

CORPORATE SOCIAL RESPONSIBILITY INDEX FOR ISLAMIC BANKS IN THE  
KINGDOM OF SAUDI ARABIA

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CORPORATE SOCIAL RESPONSIBILITY INDEX FOR ISLAMIC BANKS IN THE  
KINGDOM OF SAUDI ARABIA

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*To my beloved mother and lovely wife*

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## ABSTRACT

Islamic banking operations are widely accepted in Islamic society as the transactions are guided by Islamic principles and Shariah values. Although Islamic bank transactions are in compliance with the Shariah, all aspects of corporate social responsibility (CSR) in the Islamic banking industry have not been met. The current study investigated the limitations of existing indices to measure CSR practices in Saudi Arabia Islamic banks. Existing indices are either unable to measure actual CSR practices or do not cover all aspects of these practices in the Islamic banks. There is a need to understand the limitations of existing indices. In this study, CSR in these banks is categorised into two broader scopes: business process dimensions and oriented outcome dimensions. Selective elements to construct an appropriate CSR Index (CSRI) to measure all aspects of CSR practices for both scopes have been assigned weights in accordance with existing studies. Unstructured interviews with practitioners from selected Islamic banks as well as secondary data from annual reports and documents were used to develop this index, which was empirically tested to explore real CSR practices. Based on the developed CSRI that gave oriented outcome dimensions less weight than business process dimensions, and content analysis of annual reports and documents of Islamic banks, the findings indicated that these banks had weak CSR practices. Therefore, it is recommended that this developed CSRI be provided as a guide for Islamic banks in the Kingdom of Saudi Arabia to improve their CSR practices.

## ABSTRAK

Operasi perbankan Islam diterima secara meluas dalam masyarakat Islam kerana urusniaganya adalah berdasarkan prinsip-prinsip Islam dan nilai-nilai Syariah. Walaupun urusniaga bank Islam mematuhi prinsip Syariah, namun semua aspek tanggungjawab sosial korporat (CSR) dalam industri perbankan Islam masih belum dipenuhi. Kajian ini menyiasat kelemahan indeks yang sedia ada bagi mengukur amalan CSR di bank-bank Islam di Arab Saudi. Indeks yang sedia ada sama ada tidak dapat mengukur amalan CSR yang sebenar atau tidak merangkumi semua aspek amalan ini dalam perbankan Islam. Adalah terdapat keperluan untuk memahami limitasi indeks yang sedia ada. Dalam kajian ini, CSR dalam bank ini dikategorikan kepada dua skop yang utama: dimensi proses perniagaan dan dimensi berorientasikan hasil. Elemen-elemen terpilih untuk membina Indeks CSR (CSRI) yang sesuai bagi mengukur semua aspek amalan CSR bagi kedua-dua skop telah diberikan pemberat selari dengan kajian yang sedia ada. Kaedah temu bual tidak berstruktur bersama pengamal dari bank-bank Islam yang terpilih serta data-data sekunder daripada laporan tahunan dan dokumen telah digunakan untuk membangunkan indeks ini, yang mana ia telah diuji secara empirik untuk menerokai amalan CSR yang sebenar. Berdasarkan CSRI yang dibangunkan di mana dimensi berorientasikan hasil telah diberikan pemberat yang lebih rendah daripada dimensi proses perniagaan dan analisis kandungan terhadap laporan tahunan dan dokumen bank-bank Islam, dapatan kajian menunjukkan bahawa bank-bank ini mempunyai amalan CSR yang lemah. Oleh yang demikian, dicadangkan agar CSRI yang telah dibangunkan disediakan sebagai panduan kepada bank-bank Islam di kerajaan Arab Saudi dalam meningkatkan amalan CSR mereka.

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## LIST OF ABBREVIATIONS

CSR	-	Corporate Social Responsibility.
CSRI	-	Corporate Social Responsibility Index.
IBs	-	Islamic Banks
CBs	-	Conventional Banks
AAOIFI	-	Accounting and Auditing Organisation for Islamic Financial Institutions
MI	-	<i>Maqasid</i> Index
EII	-	Ethical Identity Index
MS	-	<i>Maqasid Shariah</i>
SSB	-	Shari'ah Supervision Board
OIC	-	Organisation of Islamic Conference
FM	-	Fiqh Muamalat
BPDs	-	Business Process Dimensions
OODs	-	Outcome-Oriented Dimensions
SAMA	-	Saudi Arabian Monetary Agency
KSA	-	Kingdom of Saudi Arabia
CEO	-	Chief Executive Officer
ARB	-	Al Rajhi Bank
AIB	-	Alinma Bank
ABB	-	Al Bilad Bank
MOSA	-	Ministry of Social Affairs
DZIT	-	The Department of <i>Zakat</i> and Income Tax

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## CHAPTER 1

### INTRODUCTION

#### 1.1 Background of the study

Several theories from both conventional and Islamic perspectives form the bases for the social performance of Islamic banks (IBs). Many authors (e.g., Maali et al., 2006; Farook et al., 2011; Rashid et al., 2013 and Adnan, 2015) have used these theories to understand and analyse Corporate Social Responsibility (CSR) in the Islamic banking industry. However, there are gaps in the literature in terms of IBs' practices, especially in their social performance and the impact of their operations on society. This research aims to measure CSR in Islamic banking practices through making a CSR's Index (CSRI) and gathering selective executive practitioners' views on the CSRI by using unstructured interviews. The primary aim of this research is to construct an acceptable and usable index.

