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Comparative Analysis of CSR Disclosure and Its Impact on Financial Performance

in the GCC Islamic Banks

Platonova, Elena, 2014

Abstract

The concept of corporate social responsibility (CSR) has been developed and promoted since the 1960s, as part of the changing nature of the corporate working environment, with the objective of corporations having their share in contributing to social good in the economy and in society. CSR, as a concept and practice, is directly related to Islamic banking operations, since Islamic finance is located within Islamic moral economy, which essentialises social justice. The Islamic banking sector, therefore, is required by the nature of Islamic injunctions and principles to produce outcomes that are in line with the larger social expectations, namely CSR, with the objective of delivering long-term economic benefits but also to help society.

The main aim of this research, therefore, is to analyse the CSR attitudes and practices of Islamic banks in the GCC region through their CSR disclosure practices. This research further aims to examine empirically the impact of CSR disclosure practices of the GCC Islamic banks on their financial performance.

In fulfilling the research aim, annual reports of GCC Islamic banks for the period 2000-2011 are scored by using content analysis. The CSR disclosure index is constructed based on the eight dimensions developed for this purpose. Despite the high expectations of full disclosure and accountability, the research findings do not produce encouraging results in terms of CSR or the social outcome of Islamic banks in the GCC region. The majority of GCC Islamic banks disclose significantly less than required, as CSR disclosure indices for all the Islamic banks remain very low in comparison to the overall score but also for each of the CSR dimensions included in the indices.

While examining the impact of CSR disclosure practices on financial performance of Islamic banks in the GCC region, the results indicate the positive relationship between CSR disclosure and financial performance. These results are in line with the set hypotheses and discussed theoretical framework that predict a positive link between corporate social and financial performance in the Islamic banking industry.

Comparative Analysis of CSR Disclosure And Its Impact on Financial Performance

in the GCC Islamic Banks

by

Elena Platonova

A thesis submitted for the degree of Doctor of Philosophy

University of Durham

Durham University Business School

United Kingdom

2014

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List of Abbreviations

BOD	Board of Directors
Cap.Ratio	Capital Ratio
CSR	Corporate Social Responsibility
CSP	Corporate Social Performance
GCC	Gulf Cooperation Council
IFI	Islamic Financial Institution
M&V	Mission and Vision
Ovhd.Exp.	Overhead Expenses
ROAA	Return on Average Assets
ROAE	Return on Average Equity
SSB	<i>Shari'ah</i> Supervisory Board
VIF	Variance Inflation Factor
UAE	United Arab Emirates

Declaration

I declare that this thesis is my own work and that, to the best of my knowledge and belief, it contains no material previously published or written by another person, except where due acknowledgement has been made in the text. I confirm that none of the materials presented in this thesis has previously been submitted for a degree in this or any other institution.

Statement of Copyright

The copyright of this thesis rests with the author. No quotation from it should be published without the author's prior written consent and information derived from it should be acknowledged.

Acknowledgements

The kind efforts of a large number of people have enabled me to write this doctoral thesis. One of the joys of having completed this work is looking back at everyone who has helped me during the journey. I am indebted to many people for various reasons related to the work, to only some of whom it is possible to give special mention.

First and foremost I would like wholeheartedly to thank my supervisors, Dr. Mehmet Asutay and Professor Rob Dixon.

I am greatly indebted to Dr. Mehmet Asutay, whose vision and passion for Islamic finance has inspired me to take my own passions seriously. He has kept a patient faith with me and he has my undying admiration. His valuable guidance and moral support helped me while going through this process, as not one of my calls for help was turned down. It is his kindness and the ability to understand that makes each of his students feel special. Dr. Mehmet Asutay has been not only my supervisor and mentor, but he has also been a father. Without the long hours he has spent on guiding, supporting and encouraging me, this work would not be completed.

Gratitude is extended to Professor Rob Dixon for his unwavering support. His worthy efforts and constructive comments have enabled me to keep focused but also to see the bigger picture. This research has certainly evolved under his special care and attention. I am eternally obliged to Professor Rob Dixon that he gave me latitude to explore the topic in my own way, while constantly providing encouragement, advice and guidance.

Above all, grateful acknowledgment is owed to my family, my Mom and Dad, my brother Jenya and his family for their love, a continual source of support and motivation. I would not be the person who I am today without my beloved parents, they have always encouraged me towards excellence.

I would like to say special thanks to Sabri, who backed me up with love and complete emotional support through the years of research, for believing that I could do it, and for that I am forever grateful.

I must acknowledge the generous support of my PhD fellows and friends. I am lucky to have many wonderful people in my life and you should know that your support and encouragements was worth more than I can express on paper.

My deepest appreciation goes to my sponsor, the Islamic Research and Training Institute (IRTI). Words cannot express my gratitude for all the kindness and generosity shown to me by the IRTI/IDB scholarship committee. Thank you very much for understanding and easing my hardship. I am also deeply grateful to Durham University Business School for the financial support that was offered to me in the first year of my studies, which was a great source of relief.

May God reward them all.

CHAPTER ONE
INTRODUCTION

CHAPTER ONE

INTRODUCTION

1.1. BACKGROUND AND MOTIVATION

The changing nature of the business environment and the relation between business and the larger environment in which a business operates has resulted in the emergence of Corporate Social Responsibility (CSR), which has become one of the most researched topics during the last a few decades through academic and professional research. Since the 1950s, the growing number of social and economic problems as a result of globalisation have significantly affected not only the terminology of the social responsibility of business through transforming it to CSR, but have also developed it as a discipline (Carriga and Melé, 2004: 51).

The field of CSR nowadays comprises a large number of theories, approaches, and definitions. The plethora of terms and concepts related to CSR encompasses corporate citizenship, the ethical corporation, sustainable development, corporate social responsiveness, ethical accounting and corporate sustainability. The great diversity of literature available on CSR, however, does not provide a common ground in articulating a particular position, which also creates additional difficulties in analysing CSR practices and performances of financial institutions (Hopkins, 2004; McWilliams *et al.*, 2006).

The broad concept of CSR represents corporate activities, beyond profit making, which include protecting the environment, caring for employees, being ethical in trading, and getting involved in the local community. Although the primary goal of enterprises is to generate profit, they can voluntarily be involved in solving social and environmental problems in addition to fulfilling certain aspects of social responsibility through regulative compliancy. Endorsing human rights, empowering individuals and the community, human resource management and development, socially responsible investing, and social reporting, in particular, are some of the main issues and aspects of CSR (CSR Europe, 2001).

The notion of CSR has become increasingly important with the impact of current globalisation in business matters. According to the objectives of modern economic and

financial organisations, wealth and profit creations are considered by companies and banks as crucial tasks (Cannon, 1994: 45); however, the mission of corporations nowadays is not only maximising their profit but also contributing to social development. In other words, “business can also be about values and virtue, about striving to meet some great need or performing some great deed, not just for oneself or even for one’s employer, but also for others” (Lantos, 2002: 220). This means that financial institutions can play a significant role in addressing societal issues such as careful use of scarce resources, human rights, community investment and welfare services; as society expects of its corporate sector to reconsider standards and principles applied in business (Cannon, 1994: 50). In fact, recent studies show that financial institutions have a tendency to emphasise the ethical aspects in their businesses, which is evidenced by the growing ethical finance sector.

Demand for greater social responsibility motivated academicians into further research and consequently, moral, ethical, and theoretical factors that are driving the movement towards CSR have been examined through various perspectives (Dusuki, 2008: 5). Among social, environmental and cultural impacts, the influence of religion on CSR activities of corporations is now recognised as an important dynamic and motivational factor, as the concept of CSR integrates and aligns with the core values of corporations and individuals, which also includes religion and culture as the source of ethicality.

In spite of the modernist convictions, which accepted religion as a completely separate issue from the business environment, it has been suggested that financial institutions can also be encouraged to apply CSR through a faith-based point of view by deriving ethical norms from religious scriptures. For example, in Judaism, Christianity and Islam believers consider working as a part of ‘worshipping to God’ and their work can be counted as a fulfilment of their obligations towards God. Consequently, the aim of life is not only about being happy, it is about living in God’s will and working ethically as well as serving the society in order to satisfy the purpose of human beings' existence on earth (Lantos, 2002: 222). In fact, as has been mentioned in the Bible “it is easier for a camel to go through the eye of a needle rather than for a rich man to enter the kingdom of God.” (Cannon, 1994: 1). This citation shows the sensitivity of the implication of social responsibility by contemporary financial institutions towards society and motivates them to contribute efficiently to social development. Thus, in addition to

humanistic sources of CSR as practised in various parts of the world, religion can also constitute an important motivation towards fulfilling individual and corporate social responsibility.

The notion of CSR is also relevant to Islamic financial institutions (IFIs), as due to religious ontological and epistemological foundations, Islamic finance is considered a socially-oriented ethical value proposition. Islamic finance is derived from Islamic law that originated from the *Qur'an* and *Sunnah*, two main sources of knowledge in Islam, the former being the Holy Book of Islam and the latter being the sayings and everyday practice of the Prophet of Islam. Islamic finance prioritises ethicality and social responsibility in financial and business dealings, as Islamic finance is based on *maqasid al-Shari'ah* (the objective of Islamic law), which is defined as human well-being, implying that all the activities and efforts should aim at socio-economic justice (Haniffa and Hudaib, 2002). Thus, human well-being is considered as one of the central objectives of IFIs in general and Islamic banks in particular. Accordingly, the role of Islamic finance is to maintain economic and social justice with the objective of essentialising human-centred economic development and improving human welfare, which, by definition refers to CSR as well.

CSR, according to Islamic moral economy, essentialises moral obligations along with stakeholders' rights and their interests. Since IFIs are expected to operate in line with Islamic financial law principles, these institutions are required by nature to adopt CSR not only for the reason of long-term economic benefits but also to help society in providing a human-centred developmentalism, as a *raison d'être*. Thus, CSR from an Islamic perspective, as part of the new paradigm, is an endogenous concept and expected to be at the top of IFIs' agendas.

The concepts of CSR from an Islamic finance perspective are linked to the Islamic accountability, as human beings are responsible in front of God for all their actions, and social justice lies at the heart of accountability. The Islamic accountability stems from two main principles: full disclosure (transparency) and social accountability (Baydoun and Willet, 2000). Full disclosure is related to the "disclosure of any information that should be rightfully given to members of the community in accordance with the principles of *Shari'a*" (Baydoun and Willet, 2000: 81). Therefore, this would include financial information that will reflect the compliance of financial operations with the

Islamic financial law. In addition, considering the strong moral values of Islamic finance, the disclosure practices of IFIs should place emphasis on the social welfare of the community and stakeholders. Hence, the disclosure of socially-responsible activities or CSR disclosure is equally important to the disclosure of financial information.

CSR disclosure is accepted as a manifestation of CSR, where the reporting of social activities is the core element of the CSR content. As a result of the growing interest in CSR reporting, a great emphasis has been placed on the CSR disclosure practices of financial institutions (Vurro and Perrini, 2011: 459). Furthermore, academic and public awareness of the advantages of recognising and managing the expectations of the stakeholders by means of voluntary actions taken by corporations beyond compliance with legislation and regulations, has led to improvement and implementation of CSR disclosure in the financial industry. It is known that CSR disclosure can be practised through annual reports, stand-alone environmental reports, advertisements or articles, booklets, leaflets and brochures, labelling products, newsletters, press releases, supplements to the annual reports, video tapes, and websites (Gray *et al.*, 1995a; Jenkins and Yakovleva, 2006).

The concept of CSR disclosure refers to voluntary or obligatory reporting of social, ethical and environmental information by the financial institutions to all groups of stakeholders (Belal and Lubinin, 2009: 165; Jenkins and Yakovleva, 2006: 273). Therefore, CSR disclosure guides stakeholders in deciding whether the financial institution is socially active or not, which would rationalise the continued existence of the financial institutions to stakeholders. CSR disclosure plays an important role in shaping public opinion of the existence and performance of the corporation and assists companies to comply with the legal requirements of the countries where they operate (Deegan *et al.*, 2000). Disclosing socially-responsible activities would help financial institutions to attract investors, as ethical investment funds are becoming part of the capital market. CSR disclosure reduces the communication gap between the financial institution and stakeholders, which results in an improved image of the institution.

As regards the IFIs, despite the ethical *raison d'être*, the developments in IFIs' institutions do not provide confidence as to their social responsibilities and ethicality. The current debate demonstrates that the gap between "the ideals and realities of Islamic finance" is growing, as Islamic finance has been criticised for being materialistic and

loosing the spirit of the Islamic moral economy (Asutay, 2009:1). Therefore, there is an urgent need for the social and moral dimension of the Islamic moral economy to be articulated in Islamic banking and finance practice. In addition, contemporary studies reveal that the practice of CSR, which is one of the articulations of the moral dimension in IFIs' institutions, is still in its infancy and their understanding of CSR is limited with issues such as the payment of *zakah* (mandatory alms) distribution, despite Islamic moral economy being the starting point of Islamic banking and finance essentialising social good, social justice and ethicality in economic and financial matters (Asutay, 2009: 16).

A divergence between the aspirational construct of Islamic finance and the practical experience of Islamic banking and finance has emerged over recent years (Sairally, 2006: 67-74; El-Gamal, 2001; Asutay, 2007; Hasan, 2005). Furthermore, recent debate on the development of the practice of Islamic finance has shown that profit and economic efficiency motives of IFIs are higher than a concern for socio-economic equity and welfare. Therefore, in an aspirational sense, it is essential to study the social potential of Islamic banks through introducing social justice oriented principles and endogenising social justice into the operational nature of these institutions, as in the original sense (Asutay, 2010: 2).

This study, therefore, is an attempt to analyse CSR attitudes and practices of Islamic banks in the Gulf Cooperation Council or the GCC region through their CSR disclosure practices and also to measure the impact of CSR disclosure practices on the financial performances of these banks. Considering that the emergence of IFIs emerged from the Gulf or the GCC region, which still remains as one of the tips of Islamic financial development, studying the GCC Islamic banks should be considered as timely and useful.

1.2. AIMS, OBJECTIVES AND RESEARCH QUESTIONS

This study aims to analyse the CSR practices of Islamic banks in the GCC region through analysing their CSR disclosure practices as communicated in the annual reports. Furthermore, this study also aims to examine the impact of CSR disclosure practices of the financial performance of the GCC Islamic banks with the assumption that there is a

correlation between the CSR disclosure practice and the amount of information communicated, and financial performance of Islamic banks.

To achieve the aims of this research, the following objectives are developed:

- (i) to compare the theoretical and conceptual framework of CSR from conventional and Islamic perspectives;
- (ii) to develop the CSR disclosure index in order to assess the extent of CSR disclosure levels or practices of Islamic banks in the GCC region;
- (iii) to conduct content analysis to measure CSR disclosure performance through disclosure scores in relation to the established index;
- (iv) to develop an econometric model to measure the impact of CSR disclosure practices on the financial performance of Islamic banks in the GCC region

In order to achieve these research objectives, this study seeks to investigate the following research questions:

- (i) What does CSR mean from a mainstream finance point of view and what is the CSR disclosure concept?
- (ii) What is the concept of CSR from an Islamic finance perspective?
- (iii) What is the extent of CSR disclosure practices in the GCC Islamic banks?
- (iv) To which extent are Islamic banks in GCC countries complying with the Islamic financial principles in terms of practising CSR?
- (v) What is the extent of the relationship between the CSR disclosure practices of the GCC Islamic banks and the financial performances of these banks?

Objectives one and two are related to the research questions (i) and (ii), and are explored in Chapters 2 and 3. They highlight the reasons for CSR becoming an integral part of Islamic banks through underlining Islamic financial principles alongside philosophical foundations of the Islamic economic system. Furthermore, they focus on the concept and definition of CSR disclosure as a manifestation of CSR and highlight the major theories underpinning CSR disclosure.

The second and third objectives are related to the research questions (iii) and (iv), which are explored in the first empirical Chapter 5. The results help to analyse the disclosure

levels and practices of CSR in the GCC Islamic banks.

The fourth objective is related to research question (v), which aims to understand the relationship between the CSR disclosure practices and the financial performance of Islamic banks. This relationship is analysed in the second empirical Chapter 6, which presents the results for the impact of CSR disclosure practices on the financial performance of the GCC Islamic banks.

1.3. SIGNIFICANT CONTRIBUTION OF THE RESEARCH

Despite the plethora of research addressing the social and ethical dimensions of conventional financial institutions from different aspects, such as CSR disclosure practices, in relation to the link between religion and CSR disclosure, there is a lack of material written about CSR disclosure practices in IFIs, in particular Islamic banks. A limited number of studies covering social reporting of Islamic banks include among others Haniffa (2002), Maali *et al.* (2006), Haniffa and Hudaib (2007), Hassan *et al.* (2010), Dinar Standard and Darul Istithmar (2010), Kamla and Rammal (2010), Hassan and Harahap (2010), and Zubairu *et al.* (2011). Furthermore, while there are a limited number of empirical studies generally on CSR disclosure in Islamic finance in particular and CSR performance in general, the impact of CSR disclosure on the financial performance of Islamic banks has not been studied extensively.

This research, hence, contributes to the previous literature on CSR disclosure practices in Islamic banks by focusing on the evaluation of CSR disclosure of Islamic banks in the GCC region using a sample of 24 Islamic banks from five countries: Saudi Arabia, Bahrain, UAE, Kuwait and Qatar over the period between 2000 and 2011. This evaluation is based on an index derived and developed from Islamic moral economy and finance principles. Applying a content analysis technique, this study adapted the CSR disclosure index developed in the previous study by Haniffa and Hudaib (2007). This index is in line with the Islamic moral economy and finance framework, in an aspirational sense that reflects the nature of disclosure items. The dimensions and sub-dimensions of the constructed index were attempted to be located in the annual reports of Islamic banks help to assess the extent of CSR disclosure practices of Islamic banks in the GCC region.

The main contribution of this research is to fill the gap in the literature by examining the impact of CSR disclosure practices on the financial performance of Islamic banks. The CSR disclosure indexes of the GCC Islamic banks are used to assess the impact of CSR disclosure practices on the return on average assets, which is employed as a proxy of financial performance. This is based on the assumption that better CSR disclosure performance creates trust for those financial institutions and hence increases the customer base and the demand for investing with such institutions. Such consequences are expected to improve the financial position of those institutions, as measured through a number of proxies representing financial performance.

This research would thereby enrich the existing literature as it provides the empirical analysis of a sample of banks from the GCC banking industry and employs a CSR disclosure index as a social performance measure. In addition, considering that the studies examining the association between CSR disclosure performance and financial performance in Islamic banking industry is rather scarce, having conducted such an empirical research should also be considered as an important contribution of this study.

The use of CSR disclosure as a social performance measure in evaluating the corporate social – corporate financial performance relationship is evidenced in several studies. For example, Belkaoui (1976), Abbott and Mosen (1979), Blacconiere and Patten (1994), Blacconiere and Northcut (1997) have proposed to employ the social and environmental disclosure as a proxy of corporate social performance.

Controlling for banks size, risk, overhead expenses, capital ratio and loan ratio, the evidence that CSR disclosure practices are positively related to financial performance of the GCC Islamic banks is found. The positive relationship between corporate social and corporate financial performance is based on ‘social impact hypothesis’ (see Preston and O’Bannon, 1997), which is derived from instrumental stakeholder theory (Freeman, 1984; Cornell and Shapiro, 1987; Donaldson and Preston, 1995). Furthermore, this positive relationship can be explained by the arguments of the ‘good management theory’ (Waddock and Graves, 1997; McGuire *et al.*, 1988; 1990; Surroca *et al.*, 2010; Soana, 2011).

From instrumental stakeholder theory, ‘social impact hypothesis’ and the ‘good management theory’ viewpoint, this suggests that maintaining good relationships with

the bank's stakeholders results in improved performance.

CSR active banks diminish the potential damage of their reputation from negative information they might receive in the future and thus protect their profits and financial results through CSR practices. This implies that communicating as much as information in a manner closer to best practice, namely 1 or 100 per cent of CSR disclosure, enhances banks' reputation and improves their credibility, which in turn results in better financial outcomes.

Considering that the GCC region is the leading centre in Islamic finance-related developments and has a large financial industry, this research contributes in raising awareness of Islamic banks in the region to boost their corporate social performance through enhancing their CSR objectives. This results in an improved financial performance of Islamic banks as well as benefitting the socio-economic development of the society.

1.4. RESEARCH METHOD

In conducting this research, a triangulation method in the form of a combination of quantitative and qualitative methods are employed. In order to analyse the CSR disclosure practices of 24 Islamic banks in the GCC countries, content analysis of annual reports of the banks is employed and the CSR disclosure index is constructed.

Furthermore, in order to examine the relationship between the CSR disclosure and financial performance of the GCC Islamic banks and to test the research hypothesis that CSR disclosure positively affects financial performance of Islamic banks, an empirical model is developed and the multiple regression analysis using a fixed-effects panel data set is employed.

The research methodology and method employed by this study is determined by the aims and objectives of the research. For this, the philosophical underlying of this research, as the epistemological base, is based on objectivism. While qualitative and quantitative methodologies constitute the methodological framework, on operational aspect, this study employs triangulation as a research method. It should also be noted that for efficiently conducting the research, explanatory design is considered to be the best design for this study.

1.5. SUMMARY OF RESEARCH FINDINGS

This research evaluates the CSR disclosure practices of Islamic banks in the GCC region based on a benchmark derived from Islamic finance principles. The gap between the ideals and realities of embracing CSR in the GCC Islamic banking sector is analysed through employing content analysis technique to the annual reports of Islamic banks and constructing the CSR disclosure index. The dimensions and sub-dimensions of the CSR disclosure index are selected based on the previous study by Haniffa and Hudaib (2007). These categories of CSR are aligned with the Islamic finance principles and also reflect features proposed to be communicated by the Accounting and Auditing Organisation for Islamic Financial institution (AAOIFI) and previous studies on CSR disclosure practices in conventional financial institutions. Consequently, eight main categories are chosen through which the annual reports of the Islamic banks subjected to content analysis: ‘mission and vision statement’; ‘board of directors and top management’; ‘products and services’; ‘commitment towards employees’; ‘commitment towards debtors’; ‘commitment towards society’; ‘*zakah*, charity and benevolent fund’ and ‘*Shari’ah* supervisory board’. The last two categories are specific for Islamic banking; however, the other six categories of social responsibility are applicable for the conventional banking industry as well.

Islamic banks are expected to be socially responsible and disclose the information related to their CSR activities to reflect accountability and justice to society as a part of their religious compliancy. However, the results of the first empirical study do not produce encouraging results in terms of CSR or the social outcome of Islamic banks in the GCC region, as CSR Disclosure Indices for all the Islamic banks remain very low. Furthermore, in the overall ranking related to dimensions, the CSR disclosure indices also yielded very low scores.

The findings indicate that Islamic banks in the GCC countries do not put enough effort into disclosing their underlying and operational values regularly. In addition, the results confirm the divergence between the CSR activities of the GCC Islamic banks revealed in the annual reports and the moral framework based on Islamic moral economy and *Shari’ah*, as the latter provides aspirational expectations beyond what Islamic banks revealed in their annual reports. The maximum overall disclosure index (0.44) is scored by the sampled Qatari Islamic banks, while the minimum is scored by the sampled

Islamic banks in Saudi Arabia (0.26). In other words, Islamic banks in Qatar disclosed only 44 per cent of the required information related to their CSR practices and Islamic banks in Saudi Arabia disclosed 26 per cent. The overall mean for the rest three GCC countries fluctuated between 0.35 and 0.42, suggesting a large inconsistency between the 'real' or disclosed and 'ideal' information about CSR practices, where 1 or 100 per cent is considered to be an 'ideal' degree or best practice of CSR disclosure index; and the measured CSR disclosure practice related performance indicates the 'real'.

The findings show that in the overall ranking related to dimensions priority is given to the 'commitments to debtors' followed by 'mission and vision statement', 'community', 'board of directors', and 'employee' dimensions. According to the findings, GCC Islamic banks attach less importance to the other three dimensions of the CSR disclosure index: '*Shari'ah* Supervisory Board', '*zakah*, charity and benevolent loans and 'product and services'. This may be explained due to their CSR activities being rather limited as also identified in other research studies, which suggests that the problem is perhaps a structural one rather than corporate governance issue.

In short, the empirical findings of the first study do not indicate an effective strategy assumed by Islamic banks in the GCC region towards disclosing CSR-related issues. The shortfall in the CSR disclosure practices of GCC Islamic banks can also be explained as a result of insufficient transparency and accountability. The Islamic principles of corporate governance require from Islamic banks to be transparent and disclose the information related to their CSR activities. However, the results of this study show that GCC Islamic banks disclose significantly less than what is required, which constitutes another aspect of social failure.

Therefore, Islamic banks in the GCC countries are required to make their CSR objectives more explicit and to further integrate social dimensions into their system, which will assist in human empowerment in their societies.

The second empirical study is a continuation of the first one and aims at examining the relationship between CSR and financial performance of the GCC Islamic banks and extends the previous research investigating this relationship.

The findings of the study indicate a significant positive relationship between social and financial performance of Islamic banks in the GCC countries. In other words, the results

of this study strongly support the hypothesis that there is a positive relationship between social and financial performance of GCC Islamic banks (Model 1). Consequently, the higher the level of CSR disclosure, the better is the bank's profitability. The second hypothesis of this study tests the impact of social performance on future financial performance measured by $ROAA_{t+1}$, where all independent variables are lagged one year (Model 2) in order to examine the robustness of the main empirical model (Model 1) within the used historical data.

In the empirical analysis, it is true that in the case of positive relationship between financial performance and the CSR disclosure performance might indicate a potential endogeneity problem. However, there are a number of econometrics measures, which can help to overcome such problem in an attempt to produce efficient results, as this study did in Chapter 6.

According to the empirical results therefore, the significant relationship between the composite measure of CSR disclosure index and financial performance is found. The findings of this study, however, do not illustrate a statistically significant relationship between the individual dimensions of the CSR disclosure index and the corporate financial performance measure except for 'mission and vision'. Thus, the results of this study are consistent with 'instrumental stakeholder theory', 'social impact hypothesis' and the 'good management theory'. Consequently, maintaining good relationships with the bank's stakeholders results in improved performance (Waddock and Graves, 1997). In other words, CSR can be perceived as an intangible asset that brings about the more efficient use of resources and subsequently has positive impacts on financial performance (Surroca *et al.*, 2010). Furthermore, CSR active banks diminish the potential damage of their reputation from negative information they might receive in the future and thus, protect profits and financial results (Soana, 2011). Hence, a good CSR programme can help to generate valuable goodwill, which will protect banks from unexpected harmful issues, and to open doors for new projects that cannot be accessed by non-CSR active banks.

Furthermore, the positive impact of CSR on future financial performance supports the theoretical arguments suggesting that CSR-active financial institutions have a long-lasting positive impact on their financial performance (McGuire *et al.*, 1988). Islamic banks that disclose significantly more information could gain the support of

stakeholders and thus increase financial performance. Last but not least, Islamic banks with a high degree of CSR disclosure can leverage new customers and more deposits, which will positively impact their financial performance in the long term.

1.6. OVERVIEW OF THE RESEARCH

This thesis is structured into seven chapters.

Chapter 1, as the Introduction chapter introduces the background of this study and highlights its motivating factors. The aims and objectives of this research are also formulated in this chapter. A summary of the methodological approach undertaken alongside with the structure of the thesis is presented in this chapter.

Chapter 2, CSR and CSR Disclosure in Financial Institutions: A Literature Survey, provides conceptual definitions of CSR, and reviews its concepts as well as providing the historical developments and trends in understanding CSR. In doing so, various perspectives and ideological positions of CSR are discussed and the practice of CSR in conventional financial institutions is shown. This chapter also discusses CSR performance and performance measurement issues and presents methods of performance measurement. The chapter ends with explaining the concept and definition of CSR disclosure and provides theoretical backgrounds for CSR disclosure.

Chapter 3, CSR from an Islamic Finance Perspective: A Literature Survey, explores the concept of CSR from an Islamic finance point of view. To provide conceptual framework of CSR in Islamic finance, the chapter starts with an introduction to Islamic moral economy and presents the rationale for ‘social good’ in Islamic moral economy by referring to ontological and epistemological sources. After highlighting the role of IFIs in Islamic moral economy as socially responsible to society, various theories underpinning the concept of CSR from an Islamic finance perspective are presented. The chapter highlights the ongoing debates on the divergence of Islamic banking and finance practices from the aspirational position of Islamic moral economy and the necessity of going back to the basics through revising the philosophy of Islamic moral economy based on the authentic principles of Islamic teachings. It concludes with the review of the previous studies on CSR disclosure practices in IFIs.

Chapter 4, Research Methodology, provides the methodology employed by the research based on the aims and objectives of the research. It starts with the section explaining the research philosophy followed by a research methodology section. This chapter also reviews and describes research design and strategy. The chapter presents in detail research methods as well as the issues related to econometrics modelling including definition of variables, model specification and data analysis employed in the first and second empirical models. Sample selection and data collection are also described.

Chapter 5, A Comparative Analysis of Corporate Social Responsibility Disclosures of Islamic Banks in the GCC Region, being the first empirical chapter, analyses the CSR disclosure practices of Islamic banks in the GCC region. In the first empirical model, the annual reports of 24 Islamic banks during the period of 2000 to 2011 are analysed using the content analysis technique through a particular CSR disclosure index. This chapter is devoted to presenting the empirical analysis describing the findings of the CSR disclosure index.

Chapter 6, The Impact of CSR Disclosure on Financial Performance: Empirical Evidence from GCC Islamic Banks, being the second empirical chapter, is a continuation of the preceding chapter and aims at analysing the relationship between CSR disclosure and performance of the GCC Islamic banks. In specific terms, the CSR disclosure index is selected as an independent, financial performance measured by return on average assets (ROAA) as a dependent variable. Bank's size, risk, overhead expenses, capital ratio and loan ratio have been employed in this second empirical model as control variables, as they are seen as the most important factors for the corporate social and financial performance linkage. In order to test the relationship between CSR disclosure and financial performance, panel data with fixed effects regression analysis is performed. Furthermore, two sensitivity tests are conducted to test the robustness of the empirical results of the model. For this purpose, in the first sensitivity test, Return on Average Equity (ROAE) is used as an alternative measure of profitability. The second sensitivity test is carried to check for the potential endogeneity issue between Corporate Social Performance (CSP) and financial performance, thus, a Durbin-Wu test is applied.

Chapter 7, Discussion and Conclusion, summarises the findings of the study, presenting new approaches and concludes the research.

CHAPTER TWO

CSR AND CSR DISCLOSURE IN FINANCIAL INSTITUTIONS: A LITERATURE SURVEY

CHAPTER TWO

CSR AND CSR DISCLOSURE IN FINANCIAL INSTITUTIONS: A LITERATURE SURVEY

2.1. INTRODUCTION

Corporate Social Responsibility (CSR) is an evolving academic and business topic that attracts attention of governments and non-governmental organisations (NGOs) worldwide, which has become more prominent in the 21st century and expanded its scope. The large amount of books, articles, and reports as well as academic and professional conferences on CSR show significant interest in the subject among academicians and practitioners.

The terms and concepts related to CSR encompass corporate citizenship, the ethical corporation, sustainable development, corporate social responsiveness, ethical accounting and corporate sustainability. Civil society nowadays put emphasis on their social, environmental and developmental impacts and a considerable part of their budget is allocated to monitor and pressurise companies (Vogel, 2005: 12). Consequently, corporate leaders have implemented voluntary projects related to improving the quality of working conditions, environmental problems and stakeholder relations.

It is expected that CSR improves the financial performance of an organisation, brand image, and reputation as well as increases the ability to attract and retain a quality workforce. Therefore, an increasing number of companies in the West nowadays are upgrading their CSR strategies as a result of current social, economic, and environmental issues. According to the European Commission (2001: 5), more companies in Europe have acknowledged the notion of CSR and included it in their development strategies. Furthermore, recent demands and proposals promoting corporate responsibility are brought about by the growing awareness of significance of CSR by employees, managers and investors or, external factors, as well as by customers or socially responsible behaviour (Aras and Growther, 2009: xx). Corporate leaders of the big companies such as Body Shop, Marks & Spencer, Starbucks, Interface and many others analyse the impact of their business on the community and environment and acknowledge their social responsibility (Vogel, 2005: 17).

It should be noted that the contemporary interest of corporations in the concept of social responsibility is motivated by strategic, defensive and philanthropic factors, each of which requires a particular strategy. In line with this, Cannon (1994: 101) indicates a number of reasons that make companies disclose social and environmental information. The key reason “is the increased awareness of the need to wed increased freedom to perform the economic functions of the enterprise with a demand for this freedom to be used responsibly” (Cannon, 1994: 101). Another reason is the expectation from enterprises to play a better role in economic progress through undertaking economic and social issues. Additionally, ethical issues have influenced business life, and industry today is seen as spearhead of economic and moral values. In fact, as highlighted by Cannon (1994: 101) “More and more, business leaders find themselves facing problems that require them to choose between actions that are based on existing norms and those that are based on some higher ethical standard. The latter course of action requires bold leadership and moral courage”.

Since 1953, when Bowen’s work ‘*Social responsibilities of the businessman*’ was published, the concept of CSR has changed dramatically from the social responsibility of business to an industry of CSR “with full-time staff, websites, newsletters, professional associations and massed armies of consultants” (Economist, 2004: 53). In this process, the roles and responsibilities of corporations in society gained greater attention at the end of the 20th century as some of the contemporary corporate entities are considerably bigger than nation states and, therefore, their influence on communities and environment should not be underestimated.

Despite such developments, the increasing awareness of the CSR concept, however, did not lead to an agreement in defining the term of CSR and brought about various explanations.

This chapter reviews the literature on CSR and CSR disclosure. It begins with the conceptual definitions and historical developments and trends in understanding CSR, which is followed by the role of CSR in financial institutions. CSR performance and performance measurement issues are also discussed. The chapter ends by explaining the concept and definition of CSR disclosure and provides theoretical backgrounds for CSR disclosure.

2.2. CONCEPTUAL DEFINITIONS OF CSR

CSR can be expressed in different ways. The social responsibility of business can be described as transparent business actions that are based on ethical values, respect for people, communities, and environment and at the same time comply with legal requirements. By and large, CSR is about how companies manage the business processes to produce an overall positive impact on society, as socially responsible companies have a positive and productive impact on society. In addition, social responsibility plays a considerable role in creating a cleaner environment (European Union, 2001: 5). According to Aras and Crowther (2009: xxi), the concept of CSR is related to business contribution to social development and social behaviour of employees. Hopkins (2004: 1), by referring to the economic aspects, develops the following definition:

CSR is concerned with treating the stakeholders of the firm ethically or in a responsible manner. ‘Ethically or responsible’ means treating stakeholders in a manner deemed acceptable in civilised societies. Social includes economic responsibility. Stakeholders exist both within a firm and outside. The natural environment is a stakeholder. The wider aim of social responsibility is to create higher and higher standards of living, while preserving the profitability of the corporation, for peoples both within and outside the corporation.

Ward (2008: 9) stresses that business has become an integral part of society and the role of CSR is to analyse how efficiently business tackles social issues and to increase socially beneficial decisions of companies. The EU highlights the voluntary nature of CSR by defining it as “a concept whereby companies integrate social and environmental concerns in their business operations and in their interactions with their stakeholders on a voluntary basis” (Hopkins, 2004: 6). On the other hand, during the United Nations Research Institute for Social Development (UNRISD) conference in Geneva in 2003, several discussions revealed the need of a regulatory approach in the CSR movement to implement better CSR strategies (UNRISD, 2003: 3). In a similar manner, Hopkins (2004: 6) proposes that there is a need to remove the word ‘voluntary’ from the definition of CSR, as it prevents any type of policies. This might be beneficial considering that numerous corporations have a tendency in favour of the legislative approach in order to maintain similar standards between other corporations (Hopkins, 2004: 7).

The UNRISD (2003) conference gives some evidence of the different perceptions of what CSR means from a number of different societies across the world. For instance, in Mexico, several companies tend to apply corporate environmental responsibility. Furthermore, government and NGOs as well as university circles and international organisations are actively involved in promoting corporate environmental responsibility. CSR-related issues, however, are not the priority and are limited to the export assembly sector or identified by other business sectors only as charitable or philanthropic. These attitudes of Mexican-based organisations towards CSR can be described by the government's policy, which aims to attract corporations by easing restrictions through cutting corporations tax liability and simplifying the existing rules. This does not challenge corporations to transform their traditional understanding of charitable donations made by organisations to a broader CSR concept (UNRISD, 2003: 3-4).

Another interesting example comes from China, where the problems of implementing the CSR agenda vary from one sector to another. For example, companies in the toy industry that attempt to improve labour conditions can be considered CSR-active compared with the Northern companies offering computer hardware products and services, where labour standards have not been applied (UNRISD, 2003: 4-5).

In short, different corporations have framed different definitions of CSR depending on the institutional and political contexts in which they operate. Therefore, according to Marrewijk (2003: 96), contemporary conceptual definitions of CSR are rather subjective. As a consequence, as stated by Corkin (2008: 39) "CSR is a very slippery concept with shifting definitions, but at very least involves a company going beyond its strict legal obligations to take into account the impact its business has on stakeholders other than its shareholders".

CSR is normally accepted as the voluntary behaviour of business towards stakeholders. The voluntary nature of CSR, however, does not assist companies in deciding how to meet the requirements and the hopes of different stakeholders and at the same time not neglect shareholder issues. Furthermore, companies face problems in choosing the reporting criteria of socially responsible practices and the choice of the best CSR initiatives remains an important and complicated matter (Aras and Crowther, 2009: xxi).

As it has been mentioned earlier, there is a plethora of literature on CSR, due to the substantial public and academic interests in the subject. Nevertheless, this does not provide a good understanding of the subject and creates additional difficulties to the contemporary definition of CSR. First of all, the scope of CSR is very wide to be applicable to corporations (Marrewijk, 2003: 96). Secondly, there is no general agreement of terms that gives a source for CSR initiatives (Marrewijk, 2003: 96). Thus, the variability of concepts and lack of comprehensive research hinder a dialogue between academicians and practitioners. Additionally, the existing literature largely highlights the positive impacts of CSR on business, whereas a small number of studies examine the price of CSR initiatives and the correlation of social responsibility and business (Vogel, 2005: 11).

In spite of the fact that “CSR is confusing” (Webb, 2002: 3) and its concept is surrounded by numerous ambiguities, media and the modern commercial era influence business entities to be more involved in the promotion of social development matters (Balabanis *et al.*, 1998: 25). CSR remains a controversial topic and attracts the attention of its critics and supporters.

Vogel (2005: 18-19), for example, highlights advantages and disadvantages of market capitalism indicated by CSR. Firstly, implementing CSR practices have definitely positive impacts on business as CSR-active companies have a tendency to utilise modern social and environmental projects, embrace innovative policies on socially responsible investment and products that may dramatically decrease operating costs, generate new markets and have a constructive effect on the redirection of staff behaviour towards higher moral standards. It can be said that the re-emergence of socially responsible behaviour offers an opportunity to communities to respond to social demands in their own way and inspire companies to improve their social, environmental and economic performance.

Nevertheless, Vogel (2005: 19) claims that the voluntary nature of CSR activities and the fact that companies are obliged to implement them result in limited practices of socially responsible behaviour. This means, basically, that companies will adopt CSR initiatives if their cost is rational. There is no doubt that CSR active companies have less risk of negative events as they adopt principles that are more transparent and strict. Socially responsible behaviour, however, cannot prevent the market from all possible

breakdowns. For instance, there has not been found a CSR practice that can effectively tackle the opportunistic behaviours in business. In addition to this, CSR principles in contrast with government directives cannot pressurise managers to adopt socially responsible actions that generate negative cash flows. CSR initiatives that involve moderate costs are certainly more preferable and acceptable. Consequently, this may cause the reduction of budget allocated by companies to CSR practices and, therefore would possibly restrict the developments of socially responsible corporate performance.

As it has been shown, what can be envisaged as CSR can vary depending on the institutional and political frameworks in which companies function. Hence, the field of CSR is still developing and in spite of the protracted debate about CSR, there is no agreement on its definition.

2.3. FIRMS AND ORGANISATIONS IN SOCIAL AND BUSINESS ENVIRONMENTS

Before explaining the historical developments and trends in CSR, it is essential to rationalise the need for CSR in the financial and business environment. Therefore, this section concentrates on this issue.

Undoubtedly, firms play a positive role in the modern times through organising the factors of production, providing working places for different employees with different levels of skills. Firms, hence, do not operate in isolated spheres, they function in a particular background, which combines situations, incidents, and effects that enclose and shape it. Therefore, it is important for firms and organisations to have knowledge of the environment in which they operate to facilitate the successful transformation of business. In fact, a good understanding of the related environment will benefit organisations in terms of dealing with its difficulties, impacts and conditions.

Organisations are symbiotically linked to social, economic, political, regulatory, technological, cultural, natural and global environments. The social environment may affect the demand of a firm's products as a result of shifting consumer choices and demographic changes (Madura, 2007: 28). The political environment dictates the laws and government policies, which in turn shape a firm's regulative rules. The economic and global environments influence an organisation's attractiveness for foreign investors. In the era of advanced technology, organisations are becoming the centre of the

economy. Therefore, the symbiosis of firms and the technological environment that provides the accessibility of firms to sophisticated technologies is of high importance. Organisations monitor the cultural environment in order to analyse the behaviours and preferences of the society. The natural environment, which comprises the natural resources, has an impact on markets where firms operate.

Taking into account that organisations function in a ‘shared environment’, it is assumed that they should adopt CSR principles (Preston and Post, 1975). Organisations perceive to have strong CSR commitment due to the fact that being “an integrated part of society and community” brings about moral and ethical rules (Azid *et al.*, 2007: 1). Apart from the economic obligations, firms are compelled to care and support the interests of all the elements of the firm and society. It is assumed that in order to meet economic goals and their responsibilities towards stakeholders and a large environment, organisations should function and grow in a corporate governance framework, which aims “to align as nearly as possible the interests of individuals, corporations and society” (Cadbury, 2000: vi). This indeed rationalises the need for CSR in the financial and business world.

2.4. HISTORICAL DEVELOPMENTS AND TRENDS IN UNDERSTANDING CSR

Modern corporations have close ties with political, cultural, and economic systems, therefore industrial transformations, changes in economic relations, as well as in the communication among companies and different groups of the community, seem to influence societies and businesses to scrutinise their methods of corporate governance (Cannon, 1994: 131). The convergence of CSR and good corporate governance has become a subject of dispute in the literature, and therefore it is a contested issue as to what extent corporate governance and CSR issues are linked (Strandberg, 2005: 2). Enthusiasts observe that recently the concept of good governance has a tendency to embrace ethical matters as a consequence of famous corporation scandals and escalating society’s expectations of business (Strandberg, 2005: 4; Van den Berghe and Louche, 2005: 427). According to Wise and Ali (2009: 2), corporate governance framework, ethical business processes and CSR practices are interconnected. Thus, it is suggested that sound corporate governance should strengthen the company’s CSR practices. Furthermore, companies should consider a shift towards a responsible corporate

governance framework, which will meet stakeholders' interests, maintain growth and accentuate ethical issues (Van den Berghe and Louche, 2005: 427).

There are only a few examples of the current discussions on CSR practices that arise from the corporate governance related issues, such as mounting market and regulatory pressures, increasing positive media coverage (Dusuki, 2008: 8). However, the history of CSR concerns is not new and its roots can be traced all over the world.

Since the Industrial Revolution in Britain in the 18th century, there have been examples of the growing awareness of the social responsibilities of business (Aras and Crowther, 2009: xxi). In conceptualising and debating the role of firm and business, Robert Owen and his proponents such as Lord Shaftesbury, Lord Ashley and John Stuart Mill introduced a new type of the responsible corporation, where problems of the needy tried to be tackled and the responsibility of business to the larger community were presented (Cannon, 1994: 12). Contextualising this in high days of industrial revolution will help to understand the essential nature of developing social responsibility.

After the Great Depression, at the beginning of the 1930s, Dodd and Berle expressed two opposite opinions on socially responsible behaviour of corporations. While Dodd advocated the social role of companies alongside profit maximisation, Berle refuted it (Hopkins, 2004: 3). Later on, the issue of social responsibility has attracted a great deal of attention in the USA during the late 1960s and the beginning of the 1970s, which is considered as an important revival movement towards CSR (Vogel, 2005: 6).

It is worth noting that during the 1980s, the movement of corporate responsibility was very popular in the USA, while it had a little prominence in Europe (Vogel, 2005: 7). This distinctive interest of Americans in ethicality issues in business stems from the fact that Protestantism, which defined the perception of business, is the mainstream religion in the United States (Vogel, 1992: 43). Considering Weber's idea of the impact of the protestant ethics on the spirit of capitalism, it has been suggested that people making higher incomes are morally obliged to help those in their communities who are less well off (Hond *et al.*, 2007: 208). This explains why American society expects companies to maintain high ethical and moral behaviour and why ethics and integrity are essential for business success. Thus, CSR activities have been legitimised in religious context, as in the USA.

In response to the developments in the USA, about a decade later, in the 1990s, the concept of CSR appeared to gain significant importance in Europe. The UK and other members of the EU as well as global companies, such as the United Nations and the World Bank addressed societal challenges and focused on developing recommendations, strategies and public policies to embed CSR in business activities.

As a consequence of this, a quick literature review depicts that CSR issues started to figure prominently in academic publications in Great Britain in the 1990s. The two key publishers of books on CSR are Greenleaf and Earthscan, both of which are based in the UK, in addition to the *Journal of Corporate Citizenship and Accountability Forum* and the *Journal of Business Ethics*. Some of the empirical research, for example, demonstrates that the UK consumers are most likely to consider ethical issues before purchasing, whereas ethical investment funds are more prevalent among Americans.

In short, at the beginning of the 21st century, Europe and the UK in particular have displaced the USA by becoming the epicentre of CSR, in terms of conceptual and theoretical framework but also as an institutionalised concept (Vogel, 2005: 22). Furthermore, there has been a shift from an implicit approach of CSR in America to an explicit one in Europe. The social issues in the USA are addressed implicitly by corporations through their CSR policies, programmes and strategies, whilst European counterparts tend to tackle these issues explicitly by institutional networks (Matten and Moon, 2005: 336).

As can be seen from this short historical overview, CSR has gained unprecedented momentum in different parts of the world in recent years and is still attracting the attention of various layers of societies around the world. It should however be noted that expansion of the idea and policies of CSR to different geographies and cultures implies that the understanding of the concept is varied and developed according to the social realities of each society. There is growing evidence that CSR, at the same time, has become one of the most discussable topics in the academic world. Under an umbrella of CSR, there are numerous disputes on the duties, functions and equilibrium among modern organisations and communities. These disputes consist of diversity of subjects and arguments on the effect of corporate activity on the various stakeholders of the companies. It is important to stress that abundant number of approaches and theoretical assumptions, which are “controversial, complex and unclear”, has been proposed by

international scholars to understand the role of socially responsible behaviour in business (Garriga and Mele, 2004: 51).

In the trajectories of the development of CSR as a discourse and a practice, the first publications on CSR date back to the 1950s, where Bowen's *Social Responsibilities of the Businessman* (1953) attempted for the first time to develop a theoretical framework of the relationship between companies and communities. This study was pioneered as a methodical and efficient description of social responsibility. In his seminal book, Bowen does not accept CSR as a universal remedy for society's problems, but as an inevitable movement that should be promoted and implemented. Considering the influence of corporate actions and their possible effects and outcomes on a larger environment, it is suggested that business entities are compelled to adopt socially responsible behaviour (Bowen, 1953).

With the prominence of CSR in the 1970s, a disagreement between CSR activists such as Bowen (1953) and Davis (1960), and opponents such as Friedman (1970), Leavitt (1958) and Hayek (1969) appeared. The members of CSR opposition camp assume that the primary goal of managers is to maximise shareholder value, and it is governments' responsibility to deal with societal issues. The most important and expressive representative of the CSR opponents is Milton Friedman, who argued that business activities should not extend their commercial boundaries by stating that "there is one and only one social responsibility of business - to use its resources and engage 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" (Friedman, 1970: 6).

Notably, harsh debates on CSR's political and social legitimacy between authors who held a pro-social responsibility position and their opposition continued until the 1980s (Wartick and Cochran, 1985). These disputes, unfortunately, were not productive and made very modest contribution to the already existing theoretical background of CSR (Elkins, 1977; Preston, 1975). Irreconcilable differences in understanding the underlying values of organisations, management behaviour and socially-responsible behaviour as well as a reluctance of both camps to see another point of view as an alternative resulted in academic stagnation of CSR during that period (Lee, 2008: 58).

The major step forward in theoretical development of CSR came with the reconciliatory article of Wallich and McGowan (1970), which aimed at showing a connection between stakeholder interests and CSR. Their proposal suggests that social initiatives of corporations can be accomplished without neglecting economic interests of stakeholders. In their construct, profit still remained the primary purpose of business. However, with the transformed meaning of the stakeholder interest in contemporary business entities, secondary social purpose appeared as a prominent and important source of profitability. This enlightened self-interest model suggests that corporations acting to further the interests of stakeholders and the community ultimately do so for their own long-term self-interest. This study revitalised the interest of academics in CSR in the 1970s, and inspired further research on the subject which, among others, include Elkins (1977), Fitch (1976), Keim (1978), Moyer (1974).

This revival of CSR interest was followed by further supporters of the self-interest based approach to corporate social responsiveness, such as Ackerman (1975) and Preston and Post (1975). Ackerman (1975) in his article '*The Social Challenge to Business*', states that while corporations tend to acknowledge their social responsibility to respond to the new climate of scrutiny and expectation and improve financial performance, social responsiveness should be considered. This implies that there is a relationship between social responsiveness and economic performance of business. In other words, when corporations are engaged in socially responsive activities the improvement of financial performance may not be improved (Wood and Jones, 1995: 234).

In the same period, there was a move from social responsibility to enlightened self-interest, which implies that "rational investors would encourage firms to invest in any activity for which the return to entire sector or publicly owned corporations exceeds the cost" (Keim, 1978: 34). This shift initiated a completely different approach, titled as 'corporate social responsiveness' (Preston and Post, 1975)

In both approaches, the authors analyse how companies respond to social pressure whilst "morality, ethics, and discretionary or voluntaristic behaviour were not necessarily part of responsiveness" (Wood and Jones, 1995: 234).

It is important to state that throughout the 1970s and 1980s, academic studies focused mostly on analysing the linkage between CSR and corporate financial performance

(CFP); nevertheless, the assessment of the relation was lacking (Lee, 2008: 56). The theoretical models on whether or not CSR contributes to CFP were developed in the 1980s (see Carroll, 1979; Cochran and Wood, 1984; McGuire *et al.*, 1988) and employed in the 1990s.

It is widely accepted that the ‘corporate performance’ model was introduced by Carroll (1979), the most influential academic in the field. His model consists of three elements: CSR, social responsibility issues and social responsiveness. Carroll’s definition of CSR can be considered as concise and precise and encompasses the whole meaning of being socially responsible. He suggests that CSR is defined as the economic, legal, ethical and discretionary demands that society places on business. In his later study, Carroll (1991: 40-43) proposes to illustrate four segments of CSR in a pyramid, named ‘The Pyramid of Corporate Social Responsibility’, which depicts four types of obligations that society expects of businesses, which can be summarised as follows:

(i) The economic responsibility is situated at the bottom of the pyramid and is considered as a central and most significant type of CSR. Economic responsibilities suggest that business is committed to maximise profit, operate efficiently and is capable of maintaining a strong competitive position. Providing goods and services that society demands as well as supplying workers with jobs and fair wages are also examples of economic responsibility of businesses. This further includes developing new products and promoting new technologies.

(ii) The legal responsibility relates to the expectation that businesses will obey the laws, rules and regulations set down by modern societies. It is expected from businesses to fulfil their economic objectives within the legal framework. Therefore, being developed from economic responsibilities, legal obligations lie on the second level of the pyramid.

The ethical and discretionary responsibilities were added by Carroll as soon as he realised that existing definitions of CSR were insufficient and limited to obligations as maximising the profit and complying with the law (Masaka, 2008: 15).

(iii) The ethical responsibility goes beyond the law and introduces the idea of morality and conducting business in a fair and just manner. Accordingly, businesses are required not only to act in accordance with the law but also meet the ethical norms, although they are not necessarily enacted in law. Respecting the rights of individuals, protecting the

environment, endorsing human rights, caring for employees and being ethical in trading are some of the examples of ethical responsibilities.

