Corporate Social Responsibility as a Mean to Mitigate Risk for Islamic Banking Industry

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Abstract

The notion of Corporate Social Responsibility (CSR) refers to the concept where companies integrate social and environmental concerns into their business operations, which is good for business and good for society. By reviewing prior literature, one can safely explain that the term CSR has received overwhelming attention by the academia as well as corporate executives globally. Widespread customer dissatisfaction of socially destructive products is the widely thought reason behind the uprisings of the CSR concept. Profit-loss-sharing ideology of Islamic banking considers stakeholders as partners. Contracts under different issues give room for risk sharing between partners. This study intends to explain CSR as a tool to mitigate risk in Islamic banking industry. Using the social contract theory, this study offers a conceptual framework for CSR-centric risk management system for Islamic banks.

Introduction

Corporate has right to conduct business without harming community and environment. The responsibility of financial institute is more than other industry, since financial institutes are working as like as blood in our complex economic system. Without financial institute no one can reckon about any business and for example if the financial institute stop funding for cigarette industry, the industry will collapse. The responsibility of Islamic Bank is even higher than other conventional bank, since the Makasid (objective) of Islamic Bank is not only providing interest free service (like, Halal Chicken) but also act as Khalisfullah (representative of Allah swt.) for this world. This paper develops a conceptual framework that shows how Islamic Bank can behave responsibly using the social contract theory of CSR.

Social contract theory urges that in absence of right, the life of human will be poor, nasty, brutish and short. Thus, human life is no longer “a war of all against all”. Since, human being cannot live alone by nature; they need to establish a contract among all. The contract will give up someone right to kill other if other does the same. In today’s business world, this philosophy work like a separate and sovereign entity for business. Current study develop a theoretical framework using social contract theory and explain how an Islamic bank can work responsibly in this complex economy.

Ahmad [1] explains few challenges for Islamic Bank in twenty first century and the first challenge is spiritual and moral re-awakening. To explain the spiritual and moral re-awakening, current study used Carroll four pillars of CSR, plus in addition environmental issue under CSR; The researcher consider corporate as separate entity which has numerous responsibility towards its stakeholder which will mitigate risk for Islamic Bank. Quranic verse and Hadith of Prophet (PBUH) has been employeed to develop the conceptual framwork, which will provide a guide line for the policy maker of Islamic Bank to mitigate risk.

Concept and dynamism of CSR:

CSR means responsibility of corporate or company to the society, environment, and economy. There are number of definition of the notion CSR, however, there is no unified definition of CSR. Based on the philosophy, different institutes or scholars present their definition on CSR. Few institutes and scholars found CSR as a mean of sustainable development, other represent CSR as strategic tool, or CSR as the social contract issue. In this section, researcher summarized number of definitions developed by different institutions and academic scholars which are related with current study. Finally, the researcher developed a single definition for this study.
Practitioner Point of View:
As mentioned, there are number of definitions on CSR given by various institutes, including World Business Council for Sustainable Development (WBCSD), Commission for European Communities, Bursa Malaysia and so on. Among all these definitions, the researcher presented few definitions on CSR given by various practitioner related with the current research.

According to the World Business Council for Sustainable Development (WBCSD), CSR 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 the local community and society at large [26]. If someone looks on the deep of this definition, he or she can easily found two beneficiaries party; corporate who is committing and other party is society or community who has been committed. Corporate committed to improve the quality of life and in return community allowing corporate to continue business. According to Business for Social Responsibility (BSR), CSR refers business decision making linked to ethical values, compliance with legal requirements and respect for people, communities and the environment [3]. This definition has two parts; legal requirement and respect the stakeholder. In this complex business world, an Islamic bank unable to conduct without following legal obligation and will unable to achieve respect from other party i.e., stakeholder.

