endorsed by Muslims, irrespective of whether they are financial practitioners or customers. The *Shari'ah* is taken as representing a wider paradigm which guides the economic, legal, ethical and philanthropic responsibilities underlying CSR, based on which the institutions' ethical policies are formulated.

To assure stakeholders of the compliance of their financial products and services with Islamic law, it was found that 36.4% of the FIIPs laid emphasis on their *Shari'ah* supervisory board and the eminence of their constituting members (Table 6.34, Chapter 6). The establishment of this board is comparable to the external verifiers that exist in the context of the SRFIs to certify compliance of company transactions with their ethical policies. In fact, in order to improve corporate governance at the level of FIIPs, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has laid out the following recommendations in its Accounting, Auditing and Governance Standards manual (2004-05):

- Every Islamic financial institution shall have a *Shari'ah* supervisory board whose members are *"entrusted with the duty of directing, reviewing and* *supervising the activities of the Islamic financial institution in order to ensure that they are in compliance with Islamic Shari'a Rules and Principles".*

- Islamic financial institutions should conduct an internal *Shari'ah* review of all their activities – including contracts, agreements, policies, products, transactions, memorandum and articles of association, financial statements, reports, and circulars – to examine the extent of their compliance with the *Shari'ah*.

- The AAOIFI (2004-05) has published a 'code of ethics for the employees of Islamic Financial Institutions' and a 'code of ethics for accountants and auditors of Islamic Financial Institutions'.

- Islamic financial institutions should establish an Audit and Governance Committee (AGC) which will help enhance transparency and disclosure in financial reporting as well as enhance the public's confidence about the genuineness in the application of *Shari'ah* rules and principles by the Islamic financial institutions. Among the duties of the AGC is their role in reviewing the reports produced by the internal *Shari'ah* review and the supervisory *Shari'ah* board. It is hereby noted that the AAOIFI did not make any recommendation on the social reporting by Islamic financial institutions, except the reporting in the sources and uses of funds pertaining to *zakah*, charity and donations.

Incidentally, it was noted that none of the sampled FIIPs referred to the compliance of their institutions to the governance structure, including the code of ethics, proposed by the AAOIFI (except for Albaraka Bank South Africa which only mentioned that it is a member of the AAOIFI). Reference to the AAOIFI standards would have demonstrated their commitment and efforts made in improving the corporate governance structure at the level of their institutions.

The scope of the role and function of the *Shari'ah* supervisory board may also be questioned. According to the AAOIFI standards (2004-05), the board should ensure compliance of the activities of the Islamic financial institutions to the rules and principles of the *Shari'ah*. Would it imply that this board looks into merely the legal compliance of the financial transactions with the *Shari'ah*? If so, it would not necessarily help in bringing about CSR which entail acting within the broader spirit of the *Shari'ah*.

With regard to the management of CSR issues, it was further noticed that the majority of the respondents from the FIIPs perceived no conflict between the social, ethical and profit-seeking objectives of the institutions. Similar results were noted on the part of the SRFIs. In fact, the institutionalisation of both FIIPs and SRFIs can be said to have often resulted out of the need to meet market demand, particularly of Muslims and of ethically-conscious customers respectively. Financial performance has therefore been of utmost importance to the institutions to ensure their survival and for gaining the trust of customers and investors. To this end, CSR has been used as a marketing tool to provide the institutions a competitive advantage over other financial institutions. This was reflected in the practices of the FIIPs and the SRFIs as they publicised their different approach of doing business: on the one hand, FIIPs promoted their *Shari'ah* compliance and on the other, SRFIs focused on their socially responsible approach. It is also recalled that the Islamic financial practitioners and the SRFIs perceived their different approach in operating their businesses as a long term value enhancing activity, thus endorsing the 'business case for CSR'.

Yet, it should be pointed out that a high percentage of 85.5% of the FIIPs clearly placed emphasis on their efficiency by highlighting provision of modern products and services, and on their profit-maximisation goal by emphasising their purpose to improve financial gain and shareholder value (Table 6.29, Chapter 6). Some of the FIIPs even called attention to their exclusive focus on high net worth clients. In comparison to this, the analysis in Chapter 6 revealed that, overall, a lower percentage of FIIPs laid emphasis on corporate governance, social responsibility, ethical responsibilities, ethical mission statements, or community involvement. This raises the question whether the FIIPs were more profit-oriented than had societal welfare at heart?

As regards the corporate responsiveness of the institutions – with the assessment based on Carroll's (1979) four-part definition of CSR and with the added criteria of acting according to both the textual directive and the spirit of Islamic law being included within the Islamic worldview – the following observations were made on the practices of the SRFIs and FIIPs:

- A large percentage of the FIIPs (69.1%) were classified as being 'accommodative' to CSR, with the majority (36.4%) pursuing the legal, economic and *Shari'ah* responsibilities (Table 6.31, Chapter 6). As it was stated earlier, the findings indicated that the majority of the FIIPs were concerned with the goal of profit maximisation and for their transactions to meet *Shari'ah* compliance. Alternatively, the majority of the FIIPs could also be classified in the category of 'apathy' (Table 5.4, Chapter 5) or 'reacting' (Table 5.3, Chapter 5) which indicate the 'compliance focused' nature of the FIIPs and their limited involvement in CSR. With regard to the SRFIs, all the 12 SRFIs were noted to be 'accommodative', largely accepting their CSR responsibilities as well as, to various extent, being *"progressive and adaptive to society's expectations"* (McAdam, 1973) (Table 7.4, Chapter 7). Table 7.6 (Chapter 7) further classified the CSR performance of the SRFIs as (i) 'leaders' (e.g. The Co-operative Bank, CIS Sustainable Leaders Trust Fund); (ii) to be at the 'integrating' stage (e.g. Triodos Bank, F&C Asset Management, Friends Provident, Henderson Global Investors, Insight Investment, Jupiter Asset Management, Morley Fund Management); and (iii) to be at the 'developing' stage (e.g. Unity Trust Bank, Ecology Building Society, Standard Life Investments).

- Involvement in community development and philanthropic activities also led about 25.4% of the FIIPs to be classified as 'proactive' to CSR (Table 6.31, Chapter 6). On the part of SRFIs, it was noticed that all the institutions participated in community activities. About 9 of the SRFIs could however be viewed as *"doing more than what is required"* (Clarkson, 1995) since they were involved in a number of philanthropic activities (Table 7.4, Chapter 7).

- It was noticed that some of the FIIPs and SRFIs (e.g. Islami Bank of Bangladesh, Norton Rose, Friends Provident, Triodos Bank, and Insight Investment) established separately-managed 'foundations' which were attributed the responsibility to carry out their charitable activities. In this way, the economic and profitable objectives of their businesses were separately maintained from their social and communal objectives. This was seen to be a useful practice because it would encourage transparency and accountability of the institutions with respect to their social activities.

- As regards the social welfare activities that the institutions participated in, it was noticed that the FIIPs would tend to spend on charitable activities like making donations to charities and for community causes, sponsoring community events, and providing benevolent loans (Table 6.43, Chapter 6). The abstention from false advertising and the promotion of ethical values among staff were also seen to be important to the FIIPs. On the other hand, cooperation with other organisations for the promotion of ethical values and sustainable development, or activities like lobbying for SEE issues and environmental protection were not ranked highly by the FIIPs (Table 6.43, Chapter 6). By contrast, the latter activities were given high priority by the SRFIs (Table 7.4, Chapter 7). Many of the SRFIs provided details on the efforts they made to reduce their impact on the environment – like recycling, reducing energy consumption, cutting down on paper usage, implementing green travel policy, recycling mobile phones, and tree planting. Other activities like supporting employees' involvement in community causes and matching staff donations to charities were also distinctive to SRFIs. Engagement with other companies was seen to be a specific SRI approach adopted by the SRFIs in order to encourage positive CSR actions by others.

- Based on the statements of the Islamic financial practitioners, it was found that the majority of the FIIPs allocated 0-2% of their annual profits towards social welfare activities, including making donations (Table 6.40, Chapter 6). No matching figure was available for the SRFIs, although some of the institutions publicised the amount they spent on charitable donations. For the Co-operative Bank and CIS, charitable donations in 2004 amounted to 2.1% and 3% of pre-tax profit, respectively (Table 7.8, Chapter 7). In fact, according to the Business in the Community 2005 Percent Standard Results, the Co-operative Group was classified among the leaders in charitable giving, ranked among the '2004 Top

Ten UK Givers' list.[3] It was noticed that many companies in the BITC Percent list donated 1 percent or more of their pre-tax profits to the community. Generally, it could be inferred that the welfare donations of both the FIIPs and SRFIs could be grouped within the 0-2% profit range.

With regard to transparency in reporting, it was noticed that the FIIPs did not embrace a corporate social reporting culture through which their ethical policies, implementation of their SRI policies, impact on their stakeholders, and their community and social activities are disseminated to the public. Comparatively, CSR and sustainability reports were annual features of most of the SRFIs. The majority of the SRFIs were perceived to be transparent about their ethical policies, their rating and selection of companies for investments, the kind of enterprises they would lend to, their engagement process with other organisations, and their voting policies. Some institutions like the Co-operative Financial Services were quite progressive in their reporting attempts: it developed qualitative and quantitative indicators to ascertain the performance of the Co-operative Bank and the CIS Sustainability Leaders Trust in terms of their "delivery of value", "social responsibility" and "ecological sustainability".