(iv) The discretionary or philanthropic responsibility is absolutely voluntary and driven by business' desire to make donations not mandated by economics, laws or ethics. Organisations are expected to be good corporate citizens. This responsibility is placed at the peak of the pyramid and it is considered as the highest criterion of social responsibility. Generous donations and investments in society are always welcomed and valued; however, philanthropy is coming after the other three above-mentioned segments of CSR.

Carroll's classification has been used extensively in numerous theoretical and empirical surveys to elaborate and broaden the conceptualisation of CSR. The first attempt of further developing Carroll's CSP model was made by Wartick and Cochran (1985), where they shifted the 'social responsibility issues' into 'social issues management'. Hence, the existing model was developed into a model that consisted of the principles of social responsibility, the process of social responsiveness and the policy of issue management.

The next elaboration and reformulation of the model came with Wood (1991: 694), who constructed the CSP model as a composition of principles of CSR, processes of corporate social responsiveness and the outcome of corporate social behaviour. In her model, she presents three principles of CSR, which are the principles of legitimacy, public responsibility, and managerial discretion. This model, however, was not largely employed by researchers and practitioners, as it did not include such an important point as an explanation on measurement and empirical test (Wood and Jones, 1995).

While the abovementioned studies beside the governments' activities and international organisations' efforts as well as the growing awareness of CSR since the end of the 20th century clearly show that although the debate on whether corporations should implement CSR principles does not appear any more, there are still quite a few researches that are sceptical about CSR initiatives in business (Idowu, 2009: 51). The arguments of oppositional positions can be found in studies of Henderson (2001) and Lantos (2001).

2.5. CSR IN FINANCIAL INSTITUTIONS

After reviewing the historical developments and recent trends in CSR, this section highlights the role of CSR in financial institutions.

Financial institutions in general and banks in particular have a great impact on modern societies as they determine the economic stability and sustainable development. Considering the fact that banks have a dominant share in the financial sector, boost and foster economic activity, they are accepted as the central pillars in the global economy (Merton, 1995; Levine, 1997; 2005). In other words, banks as financial intermediaries serve a useful purpose in society; they occupy an essential part of everyday living for most people. As business has become more complex nowadays, traditional banking facilities provide an access to the financial system. Banks perform various roles in the economy and the banking sector, therefore, is considered as a backbone of the daily financial activities in societies. Thus, the banking industry has been under continuous attention and scrutiny by the mass media and academia. In addition, debates over social and economic responsibilities of banks in the past few years have been raised as a result of their irresponsible behaviour (Chambers and Day, 2009: 18).

During the recent financial turmoil, banks were criticised for not meeting the stakeholders' needs (Decker and Sale, 2009: 153). The extent of the financial crisis and its corrupting effect on economy and society is related to inadequate regulation and supervision of banks and financial markets. In addition, the excessive bonus culture of the banking sector and its insufficient commitment to the community has raised the public anger. Consequently, the reputation of the banking sector has been damaged in the eyes of the consumers. As Decker and Sale (2009: 136) emphasise, governments and public opinion are increasing the pressure on the banking industry to embrace CSR as a result of the global financial crisis. The re-establishment of credibility and improvement of legitimacy are considered as essential issues of CSR initiatives of the banking sector. Thus, the UK and several other countries have presented special programmes in order to re-build the trust and reputation of the banking system. Due to the fact that the banking sector is a unique industry in society and its role nowadays goes far beyond bringing financial stability to the economy, to establishing new trends and strategies, to providing necessary services for the customers and reducing the

financial exclusion. It is admitted that the banking sector is at the heart of the society, thus, it is expected to be more socially responsible (Chambers and Day, 2009: 4).

Consequently, professionals and academics worldwide show a tendency towards acknowledging and researching the importance of CSR practices in the banking sector. It is vital for financial intermediaries to integrate moral or ethical as well as environmental concerns into their business operations (Evangelinos *et al.*, 2009: 167). Despite the visible trend to promote environmentally and socially responsible behaviour in corporations, the implementation of CSR practices in banks is still relatively new (Decker and Sale, 2009: 137). In Greece and other European countries documentations of CSR initiatives reveal that only a small number of banks have taken effective steps to assist efforts for CSR and achieve sustainability in order to respond to the stakeholders' expectations (Evangelinos *et al.*, 2009: 167). In fact, several studies have illustrated that in the banking industry, the problems of sustainability have been addressed very carefully (Vigano and Nicolai, 2006). The majority of banks have lagged far behind the institutions in the non-banking sector in implementing CSR as a discourse and practice. However, several attempts have been made in integrating social welfare initiatives into the operations of financial intermediaries. One of these is the guidance, published by the FORGE group in the UK in 2002, which aimed to support the efforts of professionals in the financial services sector in developing and managing the CSR reporting framework that can be applied by the variety of business industries. According to this paper, the banking sector has been facing difficulties in approving the principles and choosing the fitting answers in addressing socially responsible matters (Decker and Sale, 2009: 137). The same group continued the work and made another publication available in 2007, which was related to the response of the financial services sector to climate change issues (Decker and Sale, 2009: 137-138).

It is worth noting that the existence of standardised framework on CSR disclosures would be significantly useful in providing information and structuring the ground for a comprehensive comparison of socially and environmentally-responsible behaviour of the banking sector domestically and internationally. Nevertheless, the banking sector is suffering from the lack of such a standardised reporting framework and a number of scoring systems have been employed in its place (Evangelions *et al.*, 2009: 168).

The existing literature on CSR initiatives in the banking sector demonstrates that environmental issues such as industrial activities causing pollution were integrated into agenda of the banks before social concerns (Bouma *et al.*, 2001). It was a few years later, when banks had focused on social issues such as reputation and sensitivity in lending money to projects harmful to communities. This can be explained by the behaviour of banks, where responsible investment has become a part of standard risk assessment and placed the importance not only on environmental but also on social and financial criteria (Vigano and Nicolai, 2006: 5).

As a result, a further attempt was made to promote responsible banking in 2003, when numerous financial intermediaries adopted the *Equator Principles*, the framework for social and environmental standards for project financing (Freshfields Bruckhaus Deringer, 2005: 1). Therefore, in 2005, 30 banks, including Bank of America, Citigroup and JP Morgan Chase agreed to restrict the lending or projects sponsoring that may have environmental and social liabilities associated with them. According to the report published by an international law firm, Freshfields Bruckhaus Deringer (2005: 7), the *Equator Principles* were implemented by the banks due to external and internal pressures to embrace and improve socially responsible initiatives.

Furthermore, during the last decades, numerous banks around the world have jumped on the CSR bandwagon through engaging in international projects such as the United Nations-supported *Principles for Responsible Investment Initiative* (UN PRI)¹, where investors worldwide work on implementing the *Six Principles for Responsible Investment*; the UN Environment Programme Finance Initiative (UNEP FI)², which is a partnership of the global banking sector and UNEP to raise the awareness of bankers of the environmental concerns. Additionally, the standards of the World Bank and the UN Global Compact (UNCG)³, a framework that presents mutual clarifications to the difficulties faced by financial institutions and communities, were applied to the banking sector in order to make it more CSR-active.

Several empirical studies reveal that banks nowadays have contributed substantially to CSR initiatives and become more socially committed and environmentally friendly. For

¹ <http://www.unpri.org/about/>

² <http://www.unepfi.org/about/index.html>

³ <http://www.unglobalcompact.org/AboutTheGC/index.html>

example, Jeucken (2001) states that since the mid-1990s, European banks have become more active in responding to the new challenges and improved their policies toward environmental issues compared to their American counterparts. Swiss banks, in particular, take into consideration product development and finance the environmental industry. Dutch, German and British banks are also highlighted as proactive in improving their internal environmental performance. An investigation from 1991 to 1995 concluded that NatWest saved approximately US \$50 million in energy costs as a result of cost-effective measures (Natwest Group, 1998).

It should be noted that banks have a great potential in energy savings. These initiatives include water and transport efficiency policies and the development of eco-friendly banking services. Further example is the introduction of the first biodegradable credit card by the partnership of the Co-operative Bank and Greenpeace in 1997 (Jeucken and Bouma, 1999: 26).

Therefore, banks are driven by public demand to increase the transparency and accountability with the respect to social responsibility as a result of changing norms and expectations in society. Being socially responsible for the banking sector is accepted as a deep-rooted concept in the industry of financial services (Scholtens, 2009: 159).

The research by Scholtens (2009) that was carried out on performance assessment of the 34 international banks from the Europe, North America and the Pacific during the period 2000-2005, regarding the following matters such as reports, international codes adoption, the application of certified management systems, the spread of environmental activity internally, and the implementations of CSR strategies to stakeholders and the society, illustrated that the majority of analysed institutions currently publish a sustainability report, whereas at the beginning of the millennium only thirty per cent of those banks submitted the report. In this study, the UNEP's codes were found as the most utilised codes of conduct. In addition, eighty per cent of the banks under survey showed increasing responsiveness to environmental issues through adopting necessary policies and reporting on their environmental performance. However, in 2000, this number was limited to forty per cent. Additionally, around forty per cent of the banks had a tendency to restrict the lending to companies whose economic activities were involved in gambling operations, tobacco, alcohol and pornography. Furthermore, there is a trend between financial intermediaries towards adopting various codes of conduct.

Moreover, the range of socially responsible financial products has become more diverse. Therefore, it can be stated that with the gradually increased awareness of CSR among the business community, banks around the world have demonstrated better engagement to the communities, transparency and reporting of socially responsible behaviour (Scholtens, 2009: 172-173).

Another study conducted by Vigano and Nicolai (2006) analysed CSR practices in the European banking sector and demonstrated its recent CSR trends. The research focused on commercial, co-operative, saving and public banks that represent the most common types of banks in the region and their perception of socially responsible behaviour in relation to the three issues: climate change mitigation, gender discrimination prevention and anti-bribery programmes and policies. This study analysed the implementation of the CSR policies and strategies in the European banking sector through the CSR instruments employed by the institutions, the operations designed specially by banks in the areas related to CSR and the required resources to encourage socially responsible initiatives. The research revealed that the most popular CSR instruments that are used in the banking sector are (Vigano and Nicolai, 2006: 22- 24): (i) Codes of conducts, which include company-specific codes of conducts or ethics, UN Global Compact, UNEP FI, Equator Principles, FATF on Money Laundering; (ii) Management systems such as ISO 14000 as well as company-designed management systems, EMAS, EFQM Excellence Model and SA 8000; (iii) Different forms of stakeholder engagement and cooperation, which take in information-gathering about stakeholders, stakeholders consulting and dialogue, participating in multi-stakeholder initiatives.

According to the same study, the information regarding the resources that have been spent on promoting CSR initiatives by the European banks is not always available. On the other hand, the numerous banks in the sector tend to allocate larger funds on social and environmental projects every year. In addition, the European banks illustrated an improved performance for each subject addressed by RARE. Last but not least, an important point of this survey showed that socially- and environmentally-oriented programmes developed by the European banking industry as a part of their CSR agendas had a strong external effect (Vigano and Nicolai, 2006). In short, it can be said that the European banking sector in the last decade has strengthened its CSR policies, and the concept of CSR has become a significant issue for the sector.

Social responsibility of banks to the community development has a direct connection with the prevention of financial exclusion. According to Chambers and Day (2009: 15), the UK banks address the problem of financial exclusion adequately. In doing so, banks establish departments to tackle this difficulty and provide an assistance to economically-disadvantaged citizens. Furthermore, they work in corporation with credit unions, the community finance sector and money advice agencies to make the access to financial products available to all strata of society. Nevertheless, taking into consideration the impact of the global financial crisis on the banking sector, it is hard to predict how effectively banks can tackle the issue of financial exclusion. The financial meltdown has hit the most vulnerable members of society the worst. However, with the massive decline in bank lending, it appears most likely at the present time that the banking sector is not able to counter the financial exclusion and help these groups who suffer from the negative impacts of financial instability (Chambers and Day, 2009: 20).

Despite the great efforts of the banking industry to the development and implication of CSR initiatives, the transformation of the business environment during the global financial meltdown might affect the corporate policy of CSR practices and consequently the perceptions and attitudes of banks towards social responsibility may change. In fact, in 2008, the study conducted by one of the CSR specialised websites illustrated that forty-four per cent of professionals expect businesses to tangibly engage in CSR policies, activities and practices due to the financial crisis, whilst almost 30 per cent of them assume that the nature and identity of socially responsible behaviour will shift according to the changing environment, and twenty-two per cent have pessimistic forecasts regarding to the consequence of the global crisis on CSR (Jothi, 2010: 95).

According to Decker and Sale (2009: 153), the current financial meltdown negatively affected the self-assurance and belief of bankers in the capability of fulfilling their economic, legal, ethical and philanthropic obligations. Although the banking sector has applied strict expenditure reductions, it is doubtful whether the tasks that aimed to apply CSR initiatives within the sector will be terminated and financial pressures will not force banks to compromise their ethical values. On the other hand, it is assumed that the financing of projects, which intended to employ a CSR agenda in order to increase the development of banks will be reduced. Additionally, the economic liabilities will be evaluated more cautiously as well, as the professionals of the banking industry will tend

to show more socially-oriented behaviour.

In short, the recent financial meltdowns have shown that there is straightforward association between CSR and financial institutions, in particular banks. Thus, banks are expected to conduct their operations in a responsible fashion to ensure market stability.

2.6. CSR PERFORMANCE AND PERFORMANCE MEASUREMENT ISSUES

Having accepted that CSR has become a very prominent concept and practice, which promotes financial and non-financial institutions to acknowledge their social, environmental and economic impacts on communities, corporations are expected by the stakeholders to be accountable and transparent in their initiatives. In doing so, it is suggested that business entities are required to disclose the correct, transparent and adequate data regarding to their improvements in these aspects (Adamczyk *et al.*, 2009: 3).

Corporations are driven by public pressure to assess or rank their socially responsible performance in order to survive in modern markets, as the large corporations have begun to issue their CSR reports annually alongside their annual reports. Therefore, to be able to meet these requirements, the issue of CSR measurement should be managed and controlled professionally. Thus, in order to present a complete guidance and unified principles, there is a need for a standardised, theoretically well-grounded and comprehensive framework for CSR measurement (Adamczyk *et al.*, 2009: 3). Hopkins (2005: 213-214) emphasises the importance of indicators in CSR measurement and highlights that “the measurement systems used have no systematic conceptual basis, rarely define concepts and choose indicators based on the whim of the moment”.

It is worth mentioning that much of the work in the CSR related literature is focused on the measurement issues (Gjøllberg, 2009: 12). During the last twenty years, there has been a significant development in measuring the impact of the socially responsible behaviour of firms (Hopkins, 2005: 214). However, the field is still lacking a commonly accepted CSR measurement system.

While researchers were debating on what CSR entails, the focus of the debate moved from the definition to the evaluation of CSR initiatives. As a result, it has become more important to assess the social and environmental responsibilities that have been taken on

board by the companies and, therefore, processes and outcomes have become the centre of attention. In turn, the concept of Corporate Social Performance (CSP) has emerged (Schreck, 2009: 13).

The CSR concept has become an integral component of a larger theoretical framework of CSP (Windsor, 2001a: 227). The CSP framework is associated with CSR and corporate social responsiveness through distinguishing between moral responsibility and calculated responsiveness. The understanding of the CSR theory and its application as corporate social responsiveness occurred simultaneously with the emergence of the CSP concept (Dunne, 2008: 194). However, CSP can probably be considered as one of the widely accepted frameworks for CSR measurement.

2.6.1. Corporate Social Performance

CSP is related to positive and negative outcomes of business activities of the corporations as a result of their engagement with social, cultural, legal, political and natural environments (Wood, 2010: 51).

The first conceptual model of CSP, as mentioned above, was proposed by Carroll (1979), which encompasses three elements: a definition of social responsibility, social responsibility issues and social responsiveness. He illustrated the cube of CSP, which includes 96 boxes where CSP may be evaluated. Although Carroll's model has not been very useful in empirical research, the notion that corporations have economic, legal, ethical and discretionary obligations towards the society has been employed by numerous researchers to conceptualise and operationalise empirical studies (Wood and Jones, 1995: 233). Further development of the CSP model was initiated by Wartick and Cochran (1985), as their additions to the concept expanded the model of CSP to a more sound and rational ground (Wood, 2010: 53). Based on Wartick and Cochran (1985), Wood (1991) introduced a new model of CSP, which turned out to be "a cornerstone for the entire CSP debate" (Dunne, 2008: 196). In her model Wood (1991: 693) defined CSP as: "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".

Therefore, the Wood model of CSP consists of 'the principles of CSR', 'processes of corporate social responsiveness' and 'outcomes of corporate behaviour'. The structural

principles of responsibility were defined as “inputs”, processes of corporate social responsiveness as “throughputs”, and lastly “outputs and outcomes” (Wood, 2010: 53). The three components of CSP are interrelated and include sub-components that together shape an analytical framework. Hopkins (2005: 215) interpreted the ‘Wood CSP model’ and presented the following conceptual framework for CSR measurement:

Level 1-Principles of CSR:

The structural principles of CSR describe the institutional relationship between corporations and communities as well as identifying the expectations of the society from business entities. This level comprises three main facets: legitimacy, public responsibility and managerial discretion. The discretionary principle is completely different from Carroll’s discretionary responsibilities, as manager and employees in this model are accepted as moral agents of the organisations.

Level 2-Processes of Social Responsiveness:

Corporate processes of responsiveness represent the processes through which businesses identify and frame responses to threats and opportunities caused by societal and environmental factors and the managerial processes that form internal coping system. This category assumes that corporations should foresee the impact of policies and programmes toward societal demands that affects their performance. Therefore, this level is comprised three processes, which are business environment scanning, stakeholder management and issues management.

Level 3-Outcomes of Social Responsibility:

This level focuses on the measurement and observation. The outcome of corporate behaviour is designed in combination with the principles and processes that allow the improved pragmatic evaluation of social impacts, policies and programmes. This level has three major elements: ‘internal stakeholder effects’, ‘external stakeholder effects’ and ‘external institutional effects’.

According to the theoretical framework of CSP introduced by Wood, stakeholders define the norms and rules of corporate behaviour, analyse, estimate the impact related to behaviour change, and assess it. Consequently, it is the role of businesses to assume

the potential outcomes of the policies and projects developed to fulfil the expectations of society from business entities. The measurement of CSP is the combination of all factors of ethical perspectives (Rais and Goedegebuure, 2009: 226).

Undoubtedly, the outcome of social responsibility is the most crucial category in Wood's CSP model, which did not exist in previous models presented by Carroll (1979), Wartick and Cochran (1985) (Wood, 2010: 54). In this model, the theoretical integration is proposed in a better way as well as the strategic considerations being more emphasised, albeit not enough directions on the actual development of required strategies and instruments for the realisation of aims are provided (Meehan *et al.*, 2006: 390).

According to Wood (2010: 55), the most important development of her model was initiated by Kang (1995). Kang (1995) states that corporations are allowed to make profit so that they can fulfil their ethical and legal obligations, as without this the business cannot be considered socially legitimate. The main argument of Kang's study is that a company, which is not able to show profitable growth by conducting its business legally and ethically cannot exist, therefore, is destined to be eliminated by society.

Another valuable contribution to Wood's model was advanced by Swanson (1995), according to whom, there are three main issues in Wood's model that make it impossible to offer an efficient contribution of business entities towards better society (Swanson, 1995: 52). Firstly, normative standards are required to be under the control of the principles of social responsibility. Secondly, these principles are supposed to integrate positive tasks in institutional, organisational and individual levels. Thirdly, the principles of social responsibility are expected to concentrate on the moral motivation, which is supporting negative and positive duties.

In short, Wood contributes significantly to the CSP-related literature through encompassing the issues of social responsibility as well as structural arrangements in the corporation, processes, and measurable outcomes to the scope of social audits. The further expansion of the model by Swanson highlights the role of decision-making processes and the personal values which affect these processes. Consequently, CSR

auditing procedure has become a more challenging task than is assumed by the majority of business management consultants (Orlitzky, 2000: 11).

2.6.2. Methods of Reporting and Measuring CSR

As has been mentioned earlier, there is no universally agreed CSR measurement system. The existing literature shows that the measurement of CSR is conducted in different ways. In fact, a variety of guidelines, checklists, frameworks and models are available to organisations. For example, Igalens and Gond (2005) classified CSR performance measurement methods into five groups: measurement methods based on environmental reporting content, indices, questionnaire surveys, corporate reputation indexes as well as environmental auditing reports. The environmental and social information has been employed by these methods to measure CSR performance in a comparable and compatible way through several past years and in different industry sectors. On the other hand, a few of these methods have been used by numerous academicians to assess and analyse the data in environmental and social reports in order to be able to evaluate the CSR practices across different political-economic systems and industries. A good example of such an analysis was conducted by Gray *et al.* (1995b), where the information divided into three groups: ‘decision-usefulness’ studies, ‘economic theory’ studies and ‘social’ and ‘political theory’ studies (Evangelinos *et al.*, 2009: 162). The modern, widely accepted methods for evaluating environmental and social reports’ contents may be classified into three following categories of ‘content analysis’, ‘scoring methods’ and ‘questionnaire surveys’ (Evangelions *et al.*, 2009: 162).

The most commonly employed methods for CSR performance measurement can be summarised as follows:

2.6.2.1. CSR indices

A number of organisations design indices in order to evaluate and rate firms according to their social performance, as in the case of financial performance. They can also be used as guidelines by investors who are willing to choose businesses with socially responsible behaviour (Herrera, 2009: 27). A number of such indices are presented as follows:

(i) Business in the Community (BiTC)

The Corporate Responsibility Index is published annually by Business in the Community and was launched in 2002 as the first voluntary, business-led, UK's leading benchmark of corporate responsibility⁴. This index plays an important role in integrating and improving corporate responsibility of businesses as it provides a systematic approach to measuring, managing and reporting the various impacts that companies have upon society and the environment (BiTC, 2011: 2). The Index is internationally recognised and accepted as one of the important management tools of socially-responsible behaviour. Since its establishment, more than 300 companies have used the Corporate Responsibility Index as a management tool that assists companies in measuring their social and environmental performance. Companies with annual revenues of more than £250 million and are in the FTSE 100, FTSE 250, the Dow Jones Sustainability Index (DJSI) as well as Business in the Community member companies being invited to participate in the CR Index.

The index is designed in a form of online survey, which is based on four components: 'corporate strategy', 'integration', 'management section and performance' and 'impact areas'. The four main management areas that are 'community', 'environment', 'marketplace' and 'workplace' are encompassed by the questionnaire. Companies are expected to report on three environmental and three social impact areas (BiTC, 2011: 3).

(ii) FTSE4Good Index Series

The Socially Responsible Investment (SRI) index series called 'FTSE4Good' was launched in 2001 by the FTSE Group⁵. The index measures the performance of companies, which meet globally-recognised CSR standards and facilitates investment in these companies. Investors worldwide benefit from it as it presents the ground for assessing companies regarding their management responsibility. Therefore, it is accepted as a criterion for decisions about sustainable investment. In order to be listed in FTSE4Good, companies are required to meet strict social, ecological and ethical standards. These include sustainable environmental management, positive dialogue with stakeholders, observation and support for human rights and the maintenance of good

⁴ http://www.bitc.org.uk/cr_index/about_the_cr_index/index.html

⁵ http://www.ftse.com/Indices/FTSE4Good_Index_Series/Downloads/FTSE4Good_Factsheet.pdf

supply-chain labour standards⁶. In ensuring the ethical and social nature, producers of tobacco, manufacturers of the whole weapon systems as well as manufacturers of nuclear weapon systems and owners or operators of nuclear power stations are expelled from the FTSE4Good Index Series⁷.

(iii) Dow Jones Sustainability Indexes (DJSI)

The Dow Jones Sustainability Indexes were established in 1999, to track the performance of the sustainability leaders. The DJSI encompass a series of global and regional indices, which include Europe and the Eurozone, North America and the United States, Nordic, Asia Pacific and Korean indices⁸. Each series consists of one composite and a number of specialised sustainability indices, excluding alcohol, gambling, tobacco, armaments and firearms and adult entertainment. The Dow Jones Sustainability World Indexes (DJSI World) track the financial performance of companies globally in terms of sustainability. This index covers the top ten per cent of the 2,500 largest companies in the Dow Jones Global Total Stock Market Index. The DJSI World is reviewed annually. The Corporate Sustainability Assessment methodology, index features and data dissemination, periodic and ongoing review, the calculation model and the management and responsibilities are published in a guidebook for each of the DJSIs. The DJSI is based on the results of the annual Corporate Sustainability Assessment controlled by the Zurich-based company, SAM (Sustainable Asset Management) (Hopkins, 2005: 221).

(iv) MSCI KLD 400 Social Index

The Domini 400 Social Index was designed by Kinder, Lydenber, Domini & Co. (KLD) in 1990, renamed the FTSE KLD 400 Social Index in 2009 and modified to the MSCI ESG Indices in September 2010⁹. This is the first index to be formed using environmental, social and governance factors. It is a widely accepted benchmark for measuring the social performance of companies. A special rating system was developed by KLD in order to assess CSP. Corporations are included in or excluded from the sustainability indices according to the results of the rating scheme (Wood, 2010: 65).

⁶ http://www.ftse.com/Indices/FTSE4Good_Index_Series/Downloads/F4G_Criteria.pdf

⁷ http://www.ftse.com/Indices/FTSE4Good_Index_Series/Downloads/F4G_Criteria.pdf

⁸ http://www.samgroup.com/html/yearbook/downloads/Brochure_Dow_Jones_Sustainability_Indexes_e.pdf?CFID=3425404&CFTOKEN=5b4e14e4af292593-627D8BE2-E9C3-B3A6-5B347152E6DB7437

⁹ <http://www.msci.com/resources/factsheets/MSCI%20KLD%20Factsheet%20Nov2010.pdf>

The MSCI KLD400 Social Index is a float-adjusted, market capitalisation-weighted, common stock index of US equities. Companies involved in this index have higher environmental, social and governance factors compared to other companies in the industry¹⁰. In addition, the index excludes companies that are involved in particular industries such as tobacco, alcohol, firearms, gambling, nuclear power and military weapons. Furthermore, companies are required to meet the financial screens, or are otherwise not considered eligible.

After presenting the main rating based indices in measuring the CSP, the next section presents the scoring methods.

2.6.2.2. Scoring methods

The scoring methods are used for classifying and assessing information from environmental and social reports by means of scoring systems. The existing CSR literature shows that recent surveys have used a variety of guidelines and scoring criteria. The internationally-recognised reporting frameworks include the Global Reporting Initiative (GRI), the United Nations Environmental Program (UNEP), ISO (ISP14031) and some other frameworks designed by international organisations as Deloitte Touche Tohmatsu Limited, Ernst & Ernst and KPMG. The scoring surveys apply different criteria, measuring methods and directions (Evangelinos *et al.*, 2009: 162).

Scoring methodologies are applied to compare the non-financial reports through ranking them. Furthermore, to assess the CSR performance, these surveys employ quantified information; thus, this provides an opportunity to compare the usefulness of information within the industry as well as across different industries and countries. Moreover, it makes it possible to study how the non-financial reports are compatible with the international guidelines' suggestions (Evangelions *et al.*, 2009: 162).

(i) Global Reporting Initiative (GRI)

The Global Reporting Initiative (GRI) is a widely used sustainability-reporting framework, which has been extensively employed by the European banks (Vigano and Nicolai, 2006: 24). The GRI has recently been used by many corporations as a reporting

¹⁰ <http://www.msci.com/products/indices/thematic/esg/values-based.html>

guideline or standard, and serves as a framework for social accounting, auditing and reporting (Mcgraw and Katsouras, 2010: 3).

The GRI framework aims to develop principles and performance indicators, which can be used by companies to measure and report their economic, environmental and social performance. The reporting framework of the GRI is built on a process of consensus-seeking, systematic dialogue of multi-stakeholders from the different layers of society, such as business, civil society, academia, labour and professional institutions. The GRI consists of 'The Sustainability Reporting Guidelines' that form the basis of the GRI, 'the Sector Supplements and the Technical Protocol'.

The GRI framework can be applied to any organisation regardless of the size or type, sector or geographic location, which has been employed by numerous corporations around the world as a foundation for preparing their sustainability reports¹¹. Although the GRI is primarily a reporting mechanism, it is worth noting that its widespread recognition may play a significant role in developing CSR measures. The framework presents a starter set of CSR performance areas that can be assessed by any corporation. However, the GRI is lacking a suitable system for measuring CSR activities, namely, social and human rights impact as well as workplace impact (Herrera, 2009: 26).

This framework was updated and developed into the G3.1 Guidelines¹², the third generation of the GRI's Sustainability Reporting Guidelines. The updated framework includes reporting on human rights, local community impacts and gender.

Overall, CSR measurement is conducted in a number of ways ranging from the measurement methods based on environmental reporting content, indices, questionnaire surveys, corporate reputation indices as well as environmental auditing reports. One of the major difficulties in developing CSR measurement methods is a lack of clear consensus regarding what should be measured and why in CSR performance.

2.7. CSR DISCLOSURE: CONCEPT AND DEFINITION

Taking into account that CSR disclosure has been often viewed as a manifestation of CSR activities and performance (Gray *et al.*, 1996) and social reporting has become the

¹¹ <http://www.globalreporting.org/ReportingFramework/ReportingFrameworkOverview/>

¹² <https://www.globalreporting.org/reporting/latest-guidelines/g3-1-guidelines/Pages/default.aspx>

fundamental component of CSR agenda, this section focuses on the CSR disclosure as a concept.

With the increasing importance of CSR reporting (Panayiotou *et al.*, 2009: 150) and with the renewed expectations of corporate conduct within a global stakeholder society and the Global Reporting Initiative (GRI) publishing the third version of its Sustainability Reporting Guidelines in 2006, recent years have witnessed a substantial shift in corporate practices, with disclosure on corporate social responsibility becoming the norm instead of the exception across industries and regions. (Vurro and Perrini, 2011: 459).

It can be argued that designing and implementing CSR reports has been developed into a key element of the CSR agenda, as a consequence of the rising academic and public awareness, of the advantages received by companies that incorporate the dynamic demands of the business and social environment by recognising and managing the expectations of their stakeholders by means of voluntary actions, beyond compliance with legislation and regulations (Vurro and Perrini, 2011: 460).

It should be noted that CSR disclosure relates to the external mandatory or voluntary reporting of social, ethical and environmental information by the corporations to broad stakeholder groups (Belal and Lubinin, 2009: 165; Jenkins and Yakovleva, 2006: 273).

In the definition proposed by Guthrie and Mathew (1985), CSR disclosure is a “provision of financial and non-financial information relating to an organisation’s interaction with its physical and social environment, as stated in corporate annual reports or separate social reports”. In describing CSR, Gray *et al.* (2001: 329) in a similar manner suggest “social and environmental disclosure can typically be thought of as comprising information relating to a corporation’s activities, aspirations and public image with regards to environmental community, employee and consumer issues”.

A review of the accounting literature indicates that two different approaches to the research on CSR disclosure can be identified (Gray *et al.*, 1995b). In the first approach, social responsibility disclosure is regarded as a branch of conventional accounting which is involved in the “identification, measurement (or calculation) and communication of economic information, characterised by denomination in money amounts” (Boyce, 2000: 29). Thus, CSR disclosure will provide financial information

regarding social costs and benefits related to the measurement of social and environmental impacts of business activities. This approach suggests that managers should take into account monetary information in addition to the social and environmental information of business activities, in economic and financial decision-making process (Branco and Rodrigues, 2005: 82).

In the second alternative approach, CSR disclosure is viewed as an essential part of the investigation of the role of communication in the dialogue between business and society (Gray *et al.*, 1995b: 48). Although this approach is viewed by the proponents of conventional accounting as very ambitious, it has served as the main source for understanding the concept of CSR and at the same time as a source of critical reviews of studies conducted on CSR. This approach is dominant in the modern perspective of CSR disclosure.

There is no mutual agreement between academics and practitioners on what constitutes CSR disclosure. The very early study by Ernst and Ernst (1978) categorises CSR disclosure items into environment, energy, fair business practices, human resources, community involvement, products and other social responsibilities disclosed. Social disclosure can also encompass the following issues: 'employee-related matters', 'environmental problems', 'community involvement' and 'product quality' (Branco and Rodrigues, 2005: 82). It may also comprise ethical issues and ethical investment (see among others Kamla, 2005; Maali *et al.*, 2006).

Deegan *et al.* (2000) reviewed the previous research on CSR disclosure and summarised the grounds that justify social disclosure as a practice. Firstly, it is essential to fulfil the expectations of society. The second reason is the desire to comply with legal requirements. This, however, cannot be considered as a key drive in the countries where the legal background for social and environmental disclosures is not established. Another reason that justifies social disclosure is to attract investment funds internationally since ethical investment funds are becoming part of the capital market. Managing particular stakeholder groups and winning particular reporting awards are other motivations behind CSR disclosure. Economic rationality considerations, complying with particular codes of conduct and fulfilling borrowing requirements also take place among the grounds for CSR disclosure. Certain threats to the company's legitimacy may also motivate social disclosure practices.

It should be noted that CSR disclosure can be communicated through annual reports, stand-alone environmental reports, advertisements or articles, booklets, leaflets and brochures, labelling products, newsletters, press releases, supplements, to the annual reports, video tapes, and websites (Gray *et al.*, 1995a; Jenkins and Yakovleva, 2006).

After identifying the nature and reasons for CSR disclosure as part of CSP measurement, the following section focuses on theories in CSR disclosure.

2.8. CSR DISCLOSURE THEORIES

Various theories have been developed to explain the underlying reasons for CSR disclosure practices. Garriga and Melé (2004), for example, classify CSR theories into four main categories: ‘instrumental’, ‘political’, ‘integrative’ and ‘ethical’ theories. In classifying such theories, Gray *et al.* (1995b: 50) identify ‘decision-usefulness’, ‘economic’, ‘social’ and ‘political’ theories that are used by researchers to find a theoretical framework for empirical studies on CSR and to significantly relate the theory with empirical findings.

Social and political theories are concerned with the role of information and disclosure with regard to the relations between individuals, the state and organisations. These theories focus on the power of corporations in society and the responsible use of power in the political sphere. These theories are considered as the most suitable in explaining CSR disclosure. In fact, systems-oriented theories such as stakeholder theory, legitimacy theory and political theory are the main theories that have dominated in the CSR disclosure literature (Deegan, 2002: 288).

2.8.1. Political Economy Theory

Political economy theory refers to “the social, political and economic framework within which human life takes place” (Gray *et al.*, 1996: 47) and emphasises “interactions and connections between business and society and [on] the power and position of business and its inherent responsibility” (Garriga and Melé, 2004: 55). Different types of political economy approaches exist in the literature, which equally introduce political matters and analysis into the CSR discussion. Three key political theories can be identified: ‘integrative social contracts theory’, ‘corporate constitutionalism’ and ‘corporate citizenship’.

‘Integrative social contracts theory’ has been influenced by the traditional social contract theories of political philosophers, such as Donaldson (1982) (Garriga and Melé, 2004: 56). Proposed by Donaldson and Dunfee (1995), this theory assumes a combination of macro-social contract with a set of social contracts at micro level. It takes into account the culturally-specific background of communities and also suggests the existence of universal norms, superior to local norms and “weds the normative perspective of traditional social contract methodology with the specificity of moral understandings within and among industries, firms, departments, professions, and business communities” (Donaldson and Dunfee, 1995: 86). This theory is based on consent that consists of two levels. In the first, the macro-social level, independently authoritative hypernorms are applied to all companies, while in the second, the micro-social level, context-specific norms are specified. ‘Authentic’ norms are the outcomes of micro-social contracts, which are in harmony with the requirements of a macro-social contract are accepted as ‘legitimate’ norms. It should be noted that “priority rules, consistent with the macrosocial contract, are employed to resolve conflicts between mutually exclusive, competing, legitimate norms” (Donaldson and Dunfee, 1995: 90).

‘Integrative social contracts theory’ offers “a communitarian conception of economic morality that defines correct ethical behavior through the device of a hypothetical social contract emphasizing the moral understandings of living members of economic systems and organizations” (Donaldson and Dunfee, 1995: 86). The significant element of this theory is its tolerance to diversity of moral experiences across cultures.

‘Corporate constitutionalism’ is another important political theory under the umbrella of political economy theories. It recognises the power and responsibilities of corporations and the impact of corporations on society (Davis, 1960). Corporations are urged to use their power in a responsible manner.

‘Corporate citizenship’ theory, which is also related to political economy theory, refers to the relationship between business and societies, where companies undertake responsibilities that consider not only their economic but also social and environmental impacts.

It should be noted that ‘corporate citizenship’ is a prominent term that came as a “result of societal change and an undeniable constraint” (Harribey, 2011: 23). The concept of

'corporate citizenship' is viewed by some practitioners as more positive compared to CSR as they believe that "it may arguably serve to integrate corporate social responsibility and stakeholder management within a corporate social performance framework" (Windsor, 2001b: 44). The term 'corporate citizenship' has multiple definitions. For example, Matten and Crane (2003: 13) describe three views that underlie this concept: "a limited view" that regards 'corporate citizenship' as philanthropic donations stimulating engagement of corporations with communities, "the equivalent view", where 'corporate citizenship' is equal to CSR and businesses are not assigned any roles and "the extended view", which explains "the role of the corporation in administering citizenship rights for individuals". The extended view of corporate citizenship assumes the shift from the idea that accepts the firm as citizen as it suggests that corporations manage certain aspects of citizenship for those individuals.

According to Harribey (2011: 25), there are two approaches that help corporations to determine the importance of 'corporate citizenship' and the decision of applying it to their agenda. First, the rights of corporations to exist should be guarded exactly as the rights of citizens. Second, corporations as corporate citizens should consider their stakeholders who can challenge them in their choice of decision-making. In both cases, corporations are the stakeholders in society and play an important role alongside governments through responding to the societal issues and driving responsibility into the political arena.

In short, political economy theory focuses on exchanges that occur in any framework, such as the market, and examines the relationship among social institutions reinforced with power and the economy (Jackson, 1982). This theory also assists researchers in interpreting social disclosure from the broad socio-political and economic context within which disclosure takes place. Furthermore, it is suggested that studies that take into account the political economy theory are better at recognising broader societal matters that have an influence on the organisational processes of business and select information that should be disclosed (Deegan, 2002: 292).

As a result, from the political economy perspective, accounting reports are seen as instruments for "constructing, sustaining, and legitimising economic and political arrangements, institutions, and ideological themes which contribute to the corporation's private interests. Disclosures have the capacity to transmit social, political, and

economic meanings for a pluralistic set of report recipients” (Guthrie and Parker, 1990: 166). In fact, several studies support the use of political economy theory that concentrates on the socially responsible use of business power, as a basis for explanation of CSR disclosure (see among others Guthrie and Parker, 1989; Guthrie and Parker, 1990).

2.8.2. Legitimacy Theory

Legitimacy theory along with stakeholder theory, are grounded in the political economy theory (Deegan, 2002: 292), and adopted by the accounting literature as a theoretical basis for motivational aspects of social disclosure. According to Garriga and Melé (2004: 57), legitimacy and stakeholder theories are classified under the group of ‘integrative theories’ that examine how corporations are good at integrating social demands. Thus, these theories suggest that businesses should focus on detecting and responding to social demands, considering that social legitimacy and prestige will come as an outcome. In other words, these theories relate to the concept of ‘social contract’ between businesses and society, which reflects the expectations of stakeholders on how corporations should conduct their operations (Gray *et al.*, 1996).

In this, ‘social contract’ “reflects the interdependence of business and society” (Weyzig, 2009: 422) and assumes an agreement, where corporations accept to carry socially responsible activities in return for being able to achieve their aims and validate their existence. Hence, it is essential for corporations to discharge their CSR practices to enable society to evaluate them and decide how much business entities are socially responsible. As a result, “in legitimising its actions via disclosure, the corporation hopes ultimately to justify its continued existence” (Guthrie and Parker, 1989: 344). For this purpose, companies make efforts to establish a harmony between their own social values and the values of the society in which they operate (Dowling and Pfeffer, 1975: 122). However, if society finds that the company’s set of social norms conflicts with society’s ethical bounds and codes of behaviour, it may cease the company’s business operations (Guthrie and Parker, 1989: 344; Deegan and Rankin, 1996). In order to meet society’s expectations and to match their activities with the values acceptable by the society where they operate, companies provide enhanced disclosure of social and environmental information (Wilmshurst and Frost, 2000: 11).

Several studies have adopted legitimacy theory as a theoretical perspective for the purpose of explaining a motivation for corporate social disclosure (see: O'Dwyer, 2002; Grey et al., 1995b; Deegan and Rankin, 1996; Wilmshurst and Frost, 2000; Deegan, 2002). The findings of these studies largely recognise the applicability of legitimacy theory in explaining the driving force of CSR disclosure practices. The main reasons that lead companies to disclose their social activities are to legitimise their activities and to improve their image (Hogner, 1982; Deegan and Rankin, 1996; Clarke and Gibson-Sweet, 1999).

On the other hand, a number of studies that employed legitimacy theory to provide valuable motivations for CSR disclosure practices have come up with inconclusive results (see: Guthrie and Parker, 1989; Wilmshurst and Frost, 2000; Campbell *et al.*, 2003). For example, Guthrie and Parker (1989), despite its great input to the disclosure literature, could not provide sufficient evidence in support of legitimacy theory in explaining the variations in disclosure. Furthermore, Deegan (2002: 298) highlights that legitimacy theory, which is grounded “on managers’ perceptions of social contracts (and these perceptions will differ between managers), and potential breaches thereof, legitimacy theory does suffer resultant problems in relation to precision of prediction”. Although it may be useful in providing better understanding to the managerial decision-making process, “it can still be considered to be an under-developed theory” (Deegan, 2002: 298). Additionally, the research by Wilmshurst and Frost (2002) outlines that previous studies have not produced results in support of legitimacy theory. In a similar manner, the results of their own research show that legitimacy theory does not provide sufficient justifications for the decision to disclose environmental information. Similarly, the findings of the study conducted by Campbell *et al.* (2003) suggest that legitimacy theory might be useful in explaining motivations of disclosure in some situations, but not always.

2.8.3. Stakeholder Theory

Stakeholder theory is another important theory employed to provide theoretical motivations for CSR disclosure. Being similar to legitimacy theory, stakeholder theory focuses on the relationship between organisations and the environment where they conduct their operations (Neu *et al.*, 1998). The term ‘stakeholder theory’ has been introduced by Ansoff (1965) in describing the firm’s objectives, who stated that the

main objective of the firm is to maintain the balance between different interests of numerous groups of stakeholders (Roberts, 1992: 597). Consequently, “the corporation's continued existence requires the support of the stakeholders and their approval must be sought and the activities of the corporation adjusted to gain that approval. The more powerful the stakeholders the more the company must adapt” (Gray *et al.*, 1995b: 53).

According to Freeman (1994), stakeholder theory concentrates on two main issues. Firstly, it concerns itself with the purpose of the company. The purpose lies in identifying the company's core values, which are shared by stakeholders, and bringing core stakeholders together. Secondly, it relates to the responsibilities that managers have towards their own stakeholders. Some other studies, in defining the notion of stakeholder theory, highlight that “to perform well, managers need to pay attention to a wide array of stakeholders, and that managers have obligations to stakeholders which include, but extend beyond, shareholders” (Jones *et al.*, 2002: 20).

The stakeholder theory assumes that values are part of business and “the whole point of the stakeholder approach is to deny the Separation Thesis” (Freeman, 1994: 412). However, the proponents of the shareholder approach argue that the stakeholder approach is not practical due to its shift from focusing on the economic objectives of business towards less profitable social goals (Kakabadse, 2005: 290).

By separating ethics and economics, the proponents of the shareholder approach set apart the economic and the moral consequences and values, which results in “a narrow view that cannot possibly do justice to the panoply of human activity that is value creation and trade, i.e., business” (Freeman *et al.*, 2004: 364). Nevertheless, it should be noted that the business aim of stakeholder theory is not to refuse profitability but to widen the single-objective view of the shareholder approach. In doing so, companies do not neglect their main goals, such as achieving profitability, while justly responding to the legitimate stakeholder claims (Kakabadse, 2005: 290).

As stakeholder theory provides a way of dealing with multiple stakeholders that have potentially conflicting interests, it offers a new viewpoint of CSR (Jamali, 2008: 217). It is suggested as a useful framework in evaluating CSR disclosure through corporate social reporting (Snider *et al.*, 2003: 176).

Donaldson and Preston (1995) classified three dimensions of stakeholder theory:

‘descriptive’, ‘instrumental’ and ‘normative’, the CSR literature has identified two main categories (Deegan, 2002; Kakabadse, 2005). The first category is related to an ethical or normative approach of stakeholder theory, while the second category is related to a managerial or positive branch (Deegan, 2002: 294). The ethical or normative approach is also named ‘prescriptive’, as it “provides prescriptions in terms of how organisations should treat their stakeholders (with a variety of definition being given to “stakeholders”)” (Deegan, 2002: 294). This theoretical perspective focuses on the responsibilities of corporations and it is “employed to interpret the function of the corporation, including the identification of moral and philosophical guidelines for the operation and management of corporations” (Donaldson and Preston, 1995: 71). The normative stakeholder theory highlights the ethical legitimacy of the rights of stakeholders on the purpose of organisations (Kakabadse, 2005: 291). This approach of stakeholder theory is not directly related to the predictions of managerial behaviour (Deegan, 2002). Thus, it is worth noting that the normative dimension of stakeholder theory has not been found very useful in interpreting CSR disclosure (Gray *et al.*, 1995b: 70).

On the contrary, the managerial or positive branch relates to “the need to ‘manage’ particular stakeholder groups – particularly those that are deemed to be ‘powerful’ because of their ability to control resources that are necessary to the organisation’s operations” (Deegan, 2002: 294). Thus, according to the managerial approach of stakeholder theory, it is assumed that corporations have a tendency to prioritise the interests of stakeholders who play an important role in the continuity and survival of a business, due to the fact that the particular groups of stakeholders have a stronger impact on corporations than others (Friedman and Miles, 2002). As a result, as highlighted by Gray *et al.* (1996: 45) “information is a major element that can be employed by organisation to manage or (manipulate) the stakeholder in order to gain their support and approval, or to distract their opposition and disapproval”. This implies that information communicated by corporations to the specific group of stakeholders based on the strategic motives and not as a result of their sense of responsibility. Therefore, it can be said that the managerial branch of stakeholder theory provides a background for CSR disclosure, where corporate social disclosure is perceived as a part of the dialogue among the corporation and its stakeholders (Gray *et al.*, 1995b: 53).

Despite the belief that the normative branch frames the core interpretation of stakeholder theory (Donaldson and Preston, 1995), it is also important to look at the instrumental aspect of stakeholder theory. The instrumental stakeholder theory sees “stakeholder management theory as an instrument to achieve expected outcome, principally profitability” (Kakabadse, 2005: 291). In other words, “adherence to stakeholder principles and practices achieves conventional corporate performance objectives as well or better than rival approaches” (Donaldson and Preston, 1995: 71). The instrumental approach goes beyond the description to identify the existence or absence of the relationship among stakeholder management through testing and analysing the available data to support the descriptive explanation of the theory. Therefore, instrumental stakeholder theory may be regarded as a research on positive or negative relationships between stakeholder management and financial performance and the explanation of this relationship (Zandén and Sandberg, 2010: 38).

In short, Donaldson and Preston (1995) envisaged close relationships between the normative, descriptive and instrumental aspects of stakeholder theory.

Regarding the theoretical framework for CSR disclosure, it can be concluded that there are three major theories that dominate in the accounting literature: political economy theory, legitimacy theory and stakeholder theory. These system-oriented theories assume the existence of a social contract that reflects the interdependence of corporations and society.

Based on the discussions of this section, due to the evidence presented in the empirical chapters, this study adopts the managerial aspect of stakeholder theory perspective in explaining the CSR disclosure practices of Islamic banks in the GCC countries and instrumental aspects of stakeholder theory in measuring the impact of CSR disclosure on the financial performance of an Islamic bank.

2.9. CONCLUSION

This chapter provided conceptual definitions of CSR and reviewed the historical developments and trends in understanding CSR. In doing so, various perspectives and positions of CSR are discussed. In addition, the practice of CSR in conventional financial institutions is shown.

On the basis of discussions in this chapter, it can be said that the definition and description of CSR can vary depending on the institutional and political frameworks in which companies function due to such a nature that the field of CSR is still developing and in spite of the protracted debate about CSR.

The chapter also has shown that financial institutions in general and banks in particular, nowadays have contributed substantially to CSR initiatives and become more socially committed. Banks are driven by public demand to increase the transparency and accountability with the respect to social responsibility as a result of changing norms and expectations in society. However, the recent financial meltdown negatively affected the self-assurance and belief of bankers in the capability of fulfilling their economic, legal, ethical and philanthropic obligations. Although the banking sector has applied strict expenditure reductions, it is doubtful whether the tasks that aimed to apply CSR initiatives within the sector will be terminated and financial pressures will not force banks to compromise their ethical values. On the other hand, the economic liabilities will be evaluated more cautiously as well as the professionals of the banking industry tending to show more socially-oriented behaviour.

The chapter also overviews CSR performance and performance measurement issues and presents methods of performance measurement. It is noticed that there is no universally agreed CSR measurement system. Thus, CSR measurement is conducted in a number of ways ranging from the measurement methods based on environmental reporting content, indices, content and meta-analyses, as well as environmental auditing reports. One of the major difficulties in developing CSR measurement methods is a lack of clear consensus regarding what should be measured and why in CSR performance.

The chapter ends with focusing on the concept and definition of CSR disclosure as a manifestation of CSR and highlights the major theories underpinning CSR disclosure.

CHAPTER THREE

**CSR FROM AN ISLAMIC PERSPECTIVE: A
LITERATURE SURVEY**

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3.1. INTRODUCTION

Islamic moral economy offers a new paradigm in which moral is endogenised into the economic and financial thinking in an integrated manner. It, therefore, provides a moral filter through which economic and financial choices as part of behavioural norms can be made in line with ethical and social concerns according to the Islamic norms. The concept of CSR, by definition, hence, is considered an integral part of Islamic moral economy due to the ontological reasoning of Islamic teachings. In other words, the Islamic moral economy paradigm with its axioms and principles has direct implications and provides rationale for CSR in organisations through articulating the ideals of Islamic moral economy in personal and organisational levels.

Since Islamic Financial Institutions (IFIs) are considered as financing and operational tools of the Islamic moral economy paradigm, the business sector, including IFIs working within the Islamic moral economy paradigm, are expected to function in essentialising and prioritising CSR by also considering the social outcomes of their operations in terms of social welfare, natural resources and the environment in their attempt to fulfil their social responsibilities towards society. This is made essential through Islamic moral economy, as Islamic banks are expected to work within the objective function defined by the *Maqasid al-Shari'ah* objective aiming to promote social well-being through maintaining justice. In other words, IFIs, by definition, are expected to “consciously align their decisions and actions so that these are ‘socially responsible’” (Sairally, 2005: 419). Thus, CSR in Islam in addition to stakeholder’s duties and their interests also includes moral obligations, due to which it is expected to determine the shape of IFIs along with financial performance.

It should be noted that the epistemological and ontological sources of the Islamic thought, the *Qur'an* and *Sunnah* have a clear emphasis on human responsibilities towards other individuals, society and the environment. This rationalises as to why CSR should be considered as an essential element of IFIs.

Despite an aspirational worldview articulated by Islamic moral economy as a base for IFIs, in reality the practice is not that optimistic and critics argue that IFIs have not been able to fulfil the aspirations of Islamic moral economy as they are no longer attached to the spirit and the nature of the moral economy in delivering social responsibility. This is also observed in how Islamic banks are being converged towards their conventional counterparts in terms of objective function, and also in operational level. As a result, the social failure of IFIs has been observed. In other words, a divergence between the principles and ideals of Islamic moral economy and the course taken by the professional operations of Islamic banking and finance has been set in since the 1990s, when the internationalisation of Islamic banking and finance became a reality. However, it is suggested that Islamic moral economy can be offered as one of the remedies for the social failure of Islamic finance (Asutay, 2009: 24).