Islamic laws and values are evident in the Islamic banking system in which Islamic financial principles proscribe using *riba* (interest rates), *gharar* (ambiguity) or *maisir* (gambling), and forbid trading some products like intoxicants and pork (Rosly, 2010). These rules differentiate Islamic banking practices from conventional banking practices. Jaufeerally (2011) added two more obligations that IBs must follow, i.e. firstly, the rule of profit and loss sharing (PLS), and secondly, real asset-backed financing. In addition, Khan and Bhatti (2008) stated that the principles of Islamic finance are based on participation in an actual economy and social justice. IBs' values are not only reflected in their banking transactions, but can also be observed through

their impacts on society and the macro economy (Dusuki, 2008a). Business processes in IBs can never be separated from the ethical considerations of society (Usmani, 2002). This affects IBs' practices to achieve acceptable social performance. IBs' considerations for society can be measured through their implementation of CSR.

There is no consensus amongst researchers (e.g., Friedman, 1970; Carroll, 1979; Epstein, 1987 and Wood, 2010) on the definition of CSR. However, CSR can be categorised into two general schools of thought. The first approach argues that business is only obligated to maximise profits within the boundaries of the law and with minimal ethical constraints (Friedman, 1970; Levitt, 1958); and the second approach suggests a broader range of obligations towards society (Andrews, 1973; Carroll, 1979; Davis and Blomstrom, 1975; Epstein, 1987; McGuire, 1963). Fieseler (2011) argues that the variety of definitions of CSR is indicative of the rich body of research on CSR. These definitions vary from conceptions that focus on minimal legal and economic obligations and exclusive accountability to shareholders to broader responsibilities towards the wider social system in which the corporation is embedded. In a review of academic efforts, Wood (2010) recommended a careful integration of research and thinking in other domains into the body of CSR literature.

There are two major schools of thought about CSR in the Islamic finance and banking industry. The first argues that an Islamic business is only obligated to maximise profits within the boundaries of the Islamic law ("*Ahkam Al-Fiqih*"), so as to obey the *Shariah* Supervision Board's (SSB) opinions or the Accounting and Auditing Organisation for Islamic Financial Institution's (AAOIFI) standards (Hassan, 2012). The second school of thought suggests obligations under the principles of *Maqasid Shariah* (MS) that mean protection of basic needs by *Shariah*/Islam. The objectives of the *Shariah* are to achieve protection of the religion, life, mind/intellect, lineage, dignity and property to arrive the broader social and economic development (Bhatti and Bhatti, 2010; Abul Hassan and Harahap, 2010; Iqbal, 2006; Mohammed et al., 2008; Siddiqi, 2008; Usmani, 1999). Farook et al. (2011) confirmed that little research has tried to define CSR in the field of IBs despite the speed of the growth of Islamic institutions in terms of size and complexity.



## 1.2 Current Practices of the CSR in Saudi Arabia's Islamic Banks

Modern banking practices are tilted more towards implementations of CSR for competitive advantage. However, in the case of IBs, it is generally expected that their business practices are more socially concerned than conventional banking practices are. CSR dimensions are currently related to major social issues related to the stakeholders of the business. There is a debate amongst researchers about CSR practices in IBs' business practices. It is worth mentioning that implementations of MS should be more widely practiced than those of *Fiqh Muamalat* (FM) in Islamic banking in which FM means Islamic jurisprudence that deals with commercial activities in an economy. Fiqh accurately means understanding of judgments and precepts, whereas *Muamalat*, in this specific facet, refers to economic transactions and doings. This reflects the higher worry for social issues in IBs than in conventional banking. This research has highlighted that current CSR practices in IBs are restricted to five general issues; kinds of investment and financing, human resources, research and development issues, social sharing and Islamic levies (e.g., *zakat* and charity) and the environment.

From the Islamic perspective, an Islamic bank should work with money (i.e., *Musharakah* financing), instead of working in money (i.e., *Murabahah* financing) like a conventional bank, away from real products and business markets. The King Saudi Arabia (KSA) is the largest Islamic sector for investment and has the biggest Islamic bank. IBs there, like others banks, have the access, knowledge, and ability to determine what could be detrimental to the interests of society in the long run. Conversely, individuals are unaware of what will harm them and their financial situation without full knowledge of the issues involved. Therefore, it is banks' responsibility not to encourage individuals and organisations to participate in ventures that will likely have negative results and consequences for individuals and families. For example, as Al-Twajry (2007) wrote, this would include entry into the stock market in Saudi Arabia during the inflated-prices period of 2006. The media attracted people without appropriate experience to the stock market at that time, and IBs encouraged their customers to enter the stock market by giving them more facilities and offers to take on more debt for many years. This resulted in many families losing their savings.

While that crisis did not impact anyone who could afford to enter as a form of pure adventure, there were negative consequences for many, including those who did not enter the market, because the economic situation caused inflation that impacted the general population.