Overall, it was noted that CSR was considered and promoted as an integral part of the business activities of the SRFIs. The institutions were explicit about the SEE issues accounted for in their financial activities, along with the consideration of financial and economic objectives. For the FIIPs, it was seen that CSR was not emphasised within the practice of the institutions. Their ethical and social responsibilities were often implicit within the objectives of the institutions. *Shari'ah* compliancy was instead considered the essence of their financial business. As such, it may be contended that CSR was only adopted as a peripheral activity of the FIIPs, practised largely in the form of voluntary charitable and philanthropic activities. More proactive efforts towards encouraging CSR was lacking on the part of the FIIPs.

[3] www.bitc.org.uk

## 8.2 Lessons Learnt from the Practices of the SRFIs

In the light of the positive experiences of the SRFIs and their more proactive CSR culture, some lessons can be learnt to improve the performance of the Islamic finance industry. These lessons are deemed useful for the FIIPs in a number of ways: in upgrading their marketing skills, improving their image, rethinking about their organisational structure, assessing their social performance, educating customers, encouraging consumer responsibility, promoting transparency, and building bridges with other faith-groups and financial institutions.

### 8.2.1 Highlighting the Islamic Ethical Values

It was noticed that the SRFIs successfully disseminated their ethical and socially responsible values and policies through the use of positive and catching marketing phrases, which have both an informative content while being appealing to customers. Friends Provident Stewardship Ethical Investments, in a document introducing the fund, uses positive messages like *"the world's a better place with Friends"* and *"Friends take responsibility"* to promote its ethical and socially responsible 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"*.[4] The very use of such words like 'friends' and 'stewardship' itself impart a positive message that the company will take care of the financial resources of its customers and investors while they are held under the trust of the company. The usage of such concepts would indeed align with the notion of vicegerency (*khalifah*) in Islam where businesses are required to hold in trust the financial resources of their shareholders as well as consider the economic resources of society as God's property that need to be looked after.

It is further noticed that publication of 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.[5] Pension funds in the UK have also

[4] www.friendsprovident.co.uk/doclib/xg15.pdf
[5] www.cofe.anglican.org

been encouraged to indicate the adoption of SEE issues in their statement of investment policy by government since year 2000.

Comparatively, HSBC Amanah Finance which started to offer Islamic home financing in the UK since 2004, was seen to be describing its services in its brochure in a few words such as *"entirely halal"* and *"in accordance with Shari'ah"* (HSBC Bank plc, HSBC *amanah* Finance brochure). Again on the website of HSBC Amanah, the following captions were highlighted: *"banking without compromising your beliefs"*; *"the shar'iah compliant alternative"*.[6] Emphasis was therefore placed on compliance of its transactions with the legal *Shari'ah* rulings. However, little effort was made to describe to the customer as to 'what' *halal* means, 'how' *Shari'ah* compliancy is achieved and 'why' *Shari'ah* observance is important. It is nonetheless admitted that a brief line was included on the website of the bank for this purpose: *"Through the stages of product development, fund segregation and Shariah review, our Shariah advisors ensure that our services are free of interest and within the guidelines for commerce, finance and investment that are prescribed by the Shariah (Islamic law)."* [7]

Furthermore it was noticed that much emphasis was placed on the credentials of the bank's *Shari'ah* supervisory committee which validates its financial products (HSBC Bank plc, HSBC *Amanah* 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 (2002: 52). Reference to the *Shari'ah* committee has indeed been argued by Gambling *et. al.* (1993: 198) to represent a source of assurance of *Shari'ah* compliance to Muslim customers that they are fulfilling their religious expectations. The existence of this assurance, states Maali *et. al.* (2003: 5), reduces the necessity for FIIPs to provide detailed disclosure on many issues. However, in order to enable clients to make their own judgement of the ethicality of their investments, Wilson (2004: 44) submitted that Islamic financial institutions could also consider the provision of full

[6] www.hsbcamanah.com
[7] www.hsbcamanah.com

information on the screens they use and *"an explanation of why they are relevant to shariah compliance"*.

If FIIPs wish to attract ethically-conscious clients – who are not necessarily Muslims – on the basis that the Islamic ethical values are equally shared by other faith groups, an emphasis on customer education is believed to be necessary. In this respect, it is important that the Islamic terms used by FIIPs, the purpose of Islamic banking and finance, and the nature of Islamic financial products are explained in clear and user-friendly language. Indeed, some of the FIIPs (30.9% as per Table 6.33, Chapter 6) do include some separate information on the history and development of the Islamic financial industry as well as provide details on the Islamic financial instruments on their websites. Nevertheless, an inclusion of these details within the main body of the company information would reflect the key importance attributed to it. The use of informative and easy-to-understand brochures is also helpful for this purpose. To this end, the brochures issued by the Islamic Bank of Britain can be commended. They provide information on the bank, its principles and values, its products and on how its transactions are *Shari'ah* compliant. The brochures are equally downloadable from the bank's website. Another approach which helps in promoting transparency with respect to the Islamic Bank of Britain's policies and activities is the 'Frequently Asked Questions' section which the Bank has included on its website. This seeks to clarify some doubts that customers may have.

In short, it is submitted that the useful approach of the SRFIs to promote the ethical values and principles that the institutions stand for can be emulated by FIIPs so that the moral teachings central to the Islamic approach to financing would be made clear to prospective clients.

### 8.2.2 Learning from the Screening Criteria of the SRFIs

There is considerable overlap in the screening criteria endorsed by the SRFIs and FIIPs. The screening criteria of SRFIs especially cover a broad spectrum of issues, ranging from governance to SEE concerns. It is submitted that the negative and positive lists of criteria of SRFIs can be of interest to FIIPs as, although they are founded on secular socio-ethical values, their consideration will be in line with acting within the spirit of the *Shari'ah*.

Of particular interest are the environmental issues that SRFIs focus on. These have been described in extensive details by some of the SRI funds like Morley Fund Management and Insight Investment.[8] Speciality funds focusing on solely environmental issues also provide investment opportunities for the environmentally-conscious customer. On the other hand, it was noticed that the FIIPs hardly showed concern about harmful environmental effects and did not appear to be taking proactive measures to encourage the protection of the environment. Within the Islamic worldview, this is a responsibility assigned to human beings, who as trustees of the natural resources bestowed by God for the use of human kind, would be considered sinful if the individuals engaged in wastage or destruction of the environment.

One example in the context of Islamic financing where it is felt that an environmental assessment of the project has been altogether neglected is in the case of the construction of the ZamZam Tower. This project, whose development process has begun in November 2002 and is expected to be completed in 2006, aims at constructing a 31-floor tower within the close vicinity of the Holy mosque in Mecca and will house 1240 five-star luxurious residential suites.[9] Investors in this project, representing Muslims from any part of the world, would be given the utilization right to use the residential suites for a periodical part of the year.[10] With regard to the legal compliance of this project with the *Shari'ah*, there is no doubt that its financing mode (the *Sokouk Al-Intifa'a*) would have been well-documented and researched to ensure consistency with Islamic law. However, questions may be raised as to whether the project altogether complies with the spirit of the *Shari'ah*. First, the high

[8] As specified in Chapter 7, the environmental issues considered by the SRI funds have included such details as: climate change, deforestation, ozone depleting substances, exclusion of oil and gas companies, harmful pesticides, unsustainable timber/timber products, the encouragement of large scale infrastructure projects to take into account their environmental impacts, air quality/emissions control, drinking water purification, energy conservation, environmental assessment, pollution analysis, geothermal energy, natural gas, recycling, site remediation, waste reduction/disposal, waste water treatment, and wind power.
[9] www.zamzamtower.com/en/about.htm
[10] www.zamzamtower.com/en/about.htm

levels of investment required to acquire a residential suite in this project would mean that the project is primarily targeted to wealthy Muslim investors. Its ethicality is in this respect questioned as the basis of the project seeks to highlight the dichotomy between the rich and the poor in an area located near the House of God. The concept of equality of mankind in the *Haram* (area surrounding the House of God) seems to be undermined. The question of ethics is also raised in the marketing of the project.[11] Second, the project undermines the spiritual atmosphere surrounding the House of God as it creates a high-rise high-tech building with shopping centres, brand restaurants and shops and even providing praying spaces inside the complex. The atmosphere it creates relates to high-networthism and high consumption rather than ethical consumerism. Third, and more importantly, in the name of 'development' the environmental damage caused by the project has not been considered.[12] The historicity of the city of Mecca has been altogether neglected in the implementation of this project.

To this end, it is deemed important that the assessment of any project considers its compliancy with the *Shari'ah* legal rulings as well as with the *Shari'ah* objectives which would incorporate examining the harmful impacts of the project on the environment. In this respect, it may be said that the Islamic negative screening criteria should include detrimental effects caused to the environment just as it would negatively screened out impermissible activities like tobacco, alcohol and harmful drugs.

The detailed policies of SRFIs in being proactive towards the environment, moreover, provide useful lessons for FIIPs. The SRFIs are for instance seen to be encouraging the recycling of mobile phones (e.g. Friends Provident), supporting the use of public transport for business trips (e.g. Triodos Bank), promoting ecological mortgages (e.g. Ecology Building Society), and initiating programmes for tree planting (e.g. Friends Provident).

[11] The advertisement of the project for example pictures men and women looking down at the *Kaaba* from their balconies while having coffee.
[12] For instance, the construction of the tower has necessitated the excavation of the surrounding mountains and caused disturbance to the environment.

FIIPs could also adopt some of the positive ethical issues endorsed by SRFIs. These comprise the following: supporting the fair trade movement, financing social enterprises, encouraging organic farming, promoting ethical consumerism, and endorsing financial and social inclusion.