In responding to these issues with the objective of rendering a comprehensive understanding of CSR through the Islamic moral economy, this chapter delineates the aforementioned arguments and therefore starts with an introduction to Islamic moral economy and its axioms. It presents the rationale for ‘social responsibility’ in Islamic moral economy by referring to ontological and epistemological sources. As the aim of foundational principles and axioms of Islamic moral economy is to shape the operations of Islamic banking and finance, the next point of this chapter identifies the principles of Islamic finance and relates to CSR in a consequential manner. After highlighting the role of IFIs in Islamic moral economy as being socially responsible to society, various theories underpinning the concept of CSR from Islamic perspective are discussed. The chapter highlights the ongoing debates on the divergence of Islamic banking and finance practices from the aspirational position of Islamic moral economy and the necessity of going back to the basics through revising the philosophy of Islamic moral economy based on the authentic principles of Islamic teachings whereby CSR can be maximised. It concludes with the review of the previous studies on CSR disclosure practices in IFIs.

3.2. ISLAMIC MORAL ECONOMY AS THE BASIS OF CSR

Islamic moral economy in its modern context emerged in the end of 1960s as a response of Muslim intellectuals to the failure of capitalist and socialist development strategies in the Muslim world. These strategies were regarded as irrelevant to Islamic values and considered as neglecting the significance of human well-being in economic sphere

(Asutay, 2007a: 169-170). Therefore, Islamic economists, the founders of an Islamic economic paradigm, aimed to establish a different economic system within the Islamic norms and value framework. As a result, Islamic moral economy emerged as “a modern definition of divinely ordered rules and principles related to economic and financial activities, instruments, contracts and choices” (Asutay, 2010a: 35), the principles of which are driven from ontological and epistemological sources of Islam, the *Qur'an* and *Sunnah*.

Islamic moral economy was imagined as an alternative to capitalist market economy, where self-centred behaviour, rationalism and the maximisation of an individual's utility dominate. In contrast to the capitalist market economy, Islamic moral economy aims to develop a socio-tropic individual through norms and moral understanding, where individuals consider their own interests as well as social benefits and conduct their business affairs within the bounds of Islamic principles taking into account the social environment. Furthermore, the issue of maximising the prosperity of any individual in Islamic economics is parallel to maximising welfare of the community with the consideration of the hereafter (Asutay, 2007a: 171), as maximising *ihsan*, or beneficence is considered an essential part of human life as the axioms of Islamic economics state.

Moral values that are integrated into Islamic moral economy make this paradigm different from the conventional economics, the explicit framework of which is based on justice, equity, human dignity, freedom and moderation in everyday life, including economics and financial transactions. As an economic policy framework, Islamic moral economy also focuses on improvement and management of economic resources in order to fulfil spiritual, social and essential material needs of society, in developing a holistic approach to economic and financial issues. In addition, Islamic moral economy prioritises a moral duty on human beings to provide opportunities for those living in poverty through redistribution of wealth. In fact, the Islamic economic paradigm “aims at producing disciplined or morally filtered economics and financing which should not lead the individuals, but rather should be led by individuals as regulated by the moral economy principles of Islam” (Asutay, 2010a: 36). The strong implication of the moral dimension in economic and financial life, as proposed by Islamic moral economy, entails several conditions such as ensuring social justice, social development and

environmental protection, maintaining nature and humanity in harmony and the prohibition of taking and receiving interest. Therefore, Islamic moral economy is a modern system of economics based on the ontology of Islam, which manifests itself with following characteristics (Asutay, 2007b: 6):

- (i) Similar to any other system, theoretically Islamic moral economy deals with production, consumption and distribution of business activities of individuals within the Islamic standards of justice and equity;
- (ii) It provides rules and regulations to help individuals to make economic and financial choices within the Islamic value system;
- (iii) As a policy framework, it explains, examines, and sets rules.

The fact that religion can be a major factor in shaping economic activities and individual behavioural norms may sound irrational and emotional in relation to neo-classical economics' position based on enlightenment values. However, in the light of the current global financial crisis, the importance of morality in the economic and financial sphere cannot be underestimated. In particular, considering that greedy and selfish attitudes are considered among others as reasons for financial failure, the importance of moral and ethics shaping financial and economic choices and activities becomes clearer. Islamic moral economy, therefore, can be considered as an ideal system that filters economic and social activities of businesses and individuals through integrating moral in a systematic and spiritual manner in economic and financial choices.

It should be noted that the existing literature on Islamic economics shows a tendency to advocate socio-economic goals of the system through embedded concepts and processes such as *adalah* or social justice and *haqq* or right perspective, enhancement of human well-being and social equity and poverty reduction. The socio-economic goals of the Islamic moral economy are perfectly outlined by one of the fathers of the Islamic economics paradigm (Siddiqi, 1980: 22) as follows:

- (i) Enhancing human well-being;
- (ii) Reaching sufficiency and harmony in society as well eliminating poverty and fear;
- (iii) Meeting basic needs of individuals;

(iv) Providing the higher quality in life and a better place to live and optimising the use of available resources;

(v) Fulfilling spiritual needs of society;

(vi) Establishing economic and social justice as well as maintaining the background for equality of opportunity and cooperation;

(vii) Encouraging universal brotherhood and justice as well as distribution of national income and freedom in accordance with the principles of justice and equity and the context of social welfare.

As can be seen, Islamic moral economy offers a new paradigm in which moral is endogenised into the economic and financial thinking in an integrated manner; and therefore it provides a moral filter through which economic and financial choices can be made to have CSR or social consequences.

3.3. AXIOMATIC FOUNDATIONS OF ISLAMIC MORAL ECONOMY IN RATIONALISING CSR

The philosophical foundations of Islamic economics are completely distinct from the core theoretical issues of other conventional systems due to the fact that Islamic economics is based on strong moral values derived from the ontological sources of Islam, namely *Qur'an* and *Sunnah*, the tradition of the Prophet. The conceptual foundations or axioms, as Asutay (2007b: 7) states, have been established by the intellectual efforts of leading academic theoreticians in the field, such as Chapra (1999; 2000), Naqvi (1981; 1994), Siddiqi (1981), El-Ghazali (1994), Ahmad (1980; 1994; 2003) and Sirageldin (2002).

Naqvi (2003: 149-157), in particular, while discussing the theoretical fundamentals of Islamic economics, refers to *tawhid* (God's unity), *al'adl wa'- ihsan* (socio-economic justice and beneficence), *ikhtiyar* (free will) and *fard* (responsibility). These concepts were further expanded through the addition of *rububiyyah*, *khilafah* and *Maqasid-al Shari'ah* by Arif (1989) and Ahmad (1979; 1994).

It is suggested that the implications of these axioms on the economic system might positively affect individuals' behaviour and make their contributions to society as well

as their economic, business and financial activities more meaningful, thereby the economy will achieve socio-economic justice. In other words, the axioms through which foundations of Islamic moral economy are developed help individuals to endogenise social good and justice in their objective functions.

Islamic moral economy is defined by these philosophical foundations as an ideal to analyse the causes of economic and social problems and find solutions that suit modern societies within the context of the doctrines of Islam.

Islamic moral economy assumes following philosophical foundations:

(i) *Tawhid* (God's unity and sovereignty) is the recognition of the oneness of God. Islamic moral economy is founded upon the vertical ethicality manifested by *tawhid*. As an initial part of social justice, vertical ethicality means that all individuals are equal in the sights of God, which also includes accountability to God, who is worthy of absolute worship and this requires humans to be conscious of their actions (Naqvi, 1994: 26), as it is the belief and relationship between humans and the Creator (Naqvi, 2003:150). *Tawhid*, as a fundamental element of the Islamic moral economy, refers to the freedom of deeds wherein every human being is regarded as an essential part of the entire system. The essential components of this philosophical foundation that lead to a permanent and stable system are "*risalah* (God's [message to His] prophets as the source of divine guidance)" and "*akhirah* (life-after death, that is the continuity of life beyond death and a system of accountability based on divine law)" (Asutay, 2007b: 7). As an axiom, *tawhid* establishes the norms for economic and business activities from an Islamic point of view by not only focusing on the consequences of economic activities in this world, but also their repercussions in the hereafter and hence brings 'spiritual accountability' into the equation to establish social equilibrium in society through economic and financial means

It is important to note that *tawhid* provides an objective function for and gives meaning to human life, and this objective function is determined by *falah* or salvation or happiness. However, as a dynamic system, Islamic moral economy extends the *falah* through spiritual accountability as two-dimensional: happiness in this world and in the hereafter.

(ii) *Al-'adl wa'l-ihsan (Socio-Economic Justice and Beneficence)* is another significant axiom of Islamic moral economy, where individuals are obliged to contribute in establishing justice (*'adl*) and promoting beneficence (*ihsan*), which accordingly lead to the manifestation of socio-economic justice. Basically, this axiom alongside *tawhid* means that each human being in this life should receive what he/she deserves as well as achieving high life standards on both personal and social levels (*hayat al-tayyebah*). The horizontal equality that lies in this conceptual foundation provides all elements of the fundamental base of the social, legal, political and economic organisations in actualising justice. In addition, '*adalah*' as an axiom of social justice and beneficence, necessitates that individuals and societies are supposed to set up a balance between current and forthcoming needs of the generations as well as developing strategies to meet the requirements of human beings. Furthermore, it articulates that individuals aim to attain a higher level of life and develop suitable methods that ensure fair income and wealth distribution within the stability and sustainable development policies (Asutay, 2007b: 7).

Importantly, as part of the axiom of a dynamic system, *ihsan* or beneficence implies that an individual's *falah* or happiness lies not only in his/her excellence and reaching individual happiness, but those who fulfil such an objective function must also consider the happiness of the others; only then can an individual *falah* be possible.

(iii) *Ikhtiyar (Free will)*: the Islamic economic system aims to guarantee individual liberty and freedom of choice of opportunities, which implies that individuals are free to decide how to use their own capabilities and economic resources, which is the essential part of an economic structure but also is an essential instrument of '*adalah*', as without freedom justice cannot be realised. On the other hand, it seeks to provide effective moral filters at different levels of life and activity. Therefore, although there is a free will (*ikhtiyar*) given to individuals to choose whatever path they desire to follow, they have a responsibility as a *fard* towards themselves, society and the Creator (Naqvi, 2003: 157)

(iv) *Fard (Responsibility)* aims not to leave the social justice-related matters to individual choices, as Islamic moral economy through this axiom aims to make some of the social justice oriented arrangements mandatory. In other words, it entails that individuals and society need to uphold the public good, as human beings are the

representatives of God on earth. Although human beings are individualistic creatures, their relationship with the Creator, accountability to Him as well as to themselves and to the community, highlights the essential moral principle that individuals are more respected when they are integral parts of the social whole. This suggests being responsible or to benefit society at large (Asutay, 2007b: 7-8) through not only voluntary action but also mandatory action aiming to make sure that ‘*adalah*’ can be established.

(v) *Rububiyyah* as one of the significant conceptual foundations of Islamic moral economy, it demonstrates that individuals are obliged to show respect to the divine arrangements in broad social and environmental concept for nourishment, allowing to direct, reach, and to sustain things to their perfection (Ahmad, 1979: 12). It relates to the divine arrangement that everything on earth has a perfected development path, which has to be respected and should also be allowed to have the opportunity space to flourish accordingly. This refers to the importance of sustainable development to maintain harmonious relations between different spheres of life. Human efforts, therefore, are assumed to take place in this stable and acceptable background according to Islamic teachings (Asutay, 2007b: 8).

(vi) *Tazkiyah (Purification plus growth)* refers to growth with harmony and hence implies sustainable development, which assumes that Islamic communities will preserve “their fundamental, internal balances while undergoing various processes of change” (Sardar, 1997: 51). This axiom has come as a result of combination of *tawhid*, *adl*, *fard*, and *rubibiyah*, since it leads individuals to develop fully their human potential in addition to harmonious social and economic development, which could be conducted with ethical and moral considerations or “purified through a moral filter” (Azid, 2010: 167). Consequently, “the result of *tazkiyah* is *falah*, prosperity in this world and the hereafter” (Ahmad, 1994: 20) by developing a harmonious ‘growing’ strategy.

(vii) *Khilafah and human accountability before God (khalifa or individual’s role as God’s vicegerent on earth)*. This indicates that humankind is the representative of God on earth, therefore, “Allah has entrusted mankind with stewardship of Allah’s possession” (Farook, 2007: 33). This axiom identifies the role and status of a human being, specifies his/her duties as a Muslim and a part of the entire Muslim community and “the reasons of the existence of the individual” (Asutay, 2007b: 8). An individual’s

role as *khalifah* requires him/her to achieve *falah* and also create an environment through which others also can reach *falah*, therefore, an individual is entailed to work and contemplate in an integrated manner. Being a direct consequence of the pillar of the sovereignty of God, as it explains one's aim and behaviour of providing social welfare and justice as a crucial element of faith (Mohammed, 2007: 109), this axiom essentialises social responsibility as part of creation. Thus, in order to function according to the identified foundational axioms, Islamic moral economy imagines and considers a *khalifah* human being in the sense of *homoIslamicus*.

The practical implications of the concept of *khilafah* are “universal solidarity, sustainable consumption of resources, which are trust from God, pursuing a humble life-style, and having human freedoms to conduct daily life” (Asutay, 2007b: 8). It is worth noting here that this axiom illustrates that Islamic moral economy has a two-dimensional utility function through connecting present actions with their accountability in the hereafter (Asutay, 2007b: 8) with the objective of maximising the objective function which endogenises the social good.

Thus, the aforementioned foundational axioms of the Islamic moral economy system aim at constructing individuals who are accountable for their actions, concerned with the interests of society as a totality in an integrated manner. Additionally, and most importantly, is the concept of *khalifah*, which is translated as vicegerency of God on earth, which is a role given to individual humans by God. This can be termed as *homoislamicus* (as opposed to the *homoeconomicus*) as an individual who has immersed these axioms in his or her life by fulfilling the roles and duties expected. This is what distinguishes the Islamic methodology from the neo-classical economic methodology, where the ultimate end result will be self-development of individuals and subsequently harmonious development of the overall economy and ultimately ending in *falah* (success, happiness and well-being). As a consequence, the direct implication of this would be the creation of values and real economy embedded moral economy away from the highly materialised and financialised economy.

(viii) *Maqasid al-Shari'ah (objectives of the Shari'ah)* provides the moral and legal framework in giving meaning to the axioms, which states that the objective of *Shari'ah*, and hence any action including economic and financial action, is to promote human well-being in serving the ultimate goals and objectives of religion. In other words,

whatever the effort is dispensed must be for human well-being. The early interpretations of *Maqasid al-Shari'ah* by al-Ghazali, at the beginning of the 12th century, defines it as “promoting the well-being of all mankind, which lies in safeguarding their faith (*din*), their human self (*nafs*), their intellect (*'aql*), their posterity (*nasl*) and their wealth (*mal*)” (Chapra 2000: 118). Thus, *Maqasid al-Shari'ah*, with its unchanging moral framework and flexible and dynamic approach, presents spiritual guidelines for personal, social, political, economic and intellectual activities of human beings (Sardar, 2003).

The substance or the epistemological rationale of *Maqasid al-Shari'ah* comes from concepts such as *aqidah*, *akhlaq* and *fiqh*, the key elements of *Shari'ah*, where *aqidah* refers to a creed or a religious belief system; *akhlaq* is the practice of virtue and manners; *fiqh* is the set of legal principles that deals with the actions of individuals. *Fiqh* takes into consideration time and place, which means that its application is not stagnant and deeply related to circumstances, whereas *akhlaq* and *aqidah* have fixed and permanent characteristics that are certain and sacred. As a result, the everlasting spirits and values, which lie in *aqida* and *akhlaq*, establish individual lives as well as the social order in healthy patterns, thus define Islam as resilient and universal religion. Simultaneously, *fiqh* or Islamic legal framework presents methods that allow the adaptability of decisions in Islam to the different situations of time and place. Thus, this constructs “Islamic *Shari'ah* flexible, dynamic and relevant in the context of changing times” (Dusuki, 2005: 46).

As the *Shari'ah* provides the rules for human conduct in all aspects of life, it is impossible to detach it from the fundamental doctrines, principles and aims of Islam (Kamali, 1989). Therefore, a comprehensive understanding of *Maqasid al-Shari'ah* requires a passionate commitment to justice, solidarity and the well-being of entire society on individual, group and organisational levels. Consequently, it “will inevitably lead to a society whereby every member will cooperate with each other rather than compete, as success in life is to obtain the ultimate happiness (*falah*)” (Dusuki, 2008a: 18), indicating social responsibility of individuals towards each other.

The interpretation of the concept of *Maqasid al-Shari'ah* was enlarged by Ibn Khayyum through expanding the horizon of Islamic moral economics to be more involved with increasing public interests in order to be able to tackle issues such as poverty and inequality, where some methods based on Islamic law could not

successfully deal with. Accordingly, Islamic moral principles regard the individual welfare to be parallel to the common interests, which broadens the limited definitional margins of Islamic law (Asutay, 2007b: 9). In different words, this assists to establish an economic discipline with an emphasis on the objectives of Islam as a comprehensive way of life rather with an emphasis on the objectives of Islamic law (Siddiqi, 2004).

As a result, the abovementioned ethical axioms derived from ontological and epistemological sources of Islamic teachings form the foundation of a moral-based Islamic economic system and provide the fundamental framework, which aims “to maintain a balance between today's and tomorrow's consumption, and to maintain an equitable distribution of wealth and income” (Sirageldin, 1995: 465).

The most important or distinguishing feature of Islamic moral economy, as can be seen, is the obligatory existence of an ‘Islamic moral filter’ in individual, social and organisational levels through which individual and business activities should take place (Sirageldin, 1995: 464) within the framework of Islamic ethics as an integral part of the Islamic faith having implications for all spheres of individuals’ lives including business dealings and obligations so that interests of all the stakeholders can be served.

It should be noted that ethical considerations are relevant not only to Islamic moral economy but to other conventional economic systems (Sirageldin, 1995: 1). Business ethics has caught the attention of business leaders and has become one of the most debated topics in the last few decades. In fact, modern societies and different economic and financial systems cannot deny the importance of ethics and have developed ethical and moral codes of conduct for business transactions. However, “ethics is always an exogenous element in these systems, not the endogenous embedded core of the learning, discursive and unitary worldview of moral consciousness” (Choudhury, 2010: 53). This indeed distinguishes Islamic moral economy, which instilled ethics into its implementation as a religion in everyday life through an integrated system.

The Islamic moral economy paradigm with its axiom and principles has direct implications and provides rationale for the CSR in organisations through embedding the ideals of Islamic moral economy in personal and organisational level. For this, the business sector including IFIs working within the Islamic moral economy paradigm are expected to function in necessitating and also prioritising the CSR by focusing on social

welfare, considering natural recourses and the environment in their attempt to fulfil their social responsibilities towards society as they aim to accomplish the main *Shari'ah* objective of promoting social well-being though maintaining justice.

The notion of CSR from an Islamic perspective does not only entail stakeholders' duties and their material interests, it also entails moral obligations. Therefore, CSR, as a part of Islamic framework paradigm, is not an exogenous concept, which is expected to be apparent in IFIs; on the contrary, it is "firmly inscribed within the religious bond" (Dusuki, 2008a: 14). In the epistemological and ontological sources of the Islamic worldview, namely, the *Qur'an* and *Sunnah*, the clear emphasis of human responsibilities towards the environment in general and its living creatures in specific can be found as an attempt to reach social justice in relation to individual and social environment. Furthermore, faithful observance of social responsibility and imposed Islamic moral values encourages trustful and pleasant relations among people "and motivates them to fulfill their mutual obligations promoting family and social solidarity, tolerance and peaceful coexistence" (Chapra, 2008: 12).

It is important to note that while social responsibility has not been expanded to the corporate sector in Islamic law, the realities of the business environment in contemporary times, however, necessitate that corporates should be kept responsible for their social oriented outcomes as part of their operations.

In overall, Islamic moral economy, thus, aims to create its own institutions to respond to economic and financial needs of society in which it operates, which include financial institutions. However, they are considered as part of the ethical paradigm of Islamic moral economy and therefore are expected to contribute to socio-economic development rather than financialisation of the economy.

3.4. PRINCIPLES OF ISLAMIC FINANCE

Islamic finance emerged as the institutional forms of Islamic economic thought as in the 1970s, which aims to fulfil the aspirations of Islamic moral economy through financing and regulating economic activity according to Islamic injunctions and ideals. IFIs' aiming to articulate Islamic moral economy should serve social justice and social well-being as an integral part of their functioning in their attempt to operate within the Islamic ethical values to achieve a balance between social and financial objectives. As

socially constructed institutions, IFIs are expected to foster economic development with considering social welfare and social justice. While achieving prosperity is desirable in Islamic moral economy, the financial activities leading to it should be guided by the following Islamic principles:

(i) *Prohibition of interest (or riba)* is one of the core requirements that IFIs should observe. The condemnation of *riba*, which in Arabic defined as “to increase, to multiply, to exceed, to exact more than was due, or to practice usury” is clearly revealed in *Qur’an* (Iqbal and Mirakhor, 2007: 54). All sorts of exploitation and any source of unjustified enrichment and fixed returns in financial affairs are not allowed in Islam, which include interest. Thus, *riba* as a root of financial dis-optimality and socio-economic injustice contravenes the Islamic teaching and principles, prohibition of which is considered essential for “stable and socially efficient economic environment” (Asutay, 2010b: 25), since the primary goal in prohibiting *riba* includes promoting social justice as well as sustaining social and economic optimum (Asutay, 2007b: 14). Social justice requires that creditors and entrepreneurs share profits and losses in a just manner and the wealth is accumulated and distributed fairly, and reflects the real productivity (Askari *et al.*, 2010: 12)

(ii) *Risk sharing*: Due to prohibiting interest in the form of fixed return, Islamic finance as a result prioritises joint ventures in various forms by emphasising the risk-sharing aspect. This means that gaining from an economic activity is not permissible if the financial capital is not exposed to the risk of potential loss. Therefore, both parties, the investor and the borrower, share the risk as well as the reward (Iqbal and Mirakhor, 2007: 12). The Islamic financial models that work on the basis of risk sharing lead to a more responsible approach to lending as well as to making sensible and valuable investments (Khan and Mould, 2008: 6).

(iii) *Asset-based*: The two aforementioned principles of Islamic finance propose the existence of a direct relationship among the real and financial sectors. Islamic law requires that each financial transaction should be tied to a tangible underlying asset (Hakim, 2007: 163). Thus, financial and economic activities of IFIs are undoubtedly and directly identified with the real economic sector activity (Askari *et al.*, 2010: 13). Consequently, IFIs by definition have a limited ability to trade in debt securities and this constrains financial-over leveraging by repackaging and selling of that debt. Hence, it

can be said that conventional derivative instruments, which brought about the recent financial turmoil, would not pass through legal regulations of IFIs (Tayyebi, 2009: 15-16). As a result, IFIs have the objective of creating productive economic activities, which will lead to asset-based financing over the debt-based financing (Asutay, 2010b: 25), and therefore emphasises embedded financing.

(iv) *The concept of money*: According to Islamic thought, “money does not have any intrinsic value of its own apart from the value of the precious metals that are to be found in real sector production of the currency” (Choudhury, 2011: 293). Thus, IFIs are not allowed to engage in money creation out of debt. Central to Islamic moral economy is the idea that money serves to assist social and economic activities of individuals through being a measure of exchange (Ayub, 2007: 437). The use of money in a productive way is essential. In Islamic moral economy “the nature of money... in terms of the intrinsic relationship between money as a moral and social necessity linked endogenously with real economic activities” (Choudhury, 2011: 292).

(v) *Prohibition of speculation (maysir) and uncertainty (gharar)*: Commercial activities in Islam are subject to the restrictions such as a ban on *gharar* and *maysir*, where the former means uncertainty and the latter gambling or speculation.

Gharar refers to entering into contracts without satisfactory information regarding its final outcome or accepting very risky financial transactions (Lewis, 2011: 186). Uncertainty regarding the final outcome, the character, the price, the measure of the object and its delivery all cause *gharar*. Thus, it is associated with not being able to identify the key pillars of the contract such as the content, the value of the item and obligations (Ayub, 2007: 58). Avoiding *gharar* indicates that selling products or services without having a control over them or possessing them is not permitted. The classical examples of *gharar* mentioned in *hadith* and *fiqh* literature are selling a bird in the sky or fish in the water.

The concepts of *gharar* and *maysir* are related to each other, as *maysir* has features of *gharar*. According to Obaidullah (2005: 34), “uncertainty is the same as *gharar* and under such conditions, exchange or contracting is reduced to a gamble”. *Maysir* takes place in a situation where one side in the business venture holds a possibility of total damage or loss of its wealth or a chance to bring a huge amount of money (Scoon, 2010:

22). Islamic teachings do not permit this kind of unfair enrichment through pure chance, such as gambling. Furthermore, the majority of Muslim economists do not favour forwards, futures and options contracts due to the fact that they tend to be used by IFIs as instruments of gambling rather than instruments of risk management (Obaidullah, 2005: 34).

In short, the prohibition of speculation, gambling and uncertainty emerges from the same rationale to highlight the importance of asset-based productive economic activity through embedded financing (Asutay, 2010b: 26).

(vi) Screening of investment activities to ensure whether they are Islamically permissible or not. The Islamic financial framework based on strong moral values discourages entrepreneurs to invest in the production of goods and services and in any financial contracts that contradict the Islamic moral economy principles. Thus, it excludes financing and investing in unethical industries such as casinos, pornography, tobacco, alcohol, drugs, harmful substances, nuclear energy or any sector whose activities are considered harmful and morally unacceptable to human well-being, interests of society, and the environment. Accordingly, investing in business activities that will cause the pollution or exploitation of common natural resources of environment, which include water, air, soil, minerals, plants, animals and energy resources, is unlawful. Investors should seek to align their financial investments with Islamic financial principles in order to include social dimension to their activities and contribute to ethical and socially responsible projects.

(vii) The concept and nature of labour in Islamic finance: Labour is generally known within Islamic economics framework as a factor of production, which participates in the production process. The term labour, in modern sense, refers to blue-collar workers, white-collar employees and workers in a professional, managerial, or administrative position. Accordingly, as it might be reasonably expected, labour in an Islamic moral economy nowadays represents all human resources and encompasses both moral and material sides (Azid, 2005: 96-97).

The importance of labour is highly emphasised in the *fiqh* literature and is clearly stated in the *hadith*: “Trying to earn a lawful livelihood is an obligation in addition to the duties that are obligatory” (Bukhari cited in Azid, 2005: 97). Additionally, as far as

scholars concerned, there is no division between manual and mental labour in the Islamic economic paradigm, as they are equally important and significant (Azid, 2005: 97). Hence, employers are expected to respect the employees' dignity and recognise their merit. It is worth noting that Islamic moral economy underlines the rights of employees and promotes just and fair behaviour towards them as this will increase production and have a positive impact on the economy; and also this will be direct outcome of Islamic moral economy axiom sets.

Considering the fact that the Islamic literature based on *ahadith* or the sayings of Prophet provides guidance to the relationship between an employer and employees, the main features of this relation can be described as follows:

(a) It should be based on equality and goodwill; therefore, a positive working environment is vital, where everyone is treated with a respect and in a friendly manner, without exerting a pressure on employees and mistreating them. Hence, a safe, secure and clean working environment should be maintained (Azid, 2005: 98-99).

(b) The agreement between an employer and employee should be transparent, just and lawful. Hence, an employee's obligations and tasks should be stated in the contract along with their rights to have paid annual leave, public holidays and compensation. Both parties are obliged to meet the requirements of the contract to the best of their ability.

(c) Everyone should receive an equal amount of reward, as no work should be left unpaid (Azid, 2005: 99). Salaries should be just, reasonable, fixed and promptly paid. The Islamic economic system propagates fix wage arrangement in which wages are fixed according to the prearranged condition (Azid, 2005: 115). The issue of paying wages to employees on time has been highly emphasised in *Qur'an* and *hadith* as any form of exploitation is strictly prohibited in Islam.

The main points related to the responsibilities of employers towards employees can be summarised as follows (Azid, 2005: 101):

(a) Islamic moral economy as an ethical paradigm, where justice is essential, presents equal rights for all workers regardless of their religion, gender, race or economic and social status.

(b) Another important point worth mentioning is that employees should not be burdened with work beyond their capacity. Taking into account that Islamic moral economy stresses the importance of balanced life, employers should also be mindful of ways to assist employees fulfil their family responsibilities.

(c) Additionally, employers are obliged to ensure that employees receive fundamental training and education required for their work.

(d) Moreover, employers are required to provide healthcare benefits to workers.

On the other hand, employees have responsibilities towards their employers. For instance, employees are required to be sincere and efficient (Azid, 2005: 112). They are also responsible to uphold good relations with other employees and at the same time perform their tasks to the best of their skills and capacity. Furthermore, they are required to ensure no harm or damage their working environment.

Based on all abovementioned points, equality and justice toward employees is a noble and good behaviour and an act that undoubtedly will lead to success and salvation.

(viii) Environmental concerns and Islamic perspectives:

Environmental issues have deep roots and can be found in several fields of Islamic teachings. Concern for the environment is the central tenet in Islam as numerous Islamic thoughts and *Qur'anic* principles focus on the explanation of the interaction among human communities and their natural environment (Kamla *et al.*, 2006: 248). Individuals in Islam are regarded as social beings by nature; therefore, they are responsible to society and their isolation from society is greatly discouraged. Hence, "CSR is a moral and religious initiative based on the belief that a corporation should be "good" despite the financial consequences" (Dusuki, 2007: 34). It should be noted here that Islam does not stop financial institutions from getting engaged in profit-making activities. Maximisation of profit is still the fundamental yet not the only objective of IFIs.

Since environment and the natural resources in the Islamic moral economy are perceived as *amanah* or trust from God to humanity (Asutay, 2010d: 6), equal amount of the natural resources should be kept as trust for the future generations. The concept of

amanah, thus, prevents “waste, over-utilization and the excessive exploitation of non-renewable natural resources and the ecological and environmental aspects of moral activity” (Ahmad, 2003: 196).

In addition, *rububiyyah* and *tazkiyah* are significant conceptual foundations of Islamic moral economy, which necessitate environmental concerns. *Rububiyyah* refers to the “divine model for the useful development of resources and their mutual support and sharing. It is in the context of these divine arrangements that human efforts take place.” (Asutay, 2010e: 6). *Tazkiyah* or growth in harmony refers to the sustainable development and assumes that human efforts will take place preserving the balance with the natural environment, with society and the state (Asutay, 2010e: 6).

As has been noted, Islamic financial principles alongside philosophical foundations of Islamic economic system provide grounds as to why CSR is an essential part of Islamic moral economy and hence IFIs. Islamic financial principles emphasise the importance of facilitating provision of opportunity to all strata of society, especially to the less advantaged citizens, and promote social cohesion at the same time.

Since the Islamic economic system is based on authentic moral ethics, it is anticipated that IFIs as an operational tool of this ethical economic framework aim to contribute towards socially responsible activities. With the aim of fulfilling one of the objectives of *Shari'ah* to promote the well-being of society, these institution have to ensure that they are CSR-active (Sairally, 2005: 419). Promoting socio-economic justice and preventing any forms of exploitation are the most discussed issues in Islamic moral economy. Thus, IFIs are expected to contribute to solving economic underdevelopment problems through institutions of *zakah*, *waqf* and *taqaful* (Asutay, 2007a: 184). Furthermore, charitable giving (*sadaqah*) and lending (*qard al-hassan*) have been encouraged in the Islamic value system. This indicates that institutions that apply axioms of Islamic moral economy and the principles of Islamic finance should operate and work with their clients in a humane, generous and fair manner in difficult times.

The following descriptions of institutions of *waqf*, *zakah* and concepts of *sadaqah*, and *qard al-hassan*, present an additional explanation of accepting CSR, a part of the Islamic framework paradigm, as an endogenous concept, which is expected to be apparent in IFIs:

(i) *Payment of poor due (zakah)*: *Zakah* institutions have been used in Islamic moral economy to eliminate the difference between wealthy and disadvantaged and to assist the needy part of the community (Shanmugam and Zahari, 2009: 77). Being one of the five pillars of Islam, *zakah* is a compulsory act of giving for those who are over a certain threshold in their wealth, which highlights social justice objective in the sense of returning the right of the society to society. The importance of *zakah* institutions cannot be underestimated, as the principal objective of *zakah* is to contribute to the process of alleviating poverty in society and developing a balanced economic growth.

(ii) *Waqf (philanthropic trust)*: Under the Islamic moral and ethical precepts, the importance of facilitating provision of opportunity to all strata of society, especially to the less advantaged citizens, as well as promotion of social cohesion has been greatly accentuated. Thus, the establishment of *awqaf* institutions in the Muslim world was a result of inspiration and special attention to benevolence as an act of devotion to God. The literature shows that the *waqf* sector has remained the spearhead of delivering public goods in Muslim communities for many centuries as it had effectively institutionalised the Islamic values of charity and improved a well-developed socio-economic system.

The meaning of *waqf* (plural: *awqaf*) in Arabic is hold, confinement or prohibition (Baalbaki, 2006). *Waqf* from an economic perspective can be defined as switching funds and other assets from spending and investing them in creative properties that supply either usufruct or revenues for future consumption by individuals or groups of individuals (Pirasteh and Abdolmaleki, 2007: 4). As a part of the voluntary sector, *waqf* provides certain welfare enhancing services to society by financing it through the investment of the allocated resources.

Furthermore, it is a philanthropic organisation that aims to supply the less fortunate one of the society with income and social services (Kahf, 1998: 7). In addition, it is an endowment with strong power that moves society towards growth and prosperity (Yalawae and Tahir, 2003: 2). The *waqf* sector can be one of the best instruments in rearranging and managing the position of wealth between the rich and poor people in society and decreasing socio-economic disparities.

(iii) *Voluntary charity (sadaqah)*: *Sadaqah* is a voluntary act of giving, which alongside *zakah* is the major source of finance for poverty alleviation. This principle of free giving once more highlights that IFIs are socially accountable towards the needy and the suffering in the environment in which they function. Through promoting generous donations the unity between the individuals in society and the responsibility towards fellow human beings has been articulated in Islamic moral economy (Mohammed, 2007: 138).

(iv) *Qard al-hassan (benevolent loan)*: Taking into consideration that in Islamic finance accumulation of wealth cannot be done solely for the purpose of doing it and the *Shari'ah* accepts a loan only as a gratuitous contract, IFIs are expected to give *qard al-hassan* or benevolent loan, which is free of interest (Iqbal and Mirakhor, 2007: 66). Ayub (2007: 157) defines *qard* as “a kind of loan advanced for the benefit of the borrower and the creditor can demand it back any time. Ownership of the loaned goods is transferred to the borrower who can use, buy, sell or donate it as he wishes, like his other belongings”.

The major purpose of *riba*-free loans is again facilitating the disadvantaged citizens in society and eliminating socio-economic injustice through establishing improved relations between the wealthy and the needy. Another purpose is facilitating the distressed in creating new job opportunities alongside business projects by taking advantage of their talents, individuality and knowledge and as a result, eliminating unemployment issues in society (Anas and Mounira, 2009: 128).

Qard al-hassan loans tend to show a considerably high rate of repayments as IFIs run under the principles of partnership, mutual solidarity, confidence and trust.

By applying *qard al-hassan* in their practices, IFIs are expected to help to prevent the accumulation of wealth in certain groups of people and provide “the bite out of the assets of those who have a lot of money” in order to assist the disadvantaged “without expecting any increase” (Abdul-Rahman, 2010: 228).

3.5. CSR FROM ISLAMIC FINANCE PERSPECTIVE

The concept of CSR has been suggested as relevant to IFIs, as due to religious ontology and epistemology, Islamic finance is considered a socially-oriented ethical value proposition.

Islamic finance is based on strong moral values as one of the main principles of *Maqasid al Shari'ah* (the objective of Islamic law) is interpreted as human well-being. As *Shari'ah* aims at welfare of the people, for this purpose it requires and guides the use of certain goods and economic activities, namely, allows the permissible and forbids the unlawful, as discussed above in detail. This condition encourages engaging in productive economic activities that improve societal welfare and refrains from activities that are socially harmful (Sairally, 2006: 58). CSR is, thus, considered an integral part of Islamic moral economy, which is based on ontological sources of Islamic teachings and aims to develop socio-tropic individuals through norms and moral understanding with the objective of social justice. As a result, social responsibility is a crucial and an essential part of Islamic finance. Thus, it is believed that IFIs are operational and financing tools of Islamic moral economy and as “institutional flagship” (Hassan and Kayed, 2009: 34) of Islamic moral economy have social obligations towards the community they serve. It is, therefore, expected that IFIs by definition are expected to comply with the expectations of CSR.

IFIs are expected to implement the CSR as they are in exemplary position due to following ethical and social responsibility as a religious compliancy (Farook, 2007: 32). Furthermore, IFIs are expected to implement CSR as a moral/religious prerequisite due to the ethical and social responsibility inherently imposed on business and finance activities, which ensures religious compliancy.

The ethical and social nature of IFIs entails their contribution to social development thereby “fulfills the social and ethical expectations as identified by Islamic moral economy, but also responds to the development needs of the societies in which they are operating” (Asutay, 2010b: 26).

A distinguishing feature of IFIs, in particular, in Islamic banks, is the moral dimension in their operations. Carroll's definition of CSR, which encompasses economic, legal, ethical and discretionary demands that society places on business, is considered to be

applicable to the Islamic finance philosophy, as such values, as identified so far, are inherited part of IFIs.

In fact, profit maximisation, which is traditionally the driving force of capitalist economics, is not the ultimate objective of IFIs and this is what makes them different from other conventional financial institutions (Sairally, 2005: 422). IFIs are expected to contribute widely to the social and developmental works as “they have dual ability to redistribute and allocate wealth to the betterment of society” (Hassan and Mahlknecht, 2011: 79). Therefore, “the Islamic firm is expected to uphold such social expectations in order to reach a sustainable economy and society” (Azid *et al.*, 2007: 7).

3.6. CONTEMPORARY THEORETICAL MODELS OF CSR FROM ISLAMIC FINANCE PERSPECTIVE

This section aims at presenting the contemporary theoretical models of CSR from an Islamic finance perspective by founding on the above discussion on Islamic moral economy and its articulations.

Although the notion of CSR has been an essential part of Islamic societies and has been underpinned in Islam for over fourteen centuries, the issues of CSR from an Islamic point of view have been raised significantly at the last decade of the 20th century by modern Islamic economists.

The evaluation of the literature reveals two main positions in connection with social roles assigned to IFIs. According to the first view, which is supported by the fathers of Islamic economics, IFIs have fundamental and significant social welfare responsibilities. On the other hand, their opponents suggest that IFIs similarly to conventional financial institutions operate in the financial sector of economy; hence, social initiatives should be assigned to the third, non-profitable sector, while IFIs are supposed to have business activities that do not extend their commercial boundaries (Sairally, 2006: 65). These different positionings will be discussed below.

3.6.1. Chapra’s Model

The early writings by Islamic economics, such as Chapra (1985) and Siddiqi (1983), suggest that the social role of all sorts of IFIs should be placed upon their objective of

profit maximisation in order to maintain socio-economic justice, support and sustain economic development (Dusuki, 2007: 31; Sairally, 2006: 63). This view has been introduced in the more recent literature as Chapra's model (Lewis and Algaoud, 2001: 95).

Taking into account the fact that Islamic banks and other IFIs deal with public funds, they are required to consider the betterment of the whole of society against the benefit of individuals. This basically means that IFIs have to fulfil social obligation as a religious compliancy as well as to perform other prearranged conventional financial tasks. This model envisages Islamic banks as multipurpose or universal banks that integrate commercial banking and provide a wide range of financial services (Sairally, 2006: 63; Hassan and Lewis, 2007: 9). This view has been widely supported by contributors such as Sadr (1982), Siddiqi, M. N. (1983, 1985), Ahmad (1984), Ahmad, (2000), Siddiqi, S. H. (2001), Haron (1995), Rosly and Bakar (2003), Haron and Hisham (2003), Naqvi (2003) among others, who believe that for IFIs, setting objectives to promote Islamic religious principles, traditions and norms alongside the protection of the necessities of Muslim societies is as important as maximising their profit (Dusuki, 2008b: 135). Accordingly, it can be said that this model is compatible with the social and ethical goals of *Shari'ah* and Islamic spiritual objectives. Hence, "Islamic banks must promote social welfare programmes and activities and make more contributions towards the needy and the poor without undermining its [their] commercial viability" (Dusuki, 2008b: 135).

The implications of this model at an institutional level are expected to be as follows: while central banks will be additionally responsible for monitoring IFIs to maintain a just distribution of income, wealth and power and prevent and control the unfair advantage taken of them by a tiny minority; it is suggested that Islamic commercial banks named here as universal banks would balance profit-oriented activities with socially oriented community activities (Sairally, 2006: 64).

According to this model, therefore, there is a great expectation placed upon Islamic banks to be CSR-active and contribute significantly to the social and economic problems of the less advantaged citizens in society and at the same time Islamic banks should be able to maintain their commercial viability (Dusuki, 2008b: 135).

3.6.2. Ismail's Model

An alternative view on CSR for IFIs was proposed by Ismail (1986), who argued that IFIs are part of the commercial sector of the economy and they should be responsible only for economic and financial activities. All morally and socially concerned commercial activities are expected to be assigned to the third non-profitable sector.

In this model, Ismail draws an Islamic economic system, which consists of three financial sectors: the government sector or *siyasi*, the commercial sector or *tijari*, and the welfare sector also known as the third sector or *ijtimai* (Hassan and Lewis, 2007: 10). Ismail (1986), thus, claims that Islamic commercial institutions of the commercial or *tijari* sector are restricted to be responsible to the shareholders and depositors and not to society as a whole. Therefore, within this framework, social welfare objectives are not the primary tasks of Islamic banks and expected to be fulfilled by another institutions. In short, Ismail's view propagates the idea that Islamic banks are not different from other commercial financial institutions with the highest priority to conduct their affairs in a *Shari'ah* compliant way (Lewis and Algaud, 2001; Satkunasegaran, 2003).

According to this model, Islamic banks still have to deduct *zakah* from the returns they provide for the depositors as a religious obligation, which requires the wealthy to contribute to the welfare of society (Dusuki, 2008b: 136). On the other hand, non-profitable institutions that form the third sector should carry out all kinds of social programmes and charitable activities (Sairally, 2006: 65).

Ismail's model has been further supported by Tag el-Din (2003) who articulated the position that socio-economic needs of society should be left to the 'social sector' such as *waqf* and other charitable institutions. It is important, however, to state that socio-economic process cannot be done without including moral and ethical values (Sairally, 2006: 66).

3.6.3. Dusuki's Model (*Taqwa* Paradigm)

In extending the available models, Dusuki (2008) develops an Islamic moral economy based model as he names *taqwa* paradigm, which inspires to consider CSR as part of religious obligations (Dusuki, 2008a: 15). *Taqwa* or God-consciousness can be characterised as "the individual, spiritual, moral, ethical, and psychological capacity to

raise oneself to that higher level that makes a person almost immune from the excessive material desires of the world, elevating the individual to a higher level of prophetic self-consciousness” (Mowlana, 2008: 136). Within this framework, the purpose of creation is to be *khalifa* or to be a vicegerent of God on earth. Thus, it is assumed that people with *taqwa* paradigm continuously seek God’s pleasure and as a result, act in line with the *Shari’ah* principles. Harmonising, integrating and combining worldly affairs with spiritual values are essential for individuals, as this will determine the fate in this world and the hereafter. Individuals and corporations that embrace the *taqwa* paradigm undertake their responsibilities as vicegerents of God in all circumstances, which make them accountable to God, who is the owner of themselves and the resources they utilise and manage (Dusuki, 2008a: 15; Dusuki and Abdullah, 2007: 9). The role of *khalifa* provides human beings with the authority over the creation and this authority is accountable.

According to Dusuki (2007b: 34), corporations that operate in compliance with *Shari’ah* principles and employ the *taqwa* paradigm in their approach to conducting business activities do not focus solely on profit generation as they acknowledge and put more emphasis on the importance of social, ethical and moral dimensions in their agenda.

Four major points have been promoted by Dusuki’s *taqwa* paradigm: ‘human dignity’, ‘free will’, ‘equality and rights’, ‘trust and responsibility’ (2005: 47-49). He further argues that CSR from an Islamic perspective takes a more holistic approach, which distinguishes it from the Western approach (Dusuki, 2008a: 13). The idea central to this view is that achieving success and happiness in this world is as crucial as accomplishing *falah* and happiness in the hereafter. Dusuki (2008a) highlights that CSR has a broader meaning from the Islamic hallmark, as it places value more on spiritual reward rather than material reward.

In overall, the Islamic moral framework cultivates higher consciousness, morals and a sense of accountability, which in turn maintains balance and harmony in society and eliminates greed. As a result, business entities and individuals in Islam are expected to address the core aspect of social and economic justice. Moderating and concerning the needs of individuals in society through philanthropic activities, social welfare projects that help to combat poverty and inequality, have been considered as an essential part of CSR in IFIs. Thus, the responsibility of social welfare from an Islamic perspective has

been placed predominantly on the members of the community that in the broader context encompass also financial institutions (Parvez and Ahmed, 2004: 10-11). Accordingly, government is not the only body that is required to undertake this obligation, as has been proposed by Friedman (1966, 1967), Marshall (1999) and Humber (2002), and IFIs are expected to practice CSR activities explicitly (Dusuki, 2005: 55). This model demonstrates that IFIs infused with the *taqwa* paradigm are able to tackle various social problems more adequately than the government.

3.6.4. Reflecting on the Models of Islamic CSR

There are similarities that can be drawn between Chapra's model and Carroll's (1979) view of CSR as well as between Ismail's (1986) model and Friedman's vision of CSR. The two main aforementioned models of CSR attributed to IFIs by modern Islamic economists can also be associated with the UK and USA models of CSR (Dusuki, 2008b: 136-137; Hassan and Lewis, 2007: 10-11; Sairally, 2006: 66-67).

In Chapra's model, Islamic banks are regarded as universal institutions, where the provision of social services are emphasised beside the objective of profit maximisation. Furthermore, social welfare projects of IFIs should be in line with the principles of *Shari'ah* with the focus placed on the maximisation of stakeholders' interests. Moreover, the ethical and social responsibility are inherently imposed on business and economic activities, as religious compliancy would imply that philanthropic activities would be integrated into the business concept of IFIs due to their expected role towards community development. Consequently, Chapra's model can be related to Carroll's (1979) conceptualisation of CSR, which encompasses four main agendas: 'responsible business practices', 'consumer responsibility', 'sustainable enterprise' and 'corporate philanthropy'.

Additionally, the parallels can be drawn between Chapra's view and the UK approach to CSR, where social issues are tackled explicitly by institutional networks. In this situation, "the business policy on social responsibility ... is taken as part of the wealth creation process and 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" (Sairally, 2006: 66-67).

Conversely, Ismail's (1986) model has similarities with the new-classical position famously advocated by Friedman (1970), who defined social responsibility in a strictly limited neo-classical economic sense, where corporations are only responsible to their stakeholders due to their considerable contribution towards capital maximisation (Bichta, 2003: 16). In a similar line of arguing, Ismail's view analogously accepts IFIs as commercial institutions functioning within an Islamic framework and fulfilling mainly the interests of their shareholders and depositors. As IFIs are expected to be developed into profitable and sustainable institutions, social goals in this model are pursued indirectly. This model can also be associated with the implicit approach of CSR in America, where the social issues are addressed implicitly by corporations through their CSR policies, programmes and strategies (Matten and Moon, 2005: 336). Thus, CSR in this situation does not take place at the top of the management agenda and is not an integral part of a company's strategy. As a result, in Ismail's model CSR initiatives should be undertaken by the third non-profitable sector.

Dusuki (2008b: 137) extends this discussion by stating that Chapra's and Ismail's models do not actually have significant differences, except in degree and emphasis. According to Satkunasegaran (2003), the application of Ismail's model of CSR would be more appropriate to Islamic banks operating in multi-religious countries with different traditional religious communities. On the other hand, applying Chapra's model to Islamic banks might be more successful in the countries with a dominant Muslim population (Satkunasegaran, 2003).

3.7. THE PRACTICES OF CSR IN ISLAMIC BANKS AND FINANCIAL INSTITUTIONS: SOCIAL FAILURE OF ISLAMIC FINANCE

Islamic finance is an operational tool of the Islamic moral economy, and as a faith-based system, it is dedicated to maintaining economic and social development with the objectives of essentialising human-centred economic development and improving human well-being, within the social economy of Islam (Asutay, 2007: 11). Despite the impressive growth of Islamic finance in the last three decades, and its spiritual underpinnings, it appears that the sector is still searching for its soul (Agha, 2012: 22; Chowdhry, 2007). While Islamic finance is considered as an ethical alternative to conventional finance, however, there are concerns over its Islamicity and hence the ethicality of IFIs. Islamic finance has thus been criticised for being materialistic and

losing the spirit of Islamic moral economy. This issue has been discussed extensively in the modern literature of Islamic finance (Asutay, 2007 and 2013; Dar, 2004; Kuran, 1997; El-Gamal, 2000; Warde, 2000; Obaidullah, 2008; Dusuki and Abozaid, 2007; Sairally, 2005; Halim, 2000; Siddiqi, 2004).

As highlighted by numerous scholars, the gap between the ideals and realities of Islamic finance is growing. Until recently, researchers mainly focused on the form rather than on the substance of Islamic finance (Ahmed, 2010: 2). In fact, Islamic finance has neglected the morally-based value judgment, constituting the substance as opposed to the rules, and norms of Islamic moral economy or the forms (Asutay, 2009: 3). As a result, Islamic finance has been criticised for converging towards conventional products.

The increased role of Islamic finance in the global finance system, where financial objectives dominate over social norms based on religious values, has placed Islamic finance in the field of mainstream finance and consequently “it is recognised as heterogeneity of financial products deprived of their value system” rather than being ‘alternative’ (Asutay, 2007: 16). As a result, Islamic finance has been criticised for taking the path of replicating conventional products. Although by mimicking the conventional debt-based instruments and products the legal mechanism of Islamic financial transactions complies with the *Shari’ah* principles; it shuns the spiritual underpinnings of Islamic law (Ahmed, 2010: 2). Therefore, the current debate is developing around Islamic-based finance (fulfilling all the social requirements) versus the *Shari’ah* compliant finance, as practiced in current times. In fact, the issue of contract technicalities and the product compliance with the *Shari’ah* regulations has been placed over the moral and spiritual aspects (Hasan, 2012: 1). This view has been supported by El-Gamal (2006: xi), who describes the current practices of Islamic finance as “Islamization of contemporary financial practice ... accomplished by means of modified premodern financial contracts (such as sales, leases, and simple partnerships)”. Additionally, Islamic banking is envisaged as “a conspicuous, lucrative, and symbolically potent instrument of Islamism” (Kuran, 2010: 39).

Critics claim that the nature of IFIs do not distinct from the nature of their conventional counterparts as they apply modified conventional practices. According to Siddiqi (2007) and Chapra (2010), IFIs have been struggling to achieve the *Shari’ah* authenticity of Islamic financial products, hence, have too many similar characteristics with

conventional finance (Hasan, 2012: 1). Consequently, “Islamic finance has arguably failed to serve the objectives of Islamic Law (maqasid al-Shari‘ a)” (El-Gamal, 2006: xii), since the distinguishing factor of Islamic finance from conventional finance is its underlying philosophy, not the prohibition of *riba* or the features of contracts.

Therefore, it is essential for Islamic finance to preserve the values of Islamic moral economy, which promotes “profit-and-loss sharing, and hence risk-sharing; thus partnership against the dominance of the strong, namely the capital; serving humanity and society for the sake of spiritual attainment and to perceive resources as trust from God, and hence directing all the resources to their perfection; spiritual accountability; and working for social good and justice not as a voluntary exercise but also in some cases as compulsory acts” (Asutay, 2010b: 26) in order to have ethical IFIs.

Taking into account these values of Islamic moral economy, which, unfortunately, have been neglected in the current Islamic finance practices, Islamic banks are imposed to add ethical and CSR financing issues in their agenda alongside the other banking practices (Ahmed, 2004: 131). Islamic moral economy emphasises the importance of a social welfare system based on mutual help, as the development of societies is impossible without maintaining the social justice, where the most impoverished and marginalised are reached, their basic needs are met and resources are distributed equally. Thereby, Islamic finance is capable of playing a key role in building communities. However, in reality the situation is not that optimistic as the statistics show that the large share of Muslim population in the world is still financially excluded because the delivery of basic financial services to the people from disadvantaged strata does not exist or is still at the very beginning (Mohieldin *et al.*, 2011: 2).