According to the Government of United Kingdom, corporate social responsibility recognizes that the corporate (private sector) wider commercial interests require it to manage its impact on society and the environment in the widest sense [22]. This definition clearly explains the responsibilities of two parties; corporate and affected community or environment. Similar definition can be obtain from ACCA (Malaysia) and Business Council for Sustainable Development (Malaysia) jointly define; Corporate Responsibility (CR) is a company’s commitment to operate in an economically, socially and environmentally sustainable manner whilst balancing the interests of a diverse range of stakeholders (CRGuide, 2008). Tenth Malaysia plan define CSR as a mean to server community development like; support homeless community and day care thorough NGOs or corporate itself [23].

Academician Point of View:
As like as practitioner, the academic scholars are expressed their though about CSR in their research manuscripts. In this section, the researcher presented few definitions given by academic scholars related with this study. According to M. Friedman, ‘the only one responsibility of business towards society is the maximization of profits to the shareholders within the legal framework and the ethical custom of the country’ [9]. However, this definition has been rejected by number of scholars and they explain that a corporate must have numerous responsibility to conduct their business within a community [14]. Instead of striving only for larger profits for business’s stockholders, a responsible enterprise also takes into account account employees, suppliers, dealers, local communities, and the nation [12]. Thomas M. Jones define, ‘CSR is the notion that corporations have an obligation to constituent groups in society other than stockholders and beyond that prescribed by law and union contract’ [13].

According to Porter, CSR is a mean to achieve competitive advantage through philanthropic activities [16]. Smith and Higgins define CSR as, “a means for securing competitive advantage and at the same time a charitable cause receives substantial financial benefits”[21]. Another scholar defined CSR as a ‘contract’ between society and business. According to Woodward [28], CSR is a contract; wherein a community grants a license for the company to operate and in return the business meets certain obligations and behaves in an acceptable manner [28]. From the above definitions from practitioners and academician, it is very clear that social responsibility or corporate social responsibility is a contract between community and corporate. According to the definitions, community allow business to conduct their operation, in return business need to take social obligation and not harming the environment, community and economy.

Definition of CSR for this Study:
Ideally, CSR policy would function as a, self-regulating mechanism whereby business would monitor and ensure their adherence to law, ethical standards, and international norms, while ensuring the economic gain for business sustainability and it return society will allow corporate to conduct their business safely. Business would embrace responsibility for the impact of their activities on the environment, consumers, employees, communities, stakeholders, and all other members of the public sphere and this responsibility will ensure long term business gain. Hence, the researcher defines CSR as a contract between society and Islamic Bank to ensure social, economic and environmental development which is good for society and good for Islamic Bank.

Social Contract Theory:
Before going to link social contract theory with Islamic Bank to mitigate risk, it is worth to have to have a look on social contract theory. The social contract theory has long historical background, the researcher only present the brief background of social contract theory. The most prominent theorists of seventeenth and
eighteenth-century are the Hugo Grotius (1583–1645), Thomas Hobbes (1588–1679), John Locke (1632-1704), and Jean-Jacques Rousseau (1712–1778), Pierre Joseph Proudhon (1809–1865), John Rawls (1921–2002). Each presents attitude of rational people in different ways. Let’s have look on the scholars view from historical evidence. Hugo Grotius (1583–1645) introduced the modern idea of natural rights in individuals of the early 17th century. He postulates that each and every individual has natural rights that enable self-preservation and employs this idea as a basis for moral consensus. He urged that we should avoid doing harm to one another, which will protect us. Thus, his book ‘nature of right’ is the basis for social contract theory. Thomas Hobbes (1588–1679) is the first modern philosopher to articulate a detailed contract theory. According to Hobbes the lives of individuals in a state would solitary, poor, nasty, brutish and short, in absence of rights. He then urged in his book ‘Leviathan’ that the contracts prevented the society and resulted in the establishment of the state, a sovereign entity (like the individuals, business and so on). In today’s business world, his philosophy is providing a separate and sovereign entity for business, which led to the contract (or responsibility) between business and society. He mentioned an example, person A gives up his or her right to kill person B if person B does the same. Thus, human life is no longer “a war of all against all”. John Locke’s (1632-1704) concept of social contract differed from previous philosopher. Individuals are not only willingly come together to form a state; rather they are morally bound to form a state of nature. Early scholars urge that by nature human willing to avoid doing harm to one another, but he urges, without government to defend them against any another, people would have no security. Locke argued that individuals would agree to form a state that would provide a “neutral judge”, acting to protect the lives, liberty, and property of those who lived within it.