Research and development (R&D) and human resources (HR) in IBs' practices are complementary issues to investment and finance modes; without them, IBs cannot be competitive and take a suitable share in the market while having positive and sustainable impacts on society and the economy as a whole. R&D is often considered central to advanced business organisations striving to be on the cutting edge of new economies and to initiate new products or improve old ones. Mohammed et al. (2008) argue that R&D is very important to future investment and financing development. IBs should increase spending on R&D to build their strategies and products on a scientific basis and thereby increase profits and renew interest in the future ambitions of the community. In the KSA, according to Abul Hassan and Harahap (2010), IBs (e.g., Al-Rajhi Bank) disclose the least amount of information related to R&D. On the contrary, Aribi and Gao (2010) found that the majority of disclosures made by both IBs (in the Arab Gulf) and Conventional Banks CBs were related to the sub-themes of R&D towards innovation in making new products and services. Rashid et al. (2013) stressed that their ranking clearly indicates that IBs, including those on the Arab Gulf, consider quality and innovation in the development of newer services.

In terms of HR, Aribi and Gao (2010) pointed out that the level of CSR amongst the sub-themes under employees dimension in which both IBs and CBs (in the Arab Gulf) showed more interest in training and development and employee advantages, and less disclosure was given to equal opportunities and the workplace environment. Under the dimension of commitment towards employees, Haniffa and Hudaib (2007) found that, based on a three-year mean, Al-Rajhi Bank (ARB) in the KSA was the lowest-ranked bank. The range of this domain was from 0.18 to 0.67. Apart from ARB's 2002 commitment to provide medical welfare for its employees, none of the IBs surveyed commented on their employees' health. In 2008, Zubairu et al. (2012) ensured that all Islamic banks in the KSA (just one bank is considered an

Islamic bank, whilst the others have Islamic windows) disclosed up to half the essential items, whilst, in 2009, three of the four banks disclosed up to half the essential items. Rashid et al. (2013) reported that, according to the IBs' annual reports, IBs in the Arabian Gulf reported a good score of 0.49 out of 1.00, which was the highest amongst the others under this domain. The overall score of this domain stood at 0.413 out of .967, which was ranked at number six out of eight domains.

In terms of CSR and Islamic duty, charity and *Zakat* (the obligation to donate a certain proportion of wealth each year to charitable causes.) are the most important elements of IBs' social responsibilities. Rashid et al. (2013) stated that the proper distribution of the *Zakat* shows direct compliance with *Shariah*. IBs in the Arabian Gulf (including the KSA) scored the highest and ranked first in the region. Notably, the Department of *Zakat* and Income Tax (DZIT) in the KSA is responsible for receiving *Zakat* and forwarding it to the Ministry of Social Affairs (MOSA), which is then responsible for its distribution to the poor. Maali et al. (2006) found that IBs may be obliged by law to pay *Zakat* (as is the case in the KSA). Abul Hassan and Harahap (2010) pointed out that, according to some *Shari'ah* scholars in Saudi Arabia and other countries, payment of *Zakat* is not the responsibility of IBs but of shareholders. Only ARB (in the KSA) and another bank disclosed the appropriation of *Zakat*. Two IBs disclosed the balance of their *Zakat* and charity funds. Aribi and Gao (2010) concluded that the lack of disclosure by IBs under those dimensions could be justified on the basis that the IBs discharge the Islamic concept of accountability.

Under social and environmental dimensions, IBs should only provide financing for projects and products that are lawful (*halal*) and avoid financing or investing in practices considered unlawful in Islam, such as gambling and alcohol, or in short, those that bring damage to society and the environment. Kamla and Rammal (2013) reported that ARB actively cooperates with the Women's University in providing diplomas in the fields of body and hair care and other related industries. This activity is a way to empower women so they can support themselves and their families when they gain new professional skills. ARB reported (in 2010) on some activities that supported education and health for the disadvantaged people in society. On the other hand,

Zubairu et al. (2012) confirmed that in 2008 and 2009, three of the four banks disclosed less than half the required items under the commitment towards their society as IBs' disclosures. Unfortunately, Haniffa and Hudaib (2007) noted that the three-year mean Ethical Identity Index (EII) ranged from 0.05 (at least a three-year average) to 0.38 (at biggest a three-year average), the lowest being ARB in the dimension of commitment towards society. On the environmental dimension in the KSA, Abul Hassan and Harahap (2010) found that ARB did not disclose any information under this dimension (it scored 0). Despite environmental protection forming an integral part of CSR activities, IBs are not disclosing much on this important subject in their corporate annual reports. Further, Maali et al. (2006) found that none of the IBs (including the KSA) studied made disclosures concerning the environment (possibly environmental matters were not seen as relevant by the financial organisations).

### **1.3 Problem Statement**

Business structures can be categorised into two broader streams, i.e. business processes, which focus on the core business process, and outcome-oriented activities, which focus on the outcome of the business operations. In Islamic business, businessmen's duties to society are prioritised differently from those in non-Islamic business. This affects the nature of business operations of IBs in both streams.