Furthermore, several studies reveal that the concept of CSR in IFIs is still in its infancy and their understanding of being socially responsible is limited to *zakah* distribution (Sairally, 2005). Despite having the social objective as an inherent function, critics argue that IFIs are mainly focused on commercial and economic aspects of the industry. Therefore, as Asutay (2010b: 25-26) stresses, there is an urgent need to unlock the potential of Islamic banks and its social significance through the mechanism of microfinance and social banks. Based on Islamic principles of social equity and redistributive justice, microfinance within the Islamic finance framework can be recommended to be provided by the following instruments and institutions: *musharakah*

and *mudarabah* (PLS), *awqaf* and the existing IFIs (Asutay, 2010: 26) to respond to the development needs of the societies in which they are operating.

Against this background, however, microfinance has not been developed enough in the agenda of IFIs (Obaidullah, 2008: 3). The good examples of Islamic microfinance can be found in Syria and Yemen, where Islamic microfinance institutions were sanctioned by the government; in Indonesia and also in Bangladesh with the substantial help of Bangladeshi Islamic Bank (Asutay, 2010b: 27). However, these attempts are not enough and there is huge dissatisfaction with the performance of the Islamic finance industry. While large amounts of resources and efforts have been channelled to develop the Islamic finance sector, the same should be done in order to further the development of Islamic microfinancing.

In this case, the question arises: what is the role of IFIs, which are supposed to be CSR-active and promote ethical finance and deep concerns for the poor and needy, the issues that underlie Islamic microfinance, and what will be their contribution to the development of microfinance programmes to help people in the Middle East and North Africa (MENA) region affected by the Arab uprising?

Further demonstration of the divergence of Islamic finance practice from the ideal conception of Islamic moral economy has been a pragmatic shift from social banking to profit-oriented and PLS banking and consequently to a sales-based and debt-based system (Sairally, 2005; Rahman, 2007: 125). Deliberately, the efforts in Islamic banking and finance have been made mainly in financial engineering to design and develop short-term, liquid instruments, which are very similar to conventional financial instruments, namely, derivatives (Mirakhor, 2012: 10). Hence, little weight is given to the social aspects of Islamic finance.

Considering that derivatives have been at the heart of the global financial crisis, these short-term financial instruments should be taken seriously by Islamic finance practitioners. Therefore, in order to avoid analogous consequences in Islamic banking and finance, financial engineers are expected to stop serving “the demand-driven appetite for liquid, low risk, and short-term instruments” (Mirakhor, 2012: 10).

Thus, it can be said that the socio-economic status of communities cannot be improved through allowing the use of increasingly sophisticated financial instruments that are

currently prevailing in the market and have a solely economic purpose. The industry of Islamic banking, unfortunately, largely implements debt-like instruments that mirror images of conventional debt financing instruments and have identical economic and social effects (Hasan, 2012: 3). As a result, the existing inconsistency between the aspirations of Islamic moral economy and realities of Islamic finance has occurred and is shifting towards the directions of neoclassical economics.

This situation has been defined by Asutay (2010b) as the social failure of Islamic finance; IFIs no longer serve the communities but rather markets (Asutay, 2010c: 43). In line with Asutay's (2010) argument, the study conducted by Hassan and Harahap (2010), which includes seven IFIs, shows that Islamic banks do not have sizable CSR initiatives (Aribi and Gao, 2012: 206). Another research of thirty-two Islamic banks conducted by the scholars from the International Institute of Islamic Thoughts (1996) has been able to demonstrate the overriding emphasis on economic goals and not the social goals of the banks under the study. This study also reveals that in assessing attractiveness of the investment, economic conditions have greater impacts than social (Maali *et al.*, 2006: 269).

In order to overcome the apparent divergence between initial objectives and realities of Islamic finance, the virtues of Islamic moral economy should be unlocked further. The substance of the products should be reviewed with the same seriousness as the compliance of contracts' forms to *Shari'ah*. Islamic finance "must break free of the temptation to take the path of replicating conventional products. Success on the material plane by sacrificing its spiritual mandate is an actual failure from an Islamic perspective" (Agha, 2012: 22).

Despite their social failure and several limitations, Islamic banks play a significant role in terms of pooling funds and they have demonstrated themselves able to deliver desired valuable services that balance the needs of consumers and producers. Therefore, in order to enhance the social potential of Islamic banks and correct the failure of Islamic finance, "robust social justice oriented principles" should be introduced "into IBF (Islamic banking and finance) by endogenising social justice into its operational nature" (Asutay, 2010: 2). Consequently, attention should be drawn from the legal frame of the Islamic contracts to the spiritual message of the Islamic moral economy, which could help to reduce the gaps between the realities of Islamic banking and the aspirations of

Islamic moral economy. This reorientation should reinforce the universality and acceptability of Islamic finance, hence, would allow it to become a distinctive value proposition.

3.8. REVIEWING LITERATURE ON CSR DISCLOSURE PRACTICES IN IFIs

The concept of CSR, which is one of the articulations of moral dimension in Islamic financial institutions (IFIs), has gained the increasing attention of scholars, and several studies on social reporting for IFIs have been conducted (Haniffa, 2002; Maali *et al.*, 2006; Haniffa and Hudaib, 2007; Hassan *et al.*, 2010; Kamla and Rammal, 2010). This section, hence, discusses in detail the studies conducted on CSR reporting in IFIs.

Haniffa (2002) in her study highlights the issues faced by Muslim entrepreneurs examining CSR disclosure practices of IFIs that do not include information in their reports demonstrating the compliance of their activities with Islamic principles. Thus, these kind of social reports do not display any accountability of the corporations to God. She further proposes the use of the moral benchmark for CSR disclosure in IFIs based on *Shari'ah*. IFIs, by adopting this moral benchmark, would fulfil the objectives of accountability and transparency through taking into consideration material, moral and spiritual dimensions. In other words, *Shari'ah*-based ethical benchmark aims at seeking God's pleasure through establishing socio-economic justice; meeting responsibilities to society, and pursuing wealth. Therefore, this benchmark addresses the relationship between human beings and God, human being and human being and also human beings and the environment. As far as Haniffa (2002) is concerned, CSR disclosure practices in IFIs should differentiate from the social reporting in conventional financial institutions, as they are based on the principles derived from *Shari'ah*, despite the fact that the fundamental ideas of CSR and accountability are adopted in both types of institutions. Two broad objectives of social reporting from Islamic finance perspective are suggested by her. The first objective is to disclose the accountability of corporations towards the society where they operate and addition in their accountability to God. The second objective is to be more transparent in business activities through communicating required information compliant with the spiritual needs of Muslim entrepreneurs. Furthermore, Haniffa (2002) proposes five dimensions that should be included in the CSR disclosure from Islamic finance perspective: finance and investment, product, employees, society and environment. In overall, Haniffa (2002) proposes a valuable

moral benchmark for CSR disclosure in IFIs based on *Shari'ah*, but lacks the empirical evidence of the impact of this framework on the extent of disclosure.

Another conceptual study on CSR is conducted by Kamla *et al.* (2006). The authors discuss the notion of accounting for the environment based on the Islamic principles and previous studies on Islamic and accounting. The study highlights that the environmental issues are deeply embedded within the worldview of Islam. The authors further argue, “that the Islamic principles have a very general relevance in respect of concerns to govern our environment with its accounting implication. Reflection on these principles problematises Western ways, enhances and refines existing counter hegemonic positions and suggests new ways forward” (Kamla *et al.*, 2006: 260).

In addition to conceptual studies on social reporting in IFIs, numerous empirical studies have attempted to measure the extent of social disclosure in Islamic banks (Maali *et al.*, 2006; Haniffa and Hudaib, 2007; Hassan *et al.*, 2010; Kamla and Rammal, 2010; Hassan and Harahap, 2010; Zubairu *et al.*, 2011).

The study carried out by Maali *et al.* (2006) develops a benchmark for social disclosures in Islamic banks derived from the Islamic principles and the Islamic code of ethics. The disclosure index is constructed and content analysis is used to measure the level of social disclosures of twenty-nine Islamic banks from sixteen countries. The results of this research indicate that the extent of social disclosure by Islamic banks did not meet the expectations of the researchers, which implies that Islamic banks pay less importance to social matters. The study concludes with not a very optimistic statement stressing, “Islamic banks have some way to go in meeting the expectations of the Islamic community” (Maali *et al.*, 2006: 286).

Another prominent research on CSR disclosure in Islamic banks by Haniffa and Hudaib (2007) explores the ethical identity of seven Islamic banks in the GCC region as communicated in their annual reports. This study analyses the gap between the ideals (release of information based on Islamic ethical identity framework) and realities (based on information disclosed in annual reports) of ethical identities measured by the developed *Ethical Identity Index*. The authors highlight five unique characteristics that differentiate Islamic banks from their conventional counterparts: the underlying philosophy and values, provision of interest-free products and services, limitation to

Islamically acceptable deals, focus on developmental and social goals, and reviews by the *Shari'ah* Supervisory Board. Islamic banks are expected to disclose this information in their annual reports and portray a high level of CSR disclosure, as they possess ethical identity based on philosophical underpinnings of *Shari'ah*, which assumes that their social goals are equally important as their financial goals. However, the findings of this study reveal the opposite and show that Islamic banks in the GCC region do not put enough efforts into communicating information in a consistent manner and ensuring equivalence between the CSR disclosure practices in the annual report and the moral benchmark based on *Shari'ah*. It should be noted that Haniffa and Hudaib's (2007) study has inspired a number of researchers and numerous papers have been conducted using the methodology proposed by the authors, as this study.

In another empirical paper, Hassan *et al.* (2010) followed the approach proposed by Haniffa and Hudaib (2007) and measured the ethical identity of Islamic banks in Bangladesh. Additionally, the study by Hassan *et al.* (2010) extended the research through investigating the impact of ethical identity index on the market value of Islamic banks in the sample. The results of the research indicate significant variations in the levels of disclosure communicated by Islamic banks in Bangladesh. The findings reveal that while several dimensions of the ethical identity index are disclosed in detail, some of them lack the required information in their annual reports. Furthermore, the results show that there is a significant positive relation between the ethical identity index and market value of Islamic banks.

Zubairu *et al.* (2011) replicates Haniffa and Hudaib's (2007) study in evaluating the CSR disclosure of four Islamic banks in Saudi Arabia. The findings of this research indicate a poor level of CSR disclosure practices by Islamic banks in Saudi Arabia. Among ten dimensions constructing the ethical identity index of Islamic banks, 'commitment to debtors' is the most disclosed dimension, whilst the 'environment' dimension related to the responsibilities of banks towards the environment scored the lowest level of disclosure.

In a similar manner, Hassan and Harahap (2011) employ the methodology proposed by Haniffa and Hudaib (2007) and investigate the CSR disclosure of seven Islamic banks from Bahrain, Bangladesh, Indonesia, Malaysia, Saudi Arabia, Kuwait, and the United Arab Emirates through analysing the annual reports of banks and constructing the CSR

disclosure index based on the Islamic business ethics framework. The results of this study also indicate that CSR-related issues are not the top priority of the agendas of Islamic banks.

A similar approach is employed by Kamla and Rammal's (2010) study, which examines the role of social justice played by Islamic banks. Annual reports of ten Islamic banks from different countries are analysed by the 'explicative content analysis technique'. In doing so, the study explores the existence or absence of information related to social justice from the annual reports and websites of Islamic banks. The authors conclude, "disclosures by Islamic banks explored in this study... do not indicate that Islamic banks have serious schemes targeting poverty elimination or enhancing social justice in society" (Kamla and Rammal, 2010: 16). Furthermore, the results of this study are in line with the findings of Haniffa and Hudaib's (2007) research, indicating "a significant gap between the theoretical and ideological claims by Islamic banking and actualities" (Kamla and Rammal, 2010: 16).

Based on the review of the previous studies on CSR disclosure practices in Islamic banks, it can be said that researchers are critical of adopting a conventional CSR disclosure framework and highlight the importance of introducing a moral framework based on Islamic finance principles for social reporting in Islamic banks. Furthermore, the majority of the studies adopt the content analysis technique to measure CSR disclosure and examine the gap between the ideals and realities of embracing CSR in Islamic banks.

In short, the previous research indicate the need to expand the existing literature to explore the Islamic banks' attitude towards the CSR disclosure practices from different aspects, such as exploring the impact of CSR disclosure practices on the financial performance of banks, the impact of CSR disclosure on banks' reputation, and, hence, promoting Islamic banks in the financial market in a competitive manner with conventional banks.

This study, therefore, will focus on evaluation of CSR disclosure of Islamic banks in the GCC region based on a benchmark derived from Islamic finance principles and will also measure the impact of CSR disclosure on the financial performance of Islamic banks.

3.9. REVIEWING LITERATURE ON CORPORATE SOCIAL PERFORMANCE AND CORPORATE FINANCIAL PERFORMANCE RELATIONSHIP

For over three decades, numerous theoretical and empirical studies have been conducted in order to understand the possible relationship between corporate social performance and corporate financial performance (see: Marom, 2006: 191; Makni *et al.*, 2009: 409; Pava and Krausz, 1996: 322). It should be noted that studies by Ullman (1985), Preston and O'Bannon, (1997), Roman *et al.* (1999), Margolis and Walsh (2003), Griffin and Mahon (1997), and Orlitzky *et al.* (2003) are considered seminal works in the field and have widely been cited as focusing on the relationship between social and financial performance in the corporate sector. These studies, which tested the direction, strength and also causality of the relation, produced various results both confirmatory and contradictory. Based on the empirical results, it is difficult to assign the direction of the mentioned relationship, as the findings indicate that the correlation between CSR and corporate financial performance has been assumed to be positive, negative and neutral or non-significant and hence no conclusive result can be achieved.

It should be noted that Moskowitz's (1972) study is among the first to develop reputational indices and find that responsible corporations have higher stock returns than average corporations. The usefulness of these indices was later criticised by Ullman (1985: 544), who argued that they "do not measure social performance per se but rather perceived social performance". Ullmann (1985) indicated that the results of 31 previous studies focusing on the relationship between CSR and corporate financial performance are conflicting and ambiguous.

Later, Pava and Krausz (1996) surveyed 21 empirical studies during the period 1972-1999 and revealed that 12 studies indicated a positive association, while one found a negative association and eight found no association between a firm's social and financial performance.

Griffin and Mahon (1997) reviewed and categorised the existing literature on the relationship between corporate social performance and corporate financial performance during the period from 1972 to 1997, which is based on 51 articles; 16 studies were from the 1970s, 12 of which indicated a positive relationship. From the 27 studies conducted in the 1980s, 14 studies found a positive relationship. In the 1990s, seven of

the eight studies showed a positive correlation. The same study indicated that 20 studies supported negative results, one in the 1970s, 17 in the 1980s and three in the 1990s. Moreover, Griffin and Mahon (1997) identified nine studies with inconclusive findings, where four of them were carried out in the 1970s and five in the 1980s.

The more extended review of the research on relationship between corporate social and financial performance was conducted by Roman *et al.* (1999), who reconstructed Griffin and Mahon's (1997) study and provided different results. Roman *et al.* (1999: 120) argue that authors' incorrect interpretations of findings led to mistakes that occurred in Griffin and Mahon's (1997) study. For instance, Roman *et al.* (1999) argue that an impressive amount of research indicating negative corporate social/corporate financial performance relationship came as a result of including studies with invalid measurement as well as misinterpreting the situations where poor CSR-related activities causes poor performance and vice versa. Thus, some studies were re-categorised from indicating a negative relation to positive and from positive or negative to inconclusive, while others, which contained methodological inadequacies were removed and replaced by the recent ones. Thus, Roman *et al.* (1999) conclude that 33 studies included in their sample demonstrate positive correlations.

Another survey by Margolis and Walsh (2003) investigated the relationship between corporate social and corporate financial performance by analysing 127 published studies during the period between 1972 and 2002. The majority of these studies, around 50 per cent, treated corporate social performance as an independent variable and used it as a predictor of financial performance. They found a positive association between corporate social and financial performance. In addition, a very small amount of studies reported a negative relationship, whilst 28 of them indicated non-significant result and 20 produced mixed results.

Orlitzky *et al.* (2003) in their quantitative meta-analysis of 52 studies examined the relationship between corporate social and corporate financial performance, assuming that differences in empirical results occur due to the differences in measuring financial and social performance. Their research concludes that there is a "positive association between CSP and CFP across industries and across study contexts" (Orlitzky *et al.*, 2003: 423). Most importantly corporate social performance has been found to have better correlations with accounting-based indicators of financial performance, such as

companies' return on assets (ROA) and return on equity (ROE) than with market-based measures.

A more recent study was conducted by Mahoney and Roberts (2007) by examining the relationship of corporate social and corporate financial performance based on a large sample of publicly-held Canadian companies. Their results, which produced an opposing result to Waddock and Graves' (1997) results, indicate no significant relationship between an aggregated measure of corporate social performance and financial performance of examined companies. However, Mahoney and Robert (2007) found a significant relationship between the environmental and international dimensions of corporate social performance and financial performance.

The nexus between corporate social and corporate financial performance still attracts the attention of researchers. Among them, Makni *et al.* (2009) who examined the impact of individual dimensions of corporate social performance on financial performance of 179 publicly-held Canadian firms. The results of their study revealed non-significant linkage between an aggregate measure of corporate social and financial performance of firms in a sample. The environmental component of corporate social performance, however, showed a robust significant negative effect on ROA, ROE and market returns.

In addition to a number of Anglo-American studies assessing the relationship between corporate social and financial performance, Soana (2011) conducted a quantitative analysis on the Italian banking sector. This study could not find any evidence of either a significant or positive association between corporate social and corporate financial performance, assuming that "Italian banks have succeeded in directing investments and costs ethically without having to bear any sacrifice in terms of financial performance" (Soana, 2011: 145). Conversely, more evidence of the study suggests that CSR-active practices do not cause financial advantage.

By using a different approach to corporate social performance and financial performance relations through hypothesising that this relationship is *U*-shaped, Barnett and Salomon (2012) found that companies with low social performance tend to have higher financial performance than companies with sufficient social performance. However, companies with high social performance are associated with the higher level of return. These results align with the proposed hypothesis. In addition, the results prove

the theoretical argument of the study that stakeholder influence capacity underlies the ability to transform the outcome of social responsibility activities into profit.

Perrini *et al.* (2011) stressed that the majority of the existing studies have focused on the assessment of the relationship between composite measure of corporate social performance and different measures of financial performance. It is thus argued that by using single dimension measures of corporate social performance, the factors that affect the financial performance in relation with socially responsible practices have been neglected. Therefore, Perrini *et al.* (2011) attempts to summarise 250 empirical and theoretical studies on the business case for CSR by using a stakeholder-based approach. The results of the study provide the main mechanisms through which CSR practices can lead to performance outcomes, taking strength from the stakeholder-related performance drivers.

As this review depicts, negative, positive and non-significant relationships between corporate social and corporate financial performance have been hypothesised, justified and supported by scholars as various studies indicate. Overall, Preston and O'Bannon (1997) provide conceptual explanations for the relationship between corporate social responsibility and financial performance; they proposed six hypotheses with the objective of portraying all possible directions and causality issues for the link between corporate social and financial performance: social impact hypothesis, trade-off hypothesis, available funds hypothesis, managerial opportunism hypothesis, positive and negative synergies hypothesis.

3.10. CONCLUSION

In summary, this chapter provides the Islamic perspective of CSR as an alternative to the Western theoretical constructs of CSR, which presents the socially responsible vision and objectives of Islamic moral economy with recourse to the objectives of the Islamic law and an integration of a moral filter to the practices of Islamic banking and financial institutions. It highlights the reasons for CSR becoming an integral part of Islamic moral economy and hence, Islamic banks, through underlining Islamic financial principles alongside philosophical foundations of Islamic economic system. However, the Islamic banks deviating from the ideals of Islamic moral economy has become a part of the international financial system with the same ambitions, which they consider as

their realities. The chapter provides the review of the previous studies on CSR disclosure in IFIs, the results of which are not encouraging in terms of the CSR disclosure practice of Islamic banking industry. The chapter ends with the literature review on corporate social performance and corporate financial performance relationship.

CHAPTER FOUR
RESEARCH METHODOLOGY

CHAPTER FOUR

RESEARCH METHODOLOGY

4.1. INTRODUCTION

Previous chapters reviewed different theoretical approaches and highlighted the most suitable theory for this research. Based on the arguments of stakeholder theory, the aim of this research is to examine CSR disclosure practices of Islamic banks in the GCC region. In addition, this research aims to measure the impact of CSR disclosures on financial performances of GCC Islamic banks within the frame of ‘instrumental stakeholder theory’ and ‘good management theory’. To achieve these aims, the annual reports of Islamic banks are examined through content analysis for the year 2000-2011 with the objective of assessing the relationship between CSR disclosure as a proxy (CSP) for CSR performance and financial performance by constructing a CSR disclosure index.

Within these aims, the following hypotheses are developed and tested:

H₁: The better adherence to Islamic financial principles yields higher level of CSR disclosure of the GCC Islamic banks.

H₂: The higher level of the CSR disclosure yields better financial performance for the GCC Islamic banks.

This chapter thus presents the research process in detail in terms of developing it to test the identified hypotheses. In doing so, it provides the research methodology employed by this research based on the aims and objectives of the research. It begins with the section explaining the research philosophy followed by the research methodology section. After that, research design and strategy are reviewed and described. The next section presents in detail research methods (definition of variables, model specification and data analysis) employed in the first and second empirical models. Finally, sample selection and data collection are described.

4.2. RESEARCH PHILOSOPHY

The importance of understanding philosophical issues related to the research methodology has been underlined in numerous studies (Saunders *et al.*, 2009; Easterby-Smith *et al.*, 2002), as philosophically informed research indicates a better understanding of the research topic. As far as Easterby-Smith *et al.* (2002: 28) are concerned, the knowledge of philosophy can assist researchers with choosing a design that fits for their studies the most and it enables researchers to evaluate different methodologies and methods and avoid unnecessary work through detecting the limitations of certain approaches at the early stages. Furthermore, researchers may benefit from the exploration of knowledge by creating and innovating designs that were previously outside their experience.

The term 'research philosophy' refers to the development of the research background, research knowledge and its nature (Saunders *et al.*, 2009: 107). Methodological options of a research that allow an appropriate research strategy to be established, are based on the philosophical assumptions, related to ontology, epistemology, human nature and methodology (Burrell and Morgan, 1979). Thus, the research philosophy that is going to be employed is determined by the researcher's opinion about these assumptions or by his/her view of the reality.

As the base of philosophy, 'ontology', in general, studies the nature of reality and being (Blaikie, 1993), which, therefore, "raises questions of the assumptions researchers have about the way the world operates and the commitment held to particular views" (Saunders *et al.*, 2009: 110). The fundamental ontological question in an operational sense is "whether you consider the world is objective and external to the researcher, or socially constructed and only understood by examining the perception of the human actors" (Hussey and Hussey, 1997: 49). Saunders *et al.* (2009: 110-111) identified two contrasting ontological aspects: objectivism and subjectivism. The proponents of objectivism believe that the social world exists in the reality independent of an individual's perceptions and appreciations. The objectivists also debate that for the scientific method there is a need for publicly observable and replicable facts that can be "available only in the area of overt behavior" (Diesing, 1966: 124). Accordingly, the subjective phenomena such as intending, conceiving and repressing, can be examined only through their link with overt behaviour. The advocates of subjectivism argue that

social phenomena are made up of subjective factors – images, concepts and labels that give a structure to reality (Saunders *et al.*, 2009: 110-111; Dising, 1996: 124).

Another question that should come after the one related to what constitutes the reality should be how this reality is measured and what does and does not constitute the knowledge of this reality. This question leads to an ‘epistemological’ issue. ‘Epistemology’ is concerned with “what constitutes acceptable knowledge in a field of study” (Saunders *et al.*, 2009: 112) and asks, “How do I know the world?” “What is the relationship between the inquirer and the known?” (Denzin and Lincoln, 2005: 183). Saunders *et al.* (2009) identified three paradigms through which epistemological perspective can be realised: positivism, realism and interpretivism.

Positivism can be defined in different ways. The basic “positivists believe that only phenomena which are observable and measurable can be validly regarded as knowledge. They try to maintain an independent and objective stance” (Hussey and Hussey, 1997: 49). They contend that facts are more important than impressions and their position is derived from the methods of natural science. In the positivist approach, the theory is used to predict and analyse testable hypothesis and the research is conducted in a value-free way (Bryman, 2001: 12).

Another philosophical position that intends to apply the principles of the natural sciences to the social sciences and similar to positivism, is ‘realism’ (Bryman, 2001: 13). It is based on the assumption that “what the senses show us as reality is the truth: that objects have an existence independent of the human mind” (Saunders *et al.*, 2009: 110). The proponents of realism share the same scientific approach as positivists to the development of knowledge, which implies the same approach to the collection and interpretation of data for natural and social sciences (Bryman, 2001; Saunders *et al.*, 2009). There are two general forms of realism: ‘direct’, ‘empirical’ or ‘naïve’ and ‘critical’ realism. While ‘direct’ or ‘empirical’ realism advocates that the senses provide us with accurate and direct awareness of the world, ‘critical realism’, on the other hand, claims that we do not experience the ‘things’ directly but only the internal images or representations of the external world (Saunders *et al.*, 2009: 114-115). The critical realists believe that “society is made up of feeling, thinking human beings and their interpretations of the world must be studied” (Danemark *et al.*, 2002: 200). According to the critical realists, the reality consists of multiple levels and therefore,

generalisability is not of crucial importance as each of these levels might have an impact on the researcher's view of what is being studied; thus, it is more important to analyse the mechanisms, processes and structures that account for the patterns that are observed (Saunders *et al.*, 2009: 115).

As part of critical realism, 'interpretivism' emerged as an alternative paradigm to 'positivism' and the proponents of this view argue that "a strategy is required that respects the differences between people and the objects of the natural sciences and therefore requires the social scientists to grasp the subjective meaning of social action" (Bryman, 2001: 13). The main goal of interpretivists is to evaluate and refine human behaviour rather than to generalise and predict causes and effects. The philosophical base of interpretivism comprises Weber's notion of *verstehen*, hermeneutics and phenomenology (Bryman, 2001: 13). The proponents of the interpretive approach, hence, suggest that 'interpretivism' fits into business and management research due to the constantly changing process of business environment (Saunders *et al.*, 2009: 116).

Another set of assumptions concerns 'human nature', namely, the relationship between human beings and their environment. Burrell and Morgan (1979: 2) identified two images of human beings that emerge from these assumptions – one of them depicts human beings as responding mechanically and deterministically to their environment, while the other shows them as completely autonomous, free willed and creative, producing their own environment rather than being determined by it. These two contrasting images refer to determinism and voluntarism respectively.

The abovementioned research philosophies have direct implications for the methodological concerns of any research, since the contrasting ontologies, epistemologies and models of human beings will lead to different research methods (Burrell and Morgan, 1979: 2).

As regards to this research, it relies mainly on stakeholder theory, considered as a part of the positive accounting theory. The normative framework has been shifted by the empirical and positive accounting theory since the end of the 1980s (Baker, 2011). The positive accounting theory, in the literature, is also referred to as "neo-empirical research" (Gaffikin, 2005: 1), since it relies heavily on empirical evidence based on an established theory and it assumes an objective ontological position.

This research attempts to examine the information regarding the CSR disclosure practices of Islamic banks and examines the impact of CSR disclosure on financial performance of Islamic banks in the GCC region and develops hypothesis and tests these hypothesis for this reason. Therefore, it mainly depends on measurable observations and seeks for objective truth in examining this relation. Consequently, this research adopts an objective ontological position.

It should also be noted that this research attempts to measure religiously-constructed outcomes at the operation and CSR practices of Islamic banks. However, religious ontology does not determine the philosophical approach of this study, as the religiously informed outcomes are identified as variables to measure. Therefore, despite the religious constructs of Islamic banks, this study remains within positivist epistemology.

4.3. RESEARCH METHODOLOGY

‘Methodology’ is concerned with the methods used for obtaining knowledge about the social world (Denzin and Lincoln, 2005: 183). In other words, it is a wider research framework that consists of research design and research methods that are underlined by the concepts and theories. Therefore, choosing an appropriate research methodology will help in building a clear research framework that leads to meeting the research goals and objectives.

There are two different methodological approaches: nomothetic versus ideographic. Nomothetic perspective is characterised as group centred, standardised with controlled environmental contexts, whereas idiographic is individually centred with the naturalistic environmental contexts (Luthans and Davis, 1982: 380). The ideographic approach adopts the view that one can only understand the social world through acquiring first-hand knowledge of the subject under investigation. On the other hand, the nomothetic approach focuses on basing research on systematic protocol and technique (Burrell and Morgan, 1979: 6-7).

Based on these descriptions, this research adopts the nomothetic approach to the research methodology as the most appropriate. The nomothetic approach highlights the importance of building research based on systematic protocol and techniques and involves scientific testing of the hypotheses.

The assumptions of an ideographic methodology typically determine the use of qualitative methodologies, since for the researcher the perception of individuals' knowledge being studied is important and primary or first-hand knowledge is obtained (Burrell and Morgan, 1979; Hussey and Hussey, 1997). On the other hand, the assumptions of a nomothetic methodology bring about the use of quantitative methodologies as the researcher concentrates on measuring phenomena and secondary data or second-hand knowledge is obtained (Burrell and Morgan, 1979; Hussey and Hussey, 1997).

Qualitative research methodology can be characterised as “an umbrella term covering an array of interpretative techniques which seek to describe, decode, translate, and otherwise come to terms with the meaning, not frequency, of certain more or less naturally occurring phenomena in the social world” (Van Maanen, 1979: 520). Qualitative research tends to focus on the socially-constructed nature of reality, the close relationship between the researcher and the subject of study as well as on the situational limitations that form investigation. The proponents of qualitative research stress the value-laden nature of inquiry (Denzin and Lincoln, 2005: 10). It should be noted that qualitative researchers are more explorative and unstructured, trying to understand and clarify the problem (Ghauri and Grønhaug, 2010: 196). Therefore, qualitative research is employed to explore behaviours, attitudes and opinions.

By contrast, quantitative research tends to focus on measuring and quantifying data and analysing the relationship between variables. Quantitative researchers are concerned with descriptions and developing and employing hypotheses. The proponents of quantitative research argue that they apply a value-free framework. (Denzin and Lincoln, 2005: 19; Ghauri and Grønhaug, 2010: 196). Thus, quantitative research aims at examining the cause and effect of relationships in a formal manner.

Since the aim of the first empirical study is to measure and analyse the CSR disclosure of Islamic banks in the GCC region through constructing the CSR disclosure index by analysing annual reports of the banks using content analysis, it employs qualitative research methodology. However, in the measurement and interpretations, the data is transformed into quantitative meaning. In addition, in the second empirical chapter, in order to see the impact of CSR disclosure on the financial performance of Islamic banks, this research is located within quantitative research methodology framework. Thus, this

study employs a mixed research methodology.

4.4. RESEARCH DESIGN

Research design focuses on identifying the research problem and determining research objectives. It refers to research strategies that will be used to conduct the research, and therefore provides “a flexible set of guidelines that connect theoretical paradigms first to strategies of enquiry and second to methods for collecting empirical materials” (Denzin and Lincoln, 2005: 25). Research design can be also defined as the “science (and art) of planning procedures for conducting studies so as to get the most valid findings” (Vogt, 1993: 196).

In a nutshell, a research design will typically include methods of collecting and analysing data. In other words, the research design plays the role of ‘master techniques’ in the sense of a general framework of a research (Ghauri and Grønhaug, 2010: 54). Furthermore, it identifies how the two major challenges faced by the researcher, namely representation and legitimation, will be tackled (Denzin and Lincoln, 2005: 25).

It should be noted that neglecting the design problem often leads to design errors and researchers tend to obtain weak results due to the failure of not being able to answer the research questions as required (Ghauri and Grønhaug, 2010: 55). Thus, it is essential to design a research prior to giving decisions on methods of collecting and analysing empirical material.

Considering that the research question determines the type of design that will be employed by the researcher, research studies can be classified according to the purposes they are conducted for, as descriptive, explanatory and exploratory (Saunders *et al.*, 2009: 138-139).

Exploratory Research

As Ghauri and Grønhaug (2010: 56) suggested, exploratory research is often used when the research problem cannot be clearly identified or there is not much material available on the specific nature of the question. The main feature of an exploratory research is its flexibility and adaptability to change the direction.

An exploratory research focuses on gaining insights and familiarity for later

investigation. It is worth mentioning here that the flexibility of an exploratory research should not be understood as a lack of direction to the investigation; it actually means that the researcher at the very beginning has a very broad picture and it becomes clearer and narrower at the end of the research progress (Saunders *et al.*, 2009: 140). This type of research relies on observing, collecting information through the participants, which sometimes may lead to theorising it.

Descriptive research

Descriptive research is used when the research question and problems are well understood (Ghauri and Grønhaug, 2010: 56). The purpose of descriptive research is “to portray an accurate profile of persons, events or situations” (Robson, 2002: 59). In other words, the findings of a descriptive research will provide valuable insights into the features of the subject matter of the research. The main characteristics of descriptive research are structure, precise rules and procedures.

Explanatory research

The objective of an explanatory research is to find the causal relationship between variables and to answer the question why. It attempts to study a situation to identify the actual reasons of a phenomenon that occur (Saunders *et al.*, 2009: 140). In an explanatory research, the research question aims to explain rather than only to describe the phenomena studied. Traditionally, the research denoted by the term explanatory research intends to understand the relationship that exists between variables.

Case study research

Yin (2009: 18) defines case study as: “An empirical inquiry about a contemporary phenomenon (e.g., a “case”), set within its real-world context – especially when the boundaries between phenomenon and context are not clearly evident”.

In the case study, the researcher focuses on a process or a population of cases, not on an individual case. The researcher is expected to consistently provide sufficient information on “the nature of the case, its historical background, and its relation to its contexts and other cases, as well as providing information to the informants who have provided information” (Denzin and Lincoln, 2005: 380). Therefore, there is a need for

sufficient information to enable the researcher to describe the distinctive features of the case and to identify similarities or contrasts that exist between numerous cases (Ghauri and Grønhaug, 2010: 109).

The case studies are often used when ‘how’ and ‘why’ questions are required to be answered and are generally related to exploratory, explanatory or descriptive research. The data collection techniques may include primary sources such as interviews and observations as well as secondary data sources such as financial reports, archives, budgets and operating statements (Ghauri and Grønhaug, 2010: 109-110).

As regards the research design in this study, this research is designed as an exploratory study, as it mainly aims to explore the categories of socially responsible activities and assess the extent of the CSR disclosures of Islamic banks. It is also an explanatory case study, given that in the second empirical chapter, it intends to measure the impact of CSR disclosures on financial performance of Islamic banks in a specific region. As for the case study nature, since it covers the Islamic banks operating in the GCC region, which encompasses Bahrain, Saudi Arabia, United Arab Emirates, Kuwait and Qatar, it should also be framed as a case study. Thus, this research should be considered as a multi-design research through which each research design responds to each particular dimension of the research.

4.5. RESEARCH STRATEGY

In choosing a particular research philosophy, certain strategies should be involved. There are two broad strategies often utilised by researchers: deductive and inductive.

In the deductive approach, the researcher starts with an idea and theoretical framework and uses the data to confirm or refute the idea. It works from the general to the more specific. Within the deductive approach, the research draws conclusions from the available facts (Hussey and Hussey, 1997: 13). Thus, the deductive approach refers to testing the theory underlying the phenomena being examined.

By contrast, in the inductive approach the data is used to create ideas or theories. This approach moves from specific observations to broader generalisations and theories and involves a degree of uncertainty (Hussey and Hussey, 1997: 13). Therefore, the inductive approach refers to building the theory underpinning the phenomena being

examined.

Since this research adopts the positivist paradigm and does not aim at developing a theory but rather seeks to explore and describe the CSR disclosure practices as communicated in the annual reports of GCC Islamic banks and to investigate the relationship between CSR disclosure results and financial performance of these banks, the deductive approach will be employed.

4.6. RESEARCH METHODS AND INSTRUMENTS

This section explains an important aspect of the research – the data collection and analysis process, namely research method.

4.6.1. Research Methods

Another important step that should be taken is to choose the most suitable research method that can encompass several methods and procedures employed by researchers for collecting, analysing, interpreting and generalising empirical materials.

In referring to data collection aspect of research method, Bryman (2001: 29) defines research method as a “technique for collecting data. It can involve a specific instrument, such as a self-completion questionnaire or a structured interview schedule, or participant observation whereby the researcher listens to and watches others”. However, research method also relates to the analysis of the collected data.

There are three commonly used types of research methods, namely qualitative, quantitative and triangulation, which is combination of both. Each of these methods has an expanding set of techniques and tools and is useful for different purposes. Quantitative methods refer to “an objective approach of the reality, with precise techniques and instruments, through appeal to general logical judgments in order to obtain explanations or testable predictions” (Zait and Zait, 2009: 907). As for qualitative method, which is much more concerned with exploring the participants’ opinions, perceptions and behaviour, and is therefore more reliant upon interviews and case studies, dealing with smaller numbers. It is therefore suggested that the qualitative research method focuses on the relationship between the researcher and what is studied, thus, is more subjective and interpretive. While quantitative methods differ from

qualitative not only in the question of quantification but also by reflecting different perspectives on knowledge and research aims (Ghauri and Grønhaug, 2010: 104). Thus, qualitative research method refers to soft or primary data in exploring a particular subject matter, while quantitative data refers to fixed data in examining a particular relationship.

It should be noted that these methods are not “mutually exclusive” (Ghauri and Grønhaug, 2010: 104), as there are many examples of studies where a mixed approach is used to obtain more accurate findings (Fontana and Frey, 2005: 722). The combination of qualitative and quantitative research methodologies is defined as “methodological triangulation” (Zait and Zait, 2009: 907), which enables [researchers] to employ different research methods in different ways (Fontana and Frey, 2005: 722) in conducting one particular research question.

In this study, in the first empirical model, the emphasis is placed on understanding and interpreting the GCC Islamic banks’ approach to disclose their CSR practice and activities. For this purpose, the data from the annual reports of Islamic banks are collected and content analysis is used to code these data, which reflects the relationship of Islamic banks with their stakeholders, in a manner that allows statistical analysis. Thus, the combination of qualitative and quantitative methods is used to produce as much and as reliable data as possible, as qualitatively generated data are quantitatively analysed.

In the second empirical model, the quantitative research method is employed. The relationship between the CSR disclosure and financial performance of the GCC Islamic banks is examined and the research hypothesis that CSR disclosure positively affects financial performance of Islamic banks is tested. For this purpose, the data generated through disclosure analysis in the first empirical chapter in addition to the data collected from the financial statements of Islamic banks in relation to performance related issues are used to test through an econometric model.

Consequently, due to having quantitative and qualitative method of data collection and data analysis, this research adopts the triangulation research method, which provides an essential strength to the research.

4.6.2. Research Instruments and Data Analysis

4.6.2.1. Research methods: Data collection

The first empirical model employs quantitative and qualitative research methods in gathering the required data from annual reports by using content analysis, which is considered as qualitative in terms of the research process due to having an unobtrusive approach. However, the outcome of the content analysis, in terms of data generated and data analysis, is a quantitative method. It should be noted that for this purpose, content analysis is utilised to collect and construct the necessary data.

On the other hand, the second empirical model employs quantitative research method for data collection, as it uses data from financial reports to test the developed hypothesis through statistical analyses.

4.6.2.2. Research instruments for disclosure analysis

This section provides detailed information on the construction of CSR disclosure index in annual reports through content analysis and the literature on Islamic moral economy and finance.

4.6.2.2.1. Content analysis

Content analysis is one of the most frequently used research methods in assessing social and environmental disclosures (see Abbott and Mosen, 1979; Grey *et al.*, 1995a; Haniffa and Cooke, 2005; Maali *et al.*, 2006; Haniffa and Hudaib, 2007). It is defined as “a technique for gathering data that consists of codifying qualitative information in anecdotal and literary form into categories in order to derive quantitative scales of varying levels of complexity” (Abbott and Mosen, 1979: 504). In terms of operational aspect, it can be also defined as a method where data are coded into categories based on previously selected principles (Krippendorff, 1980; Weber, 1988). Therefore, a fundamental feature of content analysis is the use of categories, which are selected and developed in order to classify the content units (Haniffa and Cooke, 2005: 404).

The methodological issues of using content analysis to measure the CSR disclosures in the annual reports are discussed in Gray *et al.*'s (1995a) study. The proposed methodology takes place in three stages and answers three questions: ‘what’, ‘where’

and ‘how’? In the first stage, the categories and types of CSR should be clearly defined in order to answer the question of what is considered and what is not considered CSR. It is worth mentioning that CSR categories may change over time reflecting the changes in CSR practice. Therefore, it is important to choose the CSR categories based on previous studies to keep a level of comparability.

The second stage refers to the location of CSR disclosure. It answers the question of from where the information on CSR should be collected and examined determining the types of documents employed in analysis.

In the third stage, the main concerns of the researchers are placed on how to analyse and codify data and calculate scores, such as the construction of CSR disclosure index in this study. The following sections responds to such issues.

4.6.2.2.2. Data sources in content analysis: Annual reports

Annual reports are employed by financial institutions as one of the main tools to disclose their socially responsible behaviour (Tilt, 1994: 56) and are utilised by numerous researchers to measure CSR disclosures (see among others Haniffa and Hudaib, 2007; Maali *et al.*, 2006; Hassan *et al.*, 2010) through the communicated information. In addition to annual reports, CSR disclosures can be monitored through a wide range of media, which include radio and television advertising, company brochure, booklets or leaflets to address the social activities of the company, community reports, environmental reports, labelling of products to promote environmental and other concerns, press releases, supplements to the annual report or produced at interim dates, video tapes and websites (Zeghal and Ahmed, 1990: 39; Jenkins and Yakovleva, 2006: 273). It should be noted that it is, however, practically not possible for a researcher to identify all forms of communication of social and environmental disclosures (Gray *et al.*, 1995a: 82).

Therefore, taking into account this argument and limited availability of the documents transmitting socially responsible activities of Islamic banks in GCC countries, this research employs annual reports as the source of secondary data (Hussey and Hussey, 1997: 86) to assess the CSR disclosure practices of GCC Islamic banks for the period 2000-2011.

Studies on disclosure employing annual reports have been motivated by the importance of this method through highlighting that: “The presentation, within the same document or reporting process, of the financial on the one hand and the social and environmental on the other, becomes an important element in demonstrating the extent (if at all) to which the organization reconciles these matters” (Gray *et al.*, 1995a: 82).

Furthermore, annual reports have been frequently used in the CSR disclosure literature as the main external reports prepared under the control of auditors and accountants and due to their availability and opportunity to offer a consistent measure (Tilt, 1994: 57).

4.6.2.2.3. Defining dimensions and sub-dimensions of CSR disclosure index: Constructing the index

An essential element of content analysis is the selection and development of categories into which content units can be classified. It should be noted here that selecting CSR dimensions similar to dimensions selected by previous researchers is essential for comparability purposes (Gray *et al.*, 1995a: 80).

Different studies used a variety of socially responsible dimensions. For instance, Scholtens (2009: 162) identifies following categories of banks' CSR: codes of ethics, sustainability reporting, and environmental management systems; environmental management; responsible financial products and social conduct. Reviewing disclosure literature, Gray *et al.* (1995a: 81) observe four main categories for CSR: employees, environment, community and customers. In a similar manner but locating different agents, Turker (2009) in her study proposes that CSR consists of four dimensions: responsibility to social and non-social stakeholders, employees, customers and government.

Taking into consideration that the aim of the research is to assess CSR disclosure practices of Islamic banks, the categories and items of CSR should be carefully drawn from the social responsibility framework from Islamic finance perspective based on existing literature on Islamic finance and CSR. In providing a particular framework, certain industry standards can be utilised, such as the Bahrain-based non-profit standard setter in Islamic finance, Accounting and Auditing Organisation for Islamic Financial institution (AAOIFI), which has developed Governance Standard No. 7: Corporate Social Responsibility, Conduct and Disclosure for IFIs that deals with guidelines for

CSR. Among 13 categories of CSR suggested by AAOIFI are *zakah* and *waqf* management, employee welfare, client engagement, charitable activities, social development and environment based investment quotas (Dinar Standard and Darul Istithmar, 2010: 4).

This study chooses dimensions and sub-dimensions for CSR disclosure in Islamic banks based on the previous study by Haniffa and Hudaib (2007), who developed categories and items of CSR from the Islamic perspective on CSR and also reflected aspects proposed to be disclosed by AAOIFI and previous studies on CSR in conventional institutions.

As a result, eight major dimensions are selected through which the annual reports of the Islamic banks subjected to content analysis: ‘mission and vision statement’; ‘board of directors and top management’; ‘products and services’; ‘commitment towards employees’; ‘commitment towards debtors’; ‘commitment towards society’; ‘*zakah*, charity and benevolent fund’ and ‘*Shari’ah* supervisory board’. The last two dimensions are specific for Islamic banking; however, the other six dimensions of social responsibility are also applicable for the conventional banking industry. In this research, the environmental dimension, which is proposed and used by numerous studies that focused on CSR disclosure in conventional financial institutions, is not added to the list of categories as the information related to the environmental issues was not disclosed in any annual reports of GCC Islamic banks in the sample, which, as a prevailing issue, is reflected upon in the discussion/conclusion chapter as a shortcoming of Islamic banks.

As it is aimed to assess the gap between the ideals and realities of embracing CSR practices in Islamic banks, Table 4.1 depicts dimensions and sub-dimensions that compose the index of CSR disclosure:

Table 4.1. Dimensions and Sub-dimensions of the CSR Disclosure Index

No	Dimension 01: Mission and Vision Statement	No	Dimension 05: Commitment Towards Employees
1	Commitments in operating within <i>Shari'ah</i> principles/ideals	1	Employees appreciation
2	Commitments in providing returns within <i>Shari'ah</i> principles	2	Number of employees
3	Focus on maximising shareholders returns	3	Equal opportunities policy
4	Current directions in serving the needs of the Muslim community	4	Competitive salary
5	Commitments to fulfil contractual relationships with various stakeholders via contract (<i>uqud</i>) statements	5	Employee welfare
6	Future directions in serving the needs of the Muslim community	6	Training: <i>Shari'ah</i> awareness
7	Commitments to engage only in permissible financing activities	7	Training: other
8	Commitments to fulfil contracts via contract (<i>uqud</i>) statement	8	Training: student/recruitment scheme
9	Appreciation to shareholders and customers	9	Training: monetary
10	Focus on maximising stakeholders returns	10	Reward for employees

Table 4.1. Dimensions and Sub-dimensions of the CSR Disclosure Index (continued)

No	Dimension 02: Board of Directors and Top Management	No	Dimension 06: Commitment Towards Debtors
1	Names of board members	1	Debt policy
2	Positions of board members	2	Attitude towards debt products
3	Pictures of board members	3	Amount of debts written off
4	Profile of board members as indicators of their knowledge of and competence in banking and <i>Shari'ah</i>	4	Type of lending activities-general
5	Operating nature of board of Directors	5	Type of lending activities-detailed
6	Shareholdings of board members		
7	Multiple-directorships exist among board members		
8	Membership of audit committees		
9	Board composition: executive vs non-executive		
10	Role duality: CEO is Chairman of the board		
11	Names of management team		
12	Positions of management team		
13	Pictures of management team		
14	Profile of management team		
No	Dimension 03: Products and Services	No	Dimension 07: Commitment Towards Community
1	No involvement in non-permissible activities	1	Women branch
2	Involvement in non-permissible activities-% of profit	2	Creating job opportunities
3	Reason for involvement in non-permissible activities	3	Support for organisations that provide benefits to society
4	Handling of non-permissible activities	4	Participation in government social activities
5	Introduced new product	5	Sponsored community activities
6	Approval <i>ex ante</i> by SSB for new product	6	Commitment to social role
7	Basis of <i>Shari'ah</i> concept in approving new product	7	Conferences on Islamic economics and other educational areas
8	Glossary/definition of products		
9	Investment activities-general		
10	Financing projects-general		

Table 4.1. Dimensions and Sub-dimensions of the CSR Disclosure Index (continued)

No	Dimension 04: <i>Zakah</i> , Charity and Benevolent Funds	No	Dimension 08: <i>Shari'ah</i> Supervisory Board
1	Bank liable for <i>zakah</i>	1	Names of SSB members
2	Amount paid for <i>zakah</i>	2	Pictures of SSB members
3	Sources of <i>zakah</i>	3	Remuneration of SSB members
4	Uses/beneficiaries of <i>zakah</i>	4	Number of meetings held
5	Balance of <i>zakah</i> not distributed– amount	5	Report signed by all members
6	Reasons for balance of <i>zakah</i>	6	Examination of all business transactions <i>ex ante</i> and <i>ex post</i>
7	SSB attestation that sources and uses of <i>zakah</i> according to <i>Shari'ah</i>	7	Examination of a sample of business transactions <i>ex ante</i> and <i>ex post</i>
8	SSB attestation that <i>zakah</i> has been computed according to <i>Shari'ah</i>	8	Report defects in product: specific and detailed
9	<i>Zakah</i> to be paid by individuals– amount	9	Recommendation to rectify defects in product
10	Sources of charity (<i>sadaqa</i>)	10	Action taken by management to rectify defects in product
11	Uses of charity (<i>sadaqa</i>)	11	Distribution of profits and losses comply with <i>Shari'ah</i>
12	Sources of <i>qard al-hassan</i>		
13	Uses of <i>qard al-hassan</i>		
14	Policy for providing <i>qard al-hassan</i>		
15	Policy on non-payment of <i>qard al-hassan</i>		

4.6.2.2.4. Coding process and constructing disclosure index

The annual reports of Islamic banks in the GCC countries have been carefully analysed by identifying statements describing each dimension and sub-dimension of CSR. In doing so, this research adopts a dichotomous approach (see Cooke, 1989; Hossain *et al.*, 1995; Haniffa and Hudaib, 2007) in developing a scoring scheme to determine the extent of CSR disclosure in annual reports. If an Islamic bank in the sample discloses an item included in the CSR disclosure index, it receives the score of (1), and (0) in case if it is not disclosed. Added together, these scores are equal to the total amount of CSR disclosure per Islamic bank.

The CSR disclosure index constructed as a result of the dichotomous approach is termed

as unweighted and assumes that each item of disclosure is equally significant (Cooke, 1989: 115). It is suggested that unweighted indices are suitable for studies (as in the case of the current research), which do not focus on a particular group of users of annual reports but target all users of annual reports (Cooke, 1989: 115). In other words, an unweighted index permits “an analysis independent of the perception of a particular user group” (Hossain and Hammami, 2009: 259).

Unweighted indices are criticised for being able to measure only the quantity of disclosure (Beretta and Bozzolan, 2008: 337). As a result, weighted indices are used in the studies in order to measure different levels of disclosure quality. This type of disclosure indices are criticised for not being objective, as they assign weights based on predetermined factors and “reflect the importance attributed by different classes of users to each disclosure item or the type of measure associated with the information disclosed or the extension of disclosure” (Beretta and Bozzolan, 2008: 337), which may vary from one research to another depending on the value and importance attached to each of these categories.

Nevertheless, the results of the previous research did not reveal a significant difference between the studies, which adopted weighted scores and the studies used unweighted scores in computing disclosure indices. In fact, some of the studies indicated similar results in both approaches (Hossain and Hammami, 2009: 259).

In this research, a dichotomous approach and unweighted disclosure index are used to examine the presence or absence of the different dimensions and sub-dimensions of CSR in Islamic banks.

As for the calculation of the index, CSR disclosure index is calculated as the ratio of points awarded over the total number of selected dimensions. It has been measured according to the following index for the selected banks across dimensions and years:

$$CSR\ disclosure\ index_{jt} = \frac{\sum_{i=1}^n x_i}{N}$$

where:

$CSR\ disclosure\ index_{jt}$ = CSR Disclosure Index for dimension j and period t ;

X_{jt} = Variable X from 1 up to n for dimension j and time t ;

N = Number of variables/statements.

The results based on this method are presented in Chapter 5.

4.6.2.2.5. Reliability of content analysis

Reliability and validity are two important issues in content analysis that need to be addressed. It has to be demonstrated that the coded data is reliable, as Weber (1990: 12) states: "to make valid inferences from the text, it is important that the classification procedure be reliable in the sense of being consistent: Different people should code the same text in the same way". In fact, the reliability of the coding process is often demonstrated by the agreement of two or more coders on the coding of the content of interest or by showing that the inconsistencies were re-considered and the disparities resolved (Milne and Adler, 1999: 238). Furthermore, there are three forms of reliability of content analysis and disclosure measurement that have been identified by Krippendorff (1980). These are stability, reproducibility and accuracy.