Pierre-Joseph Proudhon (1809-1865) advocated that social contract is not a contract only between individual and government. Rather, the social contract is an agreement of man with man; an agreement from which must result what we call society. In today’s business world this theory can be use as contract between society and corporate. Donaldson (1982) shows the business and society relationship from the social contract point of view, mainly from the philosophical thought of Locke (1632-1704). He assumed that a sort of implicit social contract between business and society exists. According to him, business has to follow the norms of the society and in return it will get permission to conduct it business.

Linking Social Contract Theory with Islamic Ideology:

Until 19th century, no definition of contract is to be found in the treatises of Islamic law. Because Islamic law never develop theory of contract, rather majority of Muslim jurists only focused on sale contract [18]. The first article of the Majallah al-Ahkam al ‘Adliyyah (the Civil Code of the Ottoman Empire) was come in existence in 1876 [2]. Majallah mentioned human is social by nature, he or she cannot survive without society like animal. Majallah also mentioned that in order to promote an urban society it is essential to co-operate each other. This co-operation can be further explained as social contract between business and society. Carroll explain this relationship between business and society as “corporate citizen”[5]. He explains that a corporate has responsibility towards society as a corporate citizen, in return society will allow corporate to conduct it business.

Now in case of Islamic Bank, this study urges that the responsibility of Islamic Bank is much more than any other financial institute, because Islamic bank industry is based on Quranic term Khalifatullah (Quran 2:30). The important of this issue has been correctly explained by Ahmad [1] while defining the challenge and prospects of Islamic Finance and Banking. He find-out five challenges for this 21st century and the first challenge is spiritual and moral re-awakening [1]. He explains ethical relationship between business and society as key for individual character as well as group behavior. He mentioned that in Western banking, the banker moves in only when he smells prospects of bankruptcy. But in Islamic system, banker acts as partner. Current study urges this partnership relation as a contract between business and society. However, this study not only considers ethics and regulation but also responsibility as a corporate citizen. The researchers consider corporate as separate entity which has numerous responsibility towards its stakeholder which led Islamic Bank to mitigate risk. Rather it should believe with justice to give back to the society in return of its affect on society. In the holy Quran, Allah mentioned, “Allah commands you to render back your trusts to those whom they are due” (Al-Quran 4: 58).

CSR to Mitigate Risk for Islamic Bank:

The values and principles that have been central of the Western concept of CSR is very much similar with the practice of holy Prophet Muhammad (Peace and Blessings be Upon Him) and it may serve as foundation for the notion of Corporate Social Responsibility (CSR) for Islamic Bank. There are few studies which support that the concept of CSR is very much linked with the value and principles of Islam [20,15]. The current study will not discuss the similarity between CSR and Islam; rather it will focus on how Islamic Bank can mitigate it risk using the concept of CSR. Lantos in his CSR framework mentioned about several responsibilities namely; Economic responsibility, Legal responsibility, Ethical responsibility and Stewardship responsibility. The research by Bird studying what CSR activities are valued by the market, covered five areas: community, diversity, employee relations, environment, and product (e.g. high product quality, high innovation and
development to meet the special needs of the disadvantaged). According to Carroll [5] corporate has four responsibilities: economical, legal, ethical and philanthropic responsibilities [5]. He then mentioned these four pillars refer CSR, and CSR, cover environmental issue as well [6]. Hence, this study will discuss about Carroll’s five responsibilities of CSR: economical, legal, ethical, philanthropic and environmental responsibilities. Then the researcher will present the guideline from holy Quran & Sunnah and how these five responsibilities can mitigate risk for Islamic Bank.