### 8.2.3 Learning from the Engagement Practices of the SRI Funds

FIIPs could further learn from the more proactive engagement practices of SRI funds whereby they encourage companies to develop more responsible business standards. This can take the form of dialogue, negotiation or moral persuasion (UK Social Investment Forum, 2005: 14). Friends Provident, for instance, launched its *Responsible Engagement Overlay* (*reo*®) strategy in 2000, describing it as an effort made towards *"encouraging companies to be more responsive to society's expectations of them. However it does not involve taking a view of the acceptability of what a company does and instead is all about using our influence as shareholders to encourage progress."*[13] The issues for which the engagement approach is adopted are usually less controversial than under screening. Some examples are: climate change; environmental management; access to medicines in the developing world; inappropriate executive remuneration; labour standards; HIV/AIDS at the work place; bribery and corruption (UK Social Investment Forum, 2005: 14; www.friendsprovident.co.uk).

The above issues are certainly of an Islamic concern too. In line with the above definition of engagement, it is deemed appropriate that FIIPs also use the engagement approach to promote Islamic ethical values of shared concern with other institutions and companies. This approach could specifically be employed in the promotion of *riba* elimination which marks the prime distinction of the Islamic finance industry from the SRI industry and which is believed to be the root cause of economic injustice. The fact that interest has been banned by the world's major religions sets the basis to initiate dialogue with other organisations on this issue. If

[13] www.friendsprovident.co.uk

the engagement approach is successful, it will certainly help in expanding the number of *Shari'ah* compliant companies for investment purposes.[14]

The engagement process can also be taken at a different level in terms of collaboration with other organizations – NGOs, governmental bodies, international institutions, and other parties with an interest to promote CSR – to support ethical issues of public concern, like social justice, poverty elimination, eradication of child labour, establishment of better working conditions, or promotion of sustainable development. The example of the Co-operative Bank is here useful. Working in partnership with *Christian Aid* it campaigned for trade justice throughout year 2005. In 2006, it planned to work together with *Friends of the Earth* to campaign for the combat of climate change.[15] Morley Fund Management is also seen to belong to a number of collaborative engagement groups (e.g. Corporate Governance Forum, Institutional Investors Group on Burma, UN Environment Programme's Asset Management Working Group), thus partnering with others to discuss solutions on GSEE issues.[16]

The engagement approach is itself said to have positive effects on the parties involved. On the side of the financial institution, dialogue with its stakeholders can provide useful input into business strategy, help in developing its SEE policies and develop long term relationships with other organizations and sometimes with Government (Strandberg, 2005: 8). Benefits to the companies with whom engagement is held can be of the following kinds: (i) protection of company reputation and image; (ii) lower risk in legal action and consumer protests; (iii)

[14] It is noted that the engagement approach mostly provides an opportunity to dialogue with other companies when stocks are held in the company. One problem that may arise with this approach in the Islamic perspective relates to the restriction to hold stocks in companies dealing in Islamically prohibited activities. In this case, quantitative screening of the company is required to determine if the level of the prohibited activity is found to be at an 'acceptable' level of a company's operations. In such a case, holding of shares – while necessitating purification of the proceeds generated from this venture – will allow for engagement in the enterprise which might lead to a change in company's policy in line with Islamic teachings.
[15] www.co-operativebank.co.uk
[16] *Morley Sustainable Future Funds: SRI Engagement Process*, www.morleyfm.com/uk/

protection of employees and market position; and (iv) improved employee recruitment, retention and motivation.[17]

### 8.2.4 Establishment of Foundations for Carrying out Welfare Activities

Community involvement and philanthropic activities are classified as an important dimension of CSR. The undertaking of charitable activities can be particularly connoted with the concern of the institution for community welfare and the institution's efforts to *"do more than what is required"* (Clarkson, 1995). A high percentage of the respondents to the questionnaires for FIIPs conducted in this study especially associated CSR with involvement in community activities and corporate philanthropy. A high percentage of the respondents equally conceived the commitment towards CSR as a policy that brings benefit to the business.

Similar to reputable organisations like Ford and Toyota which have set up 'foundations' as part of their businesses' philanthropic activities, it is submitted that FIIPs should endeavour to follow such a strategy to benefit society. In this way the economic and financial responsibilities and the social objectives of the institutions are maintained under separate 'departments' with their functions clearly defined. This would project the institutions as profit making entities while still allowing them to fulfil their social responsibilities. The institutionalisation of foundations will assist in better management of funds which are deployed into activities like *sadaqa* (voluntary charity), *qard hassan* (charitable loans) and possibly *zakah* management. The involvement of the FIIPs in voluntary activities and the institutionalisation of the foundations will indicate a higher level of proactivity on the part of the FIIPs as they go beyond what is required of them. It is further believed that the setting up of separate entities to undertake social welfare activities will certainly help in building greater transparency in the business activities of the FIIPs.

It was noted that some of the FIIPs like the Islami Bank of Bangladesh and Norton Rose (UK) already operate their welfare services from the separate foundations they have set up. This practice has been equally adopted by some of the SRFIs such as

[17] *The Responsible Approach to Investment: Friends Use Their Influence Wisely.* www.friendsprovident.com

Friends Provident, Triodos Bank and Insight Investment. It is believed that further encouragement should be given to this practice.

### 8.2.5 Innovative Products and Ideas

SRFIs were seen to come up with several innovative ideas and products to serve their SEE purpose. The Co-operative Bank, for example, offers free community accounts – under the names of Community Directplus and Cooperatives Directplus – for groups that trade with a social purpose like charities, credit unions, voluntary organisations, parish councils, social enterprises, and cooperatives. In this way, it encourages community organisations to not only bank with an ethical bank but also to share its ethical values and sound business practices. The newly established Islamic Bank of Britain (UK) appears to have adopted this idea through its offer of free banking for *masjids* (mosques) and *madrasahs* (Islamic schools). *Masjids* and *madrasahs* represent places which attract the interest of the Muslim community. Their endorsement of the bank's services in turn lends credibility to Islamic banking and encourages its endorsement by the larger Muslim community.

The Co-operative Bank also introduced the concept of affinity debit and credit cards whereby the bank makes donations to a named charity or voluntary organisation following a certain level of spending made by customers on these cards. A number of charities have benefited from this scheme (e.g. Oxfam, Action Aid, Christian Aid, Amnesty International, Greenpeace, Help the Aged, the Medical Foundation, and Save the Children). Wilson (2002: 62) proposed that similar schemes may be run by Islamic banks to direct customers' *zakah* contributions to charities. FIIPs may also offer matching voluntary donations to represent their share of contribution to the charities. Other SRI funds like Friends Provident, Morley Fund and Jupiter Asset Management administer comparable programmes for their staff whereby they match the donations made to charities out of staff payrolls. The SRFIs also tend to support employee involvement in the community. The concept of time bank may for instance be used to encourage staff involvement in community projects.

### 8.2.6 Establishing an Explicit System for Managing CSR

The SRFIs were seen to not only define their CSR/SRI issues, but to also set up an explicit management system to put their beliefs into action. To this end, the following observations were made on the practices of the SRFIs:

- There was commitment of management to execute CSR as a deliberate policy decision;
- There seemed to be explicit processes, procedures, plans drawn to implement CSR/SRI policies. Monitoring and review processes were also seen to be in place;
- Resources were seen to be allocated to this task in the form of employment of CSR/SRI experts, analysts and managers. Some SRFIs had special CSR units for implementation of the work plans;
- Transparency in the form of reporting was observed. This helped in the assessment and review of processes; and
- Efforts towards measuring performance were undertaken. For instance, targets were set and indicators were developed to measure progress in the marketplace, workplace, the environment and the community.

On the other hand, the management system for CSR or *Shari'ah* compliance of FIIPs was not disclosed by the institutions. While this does not necessarily negate the existence of an implicit management system at the level of the FIIPs, it nonetheless points to a low degree of importance attributed to transparency and to the institutionalisation of an integral system for CSR practices at the level of the institutions. It is believed that FIIPs could learn from the explicit system of CSR management exercised by the SRFIs. Besides instilling transparency, explicit processes set clearly defined goals and help in better implementation, monitoring and achievement of the targets set.

## 8.2.7 Measurement of Performance

The measurement of corporate performance appeared to be efficiently assessed at two levels by some of the SRFIs: (i) with respect to the performance of the companies they select, evaluate, approve and monitor for investment purposes, and (ii) with regard to the delivery of value, social responsibility and ecological sustainability at the institution's own corporate level.