To evaluate the reliability of the content analysis conducted in this research, the following steps were undertaken. Firstly, reliability is determined through conducting a pilot study using randomly selected thirteen annual reports covering ten per cent of the examined sample. Secondly, to check the consistency of the score, content analysis of the annual reports used in the pilot study was conducted again after a month. Thirdly, the annual reports used in the pilot study were provided to two independent coders. During this, the dimensions and sub-dimensions of the CSR disclosure index were explained to the coders and they were asked to assess the content of CSR disclosure in the annual reports and assign related scores. Lastly, decision rules were established and revised to facilitate codifying data collected from content analysis of annual reports.

After completing the pilot study and repeating it over time and taking into consideration the evaluations of independent coders, minor changes in disclosure dimensions and sub-dimensions and the decision rules defining them were accepted. Consequently, accuracy of the coding process was assured alongside its objectivity and reliability were enhanced.

4.6.2.3. Research instruments for examining the relationship between CSR and financial performance

4.6.2.3.1. Model specification

The content analysis-based research method, as described above, enabled the research to generate data, the results of which presented in Chapter 5. By using the generated data, a quantitative analysis is also developed as presented in Chapter 6. As part of the quantitative method, the following models are developed to measure the impact of CSR disclosure on financial performance.

The Regression Model (1):

$$ROAA = \alpha + \beta_1 CSR D + \beta_2 Size + \beta_3 Cap. Ratio + \beta_4 Loan Ratio + \beta_5 Ovhd. Exp. + \beta_6 Debt Ratio + \epsilon$$

The Regression Model (2):

$$ROAA_{t+1} = \alpha + \beta_1 CSR D + \beta_2 Size + \beta_3 Cap. Ratio + \beta_4 Loan Ratio + \beta_5 Ovhd. Exp. + \beta_6 Debt Ratio + \epsilon$$

The Regression Model (3):

$$ROAA = \alpha + \beta_1 M\&V + \beta_2 Size + \beta_3 Cap. Ratio + \beta_4 Loan Ratio + \beta_5 Ovhd. Exp. + \beta_6 Debt Ratio + \epsilon$$

where:

ROAA: Return on average assets ratio is calculated by dividing net income to average total assets, which is an indicator of banks' financial performance and managerial efficiency as it shows how the management is competent in generating profits from assets and efficient in managing assets in order to generate revenues;

ROAA_{t+1}: Refers to return on average assets;

CSR D: CSR disclosure score measured as the ratio of disclosure content points over the maximum score a bank can achieve;

M&V: Mission and vision dimension of CSR disclosure index;

Size: Log of total assets;

Cap.Ratio: Capital ratio is calculated by dividing equity capital to average total assets;

LoanRatio: Loan ratio is calculated by dividing average total loans to average total assets;

Ovhd. Exp.: Overhead expenses are measured by dividing total non-interest expenses over average total assets;

DebtRatio: Debt ratio is calculated by dividing long-term debt to total assets.

α : the intercept;

$\beta_1 \dots \beta_n$: the regression coefficients;

$\hat{\epsilon}$: the error term.

4.6.2.3.2. Data analysis procedure

This section explains the statistical tests used in the second empirical model in order to test the developed hypotheses and to measure the impact of CSR disclosures on financial performances of Islamic banks in the GCC states.

STATA 11, the statistical package is used to perform statistical analyses that included descriptive statistics, the Spearman correlation matrix test and VIF test, Hausman test, Breusch-Pagan/Cook-Weisberg test and Panel Data with Fixed Effects multiple regression test. Furthermore, in order to test the robustness of the empirical results of this study, two additional sensitivity tests are conducted. Firstly, return on average assets or ROAE is used as an alternative measure of profitability. ROAE (Return on Average Assets) is calculated as the ratio of net income to average equity. Secondly, to check the potential endogeneity issue between independent (CSP) and dependent (financial performance) variable, the Durbin-Wu test is applied.

Descriptive Statistics

The descriptive statistics present simple summaries for each dependent, independent and control variable forming the examined period. In addition to minimum, maximum, mean and standard deviation values calculated for each variable in the model, a further

characterisation of data included the skewness and kurtosis statistics. The data is considered normally distributed if the skewness does not exceed the range of ± 1.96 and the kurtosis is within the range of ± 3 (Haniffa and Hudaib, 2006). Furthermore, the trend analyses for ROAA and CSR disclosure are conducted.

Multicollinearity Tests

The Spearman collinearity test and VIF tests are used to test for the existence of multicollinearity between the examined independent variables. Multicollinearity refers to what extent a variable can be explained by other variables in the analysis and takes place when two or more variable are highly correlated (Hair *et al.*, 2010: 2). In other words, it occurs when there is a linear relationship between two or more independent variables. The existence of multicollinearity between the set of variables affects “the ability of the technique to isolate the impact of any single variable”, which makes the interpretations less reliable (Hair *et al.*, 2010: 244).

It should be noted here that the commonly accepted threshold for multicollinearity is the VIF value of 10 and the closer the VIF value is to one, the lower the presence of multicollinearity (Hair *et al.*, 2010: 204; 212). Furthermore, if the correlation between two variables is equal to 0.8 or above, these variables are considered highly correlated (Brooks, 2008). Moreover, highly correlated variables (correlation is bigger than 0.8) and the results of the VIF test that exceed 10, indicate the multicollinearity problem in data (Haniffa and Cooke, 2005: 414; Neter *et al.*, 1983; Kennedy, 1992).

Regression analysis

In the second empirical model, multiple regression analysis using panel data set is employed to test the developed hypothesis. This analysis is conducted to examine the impact of CSR disclosure on financial performance (ROAA), with the respect to controls for size, capital ratio, loan ratio, overhead expenses and debt ratio, for which multiple regression analysis is used.

While multiple regression analysis is used, it is important to identify the nature of the data, as this study uses panel data. Panel or longitudinal data refer to data where multiple cases are observed at two or more time periods. There are two main types of panel data: balanced and unbalanced.

Balanced or complete panels are characterised as panel data, where data/observations are available for all cross-sectional units in the entire sample period, while in unbalanced or incomplete panels data/observations are missing for some cross-sectional units in the sample period (Baltagi, 2005: 165).

In the second empirical model, a 110-item unbalanced panel with a time series between one and twelve observations in each stratum (12-year panel data) is developed. The panel includes variables that are time-varying for the panel period, such as CSR disclosure index, *ROAA* and all control variables (size, capital ratio, loan ratio, overhead expenses and debt ratio).

In the third empirical model, a composite measure of corporate social performance is substituted with an individual measure of corporate social performance. Thus, the relationship between the individual dimensions of corporate social performance and financial performance is tested. The dependent and control variables remain the same as in the second empirical model.

In panel data, there are two frequently-used estimated models to control for omitted variables: *fixed effects* and *random effects* models.

Fixed Effects Model

A fixed effects model (the least squares dummy variable) is used to control for omitted variables that vary between cases, but are constant over time (time-invariant). The main characteristic of this model is that the effect of the omitted variables on the subject does not change over time. In other words, omitted variables have a ‘fixed’ effect on the subject. This permits using the changes in the variables over time to estimate the effects of the independent variables on the dependent variable. Allison (2006: 2) highlights that “in a fixed effects model, the unobserved variables are allowed to have any correlations whatever with the observed variables (which turns out to be equivalent to treating the unobserved variables as fixed parameters)”. It is suggested to use fixed effects model to examine the causes of changes within an entity (Baltagi, 2005: 12).

Random Effects Model

A random effects model (generalised least squares) is commonly used in case a

researcher believes that several omitted variables do not change over time but differ between cases, or that some of them might be fixed between cases but change over time. On the other hand, a random effects model regards unobserved differences as a random draw from a probability distribution (Allison, 2006).

These two models are similar to each other and attempt to tackle the same issue, to control for omitted variables that do not differ over time in an entity. However, the difference is in the structure of the correlations among the observed and unobserved variables. In fact, in a random effects model “the unobserved variables are assumed to be uncorrelated with all the observed variables” (Allison, 2006: 2).

The selection between fixed effects and random effects model is based on the Hausman test.

Hausman Test

In this research, the Hausman test is conducted to choose the best estimations obtained. This test is based on the difference between random-effect estimator and fixed effect estimator (Garcia-Castro *et al.*, 2010: 114). It tests the null hypothesis of random effects, assuming that regressors are not correlated with the unobservable variables, against the alternative hypothesis of fixed effects, assuming that regressors are correlated with the unobservable variables.

In case the Hausman test rejects the null hypothesis, the fixed effects estimator should be applied and if the test accepts the null hypothesis, the random effects estimator should be used (Baltagi *et al.*, 2003: 362).

In searching for the potential relationship between CSR and financial performance, the Hausman test rejects the null hypothesis of random effects; consequently, the fixed effects model is considered as suitable. The details are presented in Chapter 6.

Breusch-Pagan/Cook-Weisberg test

Breusch-Pagan/Cook-Weisberg test is performed in the second empirical model to test for heteroscedasticity.

In the ordinary regression model, it is typically assumed that the disturbance variance is

homogenous or constant across observations. If the error terms do not have constant variance, heteroscedasticity is indicated (Osborne and Waters, 2002: 4). Heteroscedasticity might occur as a result of the measurement errors or model misspecifications.

Breusch-Pagan/Cook-Weisberg test is one of the available methods of examining the presence of heteroscedasticity in the regression model. In this test, the null hypothesis accepts that variance is constant or homogenous. If the *p*-value is very small or the value of Chi-square is very high, then the test accepts the alternative hypothesis, which assumes that the variance is not homogenous. In other words, if the null hypothesis is rejected, this indicates the presence of heteroscedasticity (Chen *et al.*, 2003).

As reported in Chapter 6, the results of the Breusch-Pagan/Cook-Weisberg test in the second empirical model do not indicate the presence of heteroskedasticity.

Sensitivity Analysis

A number of sensitivity tests are conducted to determine the robustness of the results regarding the association between CSP and financial performance (*ROAA*). The aim of sensitivity analysis is to examine how sensitive the results are towards using different model specifications or changing the statistical tests.

In the first sensitivity test, in the main regression model, the return on average equity (*ROAE*) is used as an alternative measure of profitability. The results of the first sensitivity test using an alternative measure of profitability (*ROAE*) have reported general consistency with the results obtained when employing *ROAA* as a financial performance measure.

Secondly, in order to check for the potential endogeneity issue between CSP and financial performance, the Durbin-Wu test is applied. In a statistical model, endogeneity might occur as a result of joint determination between independent (CSP) and dependent (financial performance) variables, omitted variables and in a case if there is a correlation between explanatory variables and the error term (Greene, 2003). Rejecting the null hypothesis indicates the presence of endogeneity. Hence, accepting the null hypothesis of the Durbin-Wu test confirms that endogeneity does not represent a problem (Gujarati, 2003).

The results of the Durbin-Wu test in the second empirical model indicate that the F - test is not significant, thus, the null hypothesis of the Durbin-Wu test cannot be rejected. Therefore, does not indicate the presence of endogeneity.

4.6.2.4. Definitions and measurement of variables

After identifying and describing the empirical procedure and modelling related issues, the following section details the definitions and measurement of variables used in the disclosure analysis.

The definitions of CSR dimensions and sub-dimensions that used to construct CSR disclosure index are provided in detail in Chapter 5.

This section provides the list of dependent, independent and control variables used in the second empirical model. The detailed information regarding the definition of the main dependent and independent variables and control variables are provided in Chapter 6.

Dependent Variable: ROAA (return on average assets);

Independent Variable: CSR Disclosure Index;

Control Variables: Bank's size, risk, overhead expenses, capital ratio and loan ratio have been employed as control variables in the second empirical model.

4.6.2.5 Sample selection

Since this research assesses CSR disclosures of Islamic banks in the GCC region and examines the impact of CSR disclosures on banks' financial performance, the sample is selected from the GCC Islamic banks. The reason behind selecting the GCC region is that GCC states are the global leaders in Islamic banking and finance (Wilson, 2009: 2), and as a result, the GCC Islamic banking industry controls approximately 24 per cent of the assets of the entire region's banking sector (Al-Hassan *et al.*, 2010: 5). Furthermore, GCC Islamic banks operate under similar economic conditions, which makes the analysis more homogenous.

The sample of this research consists of 24 fully-fledged Islamic banks from five GCC countries including Bahrain, Saudi Arabia, Qatar, Kuwait, and the United Arab

Emirates (UAE). Oman was not included in the sample, as at the time of data collection Islamic banks did not exist in this GCC state due to the very negative approach of Oman towards Islamic finance (Wilson, 2009: 31). However, it should be noted that during 2013, the Central Bank of Oman approved and licensed two first fully-fledged Islamic banks: Allzz Islamic Bank and Bank Nizwa (Central Bank of Oman, 2013).

The research sample covers the period between 2000 and 2011, a period of twelve years. This period is marked by greater internationalisation and sophistication of the Islamic banking sector, as Islamic banks and financial institutions have expanded into other territories beyond Muslim countries. It is therefore important to see if such internationalisation and sophistication is matched with increased awareness of CSR practices and it is the most recent data at the time of conducting the research. The reason of starting the analysis in year 2000 is that this year is that it is the starting point of Internationalisation of Islamic banks.

The population for each country is as follows: nine banks from Bahrain, three banks from Kuwait, three banks from Qatar, four banks from Saudi Arabia, and five banks from UAE.

The sample consists of 24 Islamic banks and the main motivation of choosing these Islamic banks in the sample was the availability of the annual reports. The distribution of the banks in terms of countries is as follows:

Bahrain: ABC Islamic Bank, Al Amin Bank, Al Baraka Islamic Bank, Arcapita Bank, Bahrain Islamic Bank, Ithmaar Bank, Khaleeji Commercial Bank, Kuwait Finance House (Bahrain), and Shamil Bank;

Kuwait: Boubyan Bank, Kuwait Finance House, and Kuwait International Bank;

Qatar: Masraf Al Rayan Bank, Qatar International Bank, and Qatar Islamic Bank;

Saudi Arabia: Alinma Bank, Al Rajhi Bank, Bank Al Jazeera, and Bank Al Bilad;

UAE: Abu Dhabi Islamic Bank, Bank Al Hilal, Dubai Islamic Bank, Sharjah Islamic bank, and Emirates Islamic Bank.

The annual reports of the banks in the sample are obtained from the websites of the

banks in question in constructing the CSR disclosure index result. *Bankscope*, which is the global database of banks, and is used to collect financial statements of banks to gather the financial data to measure the impact of CSR disclosure on financial performance of GCC Islamic banks.

4.7. LIMITATIONS AND DIFFICULTIES

This research, like in any other research, has encountered various challenges and difficulties. The main challenge faced throughout was the data collection process. The limited access to data is considered as one of the main limitations, as it was hard to reach the annual reports of Islamic banks in the GCC region.

In addition, in developing the dimensions that construct the CSR disclosure index, the environmental dimension was not included into the list of categories, as the information related to the environmental issues was not disclosed in annual reports of the sampled banks.

Furthermore, the research collects the required data from annual reports, using content analysis, which is time consuming.

It should, however, be noted that facing difficulties and challenges motivated the researcher to put in more effort and ensure the success of the study.

4.8. CONCLUSION

This chapter provides the research methodology employed by the research based on the aims and objectives of the research. To fulfil its aims and objectives, this research adopts an objective methodological position of philosophical assumptions. Epistemologically, this research takes a positivism approach. As a result of the objective ontological and positivist epistemological positions of this research, it accepts deterministic human nature. Furthermore, in spite of the attempt of this research to measure a religiously-constructed outcome at the operations and CSR practices of Islamic banks, religious ontology does not determine the philosophical approach of this study and it remains within positivist epistemology.

Regarding the research methodology, this study employs a mix of qualitative and quantitative research methodologies. The study is designed as an explanatory case study

with the elements of exploratory study.

Since this research adopts the positivist paradigm and does not aim at developing a theory, the deductive approach is considered to be more suitable to this study.

Applying the triangulation research method, which is the combination of qualitative and quantitative research methods; this study collects the required data from annual reports, using content analysis, and constructs the CSR disclosure index. In addition, it collects the required data from financial statements to measure the impact of CSR disclosure practices on financial performance.

As a result, two different empirical models are developed; research methods, sample selection and data collection are described.

CHAPTER FIVE

A COMPARATIVE ANALYSIS OF CORPORATE SOCIAL RESPONSIBILITY DISCLOSURES OF ISLAMIC BANKS IN THE GCC REGION

CHAPTER FIVE

A COMPARATIVE ANALYSIS OF CORPORATE SOCIAL RESPONSIBILITY DISCLOSURES OF ISLAMIC BANKS IN THE GCC REGION

5.1. INTRODUCTION

Islamic banks guided by Islamic law are financial institutions that are accountable to fulfil their social and ethical roles alongside conducting their financial activities. As identified in chapter 3, Islamic banks' operations are justified through the *Qur'an* and *Sunnah*, the two main sources of knowledge in Islam, the former being the Holy Book of Islam and the latter being the sayings and everyday practices of the Prophet of Islam. Islamic banks are expected to discharge their social role in terms of contributing to social good and social justice through CSR activities; this implies that discharging their accountability must be through CSR disclosure consistent with the principles of Islamic moral economy and finance.

The concept of CSR, which is one of the articulations of moral dimension in IFIs, has gained the increasing attention in academia and several studies on social reporting for IFIs have been conducted (Haniffa, 2002; Kamla *et al.*, 2006; Maali *et al.*, 2006; Haniffa and Hudaib, 2007; Hassan *et al.*, 2010; Kamla and Rammal, 2010; Hassan and Harahap, 2010; Zubairu *et al.*, 2011). The trend of developing and adopting the CSR reporting standards for IFIs was accepted by some governments within the Muslim-dominated population and regulatory official bodies, namely by Malaysia and also by one of the main standard-setting agencies, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) (Farook *et al.*, 2011: 3).

While Islamic finance has grown rapidly worldwide, it is estimated that the vast amount of Islamic financial assets, approximately 80 per cent, is concentrated in the GCC region and nearly 20 per cent in Malaysia. According to the recent studies, the GCC countries collectively account for a higher percentage of growth of the *Shari'ah*-compliant financial assets, which is about 39 per cent, compared to other countries, where it reaches 15-20 per cent (Moussawi and Obeid, 2011: 11). Taking into account the significant expansion of the Islamic banking industry in the GCC region and double-digit growth rates for *Shari'ah*-compliant assets over the past decade, it is important to stress that the role of Islamic banking and finance is to maintain the economic and

social development with the objective of essentialising human centred economic development and improving human well-being as identified and essentialised by Islamic moral economy. Therefore, Islamic banks with their moral and ethical backgrounds are expected to lead the way for a socially responsible banking paradigm, which can be an example to the conventional banking industry through providing a moral compass. In other words, the Islamic banking sector is required by nature of Islamic injunctions and principles to produce outcomes that are in line with the larger social expectations, namely CSR, with the objective of delivering long-term economic benefits but also to help society. In particular *maqasid al-Shari'ah* (objective of *Shari'ah*) the nature of Islamic law prioritises CSR practices in Islamic banking and other businesses.

As a result, Islamic banks in addition to disclosing economic and financial activities in the annual reports should disclose information related to their social activities, as accountability is one of the main important principles that governs Islamic banking transactions. Islamic banks in their CSR disclosures are expected to demonstrate the compliance of their activities with Islamic principles, to show their contribution to social development and individual and community empowerment and to help Muslims to fulfil their spiritual needs (Maali *et al.*, 2006: 274).

The research presented in this chapter, therefore, focuses on the evaluation of CSR disclosure of Islamic banks in the GCC region based on a benchmark derived from Islamic finance principles. Thus, this research aims to measure the CSR disclosures of Islamic banks in the GCC Islamic banking sector whereby it aims to develop an understanding in relation to their disclosed performance in CSR. Accordingly, the research attempts to analyse the gap between the ideals and realities of embracing CSR in the GCC Islamic banking sector.

While Islamic corporate governance requires transparency, and hence, disclosure including for promoting their CSR activities, unfortunately, as identified by the previous studies, some Islamic banks put little effort into disclosing their values in a consistent manner and ensuring equivalence between the CSR practices in the annual report and the moral benchmark based on *Shari'ah*. This may be explained due to the fact that their CSR activities are rather limited as identified in other researches on other case studies, which suggests that the problem is perhaps a structural problem rather than corporate governance issue.

The remainder of this chapter is as follows: the next section provides the research sample, followed by a definition of variables in section three. After that the results are presented in section four, and the chapter ends with conclusion.

5.2. RESEARCH SAMPLE

The sample of the research presented in this chapter consists of GCC Islamic banks; and 24 Islamic banks that were selected from the GCC countries for the purpose of the study. The GCC countries from which the sample banks are drawn include Bahrain, Saudi Arabia, Qatar, Kuwait, and the United Arab Emirates. The sample consists of 24 Islamic banks and the detailed distribution of the banks in terms of countries is provided in the Research Methodology chapter (chapter 4). The research sample covers the period between 2000 and 2011.

5.3. DEFINITION OF VARIABLES

This section aims to identify the dimensions and elements or variables through which the evaluation of Islamic banking CSR disclosure is conducted in this study. Fulfilling all the elements under each dimension implies 'best practice' in this particular dimension, which also applies to the entire benchmark. This implies scoring 1 (or 100 per cent) in this dimension and overall dimensions. The higher the score towards the best practice, the better is the CSR disclosure performance of the sampled banks.

5.3.1. MISSION AND VISION STATEMENT

Islamic banks are institutional aspects of Islamic economics, which emphasises the importance of moral behaviour and aims at establishing social justice. As the original nature of Islamic banking and finance is an ethical financing system, Islamic banks beside their economic role also have the social role. Therefore, Islamic banks are expected to report clearly to shareholders and stakeholders their CSR understanding. As a result of emerging from Islamic financial law, Islamic banks are obliged to operate and utilise instruments, rules and regulations of the *Shari'ah*; they should disclose the following statements in their annual reports:

- (i) commitment to operate within *Shari'ah* principles/ideals;
- (ii) commitment to provide returns within *Shari'ah* principles/ideals;

- (iii) commitment to engage in investment activities that comply with *Shari'ah* principles;
- (iv) commitment to engage in financing activities that comply with *Shari'ah* principles;
- (v) commitment to fulfil contractual relationships with various stakeholders via contract (*uqud*) statements;
- (vi) current directions in serving the needs of Muslim communities;
- (vii) future directions in serving the needs of Muslim communities;

This part identifies factors that Islamic banks need to consider to meet their vision for community facilities. It includes plans of funding community facilities in the near future, developments and strategies that will have impact and serve the needs of communities. For example, planning to open new branches and increasing the ATM networks to reduce financial exclusion in rural areas and to make banking services accessible by all segments of consumers. Another example of future directions in serving the needs of Muslim communities can be launching and expanding new Islamic financial products for existing and future branches.

- (viii) statements of appreciation to shareholders and customers;
- (ix) focus on maximising shareholders returns;
- (x) focus on maximising stakeholders returns.

The best practice requires that sampled banks reach 10 (or score 1, or 100 per cent) in this dimension by fulfilling all the elements or the sub-categories. The closer a bank gets to 10 the better CSR disclosure it has.

5.3.2. BOARD OF DIRECTORS AND TOP MANAGEMENT

Islamic banks have relationships with their stakeholders that include shareholders, suppliers, customers, regulators, employees and local communities and operate with the interest of these key groups. As the main purpose of the board of directors (BOD) is to ensure the bank's prosperity while meeting the interests of its shareholders and stakeholders, the members of board of directors are expected to have appropriate balances of professional skills, independence and knowledge of Islamic banking as well as knowledge of *Shari'ah* to enable them to discharge their duties, burdens and responsibilities effectively. Therefore, Islamic banks should include the following items

regarding to their board of directors and top management members in the annual reports:

- (i) names of board members;
- (ii) positions of board members;
- (iii) pictures of board members;
- (iv) profile of board members and top management as indicators of their knowledge of and competence in, banking and *Shari'ah*;
- (v) operating nature of board of directors;
- (vi) shareholdings of board members;
- (vii) multiple-directorship exists among board members;
- (viii) membership of audit committee;
- (ix) board composition: executive vs. non-executive;
- (x) role duality: CEO is Chairman of Board;
- (xi) names of management team;
- (xii) positions of management team;
- (xiii) pictures of management team;
- (xiv) profile of management team.

The sub-categories or the listed elements for this dimension imply that the best practice requires each sampled bank to score 14 in this dimension.

5.3.3. INTEREST-FREE PRODUCTS AND SERVICES AND ISLAMICALLY ACCEPTABLE DEALS

Prohibition of interest or *riba* is one of the fundamental requirements that IFIs should observe. All sorts of exploitation and any source of unjustified enrichment, which also includes all forms of interest, are not allowed by Islamic law. Another important aspect of Islamic banking is “the implementation of the partnership scheme of sharing between bank and client in most transactions, both active and passive” (Piccinelli, 2010: 26). Most of the financial instruments in Islamic banking are thus driven by two principles:

mudarabah, *musharakah* (profit-loss-sharing financial products) and *murabaha*, *salam* and *ijarah* (profit markup).

The last few decades have witnessed tremendous change in Islamic banking sector, where innovative and financially engineered solutions have enabled Islamic banks to meet the increased demand for their services. However, Islamic banks in general are claimed as mimicking their conventional counterparts in offering financial products. Consequently, Islamic banks are dominated by fixed-return modes of financing, which “do not seem to provide any ethical improvement in the management of money, as their PLS alternative” (Cattelan, 2010: 80).

Considering that debt-based financing is preferred by Islamic banks more than the ideal profit and loss sharing concept, there is a need to “reduce the asymmetric information problems faced by bank in their working environment to encourage them to base their operations in optimal PLS (profit and loss sharing) contracts” (Al-Suhaibani, 2007: 208). This is possible through increasing the transparency of Islamic banks, which will also result in increased public and investor confidence and will help regulators to conduct effective supervision.

Since transparency is crucial, Islamic banks are expected to disclose the details of investment activities and approval of the new introduced product by the *Shari'ah* Supervisory Board.

Considering the fact that ideally the concept of profit and loss sharing method is the core of Islamic financial transactions, the transparency issue is vital for Islamic banks as they should disclose the information regarding their investment activities to investment account holders (Ariffin *et al.*, 2005: 148).

In addition to being interest-free, Islamic banks are not allowed to practice transactions that involve speculation (*gharar*); and also finance and investment projects, which are considered prohibited (*haram*) by Islamic law. These include all forms and manifestations of gambling (*maysir*), production of tobacco and alcohol, the arms industry, genetic manipulation, intensive farming, drugs and any other activities that are perceived harmful for the society and the environment. Thus, Islamic banks are expected to provide the following information in their annual reports:

- (i) no involvement in non-permissible activities;
- (ii) involvement in non-permissible activities-percentage profit;
- (iii) reason for involvement in non-permissible activities;
- (iv) handling of non-permissible activities;
- (v) introduced new products;
- (vi) approval *ex ante* by *Shari'ah* supervisory board;
- (vii) basis of *Shari'ah* concept in approving new product;
- (viii) glossary/definition of products;
- (ix) investment activities-general;
- (x) financing projects-general.

As the list of the elements in this dimension indicates the best practice requires scoring 10 by each of the sampled banks.

5.3.4. ZAKAH, CHARITY AND BENEVOLENT LOANS

The principles of *Shari'ah* that are at the core of Islamic banking system necessitate that Islamic banks incorporate ethical norms and social commitments in their operations (Dusuki, 2011: 5). Therefore, the disclosure on *zakah*, which is one of the financial fundamentals and requirement of Islam in the form of “obligatory transfer of alms by the rich to the poor”, is considered as an important dimension of CRS disclosure of Islamic banks (Kamla and Rammal, 2010: 14). *Zakah* is imposed on the initial capital of Islamic banks, on the reserves and on the profits (Lewis and Algaud, 2001). Thus, Islamic banks should disclose the source and amount of *zakah* as well as its beneficiaries in their annual reports. If according to the regulations of the country where Islamic banks operate, individuals, as shareholders are obliged to pay *zakah*, this information is also required to be disclosed.

While *zakah* is an important religious duty, the responsibility of giving *sadaqa* or voluntary donations, is another distinctive characteristic of social responsibility of Islamic banks. It is worth mentioning that *zakah* and *sadaqah* are essential social contributions to the solidarity and well-being of communities. Therefore, Islamic banks are encouraged to disclose sources and uses of their philanthropic donations, which may

also include *waqf* or pious foundations as part of Islamic tradition.

In addition to compulsory *zakah* and voluntary *sadaqah*, Islamic banks provide *qard al-hassan* or benevolent or interest-free loans as part of their social responsibility. The details of sources and uses of *qard al-hassan*, besides policy for providing such loans and policy on non-payment of these loans, should be disclosed in annual reports of Islamic banks as follows:

- (i) bank liable for *zakah*;
- (ii) amount paid for *zakah*;
- (iii) sources of *zakah*;
- (iv) uses/beneficiaries of *zakah*;
- (v) balance of *zakah* not distributed-amount;
- (vi) reasons for balance of *zakah*;
- (vii) *Shari'ah* supervisory board attestation that sources and uses of *zakah* according to *Shari'ah*;
- (viii) *Shari'ah* supervisory board attestation that *zakah* has been computed according to *Shari'ah*;
- (ix) *Zakah* to be paid by individuals-amount;
- (x) sources of charity (*sadaqa*);
- (xi) uses of charity (*sadaqa*).

Providing *qard al-hassan* (benevolent or interest-free loans) for socially beneficial causes is an important social contribution that Islamic banks may make, especially to the local community in which they operate. As such, Islamic banks should ideally reveal the following additional information in their annual reports:

- (xii) sources of *qard al-hassan*;
- (xiii) uses of *qard al-hassan*;
- (xiv) policy for providing *qard al-hassan*;
- (xv) policy on non-payment of *qard al-hassan*.

The best performance in this dimension implies that the sampled banks should score 15.

5.3.5. COMMITMENT TOWARDS EMPLOYEES

Commitment to employees is an important dimension to measure the CSR disclosure of Islamic banks. As the Islamic ethics require, Islamic banks are expected to deal justly with employees based on the Islam's emphasis on social justice. They are also expected to facilitate the employees' growth in an inspiring and conducive working environment. As exploitation and discrimination are prohibited in Islamic teaching, it is essential that Islamic banks treat their employees fairly and offer employment on an equal-opportunity basis. As part of this facilitation, Islamic banks are expected to provide their staff with a wide range of training programs to ensure that they have an opportunity to grow and excel, as the *tazkiyah* and *rububiyah* axioms of the Islamic moral economy necessitates. Taking into account that employees' satisfaction is a fundamental factor in driving banking institutions towards efficiency and competitiveness, Islamic banks have to make sure that competitive salary and benefits are offered to their employees. These are the aspirational positions in which the Islamic banks are expected to locate their operations. Hence, the following items should be disclosed in the annual reports of Islamic banks:

- (i) appreciation of employees;
- (ii) number of employees;
- (iii) equal opportunity policy;
- (iv) competitive salary;
- (v) employees welfare;
- (vi) training: Shari'ah awareness;
- (vii) training: other
- (viii) training: student/recruitment schemes;
- (ix) training: monetary;
- (x) reward for employees.

In this dimension, hence, a sampled bank is expected to score 10 in order to qualify as a best practice for this dimension.

5.3.6. COMMITMENT TOWARDS DEBTORS

As one of the main principles of Islamic economics is that lenders are prohibited to exploit debtors and lenders are encouraged to be lenient towards their debtors through remitting their debts (Piccinelli, 2010: 24; Montanaro, 2010: 115), Islamic banks, are therefore expected to disclose the following in their annual reports as evidence to their commitment towards debtors:

- (i) debt policy and type of debt;
- (ii) amount of debts written off;
- (iii) type of lending activities-general;
- (iv) type of lending activities-detailed.

In this dimension, best practice requires a score of 4 by individual sampled banks.

5.3.7. COMMITMENT TOWARDS SOCIETY

Islamic moral economy suggests that Islamic banks have a fundamental duty towards communities and societies where they operate, which implies that Islamic banks as socially responsible institutions by nature are required to contribute to the developments and the well-being of the community. Therefore, apart from distributing *sadaqa*, *zakat* and providing *qard al-hassan*, they are expected to be involved in socially-oriented activities, which will benefit all strata of society. As Islamic banks are governed by the principles of Islamic law, which entails the wealthy to contribute and sponsor social and charitable works, these institutions are expected to have certain behavioural practices that include having all-female branches (due to overcoming the difficulties imposed by gender segregation in some of the GCC countries), sponsoring conferences on Islamic economics and other educational areas and job-creating opportunities. Thus, Islamic banks are expected to portray these values and disclose all related information regarding their social activities in their annual reports, which include the following:

- (i) having a female branch;
- (ii) creating job opportunities;
- (iii) supporting organisations that benefit society;
- (iv) participating in government social activities;

- (v) sponsoring community activities;
- (vi) commitments to social role;
- (vii) conferences on Islamic economics and other educational areas.

The best practice in this dimension requires scoring 7.

5.3.8. SHARI'AH SUPERVISORY BOARD

One of the main characteristics of Islamic banks that make them distinct from their conventional counterparts is the compliance with *Shari'ah* and its principles in all banking operations and activities. Therefore, Islamic banks are obliged to appoint a supervisory board of *Shari'ah* scholars, who review their financial transactions in order to ensure that they comply with the principles of Islamic *Shari'ah*. As an institutional form of ensuring *Shari'ah* in the operations of Islamic banks, a *Shari'ah* Supervisory Board (SSB) advises and certifies financial products and operations of Islamic banks. Having a SSB adds credibility to Islamic banks, as the religious boards carry great responsibility through assuring that the moral expectations of stakeholders and shareholders are being met, which is normally expected to enhance the reputation of Islamic banks. Thus, Islamic banks are expected to disclose the information regarding their SSB in the annual reports as adherence to *Shari'ah* principles have ethical and social implications on the nature and composition of the SSB. The SSB report of Islamic banks should include the following:

- (i) names of members;
- (ii) pictures of members;
- (iii) remuneration of members;
- (iv) report signed by all members;
- (v) number of meetings held;
- (vi) examination of all business transactions *ex ante* and *ex post*;
- (vii) examination of a sample of business transactions *ex ante* and *ex post*;
- (vii) report defects in products: specific and detailed;
- (ix) recommendations to rectify details in products;

- (x) actions taken by management to rectify defects in products;
- (xi) distribution of profits and losses comply to *Shari'ah*.

In this dimension, the best practice implies scoring 11.

5.4. LOCATING THE CSR DISCLOSURE PRACTICES OF GCC ISLAMIC BANKS: EMPIRICAL ANALYSIS: ANALYSIS AND DISCUSSION

After identifying the dimensions and elements for disclosure analysis in the previous section, this section presents the findings of the study according to the empirical method described in detail in the Research Methodology chapter (chapter 4).

Accordingly, the CSR disclosure is measured by the following index for the selected banks across dimensions and years.

$$CSR\ Disclosure\ Index_{jt} = \frac{\sum_{i=1}^n x_{ijt}}{N}$$

where:

$CSR\ Disclosure\ Index_{jt}$ = CSR Disclosure Index for dimension j and period t ;

X_{ijt} = Variable X from 1 up to n for dimension j and time t ;

N = Number of variables/statements.

This research initially is based on eight dimensions of the CSR disclosure as defined in the previous section.

It should be reiterated that the sample period covers the 2000-2011 period.

5.4.1. FINDINGS FOR DIMENSIONS 1: VISION AND MISSION STATEMENT

The results for Dimension 1 or Vision and Mission Statements related disclosures can be found in Table 5.3.

As can be seen in Table 5.3, under the 'vision and mission' dimension, Bahrain scored the maximum overall CSR disclosure score, followed by Qatar, and Kuwait, being the

second and third respectively. The UAE was ranked the fourth with Saudi Arabia having the minimum overall CSR disclosure score in the research sample.

The results in Table 5.4 (I, II, III) (Appendix I) show that the CSR disclosure indices for this dimension seems to improve over the sample period for two Bahraini banks, ABC Islamic Bank and Ithmaar Bank; is quite stable for Al Baraka Islamic Bank and Shamil Bank; and fluctuates in the case of Arcapita Bank BSC., Khaleeji Commercial Bank and Kuwait Finance House; while declining for Al Amin and Bahrain Islamic Bank. The overall CSR disclosure score of ‘vision and mission dimension’ for the Bahraini sampled banks ranged from 0.43 to 0.77, being the minimum and the maximum CSR disclosure score respectively.

It was noted that the information revealed by Al Amin Bank under the ‘mission and vision statement’ was very poor, while Shamil and Al Baraka Islamic bank mainly disclosed the required information in their annual reports and shared the maximum score. Al Amin Bank had the minimum score in making a clear mission and vision statement due to the fact that its annual reports were not accessible. Therefore, the information from its financial statements was used. The CSR disclosure index of Al Baraka Islamic improved in 2007 to 0.80 and was constant for the following four years. One possible explanation of this improvement is due to the merger of Al Baraka Islamic Bank and the sister company Al Amin Bank in 2007, which was wholly owned by the parent company Al Baraka Banking Group. Al Baraka Islamic Bank shows a desire to increase its competitiveness in the region, as suggested in its annual report:

The year 2008 was a departure point towards strengthening our position as a leading Islamic financial institution for integrated products and services. The Bank now provides commercial and investment banking services and possesses all the factors for success and competitiveness in terms of size, efficiency, expertise and range of services offered (Al Baraka Islamic Bank, Annual Report, 2008: 17).

This was also reflected in the new Unified Corporate Identity, where the mission of the bank was restated as follows:

To meet the financial needs of communities across the world by conducting business ethically in accordance with our beliefs, practising the highest professional standards and sharing the mutual benefits with the customers, staff and shareholders who participate in our business success (Al Baraka Islamic Bank, Annual Report 2008: 9).

Similarly, a desire to increase its competitiveness in the region seems to have caused Shamil Bank to merge with Ithmaar Bank in 2007 and enhance its communication strategy, as evidenced in the following statement:

Shamil Bank strives to become one of the leading Islamic financial institutions in the region, offering a broad range of Islamic banking services through efficient and convenient channels to all categories of markets in which it operates, to achieve the highest possible returns for stakeholders (Shamil Bank, Annual Report, 2007: 1).

It should be mentioned, as a finding, that the principle requirement of being an Islamic bank is a commitment to work strictly under *Shari'ah* principles is present in all sampled Islamic banks in Bahrain. However, the fundamentals of commitment to engagement in *Shari'ah*-compliant investment and service to the Muslim community in the future were completely missing for ABC Islamic Bank and Al Amin Bank. For example, Arcapita Bank disclosed future directions in serving the needs of the Muslim community only for the year 2008.

Four Islamic banks in Bahrain, namely, Al Baraka Islamic, Arcapita, Bahrain Islamic Bank and Kuwait Finance House (Bahrain) stated that one of their objectives to be maximising shareholders' return or value but non used stronger words concerning the assurance or commitments expected of an Islamic bank, such as 'maximising *halal* (legitimate) returns' or 'returns from *halal* (legitimate) sources' rather than simply 'maximising returns'. The use of the latter phrase does not help in differentiating between the goals of an Islamic bank and those of conventional banks. Unlike the aforementioned banks, Khaleeji Commercial Bank in its 2007-2008 annual reports clearly stated:

...maximising client and shareholder value in accordance with the principles of Shari'a, contributing towards the growth of Islamic banking, and providing a challenging environment to our employees to be innovative and realise their professional objectives (Khaleeji Commercial Bank, Annual Report, 2007: 5).

It can be seen from the Table 5.3 that there is a little difference between the overall CSR disclosure scores for the 'vision and mission' dimension for Bahraini and Qatari sampled banks, 0.65 and 0.64, respectively.

Qatar Islamic Bank scored the maximum CSR disclosure index between the three Qatari banks in the sample, which remained constant at 0.70 for the years 2009-2010. Masraf Al Rayan's CSR disclosure index for this dimension improved remarkably from 0.40 in 2008 to 0.90 in 2009. The results show that Qatar International Islamic Bank has the

minimum CSR disclosure index, which is 0.60. However, annual reports for this bank were only available for the year 2009. Therefore, it is difficult to render any positive or negative indications in relation to the Qatar International Islamic Bank's CSR disclosure behaviour.

It is important to note that none of the Qatari banks in the research sample disclose any information regarding the commitments to provide returns within *Shari'ah* principles/ideas and commitments to fulfil contractual relationships with various stakeholders via contract (*uqud*) statements.

As regards to the current and future directions in serving the needs of the Muslim community and society, Masraf Al Rayan and Qatar Islamic Bank consistently stated their commitment for this dimension. For instance, Masraf Al Rayan specified in its annual report that "[It] is acutely conscious of its social responsibilities and has played a substantial role by supporting a number of educational institutions and sporting activities and providing voluntary contributions to various charities" (Masraf Al Rayan, Annual Report, 2009: 11).

As the findings in Table 5.3 depict, Kuwait was ranked third among the GCC countries, under the dimension 'vision and mission', with the overall CSR disclosure index 0.44. Among the sampled Kuwait banks, Boubyan Bank of Kuwait scored the maximum CSR disclosure index (0.53) followed by Kuwait Finance House (0.40) and Kuwait International Bank (0.40).

The CSR disclosure index shows that Boubyan Bank started from 0.40 out of 1.0 in 2005 and ended at 0.60 in 2011 with the reasonable improvement; while Kuwait Finance House started at 0.60 in 2001 and concluded at 0.20 at 2011 indicating a decline in its disclosure regarding this particular dimension. The findings also reveal that Kuwait International Bank experienced a similar decline in CSR disclosure index for the 'vision and mission' statement from 0.60 in 2007 to 0.20 in 2010.

It appears that Kuwaiti banks have a tendency to neglect the information in terms of providing the returns within *Shari'ah* principles and focusing on maximising shareholders' returns, which is the same as in the case of Qatari banks. Furthermore, 'commitments to engagement in *Shari'ah*-compliant investment activities' were also missing for all sampled Kuwaiti banks. Moreover, future directions in serving the needs

of Muslim community were also poorly reported by Kuwait Finance House and Kuwait International Bank.

Regarding the overall CSR disclosure score of 'vision and mission' dimension in the GCC countries, the research results indicate that the UAE was placed fourth, despite having two well-established Islamic banks such as Dubai Islamic Bank (established in 1975) and Sharjah Islamic Bank (established in 1976). It is worth mentioning these two well-known Islamic banks scored the minimum CSR disclosure indices, which are 0.23 for Dubai Islamic Bank and 0.00 for Sharjah Islamic Bank. On the other hand, Al Hilal Bank, which was launched recently, in 2010, has the maximum score of CSR disclosure index (0.70), among the Emirati banks in the research sample. Next in ranking for this dimension comes Emirates Islamic Bank with the CSR disclosure index (0.58), followed by Abu Dhabi Islamic Bank (0.47).

Unlike other Emirati Islamic Banks that tend to emphasise commitments to operate within *Shari'ah* principles, Sharjah Islamic Bank did not state this in its annual reports for the period 2006-2010 examined. This might be explained by either arguing that the management knows that its operations are not truly Islamic and wants to play down that image or simply management do not foresee the need to do so as its reputation as an Islamic bank is well-established. On the other hand, Dubai Islamic Bank's CSR disclosure score being low can be explained by the fact that the information it revealed was only relevant to the current directions in serving the needs of Muslim communities and commitments to operate within *Shari'ah* principles.

Five Emirati Islamic banks, namely Abu Dhabi Islamic Bank, Sharjah Islamic Bank, Dubai Islamic Bank, Emirates Islamic Bank and Al Hilal Islamic Bank did not disclose anything in their annual reports in respect of commitments to provide returns within *Shari'ah* principles/ideas and to fulfil contractual relationships with various stakeholders via contract (*uqud*) statements.

With regard to the sampled Saudi Arabian Islamic Bank's overall CSR disclosure score for 'mission and vision' dimension, this was ranked the minimum between the GCC countries with 0.22 score. The maximum CSR score among Saudi Banks goes to Alinma Bank (0.50), followed by Bank Al Jazira (0.29) and Al Rajhi (0.25). The minimum CSR disclosure index was scored by Bank Al Bilad (0.00). The CSR

disclosure indices for this dimension is constant for Alinma Bank (0.50), is slightly improved for Al Rajhi Bank from 0.25 in 2000 to 0.40 in 2011 and fluctuates in the case of Al Jazira Bank during the period 2000-2010 between 0.40 and 0.00 and ends with 0.40.

It is expected that Al Rajhi Bank, as a first founded Islamic Bank in Saudi Arabia, would disclose all the required information under the 'mission and vision' dimension to be a best-practice bank. However, the research findings illustrate the opposite. Al Rajhi Bank, as another three Saudi Islamic banks in the research sample, lacks a lucid mission and vision statement. For example, in 2010, Al Rajhi Bank on one of the first pages of the annual report presented the statement: "We continue to listen to our customers" (Al Rajhi Bank, Annual Report, 2010: 2). In addition, in the same annual report the references to the community and another statement were presented along the line of "We continue to unleash the potential within our community" (Al Rajhi Bank, Annual Report, 2010: 6). These two statements imply that the aim or direction the bank takes is to serve the community, as it has done in the past and will continue to do in the future. The emphasis is on "we continue", which shows that of the commitment of the bank has not changed and will not change in the future. In the same year, the bank demonstrated an image of being the best Islamic bank in the Middle East and stated at the bottom of the page of their 2010 Annual Report: "Our status as a leading bank stems from our customers' trust" (Al Rajhi Bank, Annual Report, 2010: 18). This, indeed, symbolises the appreciation of its customers.

The lack of the essential information under the 'mission and vision' dimension of Al Rajhi Bank, however, can be explained by the fact that as it is one of the oldest Islamic banks it may take it granted that its mission and vision are known to almost everyone and there is no need to mention it.

On the other hand, Alinma Bank, as a newly-established Saudi Arabian Islamic bank disclosed its information in a much effective manner: its vision and mission along with its values is mentioned in the annual Report (Alinma Bank, Annual Report, 2009: 11) rather clearly: "To provide our partners with total *Shari'ah*-compliant financial solutions through the best workplace that achieves sustainable development and participate in serving our community". This shows bank's mission, which includes the statement that it follows *Shari'ah* principles and serves its community. Furthermore, the

bank directs its speech to its customers and shareholders, using the word ‘partner’ in both the vision and mission.

Overall for this dimension, the results show that most Islamic banks in the GCC region lack a lucid mission and vision statement. Therefore, there is need for new guidelines to direct the Board of Directors (BOD) and top management to include statements such as the fundamentals of commitment to engagement in *Shari’ah*-compliant investment in the future, and fulfilment of contractual relationship with and service to the Muslims community in their published annual reports.

5.4.2. FINDINGS FOR DIMENSION 2: BOARD OF DIRECTORS AND TOP MANAGEMENT

With regard to dimension ‘board of directors’, as can be seen from Table 5.3 the overall CSR disclosure scores for this dimension are: Bahrain scored the maximum with 0.53, followed by Kuwait (0.43) and Qatar (0.39). Saudi Arabia and UAE, with their overall CSR disclosure score being (0.30) and (0.29), were ranked fourth and fifth respectively.

In terms of individual banks, the CSR disclosure index of only one Bahraini bank, Ithmaar Bank, seemed to be consistent for two years. Arcapita Bank’s CSR score decreased from 0.71 in 2000 to 0.64 in 2001 and later on from 0.64 in 2007 to 0.57 in 2008 as the bank removed information regarding the profile of management team for the period 2001-2008 as well as pictures of board members and of management team from 2005 to 2011. On the contrary, the CSR disclosure indices of Al Baraka Bank, Khaleeji Commercial Bank, ABC Islamic Bank, and Shamil Bank registered maximum improvement, especially regarding shareholdings and top management; whereas CSR disclosure of Kuwait Finance House Bahrain and Bahrain Islamic Bank marginally improved in relation to operating nature. The inconsistency regarding this particular dimension is a bit puzzling and no specific corporate characteristics, for instance profitability or diversification, nor any significant events or corporate culture characteristics are shown that may have caused this anomaly.

The second highest CSR disclosure score under this dimension was scored by Kuwait in country level with 0.43. Kuwait Finance House was ranked first with the CSR disclosure score for this maximum score with 0.50 among three Kuwaiti Islamic banks in the sample, whilst Boubayan Bank (0.39) and Kuwait International Bank (0.34) shared

the second and third places respectively. The CSR disclosure of Kuwait Finance House is found to be constant for the period 2000-2011. The insignificant increase in CSR score for 'board of directors' dimension of Boubyan Bank from 0.40 in 2005 to 0.60 in 2011 reflects the improvement in disclosure as the bank published pictures of board members in 2010 and 2011, whereas the CSR disclosure index of Kuwait International Bank rapidly decreased from 0.43 in 2009 to 0.07 in 2010. All three Kuwaiti banks stated that they have an audit committee. However, there was nothing written about the board composition: executive vs. non-executive and about the existence of multiple directorships among members.

At the country level, Qatar's sampled Islamic banks were ranked third with 0.39 score in the overall CSR disclosure index for the 'board of directors' dimension. It can be seen from the results in Table 5.5 (Appendix I) that amongst three Qatari Islamic banks in the research sample, Qatar Islamic Bank scored the maximum CSR disclosure score of 0.64 in providing information on board of directors and top management, which disclosed names, positions, pictures and profiles of board of directors and top management as well as names, positions, pictures and profiles of management team. Additionally, the information of the operating nature of board of directors was provided. All three banks have an audit committee. However, Masraf Al Rayan Bank and Qatar International Islamic Bank scored poorly in the category as findings in Table 5.5 (Appendix I) show.

In respect to the overall CSR disclosure score of 'board of directors' dimension, the research results in Table 5.3 indicate that Saudi Arabia was placed fourth with 0.30. In examining this, it was found that three Saudi Islamic banks disclosed the names, positions and pictures of board of directors except for Al Bilad Bank. Al Rajhi Bank disclosed the above-mentioned criteria excluding pictures of the board of directors. Al Bilad Bank scored the minimum CSR disclosure index (0.00) in this dimension between Saudi Islamic banks, as its annual reports were not accessible and financial statements were used instead. None of the four Saudi Islamic banks disclosed their members' profile and academic qualifications. On the other hand, each bank revealed the detailed information regarding the operation nature of banks, excluding Al Bilad Bank. The banks stated the remunerations and the meetings and who attended, and some specified the date of meetings. Furthermore, two banks showed the number of shareholdings for

the board of directors. As for Al Rajhi Bank in 2010 and 2011, the information regarding to the shares of each member of the board was disclosed. Bank Al Jazira in 2008 and 2009 stated only the total number of shares, but did not unveil the shares of each member. However, in 2010, Bank Al Jazira realised the importance of disclosing each member's shares, rather than the total number of shares of all members. All the three banks, namely Al Rajhi Bank, Alinma Bank and Bank Al Jazira, seem not have a dual role where the CEO is the chairman of the board. Furthermore, Bank Al Jazira was the only Islamic bank that disclosed the executive management with their names, positions and pictures, but the profile of each member was missing. Regarding to the three Saudi Islamic banks that did not display any information about the management team, this makes the reader form a negative judgement of the communication of top management.

As the results in Table 5.3 indicate, the UAE's overall CSR disclosure score of 'board of directors' dimension is found to be 0.29 for the years covered in this study, with which it is ranked the minimum between the five GCC countries. The research findings indicate that four Emirati Islamic banks: Al Hilal Bank, Emirates Islamic Bank, Abu Dhabi Islamic Bank and Sharjah Islamic Bank disclosed information related to the names, positions and pictures of board members; while only Abu Dhabi Islamic Bank revealed the names, positions and pictures of management team in 2009-2010 and the same information can be found in Emirates Islamic Bank's annual reports since 2006 to 2010. On the other hand, Dubai Islamic Bank, one of the oldest Islamic financial institutions, does not have any detailed information related to the board of directors and management team in its 2003, 2004 and 2009 annual reports. All five banks have membership of audit committees. Only Emirates Islamic Bank revealed the information in relation to the existence of multiple-directorships among members in 2010 and disclosed the profile of board of directors and top management in the same year. Al Hilal Bank ranked the maximum CSR disclosure index in 'board of directors' dimension, scoring 0.43, whereas Dubai Islamic Bank ranked the minimum, scoring 0.07.

5.4.3. FINDINGS FOR DIMENSION 3: PRODUCTS AND SERVICES

As the findings in Table 5.3 depict, the CSR disclosure scores for 'product and services' dimension for five GCC countries ranged from 0.04 to 0.33, referring to the minimum

and maximum scores respectively, over the period covered by this study. It can be seen from the results that the maximum CSR disclosure index goes to Kuwait, while the minimum CSR disclosure index scored by Saudi Arabia. UAE and Bahrain's CSR disclosure indices indicated second and third rank respectively, followed by Qatar.