**Economic Responsibility:**

Until the late 1960s, development was considered by most economists to ensure maximization of economic growth. In the year 1969, Seers had broken the theory of development. According to him, development means the increase of per capita out-put. Development means, eliminating poverty, unemployment and inequality as well; which brought out the idea of sustainable development [19]. So the economic responsibility of corporate or financial institute is not only making money and they need to count their contribution to the society. A responsible corporate cannot ask for unnecessary price for their product or service, which lead economic imbalance. They need to calculate their contribution to eliminate poverty, unemployment and inequality. It is like a contract between business and society; business is gaining profit from a community, in return it trying to ensure economic development of that community.

According to Islam, “Allah has made business lawful for you” (Al-Quran, 2:275)” and Prophet (PBUH) said: In the Day of Judgment honest businessman will stand at the side of Prophets. (Shamail-e-Tirmizi, Hidith No 1227). The mentioned Quranic verse and Hadith is clearly explained that Islam encourage to its follower to involve with business. However, they need pay Zakat (compulsory contribution) to make economic balance. Islamic regulation asks to collect the Zakat from the rich and distribute among the poor in the same community. There is a great wisdom behind the concept of Zakat, it reduce poverty from the society and help to establish a balance society.

According to Chapra [7] the Islamic worldview implies that the market system should be maintained, but that the price mechanism be complemented with a device that minimizes unnecessary claims on resources [7]. Not only reasonable price but also Islamic bank can mitigate risk by acting an institute to collect Zakat from it investment and can distribute this fund to reduce social imbalance. One of the best examples can be taken from Islamic Bank Bangladesh Limited (IBBL) foundation. This foundation is working to reduce social imbalance, it collect Zakat from all types of investor and distributing it among the needy. Foundation also provides scholarship to the poor and brilliant student. Through this project, IBBL is managing to reach very remote area where no info-structure and their project are working like an advertisement tool.

**Legal Responsibility:**

It is expected that good corporate citizens, like private individuals are always obeying the law. One way of thinking about the law is to perceive it as ethics [5]. It is not legal for a corporate to involve with any activities that harm the society or environment. Legal responsibilities cover the responsibility that goes beyond the rules and regulation of the country. It is not permissible for a financial corporate to provide fund for gambling, military weapon, photographic film and so on. As corporate citizen, Islamic bank cannot involve with these types of business, which harm the society as well as environment.

Allah (swt) said, “O you who believe! Intoxicants, lottery and …. are Shaitan’s (deviled) work (Quran 5:90). Since lottery or any kind of gambling is not allowed for individual, it also not allow for any corporate. Islamic Bank cannot provide fund for this types of industry. It is like a commitment from Islamic Bank in order to save the long term interest of the nation, in return society will allow Islamic Bank to conduct its business. These types of initiative play significant role to eradicate challenges against Islamic Bank.

**Ethical Responsibilities:**

The ethical responsibility of a business is to ensure employee and customer satisfaction [17]. Other scholar mentioned business should responsible consider employee, supplier, competitor [25]. As a corporate citizen, it is the legal responsibility to care employee right, supplier right and customer satisfaction. A responsible corporate never wants to kick-off competitors; rather they should involve win-win game.

Islamic concept consider employees, suppliers, customers and competitors as brother, according to Islam humans are the descendents of Adam (First man in the world); so, they are all equal, but they will get facilities on the basis of their ability. As a result, the manager has no right to misbehave with his subordinates. Allah also warn those who mischief. Allah said, “Woe to the defrausers. Who, when they take the measure from men take it fully. But, when they measures out to others or weight out for them, they are deficient” (Quran 83: 1-3). So a responsible firm cannot try to get more from supplier and give less to the customer. Allah (swt) curses those who want to get more from other and give less.

Islamic Bank should consider its stakeholder like employee, supplier, customer and competitors as partner in the business arena. Unfortunately, most of the Islamic banks are unable to ensure employee motivation,
customer service and better relation with competitors and supplier. A study on Islamic banks found customers and employee dissatisfaction (Hossain, 2007). However, there is also good example within the Islamic Bank of Malaysia. Bank Islam arrange family day to motivate employee, around one thousand participants from employees family member join that program.