It was found that most of the SRI funds had a clear, transparent and consistent procedure for assessing companies considered for investment purposes by the institution. Insight Investment, for instance, detailed out its criteria for implementing its ethical policies which included a statement of its ethical criteria, an interpretation of each ethical statement, and quantitative guidelines which determine the acceptability or rejection of the company under consideration.[18] Morley Fund developed "sustainability ratings" which graded companies on a qualitative basis depending on their product sustainability and management quality; it also pursued quantitative financial and market analyses of companies for assessing their investment performance.[19] Jupiter Asset Management referred to the assessment of its investment portfolio through a twin-track system where financial approval is provided by its SRI fund managers and asset management investment team; while social/environmental approval is given by the environmental research unit and environmental advisory committee.[20]

Some of the SRI funds used the ethical screens developed by EIRIS to research on the SEE performance of companies. EIRIS has developed the *Ethical Portfolio Manager* software which enables *"investment managers* [to] *analyse companies according to a wide range of social, environmental and corporate governance factors, allowing experimentation with different benchmarks, so that the effects on an*

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[18] *Detailed Criteria for Implementing the Ethical Policies of Insight Investment's European Ethical and Evergreen Funds.* www.insightinvestment.com/Documents/responsibility/Detailed%20Criteria%20 Document_for%20Website_Revised%20July%202005.doc
[19] Morley Fund. *Socially Responsible Investment Process.* www.morleyfm.com/uk/morley/groups/internet/documents/salessupportmaterial/pdf_002337.pdf
[20] *A Guide to Jupiter's Socially Responsible Investment Funds.* www.jupiteronline.co.uk

*investment universe can be seen immediately."*[21] The availability of such a package to the SRFIs certainly offers consistency in their appraisal of companies' SEE performance. No such software is currently known to have been produced within the Islamic finance industry to assist in the determination of firms' degree of *Shari'ah* compliancy and their viability in case of selection in the investment portfolio. The development of an Islamic alternative to the *Ethical Portfolio Manager* would be deemed desirable.

To assess the Co-operative Bank's and the CIS Sustainable Leaders Trust's progress in line with the triple bottom lines of value, ethics and ecology, the CFS developed a detailed indicator list which examined the institutions' delivery of value, social responsibility and ecological sustainability. A listing of the indicators compiled by the CFS was provided in Table 7.8 (Chapter 7). This list is indicative of the effort put in by the institution to obtain an assessment of its financial and SEE performance. Such rigorous analysis was not observed to have been undertaken by the FIIPs examined. The evaluation of corporate financial and social performance of FIIPs in such details would be a commendable goal to be pursued. It would provide opportunities for the rating of FIIPs in terms of their CSP. At the moment, measurement of CSP has merely been a suggestion made by academicians, with no actual exercise being carried out so far.

### 8.2.8 Qualitative Screening Index to Rank FIIPs according to their Social Performance

Qualitative screening indices could be another means of assessing the CSP of FIIPs, thus enabling their ranking in terms of their social performance. This is an added experience that could be learnt from the SRI movement.

Within the Islamic finance industry, progress has been made in the development of quantitative measures that help to establish whether a company suits Islamic investments. The Dow Jones Islamic Market (DJIM) Index and the FTSE Global Islamic Index, introduced in 1996 and 1999 respectively, have laid out cut-off rules

[21] *EIRIS The First 20 Years: 1983-2003.*
www.eiris.org/files/public%20information%20type%20publicationseiris20thanniv.pdf

that determine *Shari'ah* permissibility based on the financial ratios of companies. In the first instance, under the DJIM Index approach, the suitability of the primary business of companies is established using negative and positive screening. At a second level, more in-depth quantitative screening is pursued based on the rulings set out by the DJIM *Shari'ah* board: (i) debt to market capitalisation ratio should not exceed 33%; (ii) non-operating interest income to revenue ratio should not be over 5%; and (iii) account receivables to total assets ratio should not be above 45% (Siddiqui, 2004). The FTSE Global Islamic Index uses almost similar cut-off rules.

These indices have also been designed to track the financial performance of publicly traded *Shari'ah* compliant companies. An index to track the social performance of companies whose activities are consistent with *Shari'ah* principles is yet to be introduced. Given that the well-being of the society is the prime objective of Islamic law, establishing principles that can gauge whether FIIPs are contributing to this objective is deemed essential. This call to measure the performance of FIIPs with reference to their social responsibilities, as noted before, has been made in academia (Hasan, 2004; Tag el-Din, 2005).

Within the SRI literature, it is noted that the Business in the Community (BITC) has established since 2002 a corporate responsibility index.[22] In 2004, the Co-operative Bank was ranked third in the index while CIS Sustainable Leaders Trust Fund and Friends Provident were ranked at the 22nd position. 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 practices of FIIPs. The need for the development of innovative Islamic indexes like Islamic Muslim country indexes and Islamic corporate governance indexes has been raised by Siddiqui (2004: 57).

[22] The BITC corporate responsibility index has been 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 practice throughout the organisation, in managing four key areas – Community, Environment, Marketplace and Workplace"* (Business in the Community, 2004).

## 8.2.9 Transparency and Corporate Social Reporting

It was noticed that the SRFIs were quite advanced in their corporate social reporting policy. The following reports were published by these institutions: sustainability reports, CSR reports, partnership reports, ethical consumerism reports, and environmental policy reports. These reports were produced on a voluntary basis by the SRFIs as part of their policy to be transparent to their various stakeholder groups. Such reports were not published by the FIIPs.

The SRFIs also had a well-developed marketing literature which disseminated information on company details, their ethical policies, investment criteria, company selection and monitoring process, financial products and services, financial performance, and project lists.

Often, the publication of regular newsletters – which could be subscribed through the websites and obtained through email alerts – was made available by the SRFIs. These were an additional source of information for customers, investors and other stakeholders to learn about the activities of the SRFIs. They also assist stakeholders in forming their judgement about the SEE performance of the financial institutions.

With regard to the FIIPs, the main reports published were their financial reports. In compliance with the reporting standards set by the AAOIFI (2004-05), Islamic banks indeed have to report on their financial position, and also include a statement from their *Shari'ah* supervisory board and a statement of sources and uses of funds for their *zakah*, charity and *qard* (charitable loan) funds. Besides compliance with standards, however, it is deemed important that FIIPs *"disclose relevant information based on the moral responsibility that they accept through their claim to follow Islamic principles"* (Maali *et. al.*, 2003: 25). The study conducted by Maali *et. al.* (2003) supports the observations made in this research that, with regard to social disclosure, the practices of the FIIPs are significantly underdeveloped.

Overall, it could be said that a high level of social disclosure and transparency were observed by the SRFIs. In the light of the social role expected of FIIPs and the support of the *Shari'ah* on such principles like transparency and accountability, the high standard of corporate social reporting by the SRFIs would represent a worthwhile lesson to be learnt by the Islamic finance industry.

### 8.2.10 Customer Participation

Another valuable lesson which can be gained from the experiences of the SRFIs is in respect of the involvement of customers in determining their policy decisions. A content analysis of the websites of the FIIPs examined showed that 80% of the FIIPs highlighted customers as one of their key stakeholder groups (Table 6.29, Chapter 6). Their welfare is a prized aim of the institutions. Nonetheless their participation in constructing the overall aims and objectives of the FIIPs, their endorsement of the products and services offered, and their involvement in developing the screening criteria of the institutions were mostly not recognised.

The Co-operative Bank and the CIS Sustainable Leaders Trust, on the other hand, adopt a high degree of consumer consultation in the management of their policy decisions. The Co-operative Bank seeks customers' views in the formulation and revision of its ethical policy. It runs a *"customer who care"* campaign to involve customers in the lobbying against SEE issues. The stress on customer participation is generally perceived as a useful way to increase customer solidarity and loyalty for the bank's services (Wilson, 2002: 54).

The Unity Trust Bank also emphasises the unique characteristics of its customers and their specific needs. Its banking services target trade unions, charities, the not-for-profit sector and credit unions. As such, it adopts the *"know your customer"* approach to define its customer needs and products.

Adopting a bottom-up approach – where concern for the customers and general community needs is taken as a drive in determining the projects to finance and in developing financial services and products – is believed to represent a positive way to eliminate financial and social exclusion problems and improve socio-economic development problems.

## 8.3 Conclusion: Instilling an Islamic Banking Culture

While several lessons can be learnt from the practices and experiences of the SRFIs, within the worldview of Islamic finance a greater goal could also be pursued – that of instilling an Islamic banking culture in the players of the Islamic financial industry.

The *Shari'ah*, which sets the aims, objectives, mission, vision and functions of FIIPs, indeed represents a wider CSR paradigm within which FIIPs should be able to operate. The *Shari'ah* imperative of CSR allows FIIPs to pursue such goals like self-interest, financial performance, and economic efficiency. It requires FIIPs to be consistent in 'form' with the laws of the land and the laws of the Islamic texts (Sadeq, 2005: 490-491). It also assigns the added dimension of compliance with the spirit of the Islamic law. To this end, the pursuit of self-interest should not be promoted at the detriment of the social interest; the goal of profit maximisation should not be encouraged at the expense of indulging in prohibited (*haram*) activities; the search for the most economic and efficient means of operation should not be achieved at the cost of affecting *huquq al-ibad* (rights of all concerned in the production process); and abidance with the laws of the land should not be subordinate to abidance with the laws of the *Shari'ah.*

Acting within the spirit of Islamic law further implies being ethical – with the concept of ethics encompassing not only secular values (e.g. screening against animal testing, armaments and military, tobacco, pornography) but also including Islamic values (e.g. interest elimination, prohibiting currency speculation, promoting wellbeing, favouring asset-based transactions). The concept of ethicality in Islam therefore covers a large area of concern, which is not limited to the legal restriction of *riba* elimination and prohibited activities like alcohol and speculation, but also includes broader GSEE issues.

Moreover, the Islamic financial system would require the application of ethics at the level of financial dealings as well as at the level of the organisational structure – e.g. through the promotion of professional ethics, accountability and good governance at management level; Islamic bankers and employees embracing an ethical, polite, honest and helpful attitude; establishment of an ethical code of conduct among staff, auditors and reviewers; provision of an efficient and reliable service; development of innovative products; and showing concern for the different stakeholder groups of the FIIPs. This has been referred to as development of an *"Islamic banking culture"* by the Institute of Islamic Banking and Insurance (1994: 3).