IBs follow conventional banking operations while trying to exclude any forbidden procedures by using a checklist of allowed patterns in Islamic *Fiqih*. Consequently, CSR practices in IBs should be based on these principles. Indeed, IBs have built their CSR on the conventional CSR structure; this has led to much criticism of IBs' social performance over the years (e.g., Dusuki and Abozaid, 2007; Abul Hassan and Harahap, 2010; Maali et al. 2006; Siddiqi, 2006; Usmani, 2002). However, non-Islamic CSR also receives criticism from researchers and practitioners (Wood, 2010). Thus, researchers agree on the inefficiency of the existent measures of CSR around the globe. The current measures have not been used to evaluate CSR in business transactions and there are need to conteneue in transformation of Meqasid Shariah concepts into measurable items (e.g., Asif et al., 2013; Wood, 2010; Ahmed, 2010;

Yusof et al., 2009; Turker, 2008; Dfusuki and Abozaid, 2007; Asutay, 2007; Dusuki and Abdullah, 2007; Abul Hassan and Harahap, 2010; Maali et al., 2006; Siddiqi, 2006; Rosly, 2005; Usmani, 2002; Aggarwal and Yousef, 2000; Farooq, 2006). This gap leads to a need for a comprehensive measurement index for CSR, especially in the case of IBs.

Some researchers (e.g., Rosly, 2010 and Siddiqi, 2006) also highlighted the need to consider both perspectives, i.e. business processes dimensions (BPDs) and outcome orientations dimensions (OODs), to measure CSR, and research to date has failed to do so. Some researchers have been concerned with only Islamic concepts in Islamic banking and finance, whilst others have tried to build their work on conventional expertise in this field. Others have worked based on both the Islamic and conventional concepts of CSR but have not considered the nature of the business structure. This situation has led to difficulty in measuring IBs' CSR. Previous researchers have considered one perspective at a time to measure CSR practice in the IBs, either business processes or outcome-oriented processes. Asif et al. (2013) argued that the current literature on the integration of CSR into business processes is limited from the perspective of conventional business practices. On the Islamic side, Rosly (2010) concluded that the impact of the business process on society is not known from Islamic perspectives. Turker (2008) argued that, despite the growing body of CSR literature, the measurement of CSR is still problematic. Although the literature provides numerous methods for measuring CSR practices, almost all of them have some limitations. This implies a need to explore new methods of measuring CSR, especially in the case of IBs.

Finally, according to my reading, all past academic efforts have tried to measure the CSR in IBs by using indices that are inadequate for tracking the impact of business processes and the same weights of measurements and dimensions. The business processes in IBs depend on exposure and the sharing of risks with investors and customers. According to Rosly's (2005) argument, in Islamic finance, investors take risks and share in profits. Additionally, Ahmed (2010) stated that, from the principles of Islamic finance, there is "no risk, no gain" as a basic rule of IBs. From

that core idea of Islamic banking, Smolo and Hassan (2011) found that Murabahah financing (mark-ups) is permissible under the principles of Islamic finance in IBs, but it is not sharing profits and losses with customers. However, IBs are working on the Murabahah system instead of the profit and loss sharing system, so the literature on the CSR measures of IBs is still unable to solve the measuring issue. For example, the collapse of the stock market in KSA in 2006 indicated that CSR practices were not integrated with the business processes of the IBs, as IBs encouraged their customers to enter into the stock market whilst the IBs withdrew their own shares before the collapse, leaving the people to face the loss alone. In summary, Siddiqi (2006) argued that part of the failure of the IBs' social performance was due to a lack of macroeconomic perceptions and the appropriate tools for analysing the multipart socio-economic phenomena.

However, according to Lewis (2010), the KSA is the largest market for Islamic investment funds and according to Cebeci (2012), the world's largest Islamic bank by capital (Al Rajhi Bank). But some authors have found that IBs, in general and especially in KSA, need to create index to measure of CSR that has measurable and doable targets (e.g., Hassan and Harahap, 2010 and Zubairu et al. 2012) .

Again, researchers have provided evidence that the majority of the financing processes are not based on equity, but rather take the form of debt-like instruments in IBs (e.g., Aggarwal and Yousef, 2000; Asutay, 2007; Dusuki and Abdullah, 2007; Farooq, 2006; Yusof et al., 2009). This is because, according to Asutay (2007), IBs have opted for profitable Islamic financing, such as *Murabahah*, instead of *Musharakah* (*Musharakah* is equity-finance oriented and *Murabahah* is debt-financing). This phenomenon is described as *Murabahah* syndrome since the IBs frequently use debt-based financing as their products. In general, IBs, according to Rosly (2005), work on the interest-based debt financing system (dealing with rich people only) where the lender is guaranteed both the principal and the interest returns. Furthermore, according to Smolo and Hassan (2011), Islamic banks under *Bai Bithaman Ajil* (BBA), under this mode the customer gets the asset and is obligatory to pay amount as per the agreed tenure in instalments. Make high profit ratios with less

work and risk, and are therefore more willing to involve in projects in which the less effort or risk becomes attractive to the IBs. Even with the BBA mode as essential finance, Usmani (2002) concluded that IBs should share the risk of the commodity through the stage they are owned.

