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**ISLAMIC BANKING OPERATIONS AND CARROLL'S CSR PYRAMID: A SYSTEMATIC LITERATURE REVIEW**

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**Abstract:** *The corporate social responsible is not new concept in today's business life. Which have now turned from literary to more strategic and influences the profits of organizations. Islamic finance in itself is also considered as more social than conventional one. It is thought that products offered by Islamic banks comply with the concepts of social responsibility. To find out the fact; this study was initiated by making comparison of widely used Carroll's CSR pyramid with the basics of Islamic finance. For the purpose, readily available literature was reviewed and concluded that Islamic banking products are in parallel with all five components of Carroll's CSR pyramid. Islamic banks are acting as development institutes rather than loan houses by eliminating interest from the core banking activities. The concepts of Islamic finance are aimed at equal distribution of wealth and equal opportunities available to poor or suppressed sectors of economy for more productivity; hence resulting in foster economic growth. Like conventional banks (those follow Basel committee rules), Islamic banks also follow rules/guidelines formulated by AAOIFI and IFSB to ensure transparency, trustworthiness and sense of responsibility. In overall operations/progress, Islamic banks are acting as good corporate citizen.*

**Keywords:** Corporate Social Responsibility, Carroll's Pyramid, Islamic Banking Operations

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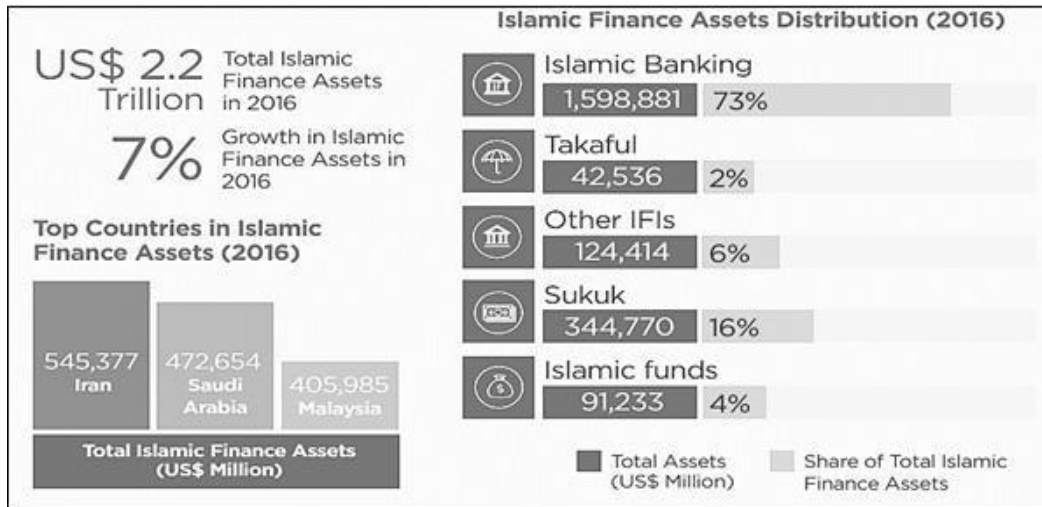
## **Introduction**

Islamic banking begins in 1963 when an economist in Egypt named Dr. Ahmad Elmagar formed MitGhamr Saving Bank and took the money from people on profit/loss sharing basis in city of MitGhamr Egypt. Till 1967, nine banks were operating on these profit/losses sharing basis in whole country. With the introduction of profit/loss sharing concept by MitGhamr bank, saving deposits of the bank were increased to 500% along with 100% increase in investment deposits during period of 1963-66. First of all, the Islamic banks focused only retail customers but with the passage of time and continuous increase in their capital base, these established wholesale as well as more innovative products. With expansion of Islamic financial market, financial products also increased. So, keeping in view the increased number of Islamic financial institutions in international financial market, an Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) was established in 1991 which until now has issued 100 Islamic Shariah compliance standards in the area of auditing, accounting, governance and ethics of financial products and these Islamic financial standards are now being applicable throughout the world.

Another organization named International Financial Services Board (IFSB) was established in 2002 to integrate these

standards with global corporate and risk management standards. Since establishment of IFSB, twenty-seven (27) internally recognized standards, guideline principles and notes were issued for Islamic financial industry. Now a days, Islamic banking is being practiced in nearly 60 countries with more than 300 Islamic banks (Lichtfous, 2018) with an estimate of USD 2.0 trillion market size at end of f.y 2016 and has growth potential of 17.6% in its assets (Dubai Int. Financial Centre, 2017). According to figures of Islamic Finance Development Indicator (IFDI) estimated by Thomson Reuters in 2016, assets are nearly accountable to 73% of total market size (of Islamic financials) where as 17% of market size is occupied by Sukuk (Islamic bond). Alongside, Thomson Reuters is forecasting USD3.2 trillion total asset of Islamic finance, in 2020. According to Thomson Reuters (2017) report on Islamic Finance Development, there are three major countries i.e. Iran, Saudi Arabia and Malaysia, dominating Islamic financial activities with 65% share in total assets of Islamic finance, whereas rest of 35% remains before whole world. The Islamic industry is divided into five major assets distributions which is as follow; Islamic banking operations comprise of 73% of total assets, Takaful (Islamic Insurance) 2%, Sukuk 16%, Islamic funds 4% and other services 6%.