The concept of the *"Islamic banking culture"* further extends the idea of social responsibility to specifically account for the well-being of man, the community and the larger society. On the one hand, it may be argued that the Islamic financial system intrinsically fosters equity and social welfare functions (e.g. with *riba* elimination, the financing of permissible activities, the focus on asset-backed financing). On the other hand, the objectives of social justice, distribution of wealth, caring for the poor and the needy may be pursued through community involvements and corporate philanthropy. It is noted that Islam has not only stipulated a minimum compulsory amount of *zakah* spending but also encourages extra spending beyond the *fard* level without specifying a maximum. Any extra effort made in spending will surely depend on one's level of piety, Islamicity, or simply generosity (Sadeq, 2005: 492).

Fulfilment of all the above responsibilities will instil within the FIIPs (or for that matter, any Islamic business) a culture of *"doing more than what is expected"*. This will represent a quest towards living up to the spirit of Islam – the *maqasid al Shari'ah* which seeks to achieve general human well-being.

However, it may be asked whether this sets out a too big goal for FIIPs? Sadeq (2005: 487) argues that it would involve injustice (*zulm*) if FIIPs, as private businesses, are asked to live up to welfare type objectives, established for specialised public and charitable organisations. Especially with regard to philanthropy, he states *"spending for social welfare, no matter how much is the amount, proves compliance of social responsibilities"* (Sadeq, 2005: 488). And further commenting on the disclosure of CSR by FIIPs, Sadeq (2005: 489) deplores the fact that FIIPs are being asked to not only *"do it, but they must also prove it by disclosing relevant information that they have done it. Otherwise, they loose* [the] *right to exist..."*

Certainly philanthropy is one part of CSR and no imposition as regards the amount of spending can be made on the part of FIIPs. However, it can be asserted that CSR is also about building a culture where FIIPs voluntarily participate in activities which engages with the society, where FIIPs can show that they care for the environment and the society in which they exist. CSR is furthermore about adopting a proactive attitude, where the objective is to do more than avoiding prohibitive activities. It encourages the meeting of ethical principles beyond the legal framework, and hence promotes the involvement in positive actions which aim higher than the minimum level. It is further about applying the teachings and ethical values of Islam at an integral level within the firm, not just as a peripheral act by merely seeking legal compliance with Islamic teachings. Such are the high expectations attributed to the objectives of FIIPs. As these institutions seek to fulfil the legal, ethical, religious, financial and social roles expected of them, they are also asked to disclose their activities in accordance with the principles of transparency and accountability. Voluntary disclosure of information certainly adds to building a positive image of trust, responsibility and proactivity.

To this end, it may be asked whether the above would require a rethinking of the structure of FIIPs altogether – to attach greater emphasis on social mission, to favour an active involvement with the local communities and the adoption of a more bottom-up approach to promoting well-being.

# CHAPTER 9

# Conclusions and Recommendations

## 9.0 Summary of the Research Findings

In general, the purpose of this study was to appraise the CSP of two groups of financial institutions which subscribed to two respective ethical paradigms: Islamic finance and socially responsible finance. A sample of 46 FIIPs located in different countries, which responded to a self-completion questionnaire, was used to examine the attitudes held by Islamic financial practitioners on the social responsibility of Islamic finance and the CSR practices of their FIIPs. These were evaluated against the Islamic worldview drawn from the *Shari'ah* and reflected in the Islamic economics literature which promotes the social aspiration of the discipline by emphasising socio-economic goals such as social justice, equity, poverty alleviation and human well-being. The websites of the FIIPs were also inspected as a way to gain further insight on the social commitments of the FIIPs and their CSR activities.

With regard to the SRFIs, a sample of 12 self-designated British financial institutions – known for their SEE leadership – was selected to examine their responses and initiatives towards CSR. The aim was also to benefit from the best practices of the SRFIs and draw useful lessons for the Islamic finance industry. The research methodology used in the examination of the SRFIs was based on a textual analysis of the information disseminated on the institutions' websites.

A number of inferences have been drawn from the analyses conducted on the practices of the FIIPs and the British SRFIs, which were delineated in Chapters 6 and 7 respectively. A summary of the main findings is presented in Table 9.1.

Table 9.1 Summary of Main Findings

| | FIIPs | SRFIs |
|---|---|---|
| **Theoretical Understanding of CSR** | The understanding of CSR by the Islamic financial practitioners was primarily related to the Islamic social obligations of FIIPs – to take care of societal needs through philanthropic activities like donations, charity (*zakah*), and community oriented activities. This understanding was also reflected through the information disseminated on the websites of the FIIPs when they communicated their social activities.<br><br>The requirement to eliminate *riba* and *gharar* in Islamic financial transactions was further considered part of the responsibility of FIIPs – mainly in line with their role to bring about a socially just financial system.<br><br>The understanding of CSR by FIIPs seemed restricted to the responsibility of *Shari'ah* compliance and philanthropy. | The understanding of CSR was perceived as an embedded activity of the business, integrating the four dimensions of responsible business practices, consumer responsibility, sustainable business enterprises and corporate involvement with the community.<br><br>CSR was also looked at in terms of its impact on the work place, market place, consumers and the environment.<br><br>Although the philanthropic aspects were included within the understanding of CSR, the focus of CSR was more on integrating GSEE issues within the business activity. |
| **Recognition of CSR by the institutions** | CSR was mostly implicitly recognised by the FIIPs. As stated above, the ethical concept underlying the notion of CSR was more associated with the Islamic legal requirement of *Shari'ah* compliance, with the ethical values being guided by the Islamic religious philosophy rather than being socially determined.<br><br>In this way, CSR was linked with the Islamic financial policies of *riba* elimination, prohibition of *gharar* and speculation and permissibility of trade instruments and *halal* investments.<br><br>The mainstream concept of CSR, as presented in the Western literature, was not recognised by most of the FIIPs. | CSR was explicitly recognised as an important aspect of the business policies of the SRFIs. The notion of social responsibility was sourced in secular ethics, being driven by GSEE concerns rather than having religious issues at its core.<br><br>The CSR issues under consideration by the SRFIs were more extensive and diverse than the FIIPs. Of interest were environmental issues, fair trade, ethical consumerism which were not considered by the FIIPs. |

| | FIIPs | SRFIs |
|---|---|---|
| **CSR as an instrument to create value for the institution** | Islamic financial practitioners perceived CSR as a value creating instrument for the organisation. In this respect, the majority of the financial practitioners (i) ascribed social responsibilities to FIIPs, (ii) disagreed that socio-economic and financial responsibilities should be primarily assigned to social organisations, (iii) stated that FIIPs should pursue similar SEE objectives like those advanced by SRI funds, (iv) thought that the ethical policies of FIIPs should be clearly spelt out, and (v) ranked financial gains and social objectives as equally important.<br><br>In spite of the socially responsible views held by the Islamic financial practitioners, the analysis of the websites of the FIIPs did not reveal much attention being given to CSR. The majority of the FIIPs (i) did not proclaim their ethical goals and mission, (ii) did not reveal their criteria of investment selection, and (iii) placed higher emphasis on financial performance than on social objectives. | The majority of the SRFIs recognised CSR as a value creating instrument for their institutions. Some viewed it as a competitive strategy to be taken advantage of (e.g. the Co-operative Bank). Others considered it a powerful tool to protect businesses against the risk of damage to their reputation and image that can directly affect their financial performance (e.g. Standard Life Investments).<br><br>As such SRFIs were seen to apply high ethical standards at the level of their businesses as well as demand similar ethical and sustainable practices from the companies they invest in. |
| **The screening approaches** | In line with Islamic teachings, FIIPs engaged in both negative and positive screening. The screening criteria of the FIIPs were however observed to be biased towards the use of negative screening rather than proactively seeking positive screening and engagement with companies for improvement of their policies.<br><br>One key point noted was that environmental screening appeared to be least endorsed by the FIIPs. | The SRFIs were seen to pursue a number of investment styles (e.g. negative and positive screening, best of class investment, shareholder advocacy, community investment, and investment in industries of the future) as well as endorsed a broader set of values (e.g. human rights, animal welfare, environment, fair trade, organic farming, community involvement, financial inclusion and support to social enterprises). Interest elimination was not one of their concerns. |

| | FIIPs | SRFIs |
|---|---|---|
| **The welfare activities of the institutions** | In the light of the earlier understanding of CSR, the welfare activities carried out by FIIPs were noted to be primarily linked to donations and corporate philanthropy. A percentage of 0-2% was generally allocated to welfare activities by the FIIPs. | A similar percentage of 0-2% was spent on corporate philanthropy by the SRFIs. Donations related activities were however not situated among the first rankings of the SRFIs.<br><br>The welfare activities that the SRFIs participated in instead had a more proactive tendency, involving engagement dialogue with other organisations on SEE issues, campaigning for SEE causes, and taking initiatives towards environmental protection and management. |
| **Management of CSR/SRI policies** | The FIIPs did not explicitly reveal how they manage and implement their CSR/SRI policies. The following were however observed:<br>- *Shari'ah* compliance was emphasised by the majority of the FIIPs;<br>- Setting up of *Shari'ah* supervisory boards to ensure *Shari'ah* compliance. According to the AAOIFI, the *Shari'ah* supervisory board has to publish an annual report to confirm *Shari'ah* compliance of the institution's transactions;<br>- Emphasis on competent staff to indicate quality and reliable service.<br><br>Absence of the following was noted:<br>- Reference to abidance by AAOIFI standards;<br>- Stakeholder consultation when developing SRI process;<br>- Transparency in reporting. | An explicit CSR/SRI compliance system was in place in the case of SRFIs. The following were noted to prevail:<br>- CSR embedded in mission and vision statements;<br>- Clear CSR & corporate governance policies;<br>- CSR staffing & setting up of CSR units;<br>- Establishment of external and internal committee boards to ensure SRI compliance;<br>- Abidance by legal rules governing the industry & by global ethical standards;<br>- Development of guidelines as to how to implement CSR/SRI policies;<br>- Incorporate stakeholder consultation when setting SRI research process;<br>- Transparency in reporting. |