As can be seen in Table 5.8 (I, II) (Appendix I) only one of the Kuwaiti Islamic banks in the research sample, Boubyan Bank, experienced an increase in CSR disclosure score for this dimension from 0.36 to 0.43 during the period 2005-2011; whereas Kuwait Finance House' CSR disclosure index was quite constant throughout 2001-2011 with very slight fluctuations between 2005-2007. On the other hand, Kuwait International Bank scored the minimum CSR disclosure index (0.23) for the 'product and services' dimension among the Kuwaiti Islamic banks. All three Kuwaiti banks provided detailed information on products and services; however, information relating to approval of products by *Shari'ah* supervisory board was missing. Furthermore, Boubyan Bank and Kuwait Finance House also disclosed their investment and financing activities, while Kuwait International Bank did not state anything in its annual reports regarding its financing activities. It should be noted that none of three Kuwaiti Islamic banks clearly stated any involvement in non-permissible activities. In addition, since most of the products offered by Islamic banks are in Arabic terms, all three Kuwaiti Islamic banks provided a list of definitions of the products in the reports to familiarise non-Arabic speakers with the products.

The research findings in Table 5.7 (I, II) (Appendix I) indicate that the UAE's overall CSR disclosure index is found to be 0.28, which resulted in sampled UAE bank average ranking second in 'product and services' dimension. Similar to Bahraini Islamic banks, Emirati Islamic banks published details of their investment and financing activities, except Sharjah Islamic Bank. Information related to the introduced new products and services was disclosed only by Abu Dhabi Islamic Bank and Sharjah Islamic Bank. Abu Dhabi Islamic Bank and Emirates Islamic Bank ranked the maximum CSR disclosure index for this dimension, scoring 0.36 and 0.32 respectively, whereas Sharjah Islamic Bank was ranked the minimum with 0.10. Abu Dhabi Islamic Bank alone clearly indicated in 2001 and 2002 annual reports that the new products have been approved by the *Shari'ah* supervisory board and further stated the basis of the *Shari'ah* concept for the new product, reinforcing legitimacy of their new product:

The Bank has also innovated new financing products such as the Covered Drawings, which is the Islamic alternative to conventional overdraft, and which was designed to give the customer access to liquidity, when needed. The product is implemented via a mechanism that has been approved by the Bank's Shari'ah and Fatwa Supervisory Board (Abu Dhabi Islamic Bank, Annual Report, 2001: 7).

As can be seen from Table 5.3, Bahrain with the overall CSR disclosure index of 0.20 for the 'product and services' dimension is ranked third among the sampled countries. As shown in the results, in Bahraini Islamic banks the situation with regard to this dimension is analogous to their Emirati counterparts and the level of disclosure is low. It has been found that Shamil Bank, Kuwait Finance House and Al Baraka Islamic Bank have the maximum CSR disclosure indices. On the other hand, Bahrain Islamic Bank (0.18), Ithmaar Bank (0.15) and Al Amin Bank (0.00) scored the minimum CSR disclosure indices for the 'product and services' dimension. It is also found that Al Baraka Islamic Bank and Khaleeji Commercial Bank experienced an increase in CSR disclosure index, whilst Bahrain Islamic Bank's CSR disclosure index started at 0.20 in 2002, slightly changed during the years and ended at 0.20.

According to the research results as depicted in Table 5.3 Saudi Arabia's CSR disclosure index with regard to the 'product and services' dimension is 0.19, which takes it down to fourth position in the ranking of the sampled countries. None of the Saudi Islamic banks in the sample have stated directly that they are not involved in non-permissible activities, however they have mentioned that all their activities are *Shari'ah* compliant. Two out of four Saudi Arabian banks, namely Al Rajhi Bank and Bank Al Jazira, have introduced new products and services. As for the approval of the *Shari'ah* supervisory boards, in all the annual reports it is stated under the *Shari'ah* board that it approves all the business activities. Nevertheless, it is not indicated directly under the new product in Bank Al Jazira: "The Bank offers its customers *Shari'ah* compliant (non-interest based) banking products, which are approved by its Shari'ah Board (Bank Al Jazira, Annual Report, 2008: 37). Only Al Bilad and Alinma Bank in all their reports define the products with Arabic terms for non-Arabic speakers and those not familiar with the terms. Alinma Bank, for example, discloses: "Financing includes primarily Murabaha and Ijarah products. Murabaha is the sale in which the Bank agrees with the customer to sell at cost plus a specified profit. It may be based on the customer's intention or promise to buy from the Bank" (Alinma Bank, Annual Report, 2009: 40).

In the case of Bank Al Jazira, the Shari'ah supervisory board stated:

The Board noticed that the Bank is still using accounting terminology such as loans, advances and deposits (with reference to Murabaha) in their Financial Statements and notes. Therefore, the Board again urges the Bank's Management to comply with Shari'ah terminology that conforms to the actually-used formulas (Bank Al Jazira, Annual Report, 2009: 21).

All Saudi banks revealed the details of their investment activities and financing projects, excluding Bank Al Bilad. Alinma Bank and Al Rajhi Bank's CSR disclosure indices are the maximum for this dimension, scoring 0.30 and 0.20 respectively, followed by CSR disclosure indices 0.19 of Al Jazira and Bank Al Bilad has the minimum CSR disclosure index 0.10.

As can be seen from the results in Table 5.3 Qatar's scored the minimum CSR disclosure score of 0.16 for the 'product and services' dimension among other GCC countries in the sample for the period covered. The CSR disclosure index for this dimension seems to improve over the period 2007-2010 from 0.00 to 0.30 for Masraf Al Rayan Islamic Bank, which scored 0.13 in the CSR disclosure index. This can be explained by the fact that for the years 2007-2008 the annual reports of the bank were not available and financial statements were utilised instead. Furthermore, with publishing 2009-2010 reports, Masraf Al Rayan Islamic Bank provided details of their investment and financing activities and also signified the introduction of a new product in 2010's annual report. One possible explanation of this is the Bank's strategy for 2010, where it is clearly stated that bank is planning to: "Develop new Islamic *Shari'a*-compliant products and add innovative features to prevailing market products." (Masraf Al Rayan Islamic Bank, Annual Report, 2009: 21). Lastly, as for the information relating to approval of new product by the *Shari'ah* supervisory board, all three Qatari Islamic banks have failed to disclose it.

5.4.4. FINDINGS FOR DIMENSION 4: ZAKAH, CHARITY AND BENEVOLENT LOANS

The results in Table 5.3 depict that the maximum overall CSR disclosure (0.33) under this dimension scored by Bahrain, followed by UAE (0.29), Kuwait (0.24) and Saudi Arabia (0.20). The minimum CSR disclosure index (0.15) goes to Qatar.

As can be seen in Table 5.4 (I, II, III) (Appendix I) Bahrain Islamic Bank was ranked the first, scoring the maximum CSR disclosure (0.71) for ‘*zakah*, charity and benevolent loans’ dimension, whereas Ithmaar Bank scored the minimum CSR disclosure index (0.10). Bahrain Islamic Bank, ABC Islamic Bank and Khaleeji Commercial Bank disclosed the amount and sources of *zakah* as well as stated uses/beneficiaries of *zakah* and as a result, their CSR disclosure indices for this dimension were ranked first with 0.71 score, second with 0.53 and third with 0.39, respectively, among surveyed Bahraini Islamic banks. The rest of the banks did not provide this information.

Bahrain Islamic Bank alongside other six Bahraini Islamic banks in the sample disclosed attestation from the *Shari’ah* supervisory board that *zakah* has been computed according to the Islamic principles, while Ithmaar Bank and Al Amin Bank did not provide this information. Although Bahrain Islamic Bank, ABC Islamic Bank and Khaleeji Commercial Bank released the balance on *zakah* and charity funds for all years and Al Amin Bank for the year 2003, neither of them provided reasons for the balance.

Furthermore, disclosure of sources and uses of charity was at the maximum for all banks, except Ithmaar Bank and Kuwait Finance House (Bahrain) that did not unveil the uses of charity. Information regarding the sources and uses of *qard al-hassan* is provided only by Bahrain Islamic Bank, Shamil Bank and by Al Baraka Islamic Bank for the period 2006-2008, which removed this information in its 2009-2010 annual reports. Additionally, policy for providing *qard al-hassan* and policy on non-payment of *qard al-hassan* were missing for all Bahraini Islamic banks in the sample, except for Ithmaar Bank for the year 2011. Therefore, the lack of policy as to who are eligible and the purpose of the funds may result in abuse of such funds. The less advantaged should be given priority in accessing such funds if social justice is to be upheld by the Islamic banks. Furthermore, the Islamic banks should have a clear policy regarding non-repayment of such funds but this was not disclosed by the surveyed Bahraini Islamic banks as was mentioned earlier.

The second highest overall CSR disclosure index for ‘*zakah*, charity and benevolent loans’ dimension was scored by UAE with 0.29. The research findings reveal that Dubai Islamic Bank has the maximum CSR score for this dimension, followed by Emirates Islamic Bank, Sharjah Islamic Bank, and Abu Dhabi Islamic Bank. The minimum CSR disclosure index (0.07) was scored by Al Hilal Bank. All surveyed Emirati Islamic

banks have clear statements about the calculation of *zakah* and its approval by the *Shari'ah* supervisory board, except Al Hilal Bank. Three out of five Emirati Islamic banks, such as Dubai Islamic Bank, Sharjah Islamic Bank and Emirates Islamic Bank disclosed the amount paid for *zakah*, *sources* and uses of *zakah*.

It should be noted that Abu Dhabi Islamic and Dubai Islamic excellently disclosed the statement of sources and uses of charity and benevolent funds in their annual reports. However, policy for providing *qard al-hassan* was again missing.

The overall CSR disclosure index of Kuwait for the '*zakah*, charity and benevolent loans' dimension is 0.24, indicating a very low disclosure. The CSR disclosure index for this dimension seems to improve for Kuwait Finance House from 0.27 in 2001 to 0.40 in 2011. Boubyan Bank and Kuwait International Bank's CSR disclosure indices were quite stable and did not indicate a significant improvement.

Only Kuwait Finance House reveals that the calculation of *zakah* has been approved by the *Shari'ah* supervisory board for all years. Boubyan, Kuwait Finance House and Kuwait International Bank disclosed the amount paid for *zakah*, while information regarding the sources of *zakah* for all years was only available for Kuwait Finance House. Boubyan Bank provided sources of *zakah* during 2005-2006 and Kuwait International Bank only for 2010. All surveyed Bahraini Islamic banks did not unveil the beneficiaries of *zakah*. Similarly, disclosure of sources and uses of charity was minimal; for example, none of the banks disclosed uses of *qard al-hassan*. However, Boubyan Bank specified policy for providing interest-free loans for the years 2007-2009.

Saudi Arabia's overall CSR disclosure index is 0.20 for the '*zakah*, charity and benevolent loans' dimension with which it is ranked the fourth. Among the Saudi Arabian banks, Al Rajhi Bank, one of the oldest Saudi Islamic banks scored the maximum CSR disclosure score of 0.25 for this dimension, whilst Alinma Bank and Al Bilad Bank shared the minimum CSR disclosure index of 0.13.

Al Rajhi bank provides a detailed position on *zakah* issues. For example, *zakah* is considered as a liability for shareholders and not the banks itself in the Saudi banks, as stated in Al Rajhi Bank:

Zakat is calculated based on the zakat rules and regulations in the Kingdom of Saudi Arabia and is considered as a liability on the shareholders to be deducted from

dividends. In case of any differences between the Bank's calculation and the Department of Zakat and Income Tax's (DZIT) assessment, such differences will be charged to the general reserve (Al Rajhi Bank, Annual Report, 2008: 37).

According to the results depicted in Table 5.6 (I, II) (Appendix I), all Saudi Islamic banks in the sample disclosed the amount and sources of *zakah* in their annual reports, excluding Bank Al Bilad, which did not publish the amount paid for *zakah*. As for the uses of *zakah*, none of the Saudi Islamic banks disclosed this in their annual reports. This might be because the amount is given to the Department of Zakat and Income Tax (DZIT), and it takes responsibility for using it under their rules and regulations. Furthermore, none of these banks stated the *Shari'ah* supervisory board approval on the uses of *zakah*. The reason for this is probably the same as mentioned above, that it is the DZIT's responsibility to collect *zakah* and use it.

It is worth mentioning that Bank Al Jazira honestly stated in the *Shari'ah* advisory board report that:

The Board was not certain about the way Shari'ah Zakat was calculated in the Bank's 2009 Financial Statements. The Bank should assign a chartered accountant to prepare the Bank's Zakat Base in accordance with Shari'ah criteria, to calculate the amount of Zakat due on each share, and to present the same to the Shari'ah Board for approval. This remark was also made in our report last year (Bank Al Jazira, 2009: 21).

This shows that Bank Al Jazira's loyalty to its stakeholders and shareholders as well as to the readers of its annual reports. Al Rajhi Bank and Bank Al Jazira are the only Saudi Islamic Banks that disclose their charity activities, the sources and where the charity money is used. Bank Al Jazira states in its 2009 annual report: "All gains made through *Shari'ah* non-compliant sources or methods have been deposited in separate accounts to be disposed of on charitable purposes" (Bank Al Jazira, Annual Report, 2009: 21). As for the Al Rajhi Bank regarding to the uses of charity it disclosed: "The Bank also provided banking and technological services for charity foundations" (Al Rajhi Bank, Annual Report, 2009: 25). None of the Saudi Islamic banks has revealed any information regarding *qard al-hassan*. It seems that these banks did not give any benevolent loans during these years. However, Bank Al Jazira in the Board of Directors' Report stated:

The Shari'ah Group's focus in 2009 was on the creation of the Research and Development Center, equipped with a library and full research facilities. The Center designed a total of eight innovative products – four for Trade Finance, two for Treasury, one structured solution for Corporate Banking, and a socially responsible Qard Al Hasan product (Bank Al Jazira, Annual Report, 2009: 14).

As the results show, Qatar scored the minimum overall CSR disclosure score of 0.15 for ‘*zakah*, charity and benevolent loans’ between five GCC countries. The research findings show that Qatar Islamic banks give a very low importance for this dimension. The maximum CSR disclosure score of 0.33 was scored by Qatar Islamic Bank, while the second and third ranks go to Masraf Al Rayan and Qatar International Islamic Bank with the very minimum scores of CSR disclosure indices of 0.08 and 0.07 respectively.

5.4.5. FINDINGS FOR DIMENSION 5: COMMITMENTS TOWARDS EMPLOYEES

This section aims to depict how Islamic banks are performing in disclosing their activities in relation to the employment issues as described previously.

In analysing the disclosure indices for the period of 2000-2011, as can be seen in Table 5.3 that Qatar scored the maximum in the dimension of ‘commitments towards employees’ with the CSR disclosure index of 0.51, which is followed by Kuwait, Bahrain and UAE with 0.33, 0.31 and 0.27 respectively. UAE scored the minimum index of 0.22 under this dimension.

As the results in Table 5.3 indicate, the research findings show that Qatari Islamic banks give high importance to this dimension. In terms of individual bank performance, as can be seen in Table 5.5 (Appendix I), Qatar Islamic Bank recorded the maximum CSR disclosure index of 0.60 in providing information about its commitment to employees, whereas Qatar International Islamic Bank scored the minimum of 0.30. The CSR disclosure index for this dimension seems to improve significantly from 0.30 to 0.80 over the period of 2007-2010 for Masraf Al Rayan and is constant for Qatar Islamic Bank. Despite its maximum score under this dimension, Qatar Islamic Bank did not communicate details of the equal opportunity policy and competitive salary package. In addition, nothing was found related to the monetary training. This was also missing in the annual reports of Qatar International Bank and Masraf Al Rayan.

Masraf Al Rayan and Qatar Islamic Bank specified that they provide training for their employees to enhance their understating of the *Shari’ah* related to Islamic banking transactions and also offer training opportunities to university students as can be seen in the following statement by Masraf Al Rayan (Masraf Al Rayan Bank, Annual Report, 2010: 32):

An integral part of these efforts is the development of various programs for Qataris ranging from fresh graduates to experienced employees. A key development this year was the initiative to develop scholarship programs and develop a training program with the College of North Atlantic for our Qatari trainees to provide them with full insight into the bank's unique banking practices, together with an understanding of Islamic banking principles.

As can be seen from the results in Table 5.3, Kuwait was ranked the second among the GCC countries, under the dimension 'commitment to employees', with the overall CSR disclosure index of 0.33. As the results indicate, all surveyed Kuwaiti banks have presented the similar level of disclosure under this dimension: 0.38 for the Kuwait International Bank, 0.36 for Boubyan Bank and 0.30 for Kuwait Finance House. It should be noted that three Kuwaiti Islamic banks did not disclose their employee welfare and equal opportunity policies as well as information about offering competitive salary. It should be noted that the Kuwait International Bank showed consistent CSR disclosure index for the years 2007-2009, however dropping significantly in 2010 from 0.50 to 0.00. It is worth mentioning that only the Kuwait Finance House did not provide training on *Shari'ah* awareness to its staff, while it was the only bank that revealed the reward programmes to employees in its annual reports from 2007 to 2011.

According to the research findings in Table 5.3 Bahrain's CSR disclosure index with regard to the 'commitment to employees' dimension is 0.31, which takes it down to the third position. Based on the overall CSR disclosure index, Ithmaar bank (0.85) and Shamil Bank (0.65), among nine Bahraini banks in the sample, shared the maximum ranking as they disclosed almost all required information under this dimension. The results indicated that almost all surveyed Islamic banks in Bahrain, except Bahrain Islamic Bank and Al-Amin Bank, have shown efforts to improve their disclosure practices related to this dimension.

As can be seen from Table 5.4 (I, II, III) (Appendix I) eight out of nine Bahraini Islamic Banks in the sample have ensured their commitments towards employees through showing an appreciation to their employees. For example, all banks, excluding the Al Amin Bank and Kuwait Finance House, mentioned the number of employees in their annual reports. On the other hand, none of the Bahraini Islamic banks stated that they support the concept of equal opportunity, but only ABC Islamic Bank in 2011 specified (ABC Islamic Bank, Annual Report, 2011: 82): "Promoting equal opportunity in the Bank and treating colleagues, clients and other counterparties in a manner that does not

discriminate with regard to gender, race, religion, age, disability, nationality, social or ethnic origin”.

As the results indicate, Islamic banks in Bahrain displayed poor results in terms of disclosing information regarding the employees’ welfare. However, Al Baraka Islamic Bank, Bahrain Islamic Bank, ABC Islamic Bank and Ithmaar Bank have stated their commitments to look after their employees’ well-being in the belief that having a healthy staff will have a positive impact on their professional and personal lives. For example, Bahrain Islamic Bank indicated in the following statement (Bahrain Islamic Bank, Annual Report, 2010: 13): “We at Bahrain Islamic Bank believe that our main asset is our staff. We have recruited high calibre staff and we pay special attention in investing in their training and their welfare to create the right environment to deliver the best service to our customers”.

Additionally to the initiatives designed to improve the welfare, health and safety of the staff at work, as the results indicate, Islamic banks of Bahrain show their commitment towards employees through offering a number of training courses and reward systems for the betterment of their career. Ithmaar Bank, Shamil Bank, Al Baraka Bank and Khaleeji Commercial Bank have continually focused on improving the professional skills and abilities of employees in the workplace through training programmes that emphasise the commitment to *Shari’ah*-compliant financial activities. Furthermore, they gave training for students and undergraduates and also provided monetary trainings. Bahrain Islamic Bank, Arcapita Bank and Kuwait Finance House have offered a number of educational activities to their employees, however they did not include training for students, except for the Kuwait Finance House for the years 2008-2009, when this training was provided. As for ‘the monetary training’ (one of the sub-categories of the dimension ‘commitments towards employees’), which is usually provided by the bank’s anti-money-laundering department to train its personnel in the field of combating money laundering in a constant and professional manner, the annual reports of Kuwait Finance House for the period of 2003-2008 did not indicate the availability of such training for the staff, while Arcapita Bank did not provide this training to its employees at all. ABC Islamic Bank and Al-Amin Bank did not disclose any information regarding their training programmes.

With regard to the employee reward system, this was missing for Al Amin Bank, Al

Baraka Islamic Bank, Bahrain Islamic Banks and Kuwait Finance House.

As regards to the disclosure results of Bahraini Islamic banks as depicted in Table 5.4 (I, II, III), (Appendix I) the poor disclosure of this dimension of ABC Islamic Bank, Kuwait Finance House and Al-Amin Bank resulted in their minimum scores: 0.21, 0.05 and 0.00, respectively. Thus, placed them seventh, eighth and ninth places respectively.

In short, the majority of Islamic banks in Kuwait have recognised the importance of special training for their employees, as bankers with the substantial experience and knowledge in the field of Islamic banking will facilitate and improve the services offered.

With regard to the UAEs, the findings in Table 5.3 show that the UAE with its CSR disclosure index of 0.27 was ranked the fourth under this dimension. The only Emirati bank that showed good results under this dimension is Al Hilal Bank, which scored the maximum CSR disclosure index (0.70) as it revealed almost all mandatory points. The other four banks put little effort into disclosing the information related to their commitments to employees. As a result, Emirates Islamic Bank scores 0.35, Abu Dhabi Islamic Bank 0.34, Dubai Islamic Bank 0.20, whilst Sharjah Islamic Bank scored only 0.00.

This poor disclosure is quite disappointing considering the fact that Dubai Islamic Bank and Sharjah Islamic Banks are the oldest banks in the UAE, founded in 1975 and 1976 respectively. Therefore, they are expected to communicate better on this dimension as the more experienced banks.

As can be seen in Table 5.3, Saudi Arabia scored the minimum overall CSR disclosure index of 0.22 for 'commitments towards employees' between five GCC countries. The CSR disclosure index for 'commitments towards employees' seems to improve for three banks: Al Rajhi Bank, Al Jazira Bank and Al Bilal Bank and is constant in the case of Alinma Bank for the period covered. The overall CSR disclosure for this dimension for Saudi banks ranged from 0.13 to 0.45, being the minimum and maximum score respectively. As the results depict, all Saudi Islamic banks in the sample showed their appreciation to their employees in the CEO's and Chairman's statement. All banks communicated the number of employees, except Bank Al Bilad, which increased its communication regarding to this point in 2010-2011.

The results in Table 5.6 (I, II) (Appendix I) show that Saudi Islamic banks' disclosure about their staff well-being programmes, equal opportunity policies, besides competitive salary, was at the very minimum level as in the case of surveyed Qatari and Kuwaiti Islamic banks.

Regarding to the *Shari'ah* awareness, Al Rajhi Bank disclosed it only during the years 2008-2011, while Bank Al Jazira only for the years 2000, 2001 and 2009.

According to their annual reports, Bank Al Jazira and Al Rajhi Bank provided a variety of training courses including compliance training and security awareness. These banks also offered training for students and undergraduates. Furthermore, Al Rajhi Bank was the only one that disclosed information about monetary training for its employees. Unfortunately, all this information was missing for Alinma Bank and Bank Al Bilad.

In short, as the results indicate, Islamic banks in the GCC region have ensured their commitment towards employees through employee welfare, training and development.

As the results indicate, employees of the Islamic banks in the GCC region were not given equal opportunities and competitive salaries for the betterment of their career. Consequently, the employee reward system has to be improved with all Islamic banks in the region.

5.4.6. FINDINGS FOR DIMENSION 6: COMMITMENT TOWARDS DEBTORS

'Commitment towards Debtors' is another dimension explored as part of the CSR disclosure in the case of Gulf Islamic banks. As the results in Table 5.3 depict, the overall CSR disclosure index on the average for the period ranged from 0.53 to 0.73, the minimum being Bahrain and the maximum Kuwait.

As the results in Table 5.8 (I, II) (Appendix I) show, All Kuwaiti Islamic banks provided detailed information for each year on debtors ranging from types of lending activities to attitudes towards debt products and amounts of debt written off. However, they did not communicate on debt policy. Kuwait Finance House scored the maximum CSR disclosure index under this dimension (0.80), which was constant for the period 2001-2011. Boubyan Bank's disclosure regarding its commitments to employees was also comprehensive and it was ranked second with 0.71. In 2001, it failed to disclose the

amount of debt written off and in the years 2005-2006 the detailed information of its types of lending activities. Kuwait International Bank was placed in third place among the Kuwaiti banks under this dimension, as it did not communicate anything regarding to its commitments towards debtors in 2009.

According to the findings depicted in 5.3, Qatari Islamic banks with the overall CSR disclosure index 0.71 show good disclosure practices under the dimension 'commitments towards debtors'. As in the case of Kuwaiti Islamic banks, three of the surveyed Islamic banks in Qatar did not disclose information related to the debt policy. Furthermore, for Masraf Al Rayan in 2007-2008 and Qatar International Islamic Bank in 2009, their attitudes towards debt products were not found in the annual reports.

As for the overall CSR disclosure index 0.69 under the 'commitments towards debtors' dimension, the UAE was ranked third after Kuwait and Qatar. Between the five Emirati Islamic banks in the research sample, Emirates Islamic Bank and Abu Dhabi Islamic Bank ranked the maximum CSR disclosure index in providing information on commitments towards employees, scoring 0.77 and 0.76 respectively. These banks were followed by Dubai Islamic Bank (0.67), while both Sharjah Islamic Bank and Al Hilal Bank shared the minimum ranking.

The results show that all the Emirati Islamic banks excellently disclosed the required items under this dimension. However, debt policy was again missing. Additionally, attitudes towards debt products were not communicated at all in the case of Sharjah Islamic Bank, Al Hilal Bank, and for Dubai Islamic Bank in 2009.

According to the results, Saudi Arabia was ranked fourth with the overall CSR disclosure index of 0.53 for 'commitments towards employees' between five GCC countries. The results show that Saudi Islamic banks as other banks in the sample have a tendency not to disclose their debt policies. For example, Al Rajhi bank improved the disclosure requirements under this dimension in 2009, by stating its attitudes towards debt products: "The Bank is not exposed to market risks from speculative operations. The Bank is committed to Shariah guidelines, which do not permit it to enter into contracts or speculative instruments such as hedging options, forward contracts and derivatives" (Al Rajhi Bank, Annual Report, 2009: 63). In addition, Bank Al Bilad and Alinma Bank did not share information on attitudes towards debt products, while Bank

Al Jazira scored the maximum CSR disclosure index 0.63, while Al Rajhi bank the minimum 0.48.

As regards Bahrain, it scored the minimum CSR disclosure index of 0.51 under the dimension ‘commitments towards employees’. Arcapita, Bahrain Islamic Bank and Ithmaar Bank indicated the same stable CSR disclosure index without any significant improvement, whilst Khaleeji Commercial Bank showed an important increase from 0.20 in 2005 to 0.80 in 2011. All these four banks shared the maximum score of 0.60 under the dimension ‘commitments towards employees’ amongst Bahraini Islamic banks in the sample. Al Baraka Bank scored the second highest CSR disclosure index of 0.57, followed by ABC Islamic Bank, Al Amin Bank and Shamil Bank that shared the third place. Among the Kuwaiti banks, Kuwait Finance House was ranked the minimum between Islamic banks in Bahrain.

It is worth mentioning that surveyed Bahraini Islamic banks completely ignored revealing their debt policies. Furthermore, only Al Baraka Bank in 2009, Kuwait Finance House in 2008 and Khaleeji Commercial Bank in 2008-20011 stated their policies towards debt products. The amount of debt written off was poorly disclosed for Kuwait Finance House and Khaleeji Commercial Bank.

Briefly, under the dimension of CSR disclosure, all Islamic banks have shown good results. It seems that Islamic banks in the Gulf region are committed to disclose the information related to debtors in their annual reports. However, surveyed Islamic banks in the GCC countries should put more efforts to improve disclosures under this dimension, as some items such as debt policies towards debt products were either not disclosed or disclosed poorly.

5.4.7. FINDINGS FOR DIMENSION 7: COMMITMENTS TOWARDS COMMUNITY AND SOCIETY

As another dimension covered in this analysis, the results in Table 5.3 for ‘commitment towards community and society’ show that Qatar had the maximum CSR disclosure index under this dimension (0.67), followed by Kuwait (0.56). UAE and Bahrain scored very similar results under this dimension with CSR disclosure index being 0.38 and 0.37 respectively, while Saudi Arabia had the minimum score (0.19).

As the results in Table 5.3 indicate, Qatar Islamic bank with CSR disclosure index being 1.00 showed an excellent performance in disclosing information related to the dimension ‘commitments towards community and society’ by revealing all required items and scoring the maximum disclosure level.

Under this dimension, it would be consistent to see that Islamic banks give priority to projects and investments that have social emphases and aims to enhance equality and social justice in societies. Qatar Islamic Bank (QIB) provided a general statement in its 2009 Annual Report regarding its commitment to projects that benefit the community (Qatar Islamic Bank, Annual Report, 2009: 55):

As an integral part of the Qatari society, QIB continues to be a strategic partner of various social activities and is committed to remain in constant touch with all sectors of the society. Wherever there is a need, the Bank is always at the forefront, staunchly supporting social empowerment programmes as well as the objectives of the country’s wise leadership to practise the qualities of integration, reciprocal responsibility and solidarity in line with the noble teachings of Islam and the eminent traditions of the Prophet; peace and blessings of Allah be upon Him.

In addition, it disclosed the details of the projects it sponsored: “During 2009 the Bank extended assistance worth around QR 6 million to various educational, cultural and health care activities, sports clubs, social causes, charity societies, scholarships, conferences, exhibitions and sports events” (Qatar Islamic Bank, Annual Report, 2009: 55).

In addition, Masraf Al Rayan and Qatar International Islamic Banks also illustrated their commitment towards community through elaborating on details of social initiatives they undertook.

Qatar Islamic Bank and Masraf Al Rayan specified that they operate ladies’ branches, which shows their commitment to meeting societal values in a community where segregation of gender is commonly practised. Having female-only branches in the Gulf region would help to foster Arab women’s involvement in the business world. Unfortunately, Qatar International Islamic Bank did not reveal anything on such an important matter.

Beyond the above disclosures, among three Qatari Islamic banks, only Qatar Islamic Bank indicated its contribution to conferences and commitment to participate in government social activities.

As regards the CSR score of Kuwait under this dimension, it was ranked second under the dimension ‘commitments toward community and society’. Despite the fact that Islamic banks should shoulder social responsibility, the results indicated that two out of three surveyed Islamic banks in Kuwait had minimum CSR disclosure indexes: Boubyan Bank scored 0.39 and Kuwait International Bank 0.21. Only Kuwait Finance House managed to reach a good level of disclosure with 0.81 under this dimension.

It should be noted that the social dimension in the operations of these banks was not communicated properly. For instance, Kuwait International Bank showed little evidence that it favours socially-driven projects and support organisations that provide a benefit to society. The existence of women’s branches and contribution to conferences on Islamic economics was also not disclosed. Similarly, Boubyan Bank did not perform well under this dimension. However, the results illustrated a temporary improvement during the years 2008-2009. As disclosed in the following statement, Boubyan Bank recognised the importance of ladies’ branches (Boubyan Bank, Annual Report, 2009: 9):

On the Retail Banking level, the year 2009 has witnessed remarkable growth in the Bank’s presence in the local market by virtue of inaugurating a number of branches to cover the most congested areas so that the number of branches totalled 15 branches by the year-end whilst focusing on branches designated for women for more privacy and convenience, in addition to increasing the number of ATMs to cover the strategic areas in Kuwait.

The results in Table 5.3 show that UAE was ranked third amongst the GCC countries, under the dimension of ‘commitments towards community and society’, with CSR disclosure index 0.38. The study revealed a scarcity of disclosures by the Emirati Islamic banks investigated on this issue. For example, only three out of five Islamic banks in UAE, namely Abu Dhabi Islamic Bank, Dubai Islamic Bank and Emirates Islamic Bank, provided information concerning ladies' banking and dedicated bank sections only for ladies. Abu Dhabi Islamic Bank explains (Abu Dhabi Islamic Bank, Annual Report, 2008: 14) that it:

...was one of the first banks in the UAE to offer products and services customised to the specific needs of female customers in the UAE. In fact, it was a pioneer in offering full service branches to serve female-only customer bases, staffed exclusively by women. Over the years, ADIB has strengthened this tradition of exclusive banking for ladies and now has a “ladies’ branch” next to all of its major branches.

Information regarding contribution to conferences on Islamic economics and other

institutional areas was also not consistent and found only in annual reports of Abu Dhabi Islamic Bank and Al Hilal Bank.

Furthermore, none of the Islamic banks in the UAE disclosed their participation in government social activities. Moreover, all surveyed Emirati Islamic banks, except Sharjah Islamic Bank indicated their commitment to a social role and sponsorship to community activities. The CSR disclosure index for UAE under the dimension of 'commitments towards community and society' ranged from 0.57 to 0.00, being the maximum and minimum scores respectively.

It was found that Bahraini Islamic banks as in the case of their Emirati counterparts disclosed minimal information on this issue and the CSR disclosure index for UAE is 0.37. The CSR disclosure index for the dimension 'commitments towards community and society' seems to improve for six Bahraini Islamic banks, is constant for ABC Islamic Bank and Ithmaar Bank and decreases for Bahraini Islamic Bank over the period covered.

It should be noted that all Bahraini Islamic banks were keen to portray their commitment to social role and sponsorship events, excluding ABC Islamic and Al Amin Bank, which did not communicate on their financial support to community activities.

As the results shown in Table 5.4 (I, II, III) (Appendix I), Bahraini banks in the sample disclosed little in the sense of their participation in government social activities. Support for organisations that provide benefit to society was communicated comprehensively only by Khaleeji Commercial Bank and Ithmaar Bank as evidenced by the following statements (Ithmaar Bank, Annual Report, 2010: 69):

Together with the Kingdom of Bahrain's Royal charity organisation, Ithmaar sponsored six under-privileged orphaned students in each of the last three years, enabling them to attend private schools in the kingdom from kindergarten 1 right through to grade 12 ... It's not all education though; we are mindful of the need to support the health and well-being of the Bahraini people and, to that end, we made a donation to the Bahrain Cancer Society.

In terms of commitment to ladies' banking, only Bahrain Islamic Bank in 2002-2003 and Kuwait Finance House in 2003-2005 stated that they offer ladies' banking (Kuwait Finance House, Annual Report, 2005: 17):

Furthermore, we also continued to expand our Ladies Banking operations, providing enhanced service and support for this increasingly important customer segment. The

financial needs of female banking customers are broad ranging from personal banking and finance to the need for the provision of corporate services.

The minimum CSR disclosure index (0.19) under the dimension ‘commitments towards community and society’ is scored by Saudi Arabia’s Islamic banking industry over the years covered, as the results in Table 5.3 show. The results indicate the very low level of social disclosures in Saudi Islamic banks. Only few and very modest exceptions can be mentioned here. For instance, investment and funding community activities was published in annual reports of Bank Al Jazira in 2008-2010 and Al Rajhi Bank in 2006-2011. The same banks and Alinma Bank communicated on commitment to social role.

It should be noted that two Saudi Islamic banks, Alinma Bank and Bank Al Bilad did not disclose anything about supporting institutions that provide benefit to society, while Al Jazira Bank and Al Rajhi Bank provided short information on this issue. Sponsorship of academic conferences was also mentioned briefly by Al Rajhi Bank in 2006 and Bank Al Jazira in 2000 and 2008.

Furthermore, commitment to a social role was very poorly disclosed by the Saudi Islamic banks in the sample. These banks also fell short on providing disclosure about ladies’ banking. It is surprising to find Saudi Banks not communicating much on this important aspect in their annual reports as the segregation of genders in the workplace is widely practiced in the Saudi Arabian community.

In addition, only Al Rajhi Bank revealed its participation in government social activities as indicated in the following statement (Al Rajhi Bank, Annual Report, 2008: 27): “In coordination with the Ministry of Social Welfare, the Bank formed an Orphan Welfare Fund in which the Bank matches investments dedicated to orphan welfare equivalent to SR 6,000,000”.

To sum up, the findings on commitments towards community and society are disappointing, because Islamic Banks with the mission of Islamic moral economy are considered social and economic institutions, and therefore are expected to provide more information on this dimension to reflect accountability and justice to society.

5.4.8. FINDINGS FOR DIMENSION 8: *SHARI'AH* SUPERVISORY BOARD (SSB)

As for the last dimension in the analysis, the results in Table 5.3 show that most of the sampled Islamic banks publish their report of the *Shari'ah* supervisory board (SSB), reflecting the importance of the report for Islamic banks as providing the necessary assurance for the stakeholders and shareholders that banks adhere to *Shari'ah* principles.

CSR disclosure index for this dimension in the country level ranged from 0.20 to 0.39 over the years; among the countries covered, Bahrain scored the maximum, followed by Kuwait and Qatar, while the UAE was ranked fourth and Saudi Arabia scored the minimum.

As can be seen in Table 5.4 (I, II, III) (Appendix I), five Bahraini Islamic banks illustrated an upward trend in disclosing information regarding the dimension '*Shari'ah* Supervisory Board', while Ithmaar Bank was found to disclose consistently. On the other hand, Shamil Bank portrayed a downward trend in communication on this issue, while Al Amin Bank did not disclose any information.

All surveyed Islamic banks in Bahrain, with the exception of Al Amin Bank, disclosed the names of their SSB members. Only ABC and Bahrain Islamic Bank regularly published the pictures of their SSB members in the annual reports, while Al Baraka Islamic Bank displayed the pictures only in 2007.

It should be noted that remuneration of SSB members and number of meetings held was indicated in all years only by Bahrain Islamic Bank. ABC Islamic Bank communicated on the remuneration of their SBB members during the period 2008-2010, Al Baraka Islamic in 2010-2011 and Arcapita Bank in 2009-2011. ABC Islamic Bank also disclosed the number of meetings held by the SSB in 2008-2011 and Kuwait Finance House in 2010.

In expressing an opinion on the operations of the Islamic banks, the SSB reports of seven Bahraini Islamic Banks, which are: ABC Islamic, Al Baraka, Arcapita, Bahrain Islamic, Ithmaar, Kuwait Finance House 2003-2008 and Shamil Bank, suggest that their reviews were based on all transactions, as indicated in the following extract from the annual report (Arcapita Bank, Annual Report, 2011: 71): "We conducted our review,

which included examining, on a test basis of each type of transaction, the relevant documentation, and procedures adopted by the Bank”. On the contrary, the SSB of Kuwait Finance House in 2009-2010 clearly stated that the reviews were based on samples. This information was missing for Khaleeji Commercial and Al Amin Bank.

As can be seen from Table 5.4 (Appendix I) (I, II, III) in terms of identifying whether there had been any defects on the transactions that they examined, the SSB of all Bahraini Islamic banks in the sample consistently reported no defects in the product, as can be seen from the following statement (Ithmaar Bank Annual Report, 2011: 77): “The Bank’s overall investment activities and banking services were conducted in full compliance with the principles and provisions of Islamic Sharia and in accordance with the Sharia Supervisory Board-approved standard contracts”. Despite this statement, there were no defects in the transactions. There were conflicting statements in the Bahrain Islamic Bank’s SSB report in 2010, and in the following banks’ SSB reports in all years: ABC Islamic, Al Baraka Islamic Bank, Arcapita Bank and Ithmaar Bank. This can be evidenced by the following statement: “Gains made from sources prohibited by Sharia were evaded and transferred to the Charity Fund” (Ithmaar Bank, Annual Report, 2011: 77). This indicates that the first statement emphasised the compliance with Islamic teachings, while the second statement suggests some aspects of earnings were from illegitimate resources and that management had been advised to dispose of them to the charity fund.

Five out of nine surveyed Islamic banks of Bahrain: ABC Islamic, Al Baraka, Arcapita, Bahrain Islamic and Kuwait Finance House regularly published that their disclosures on distribution of profit and losses were in line with *Shari’ah* during the period covered. For the rest of the Bahraini Islamic banks this information was not found.

As regards Kuwait, it scored the second highest CSR disclosure index of 0.33 under the dimension ‘*Shari’ah* Supervisory Board’. As the results indicate, all three Kuwaiti Islamic banks in the sample provided the names of the SSB members; however, only Kuwait Finance House provided pictures of the SSB members. Information about remuneration of the SSB members was missing for all surveyed Kuwaiti Islamic banks. It should also be noted that *Shari’ah* board members’ visits to Islamic banks were not regular or were not disclosed consistently as the number of meetings held was revealed by Boubyan Bank only for the year 2008 and by Kuwait International House for the

years 2008-2009. All Kuwaiti Islamic banks in the sample published the details of the basis of examining the business transactions. The recommendation of the SSB relating to product defects and the extent to which the products are not *Shari'ah*-compliant were not found in annual reports of the three Kuwaiti Islamic banks. Similarly, the attestation of whether profit and loss distribution was lawful or not was provided only by Boubyank Bank and Kuwait Finance House in 2007 and 2010-2011 respectively, as can be seen from the following statement (Boubyan Bank, Annual Report, 2007: 50): “Allocation of profits between depositors and shareholders is calculated according to the Bank’s standard procedures approved by the Bank’s Sharia’a Supervisory Board based on the result of the financial year”.

The findings indicate that Qatari Islamic banks portrayed their commitment to *Shari'ah* teachings by scoring 0.30 under the dimension ‘*Shari'ah* Supervisory Board’. Qatar International Bank scored the maximum CSR disclosure index under this dimension (0.45), while Qatar Islamic Bank and Masraf Al Rayan Islamic Bank both shared the second place with the constant CSR disclosure index of 0.27.

According to the results depicted in Table 5.5 (Appendix I), all three Qatari Islamic banks disclosed the names of SSB members and only Qatar International Islamic Bank disclosed the remuneration of their SSB members. Additionally, the Qatar International Islamic Bank’s SSB report was signed by all members. On the other hand, none of the three Qatari Islamic banks published the pictures of SSB members nor communicated on the number of meetings held by the SSB. All the three surveyed Qatari Islamic banks stated that they examine all business transactions. Furthermore, these banks did not report any defects in the transactions as well as recommendations to rectify defects in products. However, all the three Qatari Islamic banks indicated that there were actions taken by the management to rectify the shortcomings in reporting. It was also found that the information about whether the profit and loss distribution is *Shari'ah*-compliant or not, was provided only by Masraf Al Rayan Islamic Bank in 2009-2010 annual reports.

As the results in Table 5.3 indicate, Emirati Islamic banks in the sample disclosed minimum information in the sense of providing assurance that their businesses is conducted according to the Islamic principles and monitored by the SSB. UAE scored 0.23 under the dimension ‘*Shari'ah* Supervisory Board’. As can be seen from results, Emirati Islamic banks did not disclose the pictures and number of the meetings held by

their SSB members. In addition, information about the remuneration of SSB members was also missing and there was no evidence found that SSB reports were signed by all members. Three out of five Emirati Islamic banks in the sample consistently published the names of their SSB members, while Emirates Islamic bank disclosed only in the years 2008 and 2010. As for Sharjah Islamic Bank there was no communication on this aspect.

In addition, the SSB reports of Abu Dhabi Islamic Bank, Dubai Islamic Bank and Emirates Islamic Bank indicated the basis of their reviews in examining the transactions. However, Sharjah Islamic Bank and Al Hilal Bank did not communicate on this issue. However, only the SSB reports of Abu Dhabi Islamic Bank and Emirates Islamic Bank consistently indicated that distribution of profits and losses was lawful or *Shari'ah*-compliant, while Dubai Islamic Bank disclosed this only in 2004.

As regards Saudi Arabia's Islamic banking industry, similarly to the UAE Islamic banking industry, they showed a very low adherence to *Shari'ah* ethics in their disclosures and scored the minimum CSR disclosure index (0.20) under the dimension '*Shari'ah* Supervisory Board'.

The results reveal that not all of the Saudi Islamic banks accord the great importance to this dimension, as for example; none of the Saudi Islamic banks disclosed the pictures of the SSB members except of Bank Aljazira in 2000. As for the names of SSB, all Islamic banks disclosed these with the exception of Bank Al Bilad. Only Bank Aljazira disclosed the number of meetings held by the SSB members. None of the Saudi Islamic banks included the SSB report in their annual reports other than Bank Aljazira for the year 2010, which was signed by all the members. Furthermore, in the same year, Bank Aljazira's SSB report disclosed important information for their stakeholders:

The Board noticed that the Bank is still keeping SAMBA shares acquired as a settlement with a client although the Board has confirmed the necessity for disposal of such shares as soon as possible. Thus, the Board re-urges and requests the Bank to quickly sell those shares and transfer any amount in excess of the debit to the charitable purpose account enquired (Bank Aljazira, Annual Report, 2010: 26).

Bank Aljazira and Al Rajhi Bank clearly stated that they take random samples of the business transactions and examine them, as evidenced by the following statement (Bank Aljazira, Annual Report, 2010: 21): "The *Shari'ah* Board has reviewed and discussed the final annual report prepared by the Bank's *Shari'ah* Review Department, comprising

the examination of documentation and processes adopted by the Bank, based on samples taken from each transaction type”.

In addition, Alinma Bank did not communicate much on the dimension ‘*Shari’ah* Supervisory Board’. It mentioned in 2009 the date of the establishment of SSB, it was the bank’s first full year annual report. It was also stated in years 2009-2010 that the SSB monitors all business carried out by the bank and disclosed a statement (Alinma Bank, Annual Report, 2010: 41): “The Bank has established a Shariah Board in accordance with its commitment to comply with Islamic Shariah Laws. The Shariah Board ascertains that all the Bank’s activities are subject to its approval and control”.

Furthermore, Bank Aljazira, in its conversion to an Islamic bank, stated in the SSB report in 2008 (Bank AlJazira, Annual Report, 2008: 22): “...the Board is sure that Bank Aljazira has executed the conversion into an Islamic banking program as approved by the Shari’ah Board. Thus, all Bank Aljazira’s operations and activities are fully converted into practices compliant with the Islamic Shari’ah”.

Moreover, Bank Aljazira scored the maximum CSR disclosure index under this dimension (0.19) and showed a good improvement from 0.18 in 2000 to 0.45 in 2010. Alinma Bank scored 0.09, Al Rajhi 0.08 and Bank Al Bilad scored the minimum CSR disclosure index under this dimension (0.00).

5.5. CONCLUSION

Islamic banks exist to fulfil the financial and economic needs of Muslim communities within the dictates of their religious faith. In addition to providing alternative financial facilities, they are expected to contribute to social aspects of the communities in which they operate through CSR activities, as Islamic banks are considered to be ethical alternatives emerging from the ethical norms of Islam. In order to measure the CSR performance in a number of Islamic banks, Haniffa and Hudaib’s (2007) methodology has been employed to construct an index of CSR performance through codifying the related information disclosed in annual reports of the sampled Islamic banks from the GCC countries for the period of 2000-2011.

The research attempts to measure the disclosure of CSR in the GCC Islamic banks, using content analysis of the corporate annual reports for the period 2000-2011 of 24

Islamic banks from five GCC countries (Bahrain, Saudi Arabia, UAE, Qatar and Kuwait) through eight dimensions developed for this purpose. The results are presented in the form of an index, which is termed CSR Disclosure index. A high index indicates less variation and more inclination towards the ‘ideal’ CSR performance, while a low index suggests otherwise. The Islamic banks surveyed were ranked based on the index under each dimension for each year.

The empirical results in Table 5.1 over the years covered show that Qatar scored the maximum overall CSR disclosure index (0.44), while Saudi Arabia scored the minimum (0.26). This means that 44 per cent of the required information for the CSR disclosure has been disclosed in the case of Qatar and only 26 per cent for Saudi Arabia. The overall mean for the remaining three GCC countries ranged from 0.35 to 0.42, suggesting a large disparity between the ‘real’ or disclosed and ‘ideal’ CSR disclosure index. The second rank is obtained by Kuwait with a CSR score of 0.42, while Bahrain scored 0.41 and UAE scored 0.31 and were ranked the third and fourth respectively.

In the overall ranking, as can be seen from Table 5.2, in terms of dimension level, ‘commitments to debtors’ became the first priority among the five GCC countries followed by ‘mission and vision statement’, ‘community’, ‘board of directors’, and ‘employee’ dimensions. The least importance was given to the three following dimensions: ‘*Shari’ah* Supervisory Board’, ‘*zakah*, charity and benevolent loans and ‘product and services’.

Table 5.1. Classification of CSR Disclosure Index Performance According to the Country Ranking

Dimensions of CSR Disclosure Index	Overall Score	Overall Rank
Qatar	0.44	1
Kuwait	0.42	2
Bahrain	0.41	3
United Arab Emirates	0.35	4
Saudi Arabia	0.26	5

Data Source: Annual reports of the examined banks during the period 2000-2011

Table 5.2. Classification of CSR Disclosure Index Performance According to the Scores in CSR Dimensions

Dimensions of CSR Disclosure Index	Overall Score	Overall Rank
Debtors	0.64	1
Mission and Vision	0.47	2
Community	0.43	3
BOD and Top Management	0.39	4
Employee	0.33	5
<i>Shari'ah</i> Supervisory Board	0.29	6
<i>Zakah</i> , Charity and Benevolent Loans	0.24	7
Product and Services	0.23	8

Data Source: Annual reports of the examined banks during the period 2000-2011

It should be noted that the research findings do not produce an encouraging result in terms of CSR or the social outcome of Islamic banks in the GCC region, as CSR indices for all the Islamic banks remain very low. Furthermore, in the overall ranking related to dimensions, the CSR disclosure indices also yielded very low scores. While Islamic corporate governance requires transparency, and hence, disclosure including promotion for their CSR activities, unfortunately, some Islamic banks put little effort into disclosing their underlying and operational values in a consistent manner. Furthermore, the findings of the research confirm the divergence between the CSR practices of Islamic banks in the GCC region in their annual reports and the moral benchmark based on Islamic moral economy and *Shari'ah*, as the latter provides aspirational expectations beyond what Islamic banks revealed in their annual reports. This may be explained due to the fact that their CSR activities are rather limited in Islamic banking as identified in other research on other case studies, which suggests that the problem is perhaps a structural problem rather than corporate governance issue.

It can be concluded that the overall CSR disclosure practices in the sampled GCC Islamic banks are still in the stage of development and therefore, are required an immediate attention by the regulatory and supervisory bodies.

Table 5.3. CSR Disclosure Index

CSR DISCLOSURE INDEX	BAHRAIN	KUWAIT	QATAR	SAUDI ARABIA	UNITED ARAB EMIRATES	OVERALL CSR INDEX	OVERALL RANK
MISSION AND VISION	0.65	0.44	0.64	0.22	0.38	0.47	2
RANKING	(1)	(3)	(2)	(5)	(4)		
BOD AND TOP MANAGEMENT	0.53	0.43	0.39	0.30	0.29	0.39	4
RANKING	(1)	(2)	(3)	(4)	(5)		
PRODUCT AND SERVICES	0.21	0.33	0.16	0.19	0.28	0.23	8
RANKING	(3)	(1)	(4)	(5)	(2)		
ZAKAH, CHARITY AND BENEVOLENT LOANS	0.33	0.23	0.15	0.20	0.29	0.24	7
RANKING	(1)	(3)	(5)	(4)	(2)		
EMPLOYEE	0.31	0.33	0.51	0.22	0.27	0.33	5
RANKING	(3)	(2)	(1)	(5)	(4)		
DEBTORS	0.51	0.73	0.71	0.53	0.69	0.64	1
RANKING	(5)	(1)	(2)	(4)	(3)		
COMMUNITY	0.37	0.56	0.67	0.19	0.38	0.43	3
RANKING	(4)	(2)	(1)	(5)	(3)		
SHARIAH SUPERVISORY BOARD	0.39	0.33	0.30	0.20	0.23	0.29	6
RANKING	(1)	(2)	(3)	(5)	(4)		
OVERALL YEARLY AVERAGE (INDIVIDUAL)	0.41	0.42	0.44	0.26	0.35		
RANKING	(3)	(2)	(1)	(5)	(4)		

Data Source: Annual reports of the examined banks during the period 2000-2011

CHAPTER SIX

THE IMPACT OF CORPORATE SOCIAL RESPONSIBILITY

DISCLOSURE ON FINANCIAL PERFORMANCE:

EMPIRICAL EVIDENCE FROM THE GCC ISLAMIC BANKS

CHAPTER SIX

THE IMPACT OF CORPORATE SOCIAL RESPONSIBILITY DISCLOSURE ON FINANCIAL PERFORMANCE: EMPIRICAL EVIDENCE FROM THE GCC ISLAMIC BANKS

6.1. INTRODUCTION

In recent years, the subject of corporate governance has begun to take even more prominent space in public as a result of high profile corporate failures, such as Barings, Lehman Brothers and others. Taking into account that poor corporate governance can negatively affect economies and the stability of financial systems and also have tangible social and environmental consequences, the focus from the conventional ‘shareholders only’ approach of corporate governance has shifted to a broader corporate governance model that identifies issues and priorities of stakeholders (Dusuki, 2011: 6). This new model of good corporate governance incorporates ethical considerations and values in the business strategy of corporations including banks. This means that corporations understand and address stakeholders’ demands through their CSR practices, as it is believed that “CSR connects to governance at the values level, determining the boundaries and accountabilities of the company in relation to a broad universe of stakeholders and its social and environmental responsibilities” (Strandberg, 2005: 4).