In short, these limitations indicate that there are still several gaps in knowledge about inadequate items and dimensions of IBs' CSR. The literature also confirms the requirement of a comprehensive index to measure CSR performs in IBs that can establish business process and outcome orientation perspectives. The present study attempts to fill these gaps by suggesting and evaluating a new CSR measurement index for IBs.

#### **1.4 Aims of the study**

This study will empirically investigate CSR in business processes and outcome-oriented practices of IBs in Saudi Arabia. Thus this study aims to explore the limitations of existing indeces in the literature. The study also constructed and selected dimensions, including sub-dimensions and their items, in a proper index with different weighting for each part and element according to its impact on society. This study added two measurements to the index to meet Islamic law (*Maqasid Shari'ah*) requirements in Islamic banking operations.

#### **1.5 Research Questions**

This study seeks to address the following research questions:

1. Why the existing indeces used to measure the CSR of IBs do not provide enough understanding on the real implications of CSR in IBs ?
2. To what extent does categorisation of CSR aspects into business process dimensions (BPDs) and outcome orientations dimensions (OODs) clarify actual

CSR in IBs? What is the appropriate weight for each aspect?

3. How should the suggested CSR's Index (CSRI) be developed to measure the actual CSR practices of IBs?
4. To what extent Islamic Banks in the kingdom of Saudi Arabia (KSA) follow CSR practices appropriately by using the developed CSR Index (CSRI)?

## **1.6 Objectives of the Study**

The objectives of this study are

1. To investigate the limitations of the existing CSR indices in IBs in order to understand the real implications of CSR in IBs.
2. To integrate both business processes and oriented outcomes as new dimensions in a single CSR index in IBs to clarify actual level of CSR.
3. To develop an index based on the newly selected measurements of the CSR practices in IBs and instruct index of CSR in appropriate weights of all components.
4. To explore CSR implications of the Islamic banks in the KSA use the developed index of CSR.

## **1.7 Scope of the Study**

This research essentially involves an investigation of the impacts, domains and measurements of the CSR amongst participating IBs in the KSA. Only three Islamic banks in the KSA are fully-fledged Islamic banks, whilst the rest provide both conventional and Islamic banking. The researcher used unstructured interviews to collect opinions' experts in IBs and content analysis of annual reports to measure CSR performance of IBs.



## **1.8 Significance of the Study**

Mohammed (2007) concluded that, in all the research before his research, the participants clarified that IBs, though socially responsible in compliance to *Shariah* principles, were not mindful of a systematic framework of CSR in Islam. Khan (2007) reported that the rapidly increasing infrastructure for standardising and monitoring the international expansion of the Islamic finance industry (e.g., Islamic banks) is indicative of the fact that the industry should be updated enough to play a significant role in the development of the global economy. Musa (2011) reported that the current literature on Islamic banking and ethics in Islamic business has an apparent lack of an evaluation of the extent to which the ideal ethical criteria of Islam are implemented by IBs. Similarly, Farook et al. (2011) found that a number of papers explaining Islamic accounting and corporate reporting of Islamic financial institutions are either normative or analytical and have a lack of empirical research and analysis of real practice in the IB industry. This research created the selective and current measurements and dimensions in a single index of CSR in Islamic banking to give a proper framework of CSR in IBs and consider both the business processes and outcome orientation of IBs. The second significant aspect of this work concerns the suggestion of solutions based on new measurements of the present CSR practices of IBs. It is, therefore, anticipated that this study is not only have strategic implications for the Saudi Islamic banking industry, but will also be suitable for other countries intending to develop the necessary regulatory structure for their Islamic banking industry to enhance CSR through their business processes.