| | FIIPs | SRFIs |
|---|---|---|
| **Corporate Social Reporting** | The FIIPs did not embrace a corporate social reporting culture through which their ethical policies, implementation of their SRI policies, impact on their stakeholders, and their community and social activities are disseminated to the public.<br><br>The main report publicised by the FIIPs was the annual financial report. | The majority of the SRFIs were transparent about their ethical policies, their rating and selection of companies for investments, the kind of enterprises they would lend to, their engagement process with other organisations, and their voting policies. CSR and sustainability reports were annual features of most of the SRFIs. |
| **Corporate Social Responsiveness** | A large percentage of the FIIPs were classified as being 'accommodative' to CSR, with the majority pursuing the legal, economic and *Shari'ah* responsibilities. Alternatively, they could be classified in the category of 'apathy' (Table 5.4, Chapter 5) or 'reacting' (Table 5.3, Chapter 5) which indicate the 'compliance focused' nature of the FIIPs and their limited involvement in CSR.<br><br>The findings further indicated that the majority of the FIIPs were concerned with the goal of profit maximisation and for their transactions to meet *Shari'ah* compliance.<br><br>A few of the FIIPs were considered proactive in their CSR approach, involving in philanthropy and community activities. Examples were Islami Bank Bangladesh, Norton Rose and Muslim Community Cooperative Australia. | All the institutions included in this study were observed to have 'accepted' their CSR responsibilities (Clarkson, 1995) and were *"progressive and adaptive to society's expectations"* of them (McAdam, 1973), thus suggesting that they were 'accommodative' to CSR issues.<br><br>A number of the SRFIs (about 9) were equally perceived as *"doing more than what is required"* (proactive) based on their involvement in philanthropic activities and participation in community investment projects. |
| **Overall Corporate Social Performance** | It was observed that CSR was implicitly recognised in the objectives of the FIIPs. *Shari'ah* compliancy was instead regarded to be a key priority of the FIIPs. Goals like poverty alleviation and human well-being were not necessarily explicitly pursued by the FIIPs. CSR therefore appeared to be a peripheral activity of the FIIPs, practised largely in the form of voluntary charitable and philanthropic activities. Economic and financial performance was deemed more important in the practices of the FIIPs. | It was observed that CSR was promoted as an integral part of the business activities of the SRFIs. There was explicit recognition of GSEE issues as well as the financial and economic objectives by the SRFIs. Some of the SRFIs even developed social performance indicators to assess actual CSP against their planned targets. |

## 9.1 Implications of the Study

This study demonstrated how GSEE issues have been embedded in the business practices of SRFIs and promoted as an explicit CSR agenda – such that, without necessarily any Godly enforcing power such as the *Shari'ah*, these institutions aim to enhance capacity building, help humanity and protect the environment. The early promoters of Islamic economics, banking and finance promoted the unique 'Islamic' characteristics of FIIPs which make them accountable to fulfil an ethical and social role. The study, however, shed light on the under performance of the majority of the sampled FIIPs with respect to their social commitment. Most of the FIIPs appeared to pay greater attention to their economic and financial performance and *Shari'ah* adherence. If the social role was pursued, it was undertaken by most of the FIIPs in the form of piecemeal charitable activities, without a clear, explicit management strategy to engage in CSR activities.

The above analysis brings to the fore the question of whether the role played by FIIPs should be revisited and re-orientated so that they are better equipped to fulfil the socio-economic development needs of the Muslim community. This question certainly involves a number of implications on the part of the management of FIIPs and policy makers. Some of the implications are explored below.

(i) **Rethinking on the institutional structure of FIIPs.** If social goals are to be attributable to FIIPs, the organisational design of FIIPs – including management's vision and mission, uses of funds, financing methods, training of staff, managerial system, governance structure, reporting procedures, products and services – should accordingly be redirected along appropriate lines to facilitate efficient performance. Among others, Hasan (2004, 2005a, 2005b) supported the idea that Islamic banks should be *"structurally enabled to fulfil their societal obligations"*. It is submitted that CSR must first be acknowledged and treated by management as a business strategy and opportunity to be pursued by the FIIPs. Unless an explicit conscious decision of management to build up the business on sustainable Islamic, ethical, social and environmental values (like in the case of the SRFIs) is adopted, it is believed that a viable approach to implementing the CSR role expected of FIIPs would not ensue.

*(ii)* **Role of stakeholders in institutionalising a CSR culture.** Once management, owners and shareholders recognise the need to embed CSR as a business culture, there is need to establish formal systems to define and manage the CSR programme and live up to the CSR expectations attributed to FIIPs by society. Besides an appropriate organisational structure, involvement of the FIIPs in stakeholder dialogue is deemed important in making FIIPs part of the social fabric of the community they serve. For instance, customers' input is crucial in the development of products and services that meet their needs. Owners and shareholders also have a constructive role to play by voting for the endorsement of a CSR agenda. After all, the good that the FIIPs do for society will inevitably reap long term benefits to the shareholders. The CSR management system put in place should also entail appropriate disclosure, monitoring and review of the CSR policies. This will ensure transparency to stakeholders and enable assessment of the social performance of the FIIPs.

(iii) **Role of the *Shari'ah* board in instilling transparency and governance.** Institutionalising CSR is moreover about ensuring transparency in reporting and instilling good governance. While management certainly has a key role to play in these aspects, the role of the *Shari'ah* supervisory board in this respect is also regarded as important. It is submitted that the relationship of the *Shari'ah* supervisory board with the FIIPs should be seen to entail more than overseeing the adherence of the operations and code of conduct of the FIIPs to the rules of the *Shari'ah*. It should be seen as the institutional arrangement for enforcing appropriate corporate governance at the level of the FIIPs so that the rights of stakeholders are protected. In this role, it shall seek to instil transparency in the form of not only financial reporting but also voluntary CSR reporting. In this way, the ethicality and social responsibility instilled in Islamic finance will be highlighted to the public. This could serve as a competitive tool for attracting customers who wish to bank according to their conscience to subscribe to Islamic banking and finance.

(iv) **AAOIFI to consider CSR standards and indicators.** It is recalled that the AAOIFI has set some standards to promote corporate governance at the level of FIIPs. With respect to the social obligations of FIIPs, the AAOIFI standards only require the disclosure of the sources and uses of funds relating to *zakah*, *qard* and voluntary charity. These pertain only to the philanthropic aspect of CSR. It is deemed useful that the AAOIFI also considers the development of guidelines with respect to the disclosure of CSR standards – like the upholding of responsible business practices, sustainable enterprise, responsibility towards stakeholders, screening criteria, monitoring and review of the ethical and *Shari'ah* process – which would certainly enhance the credibility of FIIPs as socially responsible institutions. The development of CSR indicators to measure the social performance of FIIPs could also be envisaged (like those developed by the Co-operative Bank in the UK).

(v) **Development of practitioners with Islamic ethical values embedded in their actions and hence in the operations of the FIIPs.** It should be noted that the actions of FIIPs are inevitably shaped by the economic and moral behaviour of their managers and practitioners who act on behalf of the business. It is thus imperative that the understanding of CSR which is guided by the *maqasid al-Shari'ah* is firmly instilled within the practitioners through appropriate training and educational programmes so that the practice of Islamic finance ultimately moves from mere compliance with the letter of *Shari'ah* to acting within the spirit of *Shari'ah*.

## 9.2 Proposal for Future Research

The discussions on CSR and CSP represent a new field of study within the Islamic finance literature. It thus offers ample scope for future research. Moreover, it should be stated that this study is not without limitations. The sample size of 46 FIIPs or 55 responses to the questionnaire, for instance, may be perceived as limiting the generalisation of the results, although efforts were made to confirm the worldview endorsed by FIIPs in general by examining the websites of a further set of 24 FIIPs. While this can be justified for this study which is mainly a discourse and content analysis, future research may consider a larger sample of FIIPs to confirm the link between the attitudes of practitioners towards CSR and the practices of their institutions.

This research was primarily based on information drawn from a self-completion questionnaire and disseminated on the websites and annual reports of the FIIPs. CSR practices may however be equally publicised through other forms of media like company booklets and press releases. These could further be examined as a source of information to evaluate the social performance of FIIPs. It should be mentioned that a modest content analysis was undertaken by this study as part of an unobtrusive method of analysing publishing materials.

Future research could also include the following aspects when evaluating the corporate social performance of FIIPs: carry out a background study on the operating environment of the FIIPs; look into the individual characteristics of the institutions; appraise the market requirements facing the FIIPs; examine the financial products of the FIIPs to evaluate whether they meet the needs of the community they serve; and examine the distribution of investment projects of FIIPs according to the economic sectors.

Future research may also contribute to the CSR discussion by distinguishing between the CSR practices of Islamic banks and NBFIs which may face different legal disclosure requirements. It should be noted that this study generalised its observations for FIIPs from the banking and asset management, and to a lesser extent the insurance, sectors.