**Philanthropic Responsibility:**
Carroll [5] explains philanthropy is commonly believed to be a desire to help humankind through acts of charity, whether done by private citizens, foundations, or corporations. It is a way to giving back to the community. The author use the statement of Robert Payton, an expert on philanthropy, argues that it is defined as three related activities: voluntary service, voluntary association, and voluntary giving for public purpose.

Allah (swt) mentioned in Quran, “Take Sadaqah (alms) from their wealth in order to purify them and sanctify them.” (Al-Quran, Tauba:103). Regarding charity Allah's Messenger (may Allah's blessings and peace be upon him) says, "Among the actions and good deeds for which a believer will continue to receive reward after his death are ….. a Sadaqa (donation) which he gave from his property when he was alive and well, for which he will continue to receive reward even after his death.” (Ibn Majah and Baihaqi). Islamic Bank must have some kind of charity for the betterment of community. This will assist Islamic bank to improve brand image-reputation [10] as well as it will support bank to eliminate any kind of bad episodes [24].

**Environmental Responsibility:**
Environment is the silent stakeholder of the business organizations because it is greatly affected by the organization. According to Welford, the environmental stock must not be treated as a free good but must rather be protected, which implies minimal use of non-renewable resources and minimal emission of pollutants [27].

Apostle of Allah (pbuh) teaches Muslims to be kind with animals. Abu Hurayrah narrated that Prophet (pbuh) said, “A prostitute was forgiven by Allah, because, passing by a panting dog near a well and seeing that the dog was about to die of thirst she took off her shoe, and tying it with her head-cover she drew out some water for it. So, Allah forgave her because of that.” (Muslim)

Majallah (The code of conduct of Ottoman Empirical mentioned the following regulation to protect environment;

“If any person constructs a drain or a sewer near a well of water belonging to some other person, and pollutes the water thereof, he may be made to remove the damage. If it is impossible to remove the damage, he may be made to close up the drain or sewer. Again, if any person constructs a sewer near to a water channel, and the dirty water from such sewer flows into the channel and causes great injury thereto, and no other way can be found to remove such injury than by closing it, the sewer shall be closed”.

**Conceptual Framework for Islamic Bank to Mitigate Risk:**
Current study urges Islamic bank may act as corporate citizen to mitigate risk by involving five responsible activities; economic responsibility, legal responsibility, ethical responsibility, philanthropically responsibility and environmental responsibility.

Fig. 1: Social contract theory to mitigate risk.

The above figure 1.1 shows how an Islamic bank can exist in a society using social contract theory. Corporate will behave responsibly and in return community will allow corporate to conduct business. In order to behave responsibly corporate will follow CSR1 and CSR2. CSR1 consist of four pillars of Carroll; economic responsibility, legal responsibility, ethical responsibility and philanthropy responsibility whereas, CSR2 refers environmental responsibility of corporate. This study urges all these responsibility actually mentioned in Quran
& Hadiths even fourteen hundred years later. However, the critical evaluation of Islamic Banks’ activates are not proving that they are successfully involve with these responsibilities and in some cases they are having less performance than even conventional banks.

**Conclusion and Policy Recommendation:**

This paper explain Western concept CSR for Islamic bank. The two main outcomes of this paper; (1) provide a clear picture of Western concept CSR, which become requirement to conduct business in many country. Like in Malaysia all public listed corporation needs to publish CSR report since 2007[4]. (2) This study shows how Islamic philosophy appreciate inner concept of CSR, little known in West.

To obtain the outcome of this study, researcher employed the social contract theory of CSR. Using the Carroll’s CSR (four pillars of CSR) and CSR2 (environment), these study develop a conceptual framework which ensure two party benefits; Islamic bank and Community. Finally, researchers urge that the concept of CSR can act as a tool to mitigate risk.

**Limitation of this study & Further Study:**

The main limitation of this study is based on concept and no empirical data to support the concept. Further study may employee empirical data this conceptual framework, which may assist the policy makers of Islamic Bank to mitigate risk.

**REFERENCES**