### **1.8.1 Theoretical significance of the study**

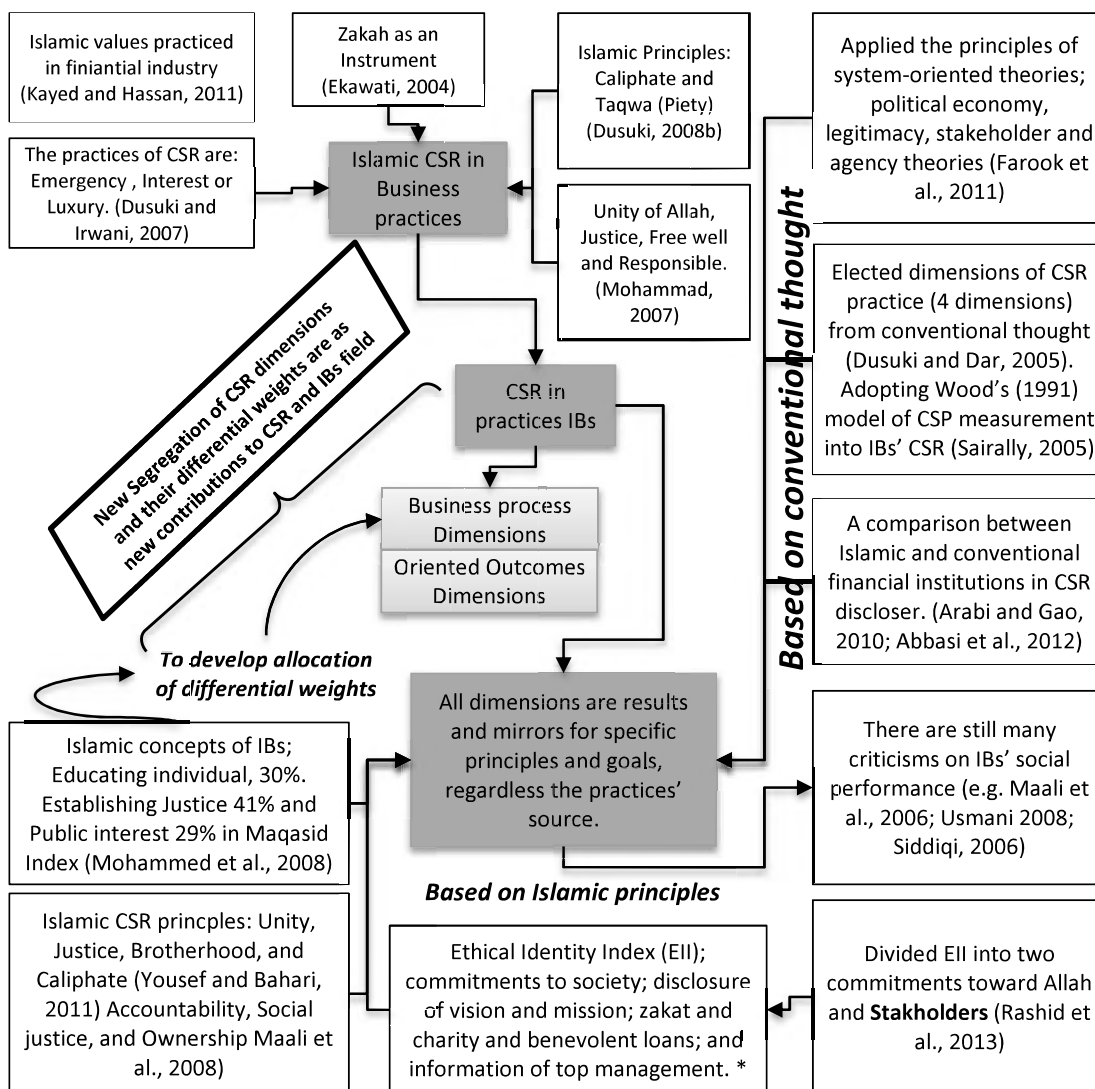
Some authors (e.g., Farook et al., 2011; Sairally, 2005) assumed that the expectations of the stakeholders of IBs according to the experience of the conventional literature of CSR, in spite of Wood's (2010) recommendation of the deliberate incorporation of research and delving into other domains of the CSR literature. Others (Mohammed et al., 2008; Yusuf and Bahari, 2011) have examined the CSR of Islamic banks by studying Islamic principles and law without paying sufficient attention to the source of the action. The CSR actions come from the core business of the IBs and from

external parts of the IBs. This idea has been constructed by taking prior recommendations on the Islamic view of CSR. Usmani (2002) stated that, according to Islamic principles, business transactions could never be separated from the moral targets of a society. On the Western side, Woermann (2013) argued that increasing emphasis on entering CSR into the core business approach is a tool for companies to meet their CSR obligations. As a result, this research is relevant and a worthy contribution because it has used dimensions divided into two parts; that is, dimensions of core business transactions and from outcome-oriented activities. The structure of the index is like the structure of a real business, in which there are two parts, the business process and the oriented outcomes. Figure 1.1 shows that this structure of the CSR's Index is considered a contribution toward both CSR and the IB fields.

One should see to the long-term impacts through Islamic banking products and investments by using macroeconomics and MS, and incorporating them into measuring the CSR in IBs. Siddiqi (2006) argued that Islamic banks should not look at the microeconomic targets of their investments to arrive at current targeted profits. Instead, they must look at the long-term benefits and the positive consequences for the community and economy. Farook et al. (2011) and Kamal et al. (2010) stated that equity finance is in line with the goals of Islam *Maqasid Shari'ah*, specifically justice, good economic impacts and social equality. However, Farook et al. (2011) and Kamal et al. (2010) argued that using debt as an investment tool has failed and is one of the major causes of the global financial crisis. Farook et al. (2011), Kamal et al. (2010) and Siddiqi (2006) have stated that IBs should increase their share in equity finance. Malik et al. (2011) concluded that it is crucial to remember that the purpose of Islamic finance practitioners is not to replicate conventional financial products in an Islamic way at all times, but rather to create new financial ideas or products that appeal to IBs and investors, even if this means slower growth than Islamisation. *Musharakah* financing, and equity investment are incorporated as new measurements in the CSRI to measure the CSR in IBs as a second contribution of this work.