Overall, it is believed that this study made an important contribution to knowledge in the field of Islamic finance by, firstly, comparing the worldview endorsed by Islamic financial practitioners with the social performance of the FIIPs from across a wide number of countries and, secondly, seeking to learn from the best practices of another group of financial institutions, the SRFIs operating in the UK. It also contributes significantly to the debate of CSR and CSP which has so far received little attention in the Islamic literature. The implications of the study certainly indicate that there is much scope for future research in this new area of CSR and CSP.

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# APPENDIX A

## Sample of Questionnaire forwarded to Financial Institutions offering Islamic Products

A SURVEY ON THE "SOCIAL RESPONSIBILITY" OF ISLAMIC FINANCE

*by Salma Sairally*
*PhD Candidate, Loughborough University, UK*
**(Student ID: A283866)**

This questionnaire is part of my PhD research entitled *A Study on the Corporate Social Responsibility of Islamic Financial Institutions: Learning from the Experiences of Socially Responsible Financial Institutions in the UK.* One of its aims is to examine the concept of corporate social responsibility from the theoretical teachings of Islamic economics and compare its application in the Islamic banking and finance industry.

To this end, I am seeking your assistance to complete a research questionnaire. Its purpose is to obtain your views on certain aspects of Islamic financial discourses and practices.

I should be grateful if you would kindly take a few minutes to complete the questionnaire that follows. Your response is essential for the successful completion of this study. Please note that all responses will be used for academic study only and will remain strictly confidential.

I thank you for your time and valued co-operation.

Yours sincerely,

Salma Sairally (Ms.)
PhD Candidate
Loughborough University

Address: Markfield Institute of Higher Education, Ratby Lane, Markfield, Leicestershire, LE67 9SY, UK. Tel: +(44) (0) 7745 620311 Fax: +(44) (0) 1530 249656 Email: B.S.Sairally@lboro.ac.uk

## QUESTIONNAIRE

**Please tick (√) the appropriate box.**

### A. Personal Profile

1. Age
   ☐ 18-25 years ☐ 26-35 years ☐ 36-45 years ☐ 46-55 years ☐ Above 55 years

2. Gender ☐ Male ☐ Female

3. Educational Qualifications
   ☐ GCSE/'O' Level ☐ 'A' Level/Equivalent ☐ Diploma
   ☐ Graduate ☐ Masters ☐ PhD/Post Doctoral
   ☐ Other Professional Qualification (Please specify) ..................

4. Profession (Please specify) ................................

5. Do you work for a Bank or a Non-Bank Financial Institution?
   ☐ Yes ☐ No

6. If yes to the above, can you please state if the institution provides Islamic financial services?
   ☐ Yes, the institution is an Islamic financial institution
   ☐ No, the institution is not an Islamic financial institution
   ☐ Yes, the institution is partly Islamic, providing Islamic financial products

### B. Questions on Islamic Finance

1. Islamic finance is equal to ...................
   ☐ Only the prohibition of *riba*
   ☐ Trade without interest
   ☐ A socially acceptable, just financial system
   ☐ A human oriented, environmentally friendly financial system
   ☐ All the above

2. "Islamic finance is a third way between capitalism and socialism."
   Strongly Agree ☐ Agree ☐ Neutral ☐ Disagree ☐ Strongly Disagree ☐

3. If agreeable to question 2, it is because Islamic finance ..................
   ☐ prohibits *riba* and encourages trade
   ☐ is based on equity finance
   ☐ is against speculation but is production oriented
   ☐ represents a more efficient financial system
   ☐ is an integrated system of financial affairs which includes the civil society, the state and the private sector

   *(Please rank your answers between 1 and 5; 1 is most important and 5 is least important)*

4. "The Islamic financial set-up imposes upon the Islamic financial institutions an extra parameter – namely a socio-economic purpose – in addition to the responsibilities assigned to them by the conventional financial laws."

   Strongly Agree ☐ Agree ☐ Neutral ☐ Disagree ☐ Strongly Disagree ☐

5. Increasingly, investment funds in the West propagate a social, environmental and ethical agenda. Their investment objectives often seek to build sustainable communities. Islamic financial institutions should adopt the objectives of these funds in their quest for sustainable development.

   Strongly Agree ☐ Agree ☐ Neutral ☐ Disagree ☐ Strongly Disagree ☐

6. The investment funds mentioned above are often called "socially responsible funds". What key words would you use to describe the term "socially responsible"?

   ..........................................................................................

7. Socially responsible funds in the West do not hesitate to spell out their "ethical" policies in their mission statements. It is argued that Islamic banks could usefully emulate this approach.

   Strongly Agree ☐ Agree ☐ Neutral ☐ Disagree ☐ Strongly Disagree ☐

8. How should financial gain be ranked in comparison to the social objectives of financial institutions?
   - ☐ Less important
   - ☐ Equally important
   - ☐ More important
   - ☐ Not important
   - ☐ Not concerned

9. "Acting in a socially responsible manner can create value for financial institutions."

   Strongly Agree ☐ Agree ☐ Neutral ☐ Disagree ☐ Strongly Disagree ☐

## C. Questions on Islamic Financial Institutions

1. Would you say Islamic financial institutions are contributing in a significant way towards socio-economic welfare?
   Strongly Agree ☐ Agree ☐ Neutral ☐ Disagree ☐ Strongly Disagree ☐

2. Should "social organizations" rather than "financial institutions" be responsible for undertaking morally motivated economic and financial activities?
   Strongly Agree ☐ Agree ☐ Neutral ☐ Disagree ☐ Strongly Disagree ☐

3. Would you say your organization is "socially responsible"?
   Strongly Agree ☐ Agree ☐ Neutral ☐ Disagree ☐ Strongly Disagree ☐

4. Does your financial institution publicize its criteria of selection for its investments?
   Yes ☐ No ☐ Where? ....................................

5. What are these criteria?
   - ☐ Not investing in *riba*
   - ☐ Not investing in impermissible activities like gambling, alcohol, pork, pornography, etc.
   - ☐ Not investing in forward currency transactions
   - ☐ Not investing in environmentally pollutive economic activities
   - ☐ Not investing in the arms industry
   - ☐ Investing in companies that contribute positively to society
   - ☐ Investing in environmentally friendly activities
   - ☐ Investing in profit and loss sharing arrangements
   - ☐ Investing in trade related transactions
   - ☐ Others (Please specify) ....................................................

6. What percentage of your organisation's annual profits would you say is spent on community enhancing activities, if there is any?
   0 – 2% ☐ 2 – 5% ☐ 5 – 7% ☐ 7 – 10% ☐

7. Is your organisation involved in the financing of any of the following activities? What percentage of your profits is attributed to these activities, where it is applicable?

| Types of Involvement | Yes | No | % of Profit Allocated |
|---|---|---|---|
| Donations to community causes | | | |
| Donations to charities | | | |
| Provision of benevolent loans (*qard al-hassanah*) | | | |
| Sponsorship of community events | | | |
| Working with local schools, colleges, universities | | | |
| Working with NGOs for sustainable development | | | |
| Scholarship to students | | | |
| Supporting employee involvement with community causes | | | |
| Lobbying for a particular social, ethical or environmental cause | | | |
| Investing or encouraging investment in deprived areas | | | |
| Investment in Research & Development | | | |
| Commitment to sustainable development | | | |
| *Zakah* collection and distribution | | | |
| Establishing fair recruitment practices, including engaging people traditionally excluded from the labour market e.g. disabled, homeless, ethnically discriminated | | | |
| Staff welfare (loans, health schemes, etc.) | | | |
| Taking initiatives to protect the environment (e.g. recycling) or enhance environmental management | | | |
| Promoting ethical values among staff (e.g. against- bribery, corruption, conflict; pro- honesty, trust, brotherhood, justice) | | | |
| Abstaining from false advertising | | | |
| Sharing best practice on social, ethical and environmental responsibility with other organisations | | | |

# APPENDIX B

## Sample of Questionnaire forwarded to Socially Responsible Financial Institutions

A SURVEY ON THE "SOCIAL RESPONSIBILITY" OF SOCIALLY RESPONSIBLE FINANCIAL INSTITUTIONS

*by Salma Sairally*
*PhD Candidate, Loughborough University, UK*
(Student ID: A283866)

This questionnaire is part of my PhD research which seeks to examine the recent movement of ethical financing in the West to compare its socially-oriented theoretical teachings with the practice of the industry.

To this end, I am seeking your assistance to complete a research questionnaire. Its purpose is to obtain your views on certain concepts like Corporate Social Responsibility (CSR) and Socially Responsible Investing (SRI) and learn about the CSR and/or SRI policies of your institution.

I should be grateful if you would kindly take a few minutes to complete the questionnaire that follows. Your response is essential for the successful completion of this study. Please note that all responses will be used for academic study only and will remain strictly confidential.

I thank you for your time and valued co-operation.

Yours sincerely,

Salma Sairally (Ms.)
PhD Candidate
Loughborough University

Address: Markfield Institute of Higher Education, Ratby Lane, Markfield, Leicestershire, LE67 9SY, UK. Tel: +(44) (0) 7745 620311 Fax: +(44) (0) 1530 249656 Email: B.S.Sairally@lboro.ac.uk

## QUESTIONNAIRE

**Please tick (√) the appropriate box.**

### A. Personal Profile

1. Age
   ☐ 18-25 years ☐ 26-35 years ☐ 36-45 years ☐ 46-55 years ☐ Above 55 years

2. Gender: ☐ Male ☐ Female

3. Educational Qualifications
   ☐ GCSE/'O' Level ☐ 'A' Level/Equivalent ☐ Diploma
   ☐ Graduate ☐ Masters ☐ PhD/Post Doctoral
   ☐ Other Professional Qualification (Please specify) ....................