In responding to the changing paradigm, companies all over the world have developed and introduced different CSR practices into their agendas in order to adopt value-based governance to meet the interests of primary and secondary stakeholders (Perrini *et al.*, 2011: 59). Among others, Kakabadse *et al.* (2005: 283) defines CSR as “part of long-term perspective of economic gain that may not be financially measurable but may provide a valuable asset for future profitability and eventually for ‘social power’”. Others believe that undertaking CSR activities can have positive results for the firms and organisations, which include increased customer loyalty, willingness to pay premium prices and lower reputational risk during times of crises. Consequently, it is argued that all these favourable results can have a positive effect on the financial performance of a corporation, such as profitability (Peloza and Shang, 2011). However, despite the existence of a rich body of evidence on the topic of how CSR activities impact financial performance, the issue still remains unresolved due to the very diverse

results produced in different case studies.

As explained in chapter 3, the notion of CSR is by definition a result of Islamic ethics, which suggests a proactive and expanded stakeholders' paradigm substantiated with moral obligations of corporations towards the society. Thus, CSR from an Islamic perspective, as part of the new paradigm, is an endogenous concept and expected to be an existential part of any Islamic corporations including Islamic banks and financial institutions.

While there is a plethora of research that has attempted to investigate the relationship between CSR and financial performance in conventional financial institutions, the papers examining this relationship or the relationship between CSR and market value in IFIs remain scarce (*see Hassan et al., 2010; Arshad et al., 2012*). Thus, the aim of this chapter is to extend the research presented in the previous chapter by exploring and examining the relationship between CSP, which is the outcome of employing CSR activities, and corporate financial performance of Islamic banks with a sample of banks in the GCC region for the period 2000-2011. In doing so, CSR performance is measured through a CSR disclosure index constructed for this purpose.

This research would thereby enrich the existing literature as it provides the empirical analysis of a sample of banks from the GCC Islamic banking industry and employs the CSR disclosure index as a social performance measure.

The empirical analysis of this study is constructed around the hypothesis that the relationship between corporate social and financial performance in the GCC Islamic banks is positive. Hence, it is expected that the higher the level of CSR disclosure should result in better bank profitability.

As explained in detail in the following sections, the findings of the analysis indicate a significant relationship between a composite measure of corporate social performance and financial performance for the sampled Islamic banks in the GCC for the period of 2000-2011. However, the empirical results of this study show no statistically significant relationship between the individual dimensions of corporate social performance and the corporate financial performance measure except for 'mission and vision'. It should be noted that the results of this study are consistent with instrumental stakeholder theory, 'social impact hypothesis' and the 'good management theory'.

This paper begins with a short review on existing literature. The next section covers the theoretical background, while section three presents the theoretical background of the empirical model and the developed hypotheses. Section four presents the definitions and measurement of the variables of the empirical model and the next section illustrates the regression model. The sixth section presents the results of data analysis and hypotheses testing. Section seven concludes the paper.

6.2. THEORETICAL BACKGROUND OF THE NEXUS BETWEEN CORPORATE SOCIAL AND FINANCIAL PERFORMANCE

After surveying some of the available empirical studies in the previous section, this section examines them in a cluster manner to develop a theoretical understanding.

6.2.1. NEGATIVE ASSOCIATION BETWEEN CORPORATE SOCIAL AND FINANCIAL PERFORMANCE

Several studies support a negative relationship between corporate social and financial performance. According to the opponents of CSR, being socially active through engaging in charity projects, supporting and promoting staff welfare and minimising environmental damage, can be expensive and cause administrative burdens (Barnett and Salomon, 2006: 1103); thereby, it is argued that, CSR activities create financial burdens on the corporations.

The negative link between corporate social and financial performance has been supported by the Preston and O'Bannon's (1997) 'trade-off hypothesis', which suggests that the better firms perform in social terms the less they will perform financially. Consequently, socially responsible firms will have less advantage compared to the average firms. The proponents of this hypothesis argue that firms, by taking socially responsible initiatives, undermine the main objective of the company: maximising the profit (Friedman, 1970). As argued by Waddock and Graves (1997a), Preston and O'Bannon (1997), Simpson and Kohers (2002), this hypothesis is based on the neoclassical economists' view that supposes that socially-responsible strategies result in additional cost and therefore, create a competitive disadvantage (Aupperle *et al.*, 1985; Friedman, 1970). The recent advocates suggest that "resources dedicated to social programs or actions should be diverted—either spent on firms' efficiency or returned to shareholders" (Perrini *et al.*, 2011: 69), as it is not the responsibility of firms to deal

with social issues and they should be undertaken by governments or the third sector.

The proponents of an agency theory such as Jensen and Meckling (1976) also supported the negative link between social and financial performance, who argue that the consumption of valuable firms' resources in order to have positive social performance strategies would significantly maximise the personal managerial benefits rather than financial benefits of shareholders (Brammer and Millington, 2008: 1328).

6.2.2. NEUTRAL ASSOCIATION BETWEEN CORPORATE SOCIAL AND FINANCIAL PERFORMANCE

Various studies that tested the impact of CSR on financial performance have reported non-significant results (see among others: Freedman and Jaggi, 1986; Patten, 1991; Ullman, 1985; McWilliams and Siegel, 2000). For example, Freedman and Jaggi (1982) detected no correlation between pollution measures and financial performance. The results of their later study (1986) have also indicated a neutral association between the extent of pollution disclosure and financial performance (Pava and Krausz, 1996: 351-352).

It is argued that the neutral link occurs due to the complexity of the environment where companies and society function; thus, direct linear relationship between corporate social and financial performance is not possible (Waddock and Graves, 1997). In line with this hypothesis, social and financial performances are not correlated and social responsibility does not impact financial outputs (Soana, 2011; 135). Furthermore, the neutral linkage between social and financial performance was predicted by McWilliams and Siegel (2001) based on supply and demand theory of the firm. They argue that (2001:125) “the firm chooses the level of the attribute that maximizes firms' performance, given the demand for the attribute and the cost of providing the attribute, subject to the caveat that this holds true to the extent that managers are attempting to maximise shareholder wealth”.

Consequently, the supply of social performance of each firm depends on the demand of corporate social performance that each firm experiences. Therefore, at equilibrium, firms will be equally profitable, but the amount of produced socially responsible activities will be different.

In support of this, the recent empirical evidence of a neutral relationship between corporate social and financial performance in Italian banks was found by Soana (2011), who argues that investing in social projects does not result in financial advantage.

6.2.3. POSITIVE ASSOCIATION BETWEEN CORPORATE SOCIAL AND FINANCIAL PERFORMANCE

Despite the long discussions, analyses, ambiguous and mixed results regarding the relationship between corporate social and financial performance, a significant amount of studies detected a positive association (Makni *et al.*, 2009: 410).

The positive relationship between corporate social and financial performance is theorised by the 'social impact hypothesis' (see: Preston and O'Bannon, 1997), which is derived from instrumental stakeholder theory (Freeman, 1984; Cornell and Shapiro, 1987; Donaldson and Preston, 1995), whose proponents argue that satisfying the needs of different groups of stakeholders would result in enhanced financial performance on the ground of expanding effectiveness and efficiency. On the other hand, ignoring the interests of stakeholders might negatively affect corporate financial performance.

A stakeholder approach of strategic management has an instrumental basis (Freeman, 1984). According to this approach, "if organizations want to be effective, they will pay attention to all and only those relationships that can affect or be affected by the achievement of the organization's purposes. That is, stakeholder management is fundamentally a pragmatic concept" (Freeman, 1999: 234). However, this does not mean that instrumental stakeholder theory is value-free simply "because it claims that consequences count" (Freeman, 1999: 235).

Stakeholder management theory is utilised by the instrumental stakeholder theory as a tool to accomplish predicted results, mainly profitability (Kakabadse *et al.*, 2005: 292). According to Donaldson and Preston (1975: 74), the instrumental aspect of stakeholder theory provides the indication of the relationship between stakeholder management and corporate performance. The instrumental side is based on the suggestion that applying stakeholder management will positively impact corporate financial performance (Berman *et al.*, 1999; Donaldson and Preston, 1995). Jones (1995: 430) has also highlighted that instrumental stakeholder theory might clarify the association between corporate social and financial performance as: "Certain types of corporate social

performance are manifestations of attempts to establish trusting, cooperative firm/stakeholder relationships and should be positively linked to a company's financial performance”.

The positive link between corporate social and financial performance can be also explained by the ‘good management theory’, which is actually another articulation of stakeholder theory. ‘Good management theory’ implies better relationships with key stakeholders that in turn will result in improved performance (Waddock and Graves, 1997: 306-307). The simple idea that lies at the ground of this theory is that social responsibility can be an intangible asset that causes the more efficient use of resources, which in turn positively impacts financial performance (Surroca *et al.*, 2010: 465). Another study has argued in this vein that companies, by having a socially responsible agenda, mitigate the potential damage of their reputation from negative information they may face in the future and, therefore, protect profits and financial results (Soana, 2011: 134-135). Thus, a good CSR program can help to generate valuable goodwill, which will protect companies from unexpected issues, and open doors for new prospects that cannot be accessed by not so socially active companies. Consequently, good stakeholder management may lead to competitive advantage (Barnett and Salomon, 2006: 1102). The empirical evidence of the good management theory can be found in the studies by McGuire *et al.* (1988; 1990), who used in their equation financial performance as the dependent variable.

According to the proponents of instrumental stakeholder theory and good management theory, corporate social performance results in better financial performance. Other studies believe that companies with better financial performance have more resources to invest in social projects. In addition, several supporters of ‘slack theory’ argue that enhanced social performance would come as a result of allocating slack resources into the CSR initiatives, which means that better financial performance predicts better social performance (Waddock and Graves, 1997: 306; Preston and O’Bannon, 1997: 423).

In addition to such theorisation, some other studies located a strong positive association between corporate social and financial performance, such as the case with Simpson and Kohers (2002), which was conducted on the US banking sector.

6.3. HYPOTHESIS CONSTRUCTION AND MODELLING

This section discusses the details of the model that are proposed to be used in this study including the measurement of the variables starting with the construction of the hypothesis.

6.3.1. HYPOTHESIS CONSTRUCTION

The previous section presented the theoretical arguments in relation to the relationship between corporate social and financial performance. Based on the arguments of ‘instrumental stakeholder theory’ and ‘good management theory’, which suggest a positive relationship between corporate social and financial performance, it is expected that social performance positively affects financial performance. Thus, the following hypothesis is tested in this study:

H₂: The higher level of the CSR disclosure yields better financial performance for the GCC Islamic banks.

The majority of papers on corporate social performance and corporate financial performance link examines the social responsibility and concurrent financial performance. However, a number of studies take into account lead/lag issues and assesses the possible impact of corporate social performance on subsequent financial performance and vice versa (McGuire *et al.*, 1988; Roberts, 1992; Pava and Krausz, 1996; Preston and O’Bannon, 1997). Considering that theoretical arguments proposed for the concurrent relationship between CSR and corporate financial performance can be valid for the relationship between CSR and subsequent financial performance (McGuire *et al.*, 1998), and also that potential advantages of employing CSR may appear later on and positively affect firms' financial performance, it is expected that corporate social performance will have a positive impact on future financial performance of the GCC Islamic banks.

6.3.2. MEASURING THE DEPENDENT VARIABLE

As part of the modelling strategy, this section initially discusses the definition of the main dependent and independent variables.

Financial performance:

Dozens of empirical studies examining the link between corporate social and financial performance have used different measures of financial performance. Griffin and Mahon (1997: 11) identified 80 financial measures of corporate financial performance that had been adopted in 51 studies. Among widely utilised measures of financial performance are accounting-based measures of profitability (see Aupperle *et al.*, 1985; Freedman and Jaggi, 1982; Waddock and Graves, 1997; McWilliams and Siegel, 2000; Simpson and Kohers, 2002), such as return on assets (ROA), return on equity (ROE) and return on sales (ROS), or market-based measures, such as market return, price to earning ratio and market value to book value (see Vance, 1975; Freedman and Jaggi, 1986). According to Perrini *et al.* (2011: 61), in addition to accounting-based and market-based indicators of financial performance of firms, a combination of them has been also used by researchers (see McGuire *et al.*, 1988; Pava and Krausz, 1996; Cochran and Wood, 1984).

Accounting-based measures of corporate financial performance have been generally perceived in the literature as indicating past or short-term financial performance. On the other hand, market-based measures capture future or long-term financial performance (Gentry and Shen, 2010: 514).

The proponents of accounting-based measures believe that market-based measures can be affected by several factors, which are not related to the firm's activity. The proponents of market-based measures, however, argue about the objectivity of accounting figures and stress the relevance of value-based measures with shareholders and investors (Brammer and Willington, 2008: 1333).

Despite being the most popular metrics for corporate financial performance measurement (Barnett and Salomon, 2008: 1308), traditional accounting performance measures have been criticised for not considering the cost of invested capital and for being affected by accrual-based accounting principles (Madinios *et al.*, 2006: 8). In addition, accounting-based indicators tend to reflect the internal efficiency of firms (Orlitzky, *et al.*, 2003: 408). Furthermore, these measures receive criticism for having the following features: they are based on financial statements, internally focused and inevitably historical or backward-looking performance measures, which concentrate mainly on departmental performance rather than on overall performance of companies

(Bourne *et al.*, 2003: 4). Moreover, some others argue that accounting returns might be linked with some particular quality measures of companies (McGuire *et al.*, 1990: 172). Alternatively, market-based measures are advocated as metrics reflecting real or actual profitability of firms (Madinios *et al.*, 2006: 8). Furthermore, it is argued that value-based metrics are less vulnerable to be manipulated by managers than traditional accounting measures (McGuire *et al.*, 1990: 172).

Griffin and Mahon (1997: 11), on the other hand, highlight the importance of employing traditional accounting performance measures as modern value-based measures might reflect more than purely corporate financial performance. Despite the limitations of accounting-based measures of financial performance, they have been widely accepted in the banking sector as the most accurate ones that capture financial performance of banks (Simpson and Kohers, 2002: 99). Furthermore, the results of previous studies advocate that corporate social performance is more likely to have strong correlations with accounting returns than with investor returns (Orlitzky *et al.*, 2003; Pelozo, 2009).

Taking into consideration the above-mentioned arguments, and the fact that not all the banks in the sample have common stock traded on stock exchanges, market returns have not been used to assess financial performance. Therefore, in this study, accounting-based variables, in particular, return on average assets (ROAA) is adopted as a proxy of corporate financial performance. In addition, return on average equity (ROAE) is used for various robustness checks throughout the analysis. The ROAA ratio is calculated by dividing net income by average total assets of the sampled Islamic banks; while ROAE is defined as the ratio of net income to average equity, both ratios expressed as a percentage.

It should be noted that ROAA is an indicator of banks' financial performance and managerial efficiency as it shows how the management is competent in generating profits from assets and how efficient they are in managing assets in order to generate revenues. This study uses the average assets value to be able to determine changes in assets during the fiscal year. This ratio has appeared in the financial literature as the fundamental and most frequently used ratio of banks performance (Dietrich and Wanzenried, 2011: 311).

Another measure of profitability employed in this study is ROAE, which reflects a rate

return on base capital. Despite being broadly employed in the financial studies, this ratio has not been regarded as the best measure of financial profitability by some authors, who argue that banks with a lower leverage ratio or higher equity tend to have higher ROAA but a lower ROAE (Dietrich and Wanzenried, 2011: 311). The reason behind this is that ROAE neglects the higher risk related to a high leverage and the impact of regulations on leverage. Therefore, in this study ROAA is used as the key dependent variable.

It should also be noted here that ROAE is generally highly associated with ROAA; however, it will be beneficial to employ this additional measure of financial performance to have the implicit opinion of investors on a common stock of companies (Pava and Krausz, 1996). Thus, the results for ROAE are also reported.

6.3.3. DEFINING THE INDEPENDENT VARIABLE

As mentioned before, corporate social performance is a multidimensional concept (Waddock and Graves, 1997: 304): “with behaviors ranging across a wide variety of inputs (*e.g.* investments in pollution control equipment or other environmental strategies), internal behaviors or processes (*e.g.* treatment of women and minorities, nature of products produced, relationships with customers), and outputs (*e.g.* community relations and philanthropic programs)”.

Dozens of measures have been employed by academics and managers to assess the financial value of socially-responsible investments (Pelozo, 2009: 1521). The first studies examining the relationship between corporate social and financial performance, where a dominantly single dimension of corporate social performance was employed, have suffered owing to the measurement problems of corporate social performance (Griffin and Mahon, 1997). Thus, several researchers stressed the importance of developing a multidimensional concept of corporate social performance measures (Griffin and Mahon, 1997; Roman *et al.*, 1999; Carroll, 2000). However, as Simpson and Kohers (2002) highlighted in their study, the issues related to the measurement of corporate social performance are still frightening.

In order to bring clarity to corporate social performance measurement, Orlitzky *et al.* (2003: 408) classified measurement strategy into four main groups: disclosures,

reputation indicators, social audit, corporate social performance processes and observable outcome, managerial corporate social performance principles and value.

In further exploring, Pelozo (2009) divided corporate social performance measures into three main groups: environmental, social and broad, which consist of both social and environmental matters. More recently, based on corporate social performance metrics, Perrini *et al.* (2011) categorised the existing studies on corporate social performance-corporate financial performance link as follows: using pollution indicators, which mainly utilise a single dimension measure (see Bragdon and Marlin, 1972; Bowman and Haire, 1975; Fogler and Nutt, 1975); implementing environmental practices (see Christmann, 2000); employing corporate reputation (Alexander and Bucholtz, 1978; Cochran and Wood, 1984); and applying the third-party social and environmental assessment such as KLD database (see Waddock and Graves, 1997; McWilliams and Siegel, 2000).

Furthermore, another group of studies have suggested the use of social and environmental disclosure as a substitute for corporate social performance (see Belkaoui, 1976; Abbott and Monsen, 1979; Blacconiere and Patten, 1994; Blacconiere and Northcut, 1997). Moreover, the Fortune reputation ratings (see McGuire *et al.*, 1988; Preston and O'Bannon, 1997) and the Moskowitz's ratings of social responsiveness (see Vance, 1975; Sturdivant and Ginter, 1977) as well as content analysis (see Bowman and Haire, 1975) and questionnaire surveys (see Aupperle *et al.*, 1985) that were among other metrics of corporate social performance employed in the empirical studies.

It should be noted that the abovementioned measurements are not considered as perfect, as each of them has advantages and disadvantages. For example, survey questionnaires, due to their internal nature, reveal managerial perceptions of CSR (Soana, 2011: 135). Additionally, survey methodologies tend to have issues associated with return rates and the agreement of raters among different companies (Waddock and Graves, 1997: 304). As for content analysis of published documents, it provides useful information on corporate activities; however, it is prone to users' errors and interpretations. This means that the data collected can be used insensitively and results might be biased. Furthermore, another limitation of the content analysis methodology is that it accepts social disclosure as the sound measure of social performance (Soana, 2011: 135), while companies may contribute to social performance but not necessarily report.

The most widely used reputational indices, which are the Moskowitz's ratings and the Fortune ratings, are characterised by being good proxies of fundamental principles and behaviours of social performance (Orlitzky *et al.*, 2003: 408). However, the Moskowitz's ratings are rarely used. The Fortune ratings, on the other hand, have been regarded not only as a measure of corporate social performance but also as a measure of overall corporate financial performance (Graves and Waddock, 1994; Waddock and Graves, 1997).

Although studies with a one-dimensional measure of corporate social performance as pollution indices have been frequently employed by researchers. It has been argued that they may not be good indicators of a firm's social performance and may be suitable only for certain industries and companies (Igalens and Gond, 2005: 134; Waddock and Graves, 1997: 305). Thus, it can be said that a one-dimensional measure, which is generally an environmental dimension, cannot fully represent the overall level of the corporate social performance construct.

As a result, multidimensional metrics of corporate social performance have emerged. The KLD social ratings database represents the third party 'stakeholder-defined' social and environmental assessment, which is collected by an independent measurement organisation. These are data collected internally and externally through adopting reliable benchmarks (Surroca *et al.*, 2010: 465). As has been stressed by Igalens and Gond (2005: 135) "(the) KLD agency's CSP measurements became a requisite yardstick in Anglo-American empirical literature in the 1990s and 2000s". Despite being a more comprehensive measure of corporate social performance, the KLD index has been criticised for having several drawbacks. Firstly, the KLD database has been described as credulous because it is adjusted to satisfy the interests of individual groups of scholars (Godfrey *et al.*, 2009: 432). Secondly, the aggregate measure of corporate social performance that consists of individual dimensions is worthless as it eliminates the importance of information of each dimension (Hillman and Keim, 2001; Mattingly and Berman, 2006 and Godfrey *et al.*, 2009). Further, there are difficulties regarding the assessment process of the diverse components of the KLD index. Considering the point that all dimensions are interpreted as equal, a component can be examined as a strength and weakness at the same time (Griffin and Mahon, 1997: 15).

As for this study, the CSR disclosure index is employed as the measure of corporate

social performance for the GCC Islamic banking industry, which was constructed in the empirical model and analysis presented in the previous chapter and it is based on the content analysis of annual reports of Islamic banks in the sample. The CSR disclosure index of the GCC Islamic banks is a multidimensional construct extracted into a single measure, which reflects the CSR activities of the banks based on a benchmark derived from Islamic financial principles. Chapter 4 and chapter 5 provide a detailed explanation on the construction of the CSR disclosure index.

The use of the CSR disclosure index as a measure of corporate social performance is subject to several limitations. It should be taken into account that this measurement as any other measurement of social reality and fact can be questioned on the grounds of its 'objectivity' (Font, 2012: 13). Furthermore, as a shortcoming, it can be mentioned that in order to foster a better public image, financial institutions might decide to misinform the users of annual reports. Thus, the information revealed in annual reports can differ from the real corporate activities (Turker, 2008: 415). If this is the case, the published annual reports might not show a reliable and true picture of financial institutions; hence any index developed with such information will be open to debate.

It is, however, worth mentioning that reputational indices and comprehensive databases, which are used in the conventional banking sector as societal barometers and financial instruments, unfortunately, are not available for GCC Islamic banks. Therefore, the CSR disclosure index has been employed in this chapter as a measurement of corporate social performance, as the most efficient available method.

6.3.4. DEFINING CONTROL VARIABLES

Based on previous theoretical and empirical studies, which emphasised the importance of mediators in the social and financial performance link, it is suggested that the corporate social performance - corporate financial performance relationship should be perceived possibly under the control of certain other variables, such as institutional size, industry specification and how closely they interact with each other and the socially responsible practices performed by institutions (Brammer and Millington, 2008: 1326, see also Orlitzky, 2001; Rowley and Berman, 2000; Margolis and Walsh, 2003).

McWilliams and Siegel (2001), among other scholars, conducted the most theoretically convincing research that identified and theoretically supported the factors affecting both

social and financial performances of companies. These factors are: a firm's size, research and development expenses, advertising, consumer income, the percentage of government sales, labour market conditions, level of diversification, and stage in the industry life cycle.

Furthermore, size, risk and industry were among the moderators of the corporate social performance/corporate financial performance relationship proposed by Ullman (1985) and Mahoney and Roberts (2007), which are also employed by Waddock and Graves (1997) as control variables. Moreover, bank size, risk, capital ratio and operational efficiency variables were among widely-used internal determinants of profitability in the banking industry (Dietrich and Wanzenried, 2011: 309). Simpson and Kohers (2002) included size, risk, asset portfolio composition, local economic environment, cost of funds level of investment in branch offices, overhead expenses, capital ratio and loan ratio as control variables in the ROA equation, to examine the corporate social performance/corporate financial performance relationship in the banking industry.

As a result, depending on prior research findings, banks' size, risk, overhead expenses, capital ratio and loan ratio have been employed in this model as control variables as they have been seen as the most important factors for the corporate social and financial performance linkage.

6.3.4.1. FIRM (BANK) SIZE

Organisational size has been constantly identified by researchers as an essential control variable in assessing the corporate social performance and corporate financial performance linkage. Following Claessens *et al.* (2002) and Gorton and Schmid (2000), in this study, the log of total assets is used as a proxy of bank size.

Godfrey *et al.* (2009: 430) hypothesised the influential role of size in the value of CSR activities. They assumed that large companies as companies with the higher risk factor tend to be more affected by negative events. Consequently, it is expected that large companies are more CSR-active and eager to be involved in socially-responsible projects compared to smaller companies, in order to minimise their risk.

According to Margolis *et al.* (2007: 14), larger firms have more resources and, therefore, may engage in more socially-responsible activities or might do the opposite, and take

less responsibility for an action. As it has been revealed in Wu's (2006) research, only a minor positive relationship between the firm size and social performance and also between firm size and some measures of financial performance was signified by firm size. Thus, Margolis *et al.* (2007) control for firm size in the case when the sample size of the study consists of the companies with similar sizes (such as assets or the total number of employees) or when it was explicitly controlled in the original analyses.

It is, however, argued that there is a positive relationship between profitability and the size of a fast-growing bank (Dietrich and Wanzenried, 2011: 312). This can be explained by a better variety of products and higher loan diversifications available in larger banks that leads to a decline in their risk; and banks with a larger asset portfolio are more likely to achieve economies of scale, compared to banks of a small size. Thus, reduced risk and economies of scale are expected to result in increased operational efficiency and banks with a bigger size are expected to have positive correlation with profitability.

An alternative view suggests a negative relation between firm size and profitability for very large banks. This can be explained by high managing costs of very large companies, which include agency costs, bureaucratic overheads and other reasons (Dietrich and Wanzenried, 2011: 312). The supporting evidence of the negative effect of size on a firm's profitability was found in the following studies: Schreck (2009); Waddock and Graves (1997); Hillman and Keim (2001); Gorton and Schmid (2000); and Claessens *et al.* (2002).

Based on the argument that the large size of banks leads to higher agency costs and bureaucratic overheads, that in turn cause higher managing costs, it is expected to have a negative association between the bank size and financial performance.

6.3.4.2. CAPITAL RATIO

Capital ratio is another major internal determinant of bank profitability. Consistent with the prior research, this ratio is defined as equity over average total assets (Simpson and Kohers, 2002), which is an indicator that banks have sufficient equity amount relative to risk and shocks they might face. As a result, banks with high capital ratio require less external funding and indicate higher profitability (Kosmidou, 2008: 151). Furthermore, it is worthy of note that well-capitalised banks are inclined to have lower funding costs

caused by their lower bankruptcy risk (Dietrich and Wanzenried, 2011: 309). The positive correlation between the capital ratio and bank profitability, which implies that banks sustaining a higher amount of equity in relation to their assets are the most profitable, has been empirically evidenced by several researchers (Bourke, 1989; Demircug-Kunt and Huizinga, 2000; Athanasoglou *et al.*, 2008; Kosmidou, 2008).

On the other hand, the existing literature provides evidence for an inverse relationship between the capital ratio and profitability. Modigliani and Miller (1963) indicate the diminishing impact of high capital to ROE (Berger and Bouwman, 2011: 7). In addition, Simpson and Kohers (2002) show the negative relationship between the capital ratio and profitability, measured by ROA.

Considering that well-capitalised banks are more efficient in following-up on available business opportunities, more flexible and able to cover unforeseen losses generated during times of crisis, consequently, reaching a higher profitability level (Athanasoglou *et al.*, 2008: 132), it is expected that higher capital ratio of GCC Islamic banks causes higher profitability.

6.3.4.3. LOAN RATIO

Loan ratio is one of the bank-specific covariates that may have an effect on bank profitability (Chronopoulos *et al.* 2013). Loan to total assets ratio, which is one of the direct indicators of the earning power of bank, is calculated by dividing average total loans to average total assets (Simpson and Kohers, 2002). This ratio was found to have a positive and significant impact on bank profitability in Demircug-Kunt and Huizinga's (2000) study. The authors explain this positive result by stating that loans are the main source of revenue that will lead to a positive impact on profitability. Similar results were reported by Staikouras *et al.* (2007) in the study, which examined the relationship between performance measured by operating expenses of the south-eastern European banking industry and industrial, country-specific characteristics. A positive significant relationship between operating expenses and loan ratio was evidenced in this study.

Alternatively, Simpson and Kohers (2002) reported a negative significant relationship between loan ratio and financial performance. In supporting this, Heffernan and Fu (2008: 14) argue that very high loan activities might cause a decrease in the liquidity position of banks and increase the potential defaults on the borrowers' side. Hence, it

would negatively affect the profitability. Berger and Bouwman (2009) stated that a high level of loan ratio is associated with the likelihood and severity of losses, where banks have to dispose of their illiquid assets at a fire-sale price in a response to high deposit withdrawals.

Since the GCC banks are relying heavily on traditional financial methods, where the deposits and loans are the main sources and uses of funds (Al Hassan *et al.*, 2010), loans are the main source of revenue (Demirguc-Kunt and Huizinga, 2000) that would positively affect the bank profitability. Therefore, it is expected that loan ratio would positively impact profitability in the case of GCC Islamic banks, and therefore, it is utilised in this study.

6.3.4.4. OVERHEAD EXPENSES

A number of empirical studies considered operating expenses as one of the major determinants of bank profitability. Operating expenses can be defined as the expenses incurred in undertaking banks' everyday financial activities and calculated by total non-interest expenses divided by average total assets (Simpson and Kohers, 2002: 103). The findings of numerous studies on profitability of banks have suggested that variables related to expenses have to be included in the profit function (Bourke, 1989; Athanasoglou, 2008). Among other studies, Molyneux and Thornton (1992) and Bourke (1989) indicate a strong positive relationship between staff expenses and profitability (Athanasoglou, 2008: 123).

Furthermore, McWilliams and Siegel (2000: 604) highlight the importance of research and development (R&D) expenses in their model by arguing that "there is long-standing theoretical literature linking investment in R&D to improvements in long-run economic performance". They also stress that in the case where R&D and advertising variables, which are the determinants of profitability, were not included in the model, this profitability model was incorrectly specified (McWilliams *et al.*, 2006).

Following Simpson and Kohers (2002: 104), who suggest that expenditures for R&D are not directly disclosed by banks, R&D-related expenditure could be possibly revealed under the overhead expenses, and therefore, they included this variable in the profitability model as a control variable.

In some studies, the relationship between overhead expenses and profitability of banks was found to be negative (Athanasoglou, 2008; Simpson and Kohers, 2002). This can be explained by saying that effective management of the overhead expenses increases efficiency that leads to a higher level of profitability.

It should be noted that effective management of overhead expenses boosts the efficiency of banks that enhances profitability (Athanasoglou, 2008: 128) through passing their non-interest expenses to their customers on both sides of balance sheet such as lowering deposit rates and raising lending rates (Demirguc-Kunt and Huizinga, 2000: 6). Hence, it is expected that overhead expenses positively affect profitability in the GCC Islamic banks.

6.3.4.5. DEBT RATIO

Risk has been used as a control variable in this study, since it has been recommended by researchers as a factor that impacts social and financial performance (Waddock and Graves, 1997: 308). The debt ratio, which is calculated as long-term debt divided by total assets, is used as a proxy for the riskiness of a bank (Waddock and Graves, 1997; Kapopoulos and Sophia, 2007; Barnett and Salomon, 2012).

The positive and negative impacts of debt on managerial behaviours have been examined in the literature (Barnett and Salomon, 2012: 1310). It is argued that debt positively affects managerial behaviour by enforcing discipline and encouraging managers to choose the best decision-making process. On the contrary, it is considered negatively affecting profit as debt reduces managerial freedom and may restrict access to new business opportunities.

A significant negative relationship between the debt ratio and financial performance has been empirically evidenced in the studies of Waddock and Graves (1997), Kapopoulos and Lazaretou (2007), Perrini *et al.* (2008), and Barnett and Salomon (2012).

Taking into account the above-mentioned definition and explanations from the relevant literature to substantiate its selection, it is expected that the debt ratio negatively impacts the financial performance in the GCC banking sector.

6.3.5. REGRESSION MODEL

In conducting the empirical analysis, the panel data linear regression estimating the relationship between CSR disclosures and financial performance forms the following equations are utilised:

Model (1):

$$ROAA = \alpha + \beta_1 CSR D + \beta_2 Size + \beta_3 Cap. Ratio + \beta_4 Loan Ratio + \beta_5 Ovhd. Exp. + \beta_6 Debt Ratio + \epsilon$$

Model (2):

$$ROAA_{t+1} = \alpha + \beta_1 CSR D + \beta_2 Size + \beta_3 Cap. Ratio + \beta_4 Loan Ratio + \beta_5 Ovhd. Exp. + \beta_6 Debt Ratio + \epsilon$$

Model (3):

$$ROAA = \alpha + \beta_1 M\&V + \beta_2 Size + \beta_3 Cap. Ratio + \beta_4 Loan Ratio + \beta_5 Ovhd. Exp. + \beta_6 Debt Ratio + \epsilon$$

where:

ROAA: return on average assets ratio is calculated by dividing net income to average total assets, which is an indicator of banks' financial performance and managerial efficiency as it shows how competent the management is in generating profits from assets and how efficient in managing assets in order to generate revenues;

ROAA_{t+1}: Refers to return on average assets;

CSR D: CSR disclosure score measured as the ratio of disclosure content points over the maximum score a bank can achieve;

M&V: Mission and vision dimension of CSR disclosure index;

Size: Log of total assets;

Cap. Ratio: Capital ratio is calculated by dividing equity capital to average total assets;

Loan Ratio: Loan ratio is calculated by dividing average total loans to average total assets;

Ovhd. Exp.: Overhead expenses are measured by dividing total non-interest expenses over average total assets;

DebtRatio: Debt ratio is calculated by dividing long-term debt to total assets.

α - the intercept;

$\beta_1 \dots \beta_n$ - the regression coefficients;

$\hat{\epsilon}$ - the error term.

Table 6.1 depicts the definitions of independent variables along with the predicted signs.

Table 6.1. Definitions of Independent Variables

Variable Name	Variable Abbreviation	Variable description	Predicted sign
CSR Disclosure Index	CSR D	CSR disclosure score measured as the ratio of disclosure content points over the maximum score a bank can achieve	+
Mission and Vision	M&V	Mission and Vision Dimension of CSR Disclosure Index	+
Size	Size	Log of Total Assets	-
Capital Ratio	Cap.Ratio	Equity Capital/Average Total Assets	+
Loan Ratio	Loan Ratio	Average Total Loans/Average Total Assets	+
Overhead Expenses	Ovhd. Exp.	Total Noninterest Expenses/Average Total Assets	+
Debt Ratio	Debt Ratio	Long-term Debt/ Total Assets	-

6.3.6. DATA SOURCES

It should be re-iterated that the data covers 24 Islamic banks from five GCC countries: Bahrain (9 banks), the United Arab Emirates (5 banks), Saudi Arabia (4 banks), Kuwait (3 banks) and Qatar (3 banks). The annual reports of 24 Islamic banks from five GCC countries are analysed for the period 2000-2011 in constructing the CSR disclosure index as a proxy for CSP, as discussed and presented in Chapter 5.

CSR disclosure content is based on banks' annual reports for the period 2000-2011. Financial data for the rest of the variables in this study is collected from the *BankScope* database for 2000-2011 period.

6.4. EMPIRICAL ANALYSIS AND INTERPRETATION

Based on identified model, this section presents the analysis and the results.

6.4.1. DESCRIPTIVE STATISTICS

The following section presents the descriptive statistics of the variables as part of the examined model. The descriptive statistics cover both the dependent and independent variables across the 133 observations collected.

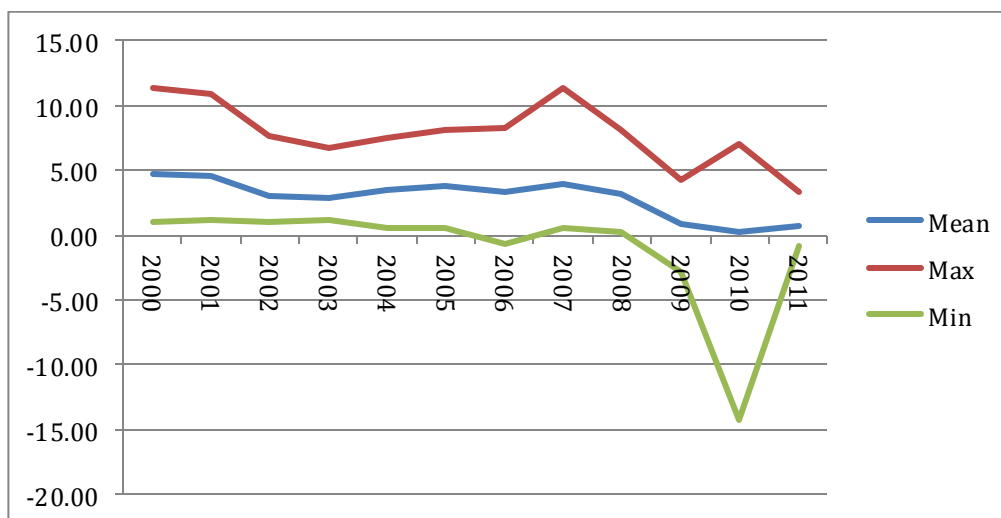
Table 6.2. Descriptive Statistics

Description	ROAA	CSRD	Size	Loan Ratio	Cap. Ratio	Ovhd. Exp.	Debt Ratio
Mean	2.33	0.38	3.96	0.57	0.23	118.88	0.06
Maximum	11.39	0.62	8.34	0.87	1.02	795.1	0.78
Minimum	-14.3	0.07	1.14	0	0	2.57	0
Skewness	-0.39	-0.54	0.99	-1.27	2.15	2.7	3.81
Kurtosis	8.27	2.49	4.38	4.89	8.75	10.21	17.07
Standard deviation	3.24	0.14	1.15	0.18	0.17	166.02	0.15

Data Source: Bankscope Database

As the results in Table 6.2 depict, ROAA varied widely during 2000-2011: the highest ROAA was 11.39 and the lowest was -14.30 with a standard deviation of 3.24 and a mean of 2.33. This is visible in Figure 6.1.

Figure 6.1. ROAA of Islamic Banks in the GCC Region, 2000-2011



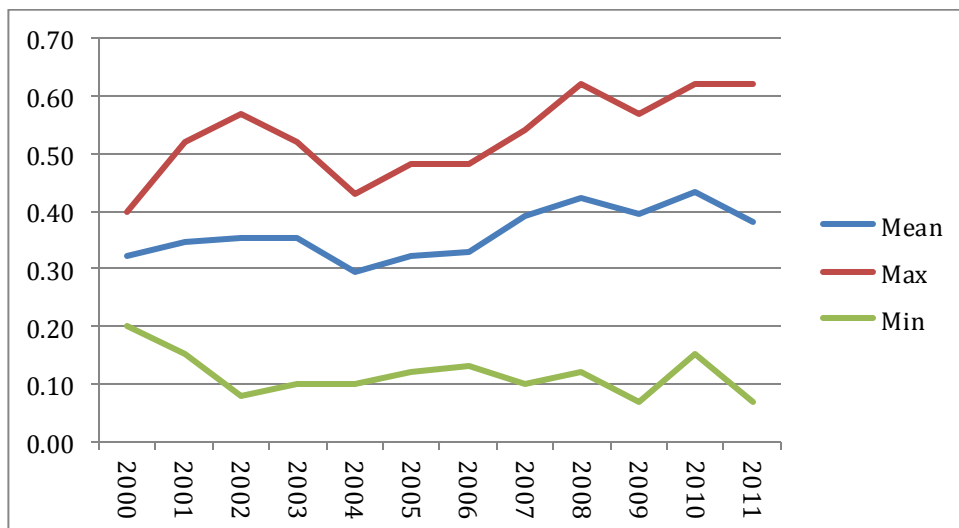
Data Source: Bankscope Database

As can be seen in Figure 6.1, the trend of ROAA of Islamic banks in GCC countries during the period 2000-2011 is quite stable. However, the mean of ROAA shows a sharp decline in ROAA in 2008 until 2010. This indicates that during the recent financial crisis period, Islamic banks earned less return on assets than before the crisis. Since late 2010 a modest positive trend is observed in ROAA.

As for the CSR disclosure index, the annual reports of 24 Islamic banks in the GCC region for the period of 2000-2011 were reviewed, coded and the score results were analysed. CSR was disclosed in banks' annual reports with different concentrations and levels of information. The maximum CSR disclosure score found was 0.62 across the eight dimensions of CSR disclosure index, while the minimum was 0.07. The mean of CSR disclosures (0.38) over the covered years for the entire sampled banks reflects a relatively low level of CSR disclosure of Islamic banks. The standard deviation is 0.14 reflecting the level of dispersion from the mean.

Figure 6.2 illustrates a steady level of CSR disclosure of Islamic banks in GCC countries from 2000 to 2003. After that, the results reflect a decline in 2004 and positive improvements in disclosing CSR activities during the period 2004-2008. Figure 6.2 also depicts a significant decrease of CSR disclosure for the periods 2008-2009 and 2010-2011.

Figure 6.2. CSR Disclosure Index of Islamic Banks in the GCC Region, 2000-2011



Data Source: Bankscope Database

As regards the control variables, a lens on control variables shows that size ranges between 1.14 and 8.34 having a mean equal to 3.96.

Loan ratio and capital ratios are also introduced into the examined model as control variables. As can be seen in Table 6.2, the loan ratio varies between 0.87 and 0 having a mean of 0.57, while the highest capital ratio was 1.02 and the lowest was 0 having a mean of 0.23.

Overhead expenses fluctuated extensively during 2000-2011 from 2.57 to 795.10 with a mean of 118.88. This variable has the highest standard deviation (166.02).

Debt ratio is another control variable used in this model. The minimum and maximum values of this ratio are 0 and 0.78 respectively and mean is 0.06.

With regards to skewness and kurtosis standards, Table 6.2 illustrates that the data is non-parametric (not normally distributed). The results indicate that skewness statistics of overhead expenses and the debt ratio exceed the range of ± 1.96 , which is demonstrating the lack of normality in distribution (see Haniffa and Hudaib, 2006). Kurtosis statistics confirm these results, thus, indicate that data is not normally distributed, as kurtosis results of each variable in the model exceed the normality range of ± 3 (see Haniffa and Hudaib, 2006).

As a result of this non-parametric data nature, the Spearman collinearity test is used to test for multicollinearity among variables. Spearman correlations matrix and VIF are conducted to test for the existence of multicollinearity between the examined independent variables.

6.4.2. TESTING THE HYPOTHESIS

The relationship between the CSR disclosure index and financial performance of the GCC Islamic banks is examined by using the fixed effects panel regression. This section analyses and illustrates the results from the employed regression.

It should be noted that initially, 133 observations were collected. However, due to unavailable data some of the observations were omitted and the panel data ended up with 110 observations. The issue with omitted observations was dealt by conducting the Durbin-Wu test (please see p. 216), which showed that this did not represent a problem.

It is important to mention that the Spearman correlations matrix and variance inflation factor (VIF) test are used to test for the existence of multicollinearity between the

examined independent variables, while a Hausman test is employed to select between random and fixed effects model, while Breusch-Pagan/Cook-Weisberg test is performed to test for heteroscedasticity

Table 6.3 shows that low risk of multi-collinear variables that exist in the examined model, with the exception of the high correlation between ROAA and capital ratio (0.57). In addition, the VIF test reports results aligned with the Spearman correlation showing low risk of collinear variables.

As can be seen in Table 6.3, the highest reported VIF value is 1.38 to the size variable and the lowest is 1.05 to the overhead expenses. Considering that the commonly accepted threshold for multicollinearity is the VIF value of 10 and the closer the VIF value is to one, the lower the presence of multicollinearity (Hair *et al.*, 2010: 204; 212), these results are statistically considered acceptable.

Table 6.3. Spearman Correlations Matrix

Variables	VIF	ROAA	CSRD	Size	Loan Ratio	Cap. Ratio	Ovhd.Exp.	Debt Ratio
ROAA		1.000						
CSRD	1.24	-0.185	1.000					
Size	1.38	0.081	0.052	1.000				
Loan Ratio	1.3	0.116	-0.222	0.419	1.000			
Cap. Ratio	1.08	0.574	-0.17	-0.094	-0.038	1.000		
Ovhd. Exp.	1.05	-0.077	0.033	0.353	-0.035	-0.126	1.0000	
Debt Ratio	1.14	-0.108	0.075	0.036	-0.062	-0.001	0.043	1.000

Data Source: Bankscope Database

It is worth mentioning that if the correlation between two variables is equal to 0.8 or above, these variables are considered highly correlated (Brooks, 2008). Furthermore, highly correlated variables (correlation is bigger than 0.8) and the results of the VIF test that exceed 10, indicate the multicollinearity problem in data (Haniffa and Cooke, 2005: 414; Neter *et al.*, 1983; Kennedy, 1992). The Spearman's rank correlation and the VIF test shown in Table 6.3 suggest that statistically there is no serious problem of multi-collinear variables.

In relation to the methodology, the selection between a fixed effects and random effects model is based on the Hausman test illustrated in Table 6.4. As can be seen in the results, the Hausman test rejects the null hypothesis of random effects; consequently,

the fixed effects model is considered as suitable.

Breusch-Pagan/Cook-Weisberg test is used to test for heteroscedasticity, and the results are depicted in Table 6.4. As can be seen, p value is equal to 1.20, which accepts the null hypothesis and reports no threat of heteroscedasticity.

Table 6.4. Results of the Panel Data with Fixed Effects Regression Analysis Testing the Concurrent Relationship between Financial Performance and the CSR Disclosure Index

ROAA	Model 1		Model 1(A)	
	Coef.	t-value	Coef.	t-value
CSR	3.926	3.560***	3.695	2.320**
SIZE	-0.140	-0.280		
LOAN RATIO	2.463	1.020	2.047	1.670
CAP.RATIO	11.386	5.400***	11.322	5.220***
OVHD.EXP.	0.004	3.880***	0.004	5.430***
DEBT RATIO	-2.713	-2.600**	-2.481	-1.660
CONSTANT	-3.180	-2.510***	-3.396	-3.970***
R-Squared		0.356		0.413
Prob>F		0.000		0.000
Hausman		11.11***		12.24**
Heterosk		1.20		1.82
Groups		12		12
Observations		110		110

Notes: *P < 0.1, **P < 0.05, ***P < 0.01

The results of the regression estimates in Table 6.4 show the concurrent relation between financial performance and the content of CSR disclosures showing that the overall model is significant at $p < 0.01$ which explains 35.6% of the variation in profitability (ROAA). As seen in Table 6.4 the content of CSR disclosure variable is statistically significant at $p < 0.01$. Based on these results, there is a strong direct relationship between CSR disclosures and ROAA.

As the results show, three out of five control variables found to be significant: capital ratio and overhead expenses at 0.01 and debt ratio at 0.05 levels, which indicates that the equation is reliable. The significant association between ROAA and CSR disclosures is consistent with the results evidenced in the previous studies of Simpson and Kohers (2002) and Scholtens (2009).

The findings of the analysis are aligned with the set hypothesis and discussed theoretical framework that predict a positive link between social and financial performance in the

Islamic banking industry. Therefore, it can be inferred that the higher the level of CSR disclosure, the better is the bank's profitability.

It should be noted that the results of this study are consistent with instrumental stakeholder theory, 'social impact hypothesis' and the 'good management theory'. The CSR significance indicates that the results support instrumental theory, which suggests that applying stakeholder management will positively affect corporate financial performance (Marom, 2006; Donaldson and Preston, 1975). Furthermore, the findings of this study are in accordance with the 'good management theory', meaning that maintaining a good relationship with stakeholders will lead to better financial performance (Waddock and Graves, 1997). In other words, social responsibility brings about using resources effectively that in turn increases financial performance. The empirical results of this study reconcile with the results obtained by O'Banion and Preston (1993) and McGuire *et al.* (1988, 1990) but contrary to Mahoney and Roberts (2007), who found no significant relationship between corporate social and financial performance.

The capital ratio, which is defined as equity capital over average total assets, has a positive and highly significant effect on bank profitability measured by ROAA. This result meets the expectation and stands in line with the results of Athanasoglou *et al.* (2008) and Demircuc-Kunt and Huizinga (1999). The results suggest that GCC Islamic banks with a sound capital position tend to be more efficient and flexible in following up on available business opportunities and able to cover unforeseen losses generated during times of crisis, thus, reaching a higher profitability level as argued by Athanasoglou *et al.* (2008) as well.

With regard to other control variables, operating expenses seem to be an important determinant of profitability, as also found by Athanasoglou *et al.* (2008) as the results indicate a positive significant relation with ROAA. This means that effective management of overhead expenses enhances the efficiency of banks that improves profitability (Athanasoglou *et al.*, 2008). The findings in this study also support the findings of Molyneux and Thornton (1992), Bourke (1989) and Demircuc-Kunt and Huizinga (2000).

As for the debt ratio result, which is used to stand in for the riskiness of the bank, the

results illustrate a negative and significant relationship between risk and profitability. This stands in line with the results of several studies (see Waddock and Graves, 1997; Kapopoulos and Lazaretou, 2007; Perrini *et al.*, 2008; Barnett and Salomon, 2012). One of the main reasons for this relation is that debt negatively affects profit, as debt reduces managerial freedom and may restrict access to new business opportunities (Barnett and Salomon, 2012).

The empirical results show that bank size, which is measured by a log of total assets, has a negative and statistically insignificant relationship with profitability. This applies that the size of Islamic banks in the GCC countries does not affect their profitability. Such a result can be justified by saying that smaller banks have a tendency to grow faster even at the expense of their profitability. To show that the effect of bank size on profitability is not important, the size is removed from the main model 1 and the sub-model 1(a) is tested. As can be seen in Table 6.4, after removing the size variable from the econometric model 1, and running the econometric model 1(a), the rest of the coefficients were not affected; this implies that the non-stationarity of size variable does not affect the performance of this model.

Finally, as regards to the loan ratio, which is measured by loan to total assets, this does not have a statistically significant effect on bank profitability. This result is inconsistent with the empirical evidence produced by Demirguc-Kunt and Huizinga (2000), stating that loans are the main source of revenue in banks and would positively affect their profitability. Yet, this is not the case with the GCC Islamic banks, where the loan ratio recorded a positive insignificant relationship with ROAA.

Table 6.5 reveals the impact of corporate social performance on future performance. In this study, Model 1 is applied to investigate the concurrent relationship between corporate social performance and financial performance, and Model 2 is applied to investigate the impact of corporate social performance on subsequent corporate financial performance. In Model 2, future financial performance is measured as $ROAA_{t+1}$ and all independent variables are lagged one year in order to examine the robustness of the main empirical model (Model 1) within the used historical data.

Table 6.5. Results of the Panel Data with Fixed Effects Regression Analysis Testing the Relationship between the Future Financial Performance and the CSR Disclosure Index

Model 2		
ROAA _{t+1}	Coef.	t-value
CSRD	3.457	2.520**
SIZE	-0.281	-0.490
LOAN RATIO	3.076	1.280
CAP.RATIO	11.122	5.040***
OVHD.EXP.	0.004	5.980***
DEBT RATIO	-1.932	-2.080**
CONSTANT	-2.984	-1.800
R-Squared		0.254
Prob>F		0.000
Hausman		35.57***
Heterosk		1.56
Groups		11
Observations		91

Notes: *P < 0.1, **P < 0.05, ***P < 0.01

The empirical results as shown in Table 6.5 indicate a positive significant relationship between corporate social performance and future financial performance at the 0.05 level. The results are consistent with the results indicated by Model 1. In particular, capital ratio and overhead expenses have positive significant relation with the financial performance, while the debt ratio has negative significant correlation with the financial performance. These results reconcile with the theoretical arguments proposed by McGuire *et al.* (1988), suggesting that current socially responsible activities carried by firms might have long-term impact on the financial performance.

Therefore, the positive effect of corporate social performance on future financial performance may be due to the positive impact of CSR disclosure on banks' reputation. Consequently, banks that are more socially active may increase customers' loyalty and receive the support of wider range of stakeholders and in turn increase the financial performance. The positive significant empirical results may also indicate that investors take into consideration banks' CSR activities. Hence, by being more socially responsible banks can leverage new customers and more deposits, which will positively impact the banks financial performance in the long term.