The third contribution of this research is its use of different weights based on the impact and importance of every dimension and measurement. Indices are used to

measure the CSR disclosure in IBs, such as the Ethical Identity Index (EII) (Haniffa and Hudaib, 2007; Abul Hassan and Harahap, 2010; Kamla and Rammal, 2013; Rashid et al., 2013; Zubairu et al., 2012). Maali et al. (2006), Aribi and Gao (2010), Abbasi et al. (2012), and Farook et al. (2011) used a disclosure index approach. Some of those authors included their indeces' AAOIFI standards as items of the CSR in Islamic financial institutions (IFIs). The last group of authors have made it their concern to report on legal and *fiqh* issues. The majority of the indeces of CSR in IBs have included equally weighted items except for the *Maqasid* Index (Mohammed et al., 2008) and the Index of Criteria and Items (Yusuf and Bahari, 2011). Both studies included differently weighted items, but Yusuf and Bahari (2011) did not use their items as measurements of the CSR in IBs. This research will give special weight for each dimension (the two dimensions are BPD and OOD) and each measurement under the dimensions (BPD and OOD).



**Figure 1.1** The theoretical significance of the study

## 1.9 Operational Definitions

This research measured the CSR in IBs in the KSA by using the developed CSR index (CSRI). CSRI has two main elements – business process dimensions and oriented outcome dimensions. Each one includes several variables that will be the measurements of the CSR. The following interpretation of the measurements is used throughout the current research.

### **1.9.1 Business Process Dimensions**

Business process dimensions (BPDs) are all the dimensions that come from the business processes in any business organisation (Wood, 1991). BPDs are integral to IBs, and IBs cannot continue in business without them.

### **1.9.2 Oriented Outcome Dimensions**

In this research, the oriented outcome dimensions (OODs) are all the dimensions that come from additional activities in any business organisations (Wood, 1991). They are outside of the IBs, and without them, IBs can continue in business.

### **1.9.3 Equity Investment**

In this research, equity investments are when an Islamic bank is a shareholder or investor in other companies or business organisations (Ahmed, 2010). For example, IBs buy *Sukuk* securities (Islamic bonds) in the security market or establish new firms with others.

### **1.9.4 Musharakah Financing**

In this research, *Musharakah* in IBs means that IBs share profits and losses with their customers, such as establishing new ventures and small businesses (Asutay, 2010). *Musharakah* is one of the financing tools.

### **1.9.5 Murabahah Finance**

*Murabahah* finance is an Islamic financing structure in which the bank buys a property or commodity with a free and clear title. The bank and its customer then agree upon a sale price that can be received through a series of instalments, or as a lump sum

payment (Yusuf and Bahari, 2011). This way helps people to get on their needs by using acceptable tool in Islam.

### **1.9.6 Financing in Significant Areas**

Some significant areas suffer from disadvantages and need financing in special education for specific people, construction, agriculture and fishing, electricity, water, gas, and healthcare, especially in remote areas. Sairally (2005) found that if this investment is high, the general public feels the benefits of the bank activities.

### **1.9.7 Commercial Finance**

In Islamic banking industry, commercial finance means offering Islamic loans (*Murabahah* for companies) to business organisations in compliance with Shari'ah. IBs offer commercial financing when the firm's cash flow allows them to repay the facility. This kind of financing will generate new jobs for new generations and enhance the positive impacts of IBs' performance (Samina, 2012).

### **1.9.8 Research and Development**

R&D is often considered essential to advanced business on the cutting edge of new economies that initiate new products or improve old ones. Mohammed et al. (2008) argue that R & D is very important in future product development. The number of new products a bank offers indicates that the bank builds its strategy and products on a scientific basis and benefits from scientific offerings, thus renewing interest in the future aspirations of the community.

### **1.9.9 Training of employees**

Employee training is increasingly required to assist the workforce to use modern tools, strategies, materials and techniques in their tasks. Mohammed et al.

(2008) state that a well-trained workforce enhances the quality of the bank's human resources and at the same time works towards helping customers to know about its objectives and products.

#### **1.9.10 Fair Treatment in Terms of Wages**

Fair treatment in terms of wages is an employee's right. Dusuki and Dar (2005) argue that Islam teaches giving to others, including giving employees their rights; they should not be overburdened with what they cannot do. Average salaries of IB employees indicate that IBs respect their employees' rights.

#### **1.9.11 Amount of Zakat**

*Zakat* is one of the five pillars of Islam. In the *Quran*, *zakat* and daily prayers (*Salaat*) are mentioned many times together. El Mosaid and Boutti (2012) and Nor and Asutay (2011) state that high *Zakat* in IBs shows a transfer of income and wealth to the poor and needy, thereby helping decrease the inequality gap.

#### **1.9.12 Amount of Charity (Sadaqah)**

Haniffa and Hudaib (2007) identified charity (*Sadaqah*) as voluntary in nature, and it is allowed by *Shariah* for several purposes including the support of society. In this study, a large amount of *Sadaqah* indicates an IB's social performance is better than others'.

#### **1.9.13 Amount of Qardh-Hassan**

In this research, high *Qardh-Hassan*, loans are interest-free and extended on goodwill basis, indicates the transfer of income and wealth to the poor and the needy. Haniffa and Hudaib (2007) stated that providing *Qardh-Hassan* for socially beneficial causes is an important social contribution that IBs may make, especially to the local

community in which they operate.

#### **1.9.14 Sponsoring Islamic educational and social events**

Under CSR strategies, the needs of the community within which the IBs work should first be catered to. IBs need to disclose their commitments to society under the CSR disclosure policies. Rashid et al. (2013) conclude that education is very important to establish compliance with *Shariah* in Islamic banking.