4. Profession (Please specify) .................................

5. Name of your institution (Optional) ...........................

6. Please state whether your institution falls in any of the following categories.
   ☐ Bank ☐ Social Finance Organisation
   ☐ Building Society ☐ Financial Advisory Firm
   ☐ Investment Management Institution ☐ Other (Please specify) .............

7. Does your organisation specifically classify itself as a provider of "ethical" or "socially responsible" financial services?
   Strongly Agree☐ Agree☐ Neutral ☐ Disagree ☐ Strongly Disagree ☐

### B. General Questions on CSR and SRI

1. "Corporate Social Responsibility (CSR) is becoming an important issue in finance. It has given rise to the Socially Responsible Investment (SRI) movement which is expanding worldwide." Are you aware of the concepts: CSR and SRI?
   Very Aware☐ Aware☐ Not concerned ☐ Not Aware ☐ Not Aware at all ☐

2. Do you think CSR and SRI are relevant to the domain of finance?
   Strongly Agree☐ Agree☐ Neutral ☐ Disagree ☐ Strongly Disagree ☐

3. Do you think CSR and SRI are important issues that financial institutions in general should take into account in their financial policies?
   Strongly Agree☐ Agree☐ Neutral ☐ Disagree ☐ Strongly Disagree ☐

4. Do you believe that social organisations and government should take care of social welfare issues instead of financial institutions?
   Strongly Agree☐ Agree☐ Neutral ☐ Disagree ☐ Strongly Disagree ☐

5. How do you think financial gain should be ranked in comparison to ethical and social responsibilities of financial institutions in general?
   More important ☐ Equally important ☐ Not concerned ☐ Less important ☐ Not important ☐

6. Would you agree with the following general statements regarding CSR?
*(Please tick the appropriate square)*

| | Strongly Agree | Agree | Neutral | Disagree | Strongly Disagree |
|---|---|---|---|---|---|
| CSR is a powerful tool for the fulfilment of non-profit social goals | | | | | |
| CSR is an important business tool which protects financial institutions from social and ethical scandals | | | | | |
| CSR policies enable financial institutions to provide unique financial products and services | | | | | |
| CSR can create value for financial institutions by helping them compete in the market | | | | | |
| CSR enable financial institutions to reap both financial benefits and take care of the needs of society | | | | | |
| CSR is an important PR (public relations) tool | | | | | |
| CSR can only take root when it is rewarded by the financial markets | | | | | |

7. Would you agree with the following general statements regarding SRI?
*(Please tick the appropriate square)*

| SRI is about ......... | Strongly Agree | Agree | Neutral | Disagree | Strongly Disagree |
|---|---|---|---|---|---|
| Negative and positive screening of investments to account for social, ethical and environmental values | | | | | |
| Shareholders advocating social and ethical principles in companies they invest in | | | | | |
| Contributing to establish a just and socially acceptable financial system | | | | | |
| Contributing to change the method and structure of providing finance so that it reflects ethical and social values and at the same time have a socially just outcome | | | | | |
| Making finance available to the socially disadvantaged members of the society | | | | | |

8. The SRI movement has been specifically questioned for being an *oxymoron*, whereby the genuineness in the ethical behaviour of those providing socially responsible finance as well as the impact of the SRI practice on society are put to question. Would you agree with this criticism?

Strongly Agree☐ Agree☐ Neutral ☐ Disagree☐ Strongly Disagree ☐

## C. Questions on Your Institution and CSR/SRI policies

1. Are CSR and SRI important issues for your financial institution?
   Strongly Agree☐ Agree☐ Neutral ☐ Disagree☐ Strongly Disagree☐

2. Would you say your institution is "socially responsible"?
   Strongly Agree☐ Agree☐ Neutral ☐ Disagree☐ Strongly Disagree☐

3. Would you say your institution's CSR and/or SRI practices contribute positively to society's welfare?
   Strongly Agree☐ Agree☐ Neutral ☐ Disagree☐ Strongly Disagree☐

4. What is the basis, if any, for your institution's CSR and/or SRI policies?
   ☐ Humanistic ethical values
   ☐ Concerns for local communities
   ☐ Meeting investors' preferences
   ☐ Abidance by the law
   ☐ Compliance with the norm
   ☐ Establishment of a just financial system
   ☐ Religion (Please specify) ..........................
   ☐ Other reasons (Please specify) ....................

5. Please suggest some key words you would use to describe the meaning of **CSR** in your institution?

   .....................................................................................

6. Please suggest some key words you would use to describe the meaning of **SRI** in your institution?

   .....................................................................................

7. The literature on CSR usually attributes the following responsibilities that society generally expects of institutions. Does your institution associate itself with any of these corporate responsibilities? *(Please tick the appropriate square)*

| | Strongly Agree | Agree | Neutral | Disagree | Strongly Disagree |
|---|---|---|---|---|---|
| Be foremost profitable, efficient and viable | | | | | |
| Be observing to laws and regulations of the land | | | | | |
| Be concerned with ethically motivated activities | | | | | |
| Be involved in corporate philanthropy | | | | | |

8. How does your institution ensure compliance to its CSR and/or SRI policies?
   ☐ We comply by an internally published code of ethics
   ☐ We abide by some legal rules which govern the industry
   ☐ We have set up an ethical policy unit which ascertains compliance
   ☐ We have trained staff whose role is particularly to ensure compliance
   ☐ We abide by some global ethical standards (Please specify) ....................
   ☐ Through other means (Please specify) ..........................................

9. How does your institution manage its socially responsible investments?
- ☐ By adopting a capital protection policy through risk avoidance
- ☐ By adopting a policy of cost efficiency
- ☐ Other (Please specify) ................................

10. What measurable standard has your institution set in place in order to assess or monitor the social impact of its CSR and/or SRI policies?

..........................................................................................................

11. Does your institution publicize its screening criteria of selection for its investments?
☐ Yes (Please specify where?) ...................... ☐ No ☐ Don't know

12. Does your institution publicize the methodology for selecting companies included in its investment portfolio?
☐ Yes (Please specify where?) ...................... ☐ No ☐ Don't know

13. Does your institution disclose any corporate social reports to particular interest groups or to the public?
☐ Yes (Please specify where?) ...................... ☐ No ☐ Don't know

14. Looking at these negative and positive criteria for screening investments, which of the following does your institution subscribe to?
- ☐ Not investing in environmentally polluting economic activities
- ☐ Not investing in the arms industry
- ☐ Not investing in oppressive regimes
- ☐ Not investing in companies contravening human rights issues
- ☐ Not investing in animal exploitation
- ☐ Not investing in activities like gambling, alcohol, pornography
- ☐ Not investing in speculative activities
- ☐ Not investing in interest bearing financial transactions
- ☐ Investing in companies that contribute positively to society
- ☐ Investing in environmentally friendly activities
- ☐ Investing in companies involved in fair-trade
- ☐ Investing in micro-credit companies
- ☐ Investing in the local enterprise sector
- ☐ Others (Please specify) ............................

15. What is the estimated percentage of the investments made by your institution by reference to the following?

| | |
|---|---|
| Positive screening | ☐ % |
| Negative screening | ☐ % |
| Shareholder advocacy | ☐ % |
| Best of sector investment | ☐ % |
| Community investing | ☐ % |

16. What percentage of your institution's annual profits is spent on philanthropic activities to promote societal welfare, if any?
0 – 2% ☐ 2 – 5% ☐ 5 – 7% ☐ 7 – 10% ☐

17. Does your institution support any of the following activities? Please give the percentage of your institution's profits which is attributed to any of these activities, where applicable? *(Please tick the appropriate square)*

| Types of Involvement | Yes | No | % of Profit Allocated | | | |
|---|---|---|---|---|---|---|
| | | | 0-2% | 2-5% | 5-7% | 7-10% |
| Donations to community causes | | | | | | |
| Donations to charities | | | | | | |
| Provision of benevolent loans | | | | | | |
| Providing scholarship to students | | | | | | |
| Provision for staff welfare (loans, health schemes, etc.) | | | | | | |
| Supporting employee involvement with community causes | | | | | | |
| Sponsorship of community events | | | | | | |
| Working with local schools, colleges, universities | | | | | | |
| Working with NGOs for sustainable development | | | | | | |
| Lobbying for a particular social, ethical or environmental cause | | | | | | |
| Contributing to the promotion of poverty reduction | | | | | | |
| Contributing to sustainable development | | | | | | |
| Investing or encouraging investment in deprived areas | | | | | | |
| Investment in Research & Development | | | | | | |
| Establishing fair recruitment practices, including engaging people traditionally excluded from the labour market e.g. disabled, homeless, ethnically discriminated | | | | | | |
| Promoting ethical values among staff (e.g. against- bribery, corruption, conflict; pro- honesty, trust, brotherhood, justice) | | | | | | |
| Taking initiatives to protect the environment (e.g. recycling) or enhance environmental management | | | | | | |
| Abstaining from false advertising | | | | | | |
| Sharing best practice on social, ethical and environmental responsibility with other organisations | | | | | | |
| Encouragement of financial and social inclusion | | | | | | |

**Your time and cooperation in filling this questionnaire is very much appreciated. Thank you. Do not hesitate to get in touch, should you have any other comments.**