6.4.3. RESULTS OF THE RELATIONSHIP BETWEEN FINANCIAL PERFORMANCE AND CSR DIMENSIONS

In the previous section, the impact of the aggregated score of CSR disclosure index on banks' financial performance is analysed, and some positive results are established.

A number of researchers (e.g. Mahoney and Roberts, 2007; Makni *et al.*, 2009; Mahoney and Thorne, 2005; Hillman and Keim, 2001; Backhaus *et al.*, 2002; Waddock and Graves, 1997; Griffin and Mahon, 1997) have stressed the importance of individual components of the total corporate social performance index while examining the impact of corporate social performance on financial performance, suggesting “that interesting and explanatory information is lost” when aggregate measure of corporate social performance is used (Johnson and Greening, 1999: 574).

In explaining this, the findings of Makni *et al.* (2009), which tested the relationship between corporate social and financial performance of publicly held Canadian firms and used the measures of corporate social performance from the Canadian Social Investment Database, indicated no statistically significant relationship between an aggregate measure of corporate social performance and financial performance. On the other hand, their empirical results indicated a significant relationship between individual dimensions of corporate social performance, such as environment and employee and financial performance, justifying why individual dimensions can be considered to be modelled. It should be noted that similar results are found by Mahoney and Roberts (2007), who tested the link between the corporate social performance and financial performance of Canadian firms during the period 1997-2000. Their findings also indicate a non-significant relationship between the combined measure of companies' corporate social performance and financial performance. Turning to the individual measures of CSR, Mahoney and Roberts (2007) reported that the environment measure and international activities measure of CSR significantly affect financial performance.

The importance of taking into consideration the individual measures of corporate social performance is also stressed by Fisman *et al.* (2005), who indicate the positive significant correlation between the community dimension of corporate social and financial performance in advertising-intensive industries.

Thus, since corporate social performance is multi-faceted, there is a need to look at

individual dimensions of corporate social performance as they might affect differently financial performance (Buckingham *et al.*, 2011: 13). This is also considered in this study.

Taking into account the previous research outcomes, this section highlights the multidimensional nature of corporate social performance and the need to disaggregate it to sub-dimensions in order to have an improved understanding of the investigated relationship. In this section, therefore, the impact of individual dimension variables of corporate social performance is empirically tested using a disclosure index for each of the following dimensions as separate variables: ‘mission and vision’, ‘board of directors’, ‘products’, ‘*zakah*’, ‘employees’, ‘debtors’, ‘community’, ‘*Shari’ah* supervisory board’. These results for presented in Chapter 5.

In the regression Model 3, the composite measure of corporate social performance is substituted with individual measure of corporate social performance. The results in Table 6.6 show no statistically significant relationship between the individual dimensions of corporate social performance and financial performance measure except for ‘mission and vision’. Therefore, the detailed regression results only with the dimension of ‘mission and vision’ are presented. Model 3 indicates the significant positive association between the individual dimension of ‘mission and vision’ and ROAA.

Table 6.6. Results of the Panel Data with Fixed Effects Regression Analysis Testing the Relationship between Financial Performance and Mission and Vision Score

	Model 3	
ROAA	Coef.	t-value
MISSION AND VISION	2.790	2.240**
SIZE	-0.211	-0.530
LOAN RATIO	3.555	1.290
CAPITAL RATIO	8.916	3.570***
OVERHEAD EXPENSES	0.005	6.250***
DEBT RATIO	-3.728	-2.470**
CONSTANT	-2.395	-2.240**
R-Squared		0.467
Prob>F		0.000
Groups		12
Observations		110

Notes: *P < 0.1, **P < 0.05, ***P < 0.01

In conclusion, the results of this research are consistent with the theoretical constructs of corporate social performance that predict a positive association between social and financial performance. Furthermore, the results of this study support the ‘good management’ hypothesis and instrumental stakeholder theory. The positive relationship between CSR disclosure and financial performance of Islamic banks supports the instrumental theory that assumes that applying stakeholder management will have a positive impact on corporate financial performance. In addition, the results support the ‘good management theory’, which suggests that keeping a good relationship with stakeholders would positively impact financial performance.

6.4.4. SENSITIVITY TESTS

In this section, in order to test the robustness of the empirical results of this study, two additional tests are conducted.

Firstly, ROAE is used as an alternative measure of profitability. Table 6.7 reports the regression results of the estimation Model 1 using ROAE as a dependent variable and the same regression procedure adopted in Model 1. As the results presented in Table 6.7, the results of fixed effects regression, estimating the relationship between CSR disclosure index and ROAE, report general consistency with the results obtained when employing ROAA as a financial performance measure. The CSR disclosure index is significant at $t = 2.40$, $p < 0.05$, overhead expenses are significant at $t = 4.74$, $p < 0.01$ and debt ratio is significant at $t = -2.46$, $p < 0.05$. These results are similar to the results obtained from the main regression model 1, where ROAA was used as a dependent variable. However, capital ratio does not indicate significant relationship with ROAE and another exception is the result of the CSR disclosure index variable, which is significant at $p < 0.05$. This variable showed a higher significance level $p < 0.001$ in the regression, where ROAA was used as the financial performance measure.

Secondly, in order to check for the potential endogeneity issue between corporate social performance and financial performance, the Durbin-Wu test is applied. In a statistical model, endogeneity might occur as a result of joint determination between independent (corporate social performance) and dependent (financial performance) variables, omitted variables and if there is a correlation between explanatory variables and the error term (Greene, 2003). The results in Table 6.7 indicate that the F - test is not

significant, thus, the null hypothesis of the Durbin-Wu test cannot be rejected. Hence, accepting the null hypothesis of the Durbin-Wu test confirms that endogeneity does not represent a problem (Gujarati, 2003) in this research.

Table 6.7. Panel Data with Fixed Effects Regression Analysis Testing the Relationship between Financial Performance (ROAE) and the CSR Disclosure Index

ROAE	Coef.	t-value
CSRD	14.856	2.40**
SIZE	0.548	0.320
LOAN RATIO	9.361	0.880
CAP.RATIO	5.706	1.370
OVHD.EXP.	0.022	4.74***
DEBT RATIO	-14.536	-2.46**
CONSTANT	-6.229	-1.95**
R-Squared		0.218
Prob>F		0
Hausman		18.06**
Heterosk		1.20
Durbin-Wu		0.80
Groups		12
Observations		110

Notes: *P < 0.1, **P < 0.05, ***P < 0.01

6.5. CONCLUSION

In conclusion, this study examines the relationship between CSR performance through the disclosure index and financial performance of Islamic banks in the GCC region and extends the previous research investigating this relationship. Thus, this study assesses the impact of CSR disclosures of GCC Islamic banks, employed as a social performance measure, on their financial performance.

The findings of this study indicate the significant positive relationship between social and financial performance of Islamic banks in the GCC countries. These results verify the set hypothesis and show that it is also in line with the discussed theoretical framework that predicts the positive link between corporate social and financial performance in the Islamic banking industry. Hence, it can be concluded that the higher the level of CSR disclosure, the better is the bank's profitability.

These results are supported by the findings of empirical model 2, which tested the impact of social performance on future financial performance and indicated a positive relationship. Thus, the results align with the theoretical arguments advocating that

current CSR activities carried by financial institutions could have a long-term impact on the financial performance (McGuire *et al.*, 1988). Consequently, the positive effect of corporate social performance on future financial performance may be explained by the positive impact of CSR disclosure on banks' reputation. Islamic banks, which ensured that CSR is practised extensively beyond charity, may increase the loyalty of customers and receive the support of a wider range of stakeholders and in turn, increase the financial performance. As CSR activities would provide legitimacy due to the fact that having Islamic banks conducting extensive CSR activities would be perceived as fulfilling the requirements of Islamic ethics and norms. The positive significant relationship between CSR disclosure and future financial performance may also indicate that investors take into consideration banks' CSR activities. Hence, by being more socially responsible banks can leverage new customers and more deposits, which will have a positive impact on banks' financial performance in the long-term.

Furthermore, the empirical results indicate a significant positive relationship between the composite measure of corporate social performance and financial performance. However, the findings of this study show no statistically significant relationship between the individual dimensions of corporate social performance and the corporate financial performance measure except for 'mission and vision'. The results of this study are consistent with instrumental stakeholder theory, 'social impact hypothesis' and the 'good management theory'.

CHAPTER SEVEN

CONCLUSION

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CONCLUSION

7.1. INTRODUCTION

This chapter aims to summarise the empirical findings and provide a discussion on the empirical results presented in chapter 5 and chapter 6 by highlighting the main points and establishing the research implications of the study. To reiterate, the first empirical investigation assessed the CSR disclosure practices, while the second analysed the impact of CSR disclosure on financial performance of Islamic banks in the GCC region.

This chapter also details the limitations of the research conducted as well as providing suggestions for future research. Hence, this chapter commences with a summary of results, followed by critical reflections on the findings and policy recommendations. Finally, the limitations of the research and suggestions for future research are identified.

7.2. SUMMARY OF THE RESULTS

This research aims at assessing how effectively Islamic banks in the GCC countries have endogenised CSR through analysing their CSR disclosure practice. In addition, this research also examines the impact of CSR disclosure practices on the financial performance of Islamic banks in the GCC region.

In the first empirical investigation, the difference between the ideals and realities of embracing CSR in the Islamic banking sector is analysed through scanning the annual reports of banks, using content analysis and constructing the CSR disclosure index. The dimensions and sub-dimensions of the CSR disclosure index are selected based on the Islamic finance framework and include eight main content categories: ‘mission and vision statement’; ‘board of directors and top management’; ‘products and services’; ‘commitment towards employees’; ‘commitment towards debtors’; ‘commitment towards society’; ‘*zakah*, charity and benevolent fund’ and ‘*Shari’ah* supervisory board’. Islamic banks are expected to be socially responsible and disclose the information related to their CSR activities to reflect accountability and justice to society as a part of their religious compliancy. Therefore, to emphasise their role in society, it is expected that Islamic banks should disclose more detailed information that reflects their socially-

responsible activities but at the same time respond to the expectations from Islamic ethical norms.

The findings of this research, however, do not produce encouraging results in terms of CSR or the social outcome of Islamic banks in the GCC region, as the overall scores for CSR disclosure indices for all the Islamic banks also remain comparatively low for each of the categories included in the indices. The study reveals that Islamic banks in GCC countries are reluctant to disclose a considerable amount of CSR information. In fact, the evidence shows that Qatar scored the maximum overall CSR disclosure index (0.44) while Saudi Arabia scored the minimum (0.26). Considering that full CSR disclosure compliancy, as a best practice, requires '1', 0.44 as the best result within the sample is rather disappointing. This means that 44 per cent of the required information for the CSR disclosure has been disclosed in the case of Qatar and only 26 per cent for Saudi Arabia. The overall mean of CSR disclosure level for the remaining three countries varies between 0.35 and 0.42, which also indicates a large disparity between the 'real' or revealed and 'ideal' CSR disclosure degree. The second rank is obtained by Kuwait (0.42), while Bahrain (0.41) and UAE (0.31) were ranked the third and fourth relatively.

In the overall ranking, in a similar manner, GCC Islamic banks show little incentive to disclose CSR-related information. The dimension 'commitments to debtors' became the first priority among the five GCC countries followed by 'mission and vision statement', 'community', 'board of directors', and 'employee' dimension. The least importance was given to the three following dimensions: '*Shari'ah* Supervisory Board', '*zakah*, charity and benevolent loans' and 'products and services'. Taking into consideration that these two former dimensions are rather particular for Islamic banking, having the minimum score causes a great deal of worry which suggests that the Islamic finance industry should ponder upon the relation to their Islamic ethical legitimacy.

In short, despite the high expectations of full disclosure and accountability, the results indicate that the majority of GCC Islamic banks disclose significantly less than required. The underperformance in the CSR disclosure practices of GCC Islamic banks might come as a result of insufficient transparency and accountability. Therefore, Islamic banks in the GCC countries are required to make their CSR objectives more explicit and to further integrate social dimensions into their system, which will assist in human empowerment in their societies. Hence, there is an urgent need for the social and moral

dimensions of Islamic moral economy to be articulated and integrated in Islamic finance practice.

The second investigation carried out by this research examines the impact of CSR disclosure practices on financial performance of Islamic banks in the GCC countries. In this study, the CSR disclosure index constructed in the first empirical study is employed as a social performance measure, ROAA is used as a financial performance measure and banks' size, risk, overhead expenses, capital ratio and loan ratio are used in this model as control variables as they have been seen as the most important factors for the corporate social and financial performance relationship.

After reviewing the theoretical background of the link between social and financial performance, based on the arguments of 'instrumental stakeholder theory' and 'good management theory', which suggest the positive relationship between corporate social and financial performance, it is hypothesised that social performance positively affects financial performance (model 1). Furthermore, the impact of social performance on the future financial performance is also examined (model 2). This relationship is worthy of examination in order to evaluate the robustness of the main model.

The empirical evidence indicates a significant positive relationship between social and financial performance of Islamic banks in the GCC countries. These results are in line with the set hypothesis and discussed theoretical framework that predict a positive link between corporate social and financial performance in the Islamic banking industry. Therefore, it can be said that banks with a high level of CSR disclosure have the better profitability.

The results also indicate the positive correlation between social performance and future financial performance and support the main findings of the second investigation. Thus, the results align with the theoretical arguments, advocating that current CSR activities carried by financial institutions could have long-term impact on the financial performance (McGuire *et al.*, 1988). Consequently, the positive effect of corporate social performance on future financial performance may be explained by the positive impact of CSR disclosure on banks' reputation. This implies that Islamic banks that illustrate a high transparency in their CSR disclosure practices may attract new customers alongside improving the loyalty of existing ones and therefore, increasing

financial performance. The positive correlation between CSR disclosure and future financial performance could be also explained by saying that investors consider bank's CSR activities in their decision-making process. Thus, CSR-active Islamic banks have an advantage compared to Islamic banks that have less CSR initiative, as they can attract new customers and more deposits that will positively affect financial performance in the long term.

The findings of this study show the significant positive relationship between the aggregated measure of corporate social performance and financial performance. In order to have a better understanding of the investigated relationship, the impact of individual dimension variables of CSR disclosure index on financial performance is examined. The empirical results, however, indicate a significant positive correlation only between the dimension 'mission and vision' and financial performance. The rest of the CSR dimensions do not show any significant relations to financial performance.

Overall, the results of this study are consistent with 'instrumental stakeholder theory', 'social impact hypothesis' and the 'good management theory'.

7.3. CRITICAL REFLECTIONS ON THE FINDINGS

As the findings on the CSR performance index through disclosure indicate, the sampled GCC Islamic banks did not perform well. Considering that CSR is essentialised as the foundational aspect of ethical norms of Islam in banking and finance, finding such results is terribly discouraging.

A possible explanation of the results could be related to the fact CSR activities of Islamic banks are rather limited as identified in other researches, which suggests that the problem is perhaps structural rather than corporate governance issue.

Secondly, and most importantly, the 'nature of giving' in Islam should be considered in reflecting on the results. Islamic ethics do not encourage on the contrary, would discourage, anyone from revealing their socially-responsible activities and social giving, as such a revelation is considered against the dignity of those who receive. This perhaps can be used as a goodwill-oriented explanation on the desperate level of CSR disclosure scores established by this study in GCC Islamic banking. Therefore, it can perhaps be assumed that the GCC Islamic banks do perform CSR activities, but due to Islamic

ethicality they shun away from disclosing them. Thus, Islamic ethicality may have implications on the low disclosure. However, considering that transparency as part of governance system is justified through *fiqh* and therefore endogenised by the available standards, Islamic banks may not be able to use such an excuse to hide their social failure.

Thirdly, political economy of corporate governance issues should be discussed in each individual country, as the regulations in the GCC countries mostly do not have any expectations in terms of disclosing much information. Under such circumstances, the companies including Islamic banks would not voluntarily disclose information. Thus, the corporate governance nature of the GCC countries in relation to transparency and disclosure should critically be discussed.

Furthermore, the *fiqhi* approach may indicate that since Islamic banks, as only a legal entity, are not expected to contribute to the social good by definition. This resembles the case of *zakah*, the Islamic banks, as firms having the legal entity are not expected to pay *zakah* out of their profit or wealth. It is argued by the same token that conducting CSR activities and working towards social wellbeing is considered as a source of an individual act, and consequently, a corporation cannot gain the grace of God. Therefore, it is argued by this *fiqhi* approach Islamic banks should not contribute to the social good nor should they deliver social responsibility, as they are not ‘real persons’. However, as explained in Chapter 3, Islamic moral economy relates to substance rather than form-based understanding.

In conclusion, in critically evaluating the empirical findings established by this study, these factors should also be considered in relation to CSR performance of Islamic banks rather than immediately concluding that they are not doing enough. Therefore, perhaps substantiating the results, it is essential to observe the operations and explore the views of the Islamic bank managers in terms of their social responsibility oriented activism that will be essential to reach a conclusive result.

7.4. THEORETICAL CONSIDERATIONS

The theoretical issues are discussed in Chapter 2 and Chapter 3, and the latter chapter presented the existing theoretical frameworks in explaining the rationale for CSR in Islamic worldview.

According to the research findings, the practical implications of CSR in the GCC Islamic banks seem to be consistent with the theoretical conception of CSR in Islamic finance proposed by Ismail (1986), who perceives and theorise Islamic banks as a part of the commercial sector of the economy and suggests that socially-oriented financial activities should be carried out by the third or non-profitable sector. The empirical results of this study show that Islamic banks conduct their operations in accordance with Islamic financial principles, however mainly fulfil the interests of their shareholders and depositors. Consequently, social objectives are not placed on the top of Islamic banks agenda.

The low levels of CSR disclosure performances of the surveyed Islamic banks indicate that they do not balance profit-oriented activities with morally and socially motivated objectives as suggested by Chapra's (1985) model of CSR. The findings show that philanthropic activities are not accepted by Islamic banks, as an integral CSR policy. Thus, the GCC Islamic banks do not play a pro-actively significant role in the community development nor do they seem to support a developmentalist agenda as indicated by Islamic moral economy.

Furthermore, the results of this study do not align with the Dusuki's (2008a) view of CSR, where Islamic banks should be socially-active as a part of their religious obligation. According to this model, Islamic banks ideally should not only focus on profit generation activities, as they are expected to acknowledge and emphasise on the importance of ethical, social and moral dimensions in their agenda.

However, the research findings show the positive impact of CSR disclosure practices on the financial performances of Islamic banks. These findings reflect that CSR activities should be embedded in the agendas of Islamic banks as this would result in mutual benefit of society and banks.

It is important to note that this theoretical reflections should be considered within the critical reflections provided in the previous section, as Islamic banks may have involved pro-actively in CSR but they may not communicate such activities due to a number of reasons as presented above. Having said that it is also a fact that the survey questionnaire based results as presented in Chapter 3 do not provide confidence in the oral communication either.

7.5. POLICY IMPLICATIONS AND RECOMMENDATIONS

This study demonstrated how effectively CSR activities have been embedded in the agendas of GCC Islamic banks through analysing their CSR disclosure practices, which are expected to demonstrate a high level of disclosure and transparency based on the Islamic finance principles that highlight the moral and social aspects of business activities. This study, however, indicates that the majority of Islamic banks, despite the high expectations of full CSR disclosure, reveal significantly less than a satisfactory level. It seems that the priority is given to the information related to their financial obligations towards their shareholders rather than to interests of a wider range of stakeholders. This research confirms the results of the previous studies which showed evidence that CSR disclosure practices of Islamic banks lack the essential information.

The major strength of this study is its practical implications and its usefulness in providing evidence of the Islamic banks' practices of CSR disclosure in the case of GCC countries and the impact of CSR disclosure on financial performance of Islamic banks.

The research results can benefit the Islamic banking industry through the following implications:

(i) *Restructuring Business Strategy of Islamic Banks in Relation to CSR Practices:*

In order to integrate the social dimension of Islamic moral economy into Islamic banks' business strategy, it is important to make CSR objectives more explicit through reconsidering Islamic banks' approach towards the CSR activities, including banks' mission and vision statements, boards of directors, products and services, *zakah*, charity and benevolent funds, commitments towards community, employees and debtors and *Shari'ah* Supervisory Board. Since Islamic banks are obliged to operate according to the objectives of Islamic law, it is essential for them to place CSR-related policies at the top of their business agenda. It should be noted that without embedding the social dimensions in their business strategy, these institutions cannot be regarded as *Shari'ah*-compliant, which will negatively affect the concept of the Islamic banking industry as a whole.

(ii) *The Role of Shari'ah Supervisory Board in Assuring the Moral Expectations of Stakeholders:*

Islamic banks by their distinct nature have to appoint a supervisory board of *Shari'ah* scholars to review the financial transactions of banks to ensure their compliancy with the principles of Islamic law. A full authority is required to be given to the *Shari'ah* Supervisory Board to review and certify that financial products and services are in line with the Islamic finance principles. This implies that the *Shari'ah* board needs to have the power to intervene in the bank's management decisions to take specific actions to prevent and correct the bank's direction when necessary. On the other hand, the *Shari'ah* Supervisory Board should ensure the transparency and disclosure of its actions to the public. In doing so, Islamic banks will highlight their social behaviour which in turn will improve their reputation and increase the loyalty of the existing customers and attract new investors as a result of high public trust in Islamic banks.

(iii) *Fulfilling Good Stakeholder Management:*

Maintaining a good CSR policy would increase the capability of Islamic banks to cope with possible reputation-damaging events and the external negative news they may receive in the future and thus protect their profits and financial results. Therefore, by having a comprehensive socially-responsible agenda could assist Islamic banks in generating valuable goodwill that will safeguard them from unexpected challenges and give an access to new projects that are not available for companies with less CSR incentive. Thus, good stakeholder management leads to competitive advantage that will have a positive simultaneous impact on business and society.

In addition, this research provides the following recommendation for the regulators and policy makers:

(iv) *Standardisation of Financial and Annual Reports of Islamic Banks:*

There is an urgent need of standardising and unifying the financial and annual reports of Islamic banks. In this respect, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) released *Governance Standard No. 7: Corporate Social Responsibility, Conduct and Disclosure for IFIs*, that deals with guidelines for CSR. However, these standards are not obligatory for all GCC countries, except Bahrain. This

voluntarily adherence to AAOIFI standards can be one of the main reasons of the low social performance of Islamic banks. Hence, it is vital to implement such standards as a mandatory policy to enter into the Islamic banking industry. Applying such CSR regulations would enhance their social performance and result in a higher level of CSR disclosure. Consequently, having more stringent CSR policies would increase Islamic banks' contribution towards social welfare that will result in meeting the objectives of Islamic banks' existence.

7.6. LIMITATIONS AND FUTURE RESEARCH

The discussions on CSR disclosure and its impact on financial performance of Islamic banks represent a relatively new field of study within the Islamic finance literature and offers ample scope for future research. It should be noted, however, that this research still has some limitations. The limited access to data is considered as one of the main limitation in generalising the research findings.

Furthermore, constructing the CSR disclosure index may suffer from subjectivity and bias. Applying an equal weight method to scoring the dimensions and sub-dimensions of CSR to calculate the composite measure of CSR disclosure index is subjected to a doubt of obtaining unbiased results. However, assuming that each and every dimension is equally important to all stakeholders can be an appropriate justification to follow such an approach. Furthermore, such an approach is applied since the research does not focus on a particular interest of a group of stakeholders but considers interests of all stakeholders.

Moreover, the researcher was not able to interview *Shari'ah* scholars sitting in the boards of GCC Islamic banks to obtain their opinions on CSR practices and their role in encouraging Islamic banks to be more socially-active, due to the difficulties in approaching them.

Despite these limitations, the empirical evidence of this research provides the following recommendations for future research. In constructing the CSR disclosure index, other aspects can be considered, such as environmental disclosure, interviewing *Shari'ah* scholars to improve the robustness of the index.

Other recommendation would be to examine the association between CSR practices and

banking regulations, such as the restrictions on banking activities, the power of official supervisory agencies in the banking sector and entry to banking standards.

Another recommendation can be related to examining the relationship between CSR practices and the reputation of Islamic banks, which is a critical issue that needs to be evaluated. Moreover, the impact of CSR practices on risk exposures in the Islamic banking sector can be another dynamic topic that needs to be explored to assess whether the promotion of CSR practices has a positive influence in enhancing the banks' position from the customers' perspective and hence, enhance their trust in the banking sector. In turn, this will positively prevent some critical potential risks that banks may face, such as a bank run that occurs when depositors panic and withdraw their funds simultaneously at an inconvenient time.

7.7. EPILOGUE

To conclude, this research aimed at evaluating the CSR disclosure practices of Islamic banks in the case of the GCC region and also examined the impact of CSR disclosure practices on banks' financial performance. Despite the empirical evidence of this research that indicated the low level of CSR disclosure, Islamic banks play a significant role in terms of pooling funds and they have been demonstrated to deliver desired valuable services that balance the needs of consumers and producers. However, in order to enhance the social potential of Islamic banks the social dimension should be integrated into the business strategies of Islamic banks to reduce the gaps between the realities of Islamic banking and the aspirations of the objectives of Islamic law.

Overall, as the foundational chapters and the empirical chapters demonstrate, this research has fulfilled its aims and objectives set in the beginning of the research. The research also demonstrates that it has been systematically and scientifically conducted in a structured manner.

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Appendix I. Table 5.4. CSR Disclosure Index of Bahrain (I)

BAHRAIN	ABC ISLAMIC								AL AMIN			AL BARAKA					
Year	2004	2005	2006	2007	2008	2009	2010	2011	2001	2002	2003	2006	2007	2008	2009	2010	2011
Mission and Vision Statements	0.40	0.40	0.60	0.60	0.60	0.60	0.60	0.60	0.50	0.40	0.40	0.70	0.80	0.80	0.80	0.80	0.70
Yearly Average	0.55								0.43			0.77					
Ranking (based on Yearly Avg)	(7)								(8)			(1)					
BOD and Top Management	0.29	0.29	0.29	0.29	0.64	0.64	0.64	0.71	0.00	0.00	0.00	0.50	0.64	0.86	0.93	0.93	0.93
Yearly Average	0.47								0.00			0.80					
Ranking (based on Yearly Avg)	(5)								(9)			(2)					
Products and Services	0.00	0.20	0.20	0.30	0.30	0.00	0.20	0.00	0.00	0.00	0.00	0.10	0.30	0.30	0.30	0.30	0.30
Yearly Average	0.15								0.00			0.27					
Ranking (based on Yearly Avg)	(6)								(8)			(3)					
Zakah, Charity and Benevolent Loan	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.13	0.13	0.40	0.27	0.40	0.40	0.27	0.27	0.27
Yearly Average	0.53								0.22			0.31					
Ranking (based on Yearly Avg)	(2)								(5)			(4)					
Employee	0.00	0.10	0.10	0.20	0.30	0.30	0.30	0.40	0.00	0.00	0.00	0.20	0.50	0.70	0.70	0.70	0.50
Yearly Average	0.21								0.00			0.55					
Ranking (based on Yearly Avg)	(7)								(9)			(3)					
Debtors	0.20	0.40	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.40	0.60	0.60	0.60	0.80	0.60	0.20
Yearly Average	0.53								0.53			0.57					
Ranking (based on Yearly Avg)	(3)								(3)			(2)					
Community	0.17	0.17	0.17	0.17	0.17	0.17	0.17	0.17	0.00	0.17	0.17	0.17	0.17	0.83	0.33	0.33	0.50
Yearly Average	0.17								0.11			0.36					
Ranking (based on Yearly Avg)	(7)								(8)			(5)					
Shari'ah Supervisory Board	0.55	0.45	0.45	0.55	0.64	0.73	0.73	0.64	0.00	0.00	0.00	0.36	0.45	0.45	0.45	0.55	0.55
Yearly Average	0.59								0.00			0.47					
Ranking (based on Yearly Avg)	(1)								(7)			(2)					
Yearly Average (Individual)	0.27	0.32	0.37	0.4	0.47	0.45	0.47	0.46	0.15	0.16	0.17	0.36	0.48	0.62	0.57	0.56	0.49

Data Source: Annual reports of the examined banks during the period 2000-2011

Table 5.4. CSR Disclosure Index of Bahrain (II)

BAHRAIN	ARCAPITA											BAHRAIN ISLAMIC						ITHMAAR	
	2000	2001	2002	2003	2004	2005	2007	2008	2009	2010	2011	2002	2003	2006	2008	2009	2010	2010	2011
Mission and Vision Statements	0.70	0.70	0.70	0.60	0.60	0.60	0.70	0.90	0.90	0.60	0.80	0.80	0.80	0.20	0.80	0.40	0.50	0.50	0.70
Yearly Average	0.71											0.58						0.60	
Ranking (based on Yearly Avg)	(2)											(6)						(5)	
BOD and Top Management	0.71	0.64	0.64	0.64	0.64	0.57	0.57	0.57	0.64	0.64	0.64	0.50	0.43	0.07	0.64	0.07	0.71	0.93	0.93
Yearly Average	0.63											0.40						0.93	
Ranking (based on Yearly Avg)	(3)											(8)						(1)	
Products and Services	0.20	0.30	0.30	0.20	0.10	0.20	0.20	0.20	0.10	0.20	0.20	0.30	0.20	0.00	0.40	0.30	0.30	0.10	0.20
Yearly Average	0.20											0.25						0.15	
Ranking (based on Yearly Avg)	(5)											(6)						(7)	
Zakah, Charity and Benevolent Loan	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.73	0.73	0.73	0.73	0.67	0.73	0.07	0.13
Yearly Average	0.20											0.72						0.10	
Ranking (based on Yearly Avg)	(6)											(1)						(8)	
Employee	0.20	0.20	0.20	0.20	0.20	0.30	0.40	0.20	0.40	0.40	0.40	0.50	0.30	0.00	0.60	0.10	0.40	0.80	0.90
Yearly Average	0.28											0.32						0.85	
Ranking (based on Yearly Avg)	(6)											(5)						(1)	
Debtors	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
Yearly Average	0.60											0.60						0.60	
Ranking (based on Yearly Avg)	(1)											(1)						(1)	
Community	0.17	0.17	0.17	0.17	0.17	0.33	0.33	0.33	0.33	0.17	0.33	0.50	0.50	0.17	0.33	0.33	0.33	0.83	0.83
Yearly Average	0.24											0.36						0.83	
Ranking (based on Yearly Avg)	(6)											(5)						(1)	
Shari'ah Supervisory Board	0.45	0.45	0.36	0.36	0.45	0.45	0.36	0.36	0.55	0.55	0.55	0.64	0.64	0.09	0.64	0.09	0.73	0.45	0.45
Yearly Average	0.45											0.47						0.45	
Ranking (based on Yearly Avg)	(3)											(2)						(3)	
Yearly Average (Individual)	0.40	0.41	0.40	0.37	0.37	0.41	0.42	0.42	0.47	0.42	0.47	0.57	0.52	0.23	0.59	0.32	0.54	0.54	0.59

Data Source: Annual reports of the examined banks during the period 2000-2011

Table 5.4. CSR Disclosure Index of Bahrain (III)

BAHRAIN	KHALEEJI COMMERCIAL							KUWAIT FINANCE HOUSE								SHAMIL			CSR INDEX
Year	2005	2006	2007	2008	2009	2010	2011	2003	2004	2005	2006	2007	2008	2009	2010	2002	2003	2007	
Mission and Vision Statements	0.20	0.60	0.80	0.80	0.70	0.70	0.70	0.60	0.60	0.60	0.80	0.80	0.70	0.70	0.60	0.80	0.80	0.70	0.65
Yearly Average	0.64							0.68								0.77			0.64
Ranking (based on Yearly Avg)	(4)							(3)								(1)			
BOD and Top Management	0.07	0.50	0.57	0.79	0.86	0.79	0.93	0.43	0.14	0.29	0.50	0.57	0.57	0.57	0.57	0.21	0.43	0.71	0.53
Yearly Average	0.64							0.46								0.45			0.53
Ranking (based on Yearly Avg)	(4)							(6)								(7)			
Products and Services	0.00	0.30	0.20	0.30	0.20	0.30	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.20	0.30	0.30	0.30	0.21
Yearly Average	0.21							0.29								0.30			0.20
Ranking (based on Yearly Avg)	(4)							(2)								(1)			
Zakah, Charity and Benevolent Loan	0.20	0.07	0.53	0.53	0.33	0.53	0.53	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.33	0.33	0.27	0.33
Yearly Average	0.39							0.13								0.31			0.32
Ranking (based on Yearly Avg)	(3)							(7)								(4)			
Employee	0.00	0.10	0.40	0.60	0.50	0.70	0.60	0.00	0.00	0.00	0.00	0.00	0.10	0.20	0.10	0.60	0.60	0.80	0.31
Yearly Average	0.41							0.05								0.67			0.37
Ranking (based on Yearly Avg)	(4)							(8)								(2)			
Debtors	0.20	0.20	0.40	0.80	1.00	0.80	0.80	0.60	0.20	0.00	0.40	0.40	0.80	0.60	0.20	0.60	0.60	0.40	0.51
Yearly Average	0.60							0.40								0.53			0.55
Ranking (based on Yearly Avg)	(1)							(4)								(3)			
Community	0.17	0.67	0.33	0.33	0.67	0.83	0.83	0.17	0.17	0.67	0.50	0.83	0.67	0.33	0.50	0.33	0.67	0.83	0.37
Yearly Average	0.55							0.48								0.61			0.41
Ranking (based on Yearly Avg)	(3)							(4)								(2)			
Shari'ah Supervisory Board	0.09	0.27	0.27	0.27	0.27	0.27	0.27	0.27	0.27	0.27	0.27	0.27	0.27	0.27	0.45	0.27	0.27	0.18	0.39
Yearly Average	0.25							0.30								0.24			0.36
Ranking (based on Yearly Avg)	(5)							(4)								(6)			

Data Source: Annual reports of the examined banks during the period 2000-2011

Table 5.5. CSR Disclosure Index of Qatar

QATAR	MASRAF AL RAYAN				QATAR INT. ISLAMIC	QATAR ISLAMIC		CSR INDEX
	2007	2008	2009	2010		2009	2010	
Mission and Vision Statements	0.60	0.40	0.80	0.70	0.60	0.70	0.70	0.64
Yearly Average	0.63				0.60	0.70		0.64
Ranking (based on Yearly Avg)	(2)				(3)	(1)		
BOD and Top Management	0.07	0.07	0.43	0.43	0.43	0.57	0.71	0.39
Yearly Average	0.25				0.43	0.64		0.44
Ranking (based on Yearly Avg)	(3)				(2)	(1)		
Products and Services	0.00	0.00	0.20	0.30	0.00	0.30	0.30	0.16
Yearly Average	0.13				0.00	0.30		0.14
Ranking (based on Yearly Avg)	(2)				(3)	(1)		
Zakah, Charity and Benevolent Loan	0.07	0.07	0.07	0.13	0.07	0.27	0.40	0.15
Yearly Average	0.08				0.07	0.33		0.16
Ranking (based on Yearly Avg)	(2)				(3)	(1)		
Employee	0.30	0.30	0.70	0.80	0.30	0.60	0.60	0.51
Yearly Average	0.53				0.30	0.60		0.48
Ranking (based on Yearly Avg)	(2)				(3)	(1)		
Debtors	0.60	0.60	0.80	0.80	0.60	0.80	0.80	0.71
Yearly Average	0.70				0.60	0.80		0.70
Ranking (based on Yearly Avg)	(2)				(3)	(1)		
Community	0.43	0.57	0.71	0.57	0.43	1.00	1.00	0.67
Yearly Average	0.57				0.43	1.00		0.67
Ranking (based on Yearly Avg)	(2)				(3)	(1)		
Shari'ah Supervisory Board	0.27	0.27	0.27	0.27	0.45	0.27	0.27	0.30
Yearly Average	0.27				0.45	0.27		0.33
Ranking (based on Yearly Avg)	(2)				(1)	(2)		
Yearly Average (Individual)	0.29	0.29	0.50	0.50	0.36	0.56	0.60	0.44

Data Source: Annual reports of the examined banks during the period 2000-2011

Table 5.6. CSR Disclosure Index of Saudi Arabia (I)

SAUDI ARABIA	ALINMA		AL RAJHI									
	2009	2010	2000	2001	2002	2003	2004	2006	2008	2009	2010	2011
Mission and Vision Statements	0.50	0.50	0.30	0.30	0.30	0.30	0.00	0.20	0.20	0.20	0.30	0.40
Yearly Average	0.50		0.25									
Ranking (based on Yearly Avg)	(1)		(3)									
BOD and Top Management	0.43	0.43	0.21	0.14	0.29	0.29	0.07	0.29	0.36	0.36	0.43	0.43
Yearly Average	0.43		0.29									
Ranking (based on Yearly Avg)	(2)		(3)									
Products and Services	0.30	0.30	0.10	0.20	0.20	0.20	0.00	0.30	0.30	0.30	0.30	0.30
Yearly Average	0.30		0.22									
Ranking (based on Yearly Avg)	(1)		(2)									
Zakah, Charity and Benevolent Loan	0.20	0.20	0.20	0.27	0.27	0.27	0.27	0.27	0.27	0.2	0.27	0.27
Yearly Average	0.13		0.25									
Ranking (based on Yearly Avg)	(3)		(1)									
Employee	0.30	0.30	0.30	0.40	0.40	0.40	0.10	0.40	0.70	0.50	0.50	0.80
Yearly Average	0.30		0.45									
Ranking (based on Yearly Avg)	(3)		(1)									
Debtors	0.40	0.60	0.20	0.20	0.40	0.40	0.20	0.40	0.60	0.80	0.80	0.80
Yearly Average	0.50		0.48									
Ranking (based on Yearly Avg)	(2)		(3)									
Community	0.43	0.43	0.29	0.14	0.29	0.29	0.14	1	0.71	0.57	0.43	0.43
Yearly Average	0.43		0.43									
Ranking (based on Yearly Avg)	(1)		(1)									
Shari'ah Supervisory Board	0.09	0.09	0.00	0.00	0.00	0.00	0.00	0.09	0.18	0.18	0.18	0.18
Yearly Average	0.09		0.08									
Ranking (based on Yearly Avg)	(2)		(3)									
Yearly Average (Individual)	0.33	0.36	0.20	0.21	0.27	0.27	0.10	0.37	0.41	0.39	0.40	0.45

Data Source: Annual reports of the examined banks during the period 2000-2011

Table 5.6. CSR Disclosure Index of Saudi Arabia (II)

SAUDI ARABIA	AL JAZIRA							AL BILAD						CSR INDEX
	2000	2001	2002	2003	2008	2009	2010	2006	2007	2008	2009	2010	2011	
Mission and Vision Statements	0.40	0.40	0.00	0.00	0.40	0.40	0.40	0.00	0.00	0.00	0.00	0.00	0.00	0.22
Yearly Average	0.29							0.00						0.26
Ranking (based on Yearly Avg)	(2)							(4)						
BOD and Top Management	0.57	0.57	0.07	0.07	0.79	0.79	0.79	0.07	0.07	0.00	0.00	0.00	0.07	0.30
Yearly Average	0.52							0.04						0.32
Ranking (based on Yearly Avg)	(1)							(4)						
Products and Services	0.30	0.30	0.00	0.00	0.30	0.20	0.20	0.10	0.10	0.10	0.10	0.10	0.10	0.19
Yearly Average	0.19							0.10						0.20
Ranking (based on Yearly Avg)	(3)							(4)						
Zakah, Charity and Benevolent Loan	0.07	0.07	0.07	0.20	0.33	0.13	0.33	0.13	0.13	0.13	0.13	0.13	0.13	0.20
Yearly Average	0.17							0.13						0.17
Ranking (based on Yearly Avg)	(2)							(3)						
Employee	0.40	0.50	0.10	0.10	0.30	0.40	0.50	0.10	0.10	0.10	0.10	0.20	0.20	0.33
Yearly Average	0.33							0.13						0.30
Ranking (based on Yearly Avg)	(2)							(4)						
Debtors	0.60	0.60	0.40	0.40	0.80	0.80	0.80	0.60	0.40	0.60	0.20	0.60	0.60	0.53
Yearly Average	0.63							0.50						0.53
Ranking (based on Yearly Avg)	(1)							(2)						
Community	0.43	0.29	0	0	1	0.57	0.57	0.00	0.00	0.00	0.00	0.14	0.14	0.33
Yearly Average	0.41							0.05						0.33
Ranking (based on Yearly Avg)	(2)							(3)						
Shari'ah Supervisory Board	0.18	0.18	0	0	0.18	0.36	0.45	0.00	0.00	0.00	0.00	0.00	0.00	0.09
Yearly Average	0.19							0.00						0.09
Ranking (based on Yearly Avg)	(1)							(4)						
Yearly Average (Individual)	0.37	0.36	0.08	0.10	0.51	0.46	0.51	0.13	0.10	0.12	0.07	0.15	0.16	0.27

Data Source: Annual reports of the examined banks during the period 2000-2011

TABLE 5.7. CSR Disclosure Index of United Arab Emirates (I)

UNITED ARAB EMIRATES	ABU DHABI ISLAMIC										AL HILAL	DUBAI ISLAMIC		
	2000	2001	2002	2003	2004	2005	2006	2008	2009	2010	2010	2003	2004	2009
Mission and Vision Statements	0.50	0.70	0.60	0.80	0.10	0.20	0.10	0.70	0.50	0.50	0.70	0.30	0.20	0.20
Yearly Average	0.47										0.70	0.23		
Ranking (based on Yearly Avg)	(3)										(1)	(4)		
BOD and Top Management	0.21	0.21	0.21	0.21	0.07	0.21	0.21	0.36	0.64	0.79	0.43	0.07	0.07	0.07
Yearly Average	0.31										0.43	0.07		
Ranking (based on Yearly Avg)	(3)										(1)	(5)		
Products and Services	0.30	0.60	0.60	0.40	0.20	0.10	0.30	0.40	0.30	0.40	0.30	0.30	0.30	0.10
Yearly Average	0.36										0.30	0.23		
Ranking (based on Yearly Avg)	(1)										(3)	(4)		
Zakah, Charity and Benevolent Loan	0.20	0.20	0.27	0.27	0.20	0.27	0.20	0.20	0.27	0.27	0.07	0.60	0.60	0.20
Yearly Average	0.23										0.07	0.47		
Ranking (based on Yearly Avg)	(4)										(5)	(1)		
Employee	0.40	0.30	0.30	0.30	0.30	0.10	0.30	0.50	0.50	0.40	0.70	0.10	0.40	0.10
Yearly Average	0.34										0.70	0.20		
Ranking (based on Yearly Avg)	(3)										(1)	(4)		
Debtors	0.60	0.80	0.80	0.80	0.80	0.80	0.80	0.60	0.80	0.80	0.60	0.60	0.60	0.80
Yearly Average	0.76										0.60	0.67		
Ranking (based on Yearly Avg)	(2)										(4)	(3)		
Community	0.00	0.29	0.43	0.71	0.29	0.43	0.57	0.71	0.57	0.71	0.57	0.57	0.43	0.14
Yearly Average	0.47										0.57	0.38		
Ranking (based on Yearly Avg)	(3)										(1)	(4)		
Shari'ah Supervisory Board	0.36	0.36	0.36	0.36	0.36	0.36	0.36	0.36	0.36	0.36	0.09	0.27	0.27	0.18
Yearly Average	0.36										0.09	0.24		
Ranking (based on Yearly Avg)	(1)										(4)	(2)		
Yearly Average (Individual)	0.32	0.43	0.45	0.48	0.29	0.31	0.36	0.48	0.49	0.53	0.43	0.35	0.36	0.22

Data Source: Annual reports of the examined banks during the period 2000-2011

TABLE 5.7. CSR Disclosure Index of United Arab Emirates (II)

UNITED ARAB EMIRATES	SHARJAH ISLAMIC					EMIRATES ISLAMIC						CSR INDEX
Year	2006	2007	2008	2009	2010	2005	2006	2007	2008	2009	2010	
Mission and Vision Statements	0.00	0.00	0.00	0.00	0.00	0.20	0.60	0.80	0.70	0.60	0.60	0.38
Yearly Average	0.00					0.58						0.40
Ranking (based on Yearly Avg)	(5)					(2)						
BOD and Top Management	0.21	0.21	0.21	0.21	0.21	0.21	0.50	0.50	0.50	0.07	0.64	0.29
Yearly Average	0.21					0.40						0.29
Ranking (based on Yearly Avg)	(4)					(2)						
Products and Services	0.10	0.10	0.10	0.10	0.10	0.30	0.40	0.40	0.40	0.30	0.10	0.28
Yearly Average	0.10					0.32						0.26
Ranking (based on Yearly Avg)	(5)					(2)						
Zakah, Charity and Benevolent Loan	0.20	0.27	0.27	0.27	0.27	0.27	0.40	0.40	0.33	0.33	0.33	0.29
Yearly Average	0.25					0.34						0.27
Ranking (based on Yearly Avg)	(3)					(2)						
Employee	0.00	0.00	0.00	0.00	0.00	0.20	0.30	0.50	0.40	0.40	0.30	0.27
Yearly Average	0.00					0.35						0.32
Ranking (based on Yearly Avg)	(5)					(2)						
Debtors	0.60	0.60	0.60	0.60	0.60	0.80	0.80	0.80	0.80	0.80	0.60	0.69
Yearly Average	0.60					0.77						0.68
Ranking (based on Yearly Avg)	(4)					(1)						
Community	0.00	0.00	0.00	0.00	0.00	0.29	0.57	0.71	0.57	0.57	0.29	0.38
Yearly Average	0.00					0.50						0.38
Ranking (based on Yearly Avg)	(5)					(2)						
Shari'ah Supervisory Board	0.00	0.00	0.00	0.00	0.00	0.18	0.18	0.18	0.27	0.18	0.27	0.23
Yearly Average	0.00					0.21						0.18
Ranking (based on Yearly Avg)	(5)					(3)						
Yearly Average (Individual)	0.14	0.15	0.15	0.15	0.15	0.31	0.47	0.54	0.50	0.41	0.39	0.35

Data Source: Annual reports of the examined banks during the period 2000-2011

TABLE 5.8. CSR Disclosure Index of Kuwait (I)

KUWAIT	BOUBYAN BANK							KUW. INTERNTNL			
	2005	2006	2007	2008	2009	2010	2011	2007	2008	2009	2010
Mission and Vision Statements	0.40	0.60	0.60	0.40	0.40	0.70	0.60	0.60	0.30	0.50	0.20
Yearly Average	0.53							0.4			
Ranking (based on Yearly Avg)	(1)							(2)			
BOD and Top Management	0.36	0.36	0.36	0.43	0.36	0.43	0.43	0.43	0.43	0.43	0.07
Yearly Average	0.39							0.34			
Ranking (based on Yearly Avg)	(2)							(3)			
Products and Services	0.30	0.40	0.40	0.30	0.30	0.20	0.40	0.30	0.30	0.20	0.10
Yearly Average	0.33							0.23			
Ranking (based on Yearly Avg)	(2)							(3)			
Zakah, Charity and Benevolent Loan	0.13	0.2	0.2	0.2	0.13	0.13	0.13	0.13	0.13	0.00	0.13
Yearly Average	0.16							0.1			
Ranking (based on Yearly Avg)	(2)							(3)			
Employee	0.50	0.10	0.40	0.30	0.40	0.40	0.40	0.50	0.50	0.50	0.00
Yearly Average	0.36							0.38			
Ranking (based on Yearly Avg)	(2)							(1)			
Debtors	0.60	0.60	0.80	0.80	0.80	0.80	0.60	0.80	0.80	0.00	0.80
Yearly Average	0.71							0.60			
Ranking (based on Yearly Avg)	(2)							(3)			
Community	0.14	0.00	0.29	0.71	0.71	0.43	0.43	0.29	0.14	0.43	0.00
Yearly Average	0.39							0.21			
Ranking (based on Yearly Avg)	(2)							(3)			
Shari'ah Supervisory Board	0.27	0.27	0.36	0.36	0.27	0.36	0.36	0.09	0.27	0.27	0.00
Yearly Average	0.32							0.16			
Ranking (based on Yearly Avg)	(2)							(3)			
Yearly Average (Individual)	0.34	0.32	0.43	0.44	0.42	0.43	0.42	0.39	0.36	0.29	0.16

Data Source: Annual reports of the examined banks during the period 2000-2011

TABLE 5.8. CSR Disclosure Index of Kuwait (II)

KUWAIT	KUWAIT FINANCE HOUSE										CSR INDEX
	2001	2002	2003	2004	2005	2006	2007	2009	2010	2011	
Mission and Vision Statements	0.60	0.50	0.40	0.40	0.50	0.40	0.50	0.20	0.30	0.20	0.44
Yearly Average	0.40										0.44
Ranking (based on Yearly Avg)	(2)										
BOD and Top Management	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.43
Yearly Average	0.50										0.41
Ranking (based on Yearly Avg)	(1)										
Products and Services	0.40	0.40	0.40	0.40	0.40	0.30	0.30	0.40	0.30	0.40	0.33
Yearly Average	0.37										0.31
Ranking (based on Yearly Avg)	(1)										
Zakah, Charity and Benevolent Loan	0.27	0.27	0.27	0.33	0.33	0.33	0.40	0.40	0.40	0.40	0.23
Yearly Average	0.34										0.20
Ranking (based on Yearly Avg)	(1)										
Employee	0.40	0.10	0.20	0.10	0.10	0.40	0.50	0.30	0.50	0.40	0.33
Yearly Average	0.30										0.34
Ranking (based on Yearly Avg)	(3)										
Debtors	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.73
Yearly Average	0.80										0.70
Ranking (based on Yearly Avg)	(1)										
Community	0.86	0.86	0.71	0.57	0.86	0.71	0.86	1.00	0.86	0.86	0.56
Yearly Average	0.81										0.47
Ranking (based on Yearly Avg)	(1)										
Shari'ah Supervisory Board	0.36	0.36	0.36	0.36	0.36	0.36	0.36	0.36	0.55	0.55	0.33
Yearly Average	0.4										0.29
Ranking (based on Yearly Avg)	(1)										
Yearly Average (Individual)	0.52	0.47	0.46	0.43	0.48	0.48	0.53	0.50	0.53	0.51	0.42

Data Source: Annual reports of the examined banks during the period 2000-2011

Appendix II. Classification of Islamic Banks in the GCC region According to Year of Establishment

To further demonstrate the extent of CSR disclosure practices in the GCC Islamic banks, these banks are classified into five different clusters according to the years of their establishment. Cluster 1 refers to the GCC Islamic banks that were established during the period 1950-1960, Cluster 2 during the period 1961-1980, Cluster 3 during the period 1981-1990, Cluster 4 between 1991-2000 and Cluster 5 between 2001-2010. The table below illustrates the details of this classification.

Table 5.9. Classification of Islamic Banks in the GCC region According to Year of Establishment

Year of Establishment	Number of Banks	Overall Score and Ranking
Cluster 1: 1950 - 1960	1	(0.30) - 'Underdeveloped Practice'
Cluster 2: 1961 - 1980	5	(0.35) - 'Underdeveloped Practice'
Cluster 3: 1981 - 1990	4	(0.48) - 'Underdeveloped Practice'
Cluster 4: 1991 - 2000	3	(0.39) - 'Underdeveloped Practice'
Cluster 5: 2001 – 2010	11	(0.36) - 'Underdeveloped Practice'

This classification highlights the level of CSR disclosure scores on the basis of the year of banks' foundation with the objective of building a correlation between the year of establishment and the CSR disclosure score. As can be seen from the table, CSR disclosure scores of the GCC Islamic banks in all clusters were ranked as 'underdeveloped practice'. Although there is a sign of improvement in the CSR disclosure score during the period of bank's establishment, as for the banks in Cluster 1 it was 0.30, where the oldest bank (Al Rajhi) in the sample was established and increased to 0.36 for the banks in Cluster 5 (where the majority of the sampled banks are presented), this improvement cannot be considered as satisfactory for the period of 60 years.

These findings are rather disappointing as it is expected that Islamic banks in Cluster 1 and 2, as well-established and institutionalised banks, would have

better CSR disclosure scores than Islamic banks in Clusters 3, 4 and 5. However, the GCC Islamic banks in all clusters indicated very poor levels of CSR disclosure and fall into the category of 'underdeveloped practice' of CSR.

Therefore, the research results could not establish any significant relationship between the year of the bank's establishment and the CSR disclosure score. Hence, it is difficult to state that longevity has resulted in developing an institutional approach and culture towards CSR disclosure in particular and disclosure in general.