#### **1.9.15 ATMs and IB Branches**

Providing banking services for society is a very important aspect of IBs' CSR practices (Abul Hassan and Harahap, 2010 and Zubairu et al. 2012). In this study, the number of ATMs and branches indicate that Islamic banks play a positive role in society by providing ample facilities for customers.

#### **1.9.16 Profit**

In general, net profit (referred to as net income or net earnings) is a profitability measure of a business after accounting for all costs. Mohammed et al. (2008) argue that high profitability shows that Islamic banking is enjoying high financial gains for its shareholders.

#### **1.9.17 Energy Conservation**

Energy conservation is an important issue of CSR field in any business. The philosophy of Islamic business, as enshrined by the *Shariah*, requires IBs to operate in a moral, ethical and socially responsible way (e.g., Dusuki and Dar, 2005).

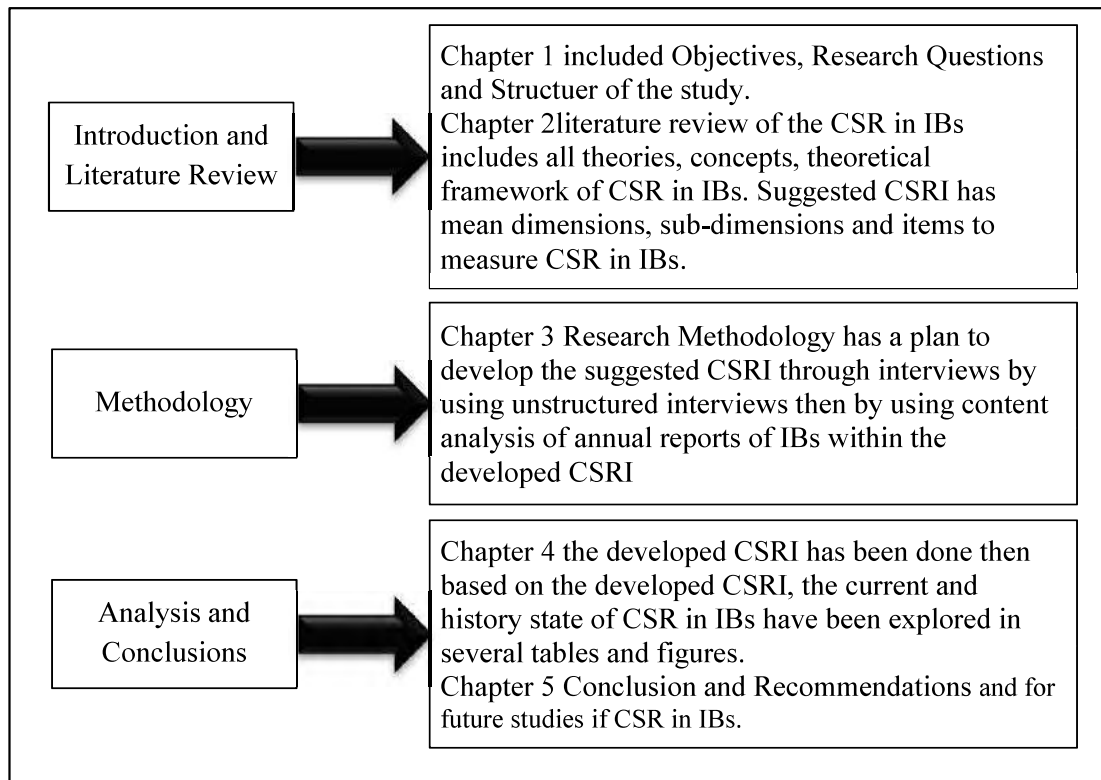


## 1.10 Structure of the thesis

Figure 1.2 illustrates that this chapter has shown the background of the research, outlined the objectives and briefly explained the research methodology. Chapter Two has reviewed the literature on the CSR of IBs and on conventional thought. This chapter highlights some issues in the current research as the theoretical framework for the study of CSR in IBs. Chapter Two has reviewed related theories and dimensions of CSR in the Western world. It also has reviewed literature on Islamic dimensions of banking, especially *Maqasid Shariah* principles, and reviewed earlier academic works on CSR in IBs.

In Chapter Three, the qualitative and quantitative data collection methods used to analyse the annual reports and fill gaps in the theoretical framework has been discussed. Chapter Three is concerned with the research methodology, describing the objectives of the research and the processes that will ensue. The research will develop the CSRI by using unstructured interviews with 15 executive practitioners in selected IBs to confirm the selective measurements, including new two measurements, its items of CSR and their weights. In this chapter, various sources of data will be collected through a mixed-method approach.

In Chapter Four, the results are analysed using selected methods and procedures after the collection of data from several sources. This chapter will analyse the data by using content analysis. The results from the annual reports using the developed index should determine the level of CSR in IBs in Saudi Arabia. Finally, Chapter Five will provide a brief summary of the overall research and discuss several conclusions and implications for the CSRI on the IBs' practices. The limitations of this research will also be highlighted, and a number of recommendations will be made for future study in the field.



**Figure 1.2** Structure of the thesis

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