Figure 1 Islamic Financial Market Size and Asset Distribution



Source: Thomson Reuters Report #IFDI2017

Figure 2 shows the list of top 22 banks dealing in Islamic Finance and its products, and showing that all these banks are operating in Islamic world with healthy pre-tax profits from USD 226 million to USD 1823 million FY-2015. According to risk profile of Islamic banks, price of their products and rate of return are not related to conventional banks so these are not compatible with benchmark such as London Interbank Offer Rate (LIBOR) which does not consider their assets risk profile (Thomson Reuters, 2011). To overcome misconception, Thomson Reuters introduced Islamic Interbank Benchmark Rate (IIBR) extracting from panel of 18 major Islamic banks which indicate average expected cost of funding for Islamic finance sector (Alaqtani, 2018).

The discussion of corporate social responsibility has turned to more strategic from theoretical one. Now it become part of organizational structure and is being consider as a tool to competitive advantage. So, the company's major investment and financing

decisions are very much sensitive to its degree of involvement in the corporate social responsibility (CSR) activities. For centuries and with the evolution of banking system, the relationship between vendor and client were based on ethics because the relationship was of exchange, deposit and lending where no any specific rule of law was present. But with the emergence of market economy these ethical values disappeared and all focus was made on developments (Fekete and Tatay, 2013).

**Study Objectives**

This study aims at comparison of widely used notion of social responsibility i.e Carroll's CSR pyramid with the concepts of Islamic banking operations because it is thought that Islamic banking principles are based on basic CSR concepts. And many Islamic banks are operating in different emerging/dominant economies of the world. So the integrity of their operation may be questioned and to answer this a literature is being review from ready available resources to reach any possible conclusion.

**Figure 2 List of Top 20 Shariah Compliant Islamic Banks**

Rank	Institution	Country	Pre-tax profits \$m	% change
1	Al Rajhi Bank	Saudi Arabia	1,822.98	-8.09
2	Mellat Bank	Iran	947.01	51.34
3	Dubai Islamic Bank	UAE	768.00	64.10
4	Pasargad Bank	Iran	663.00	-42.70
5	Kuwait Finance House	Kuwait	633.00	18.32
6	Bank Rakyat (Bank Kerjasama Rakyat Malaysia)	Malaysia	613.00	-5.26
7	The Company for Co-operative Insurance (NCCI)	Saudi Arabia	560.12	n/a
8	Masraf Al Rayan   Al Rayan Bank	Qatar	554.00	16.14
9	Abu Dhabi Islamic Bank	UAE	476.00	20.81
10	Qatar Islamic Bank	Qatar	469.00	30.64
11	Bank Saderat Iran	Iran	446.00	-10.44
12	Tejarat Bank	Iran	434.42	57.09
13	Al Baraka Banking Group	Bahrain	375.00	5.93
14	Parsian Bank	Iran	348.00	-47.75
15	Alinma Bank	Saudi Arabia	337.00	26.22
16	BUPA Arabia for Cooperative Insurance	Saudi Arabia	301.28	104.48
17	Eghtesad Novin Bank (EN Bank)	Iran	236.00	-41.73
18	Bank Albilad	Saudi Arabia	230.00	18.55
19	BIMB Holdings	Malaysia	229.00	-6.53
20	Qatar International Islamic Bank, Doha	Qatar	226.00	9.71

Source: A report of Dubai International Financial Centre 2015

### **Theoretical Review**

During the history of financial institutions, the coordination of organization development, market development, ethical behavior and bureaucratic influence was present with varying degree. In 19<sup>th</sup> & 20<sup>th</sup> century, introduction of new technologies by financial institutions, very much helped in expansion of their operations and make them capable of the cross border operations. This take people of different regions near to each other and made them sensitive of others financial behavior. This varying behavior in financial institutions caused to formulate regulation with the aim to protect the best interest of stakeholders (Sagi, 2012).

### **Corporate Social Responsibility**

When the US financial markets stuck with crisis, named financial markets of USA, its shocks were also bear by most of developed world. Which is not only jerked economies but driven social problems also. Several remedies were then diagnosed to come out of crisis including financial literacy of individuals as well as adoption of ethical aspects in financial sector. And preview of these ethical aspects is very much visible in Islamic way of financing, in which banks share risks with customers, put less burden on borrower and not offer interest on deposits (Bajko and Varga, 2013). After the crisis of 2008, financial organizations put their efforts to implement concept of social

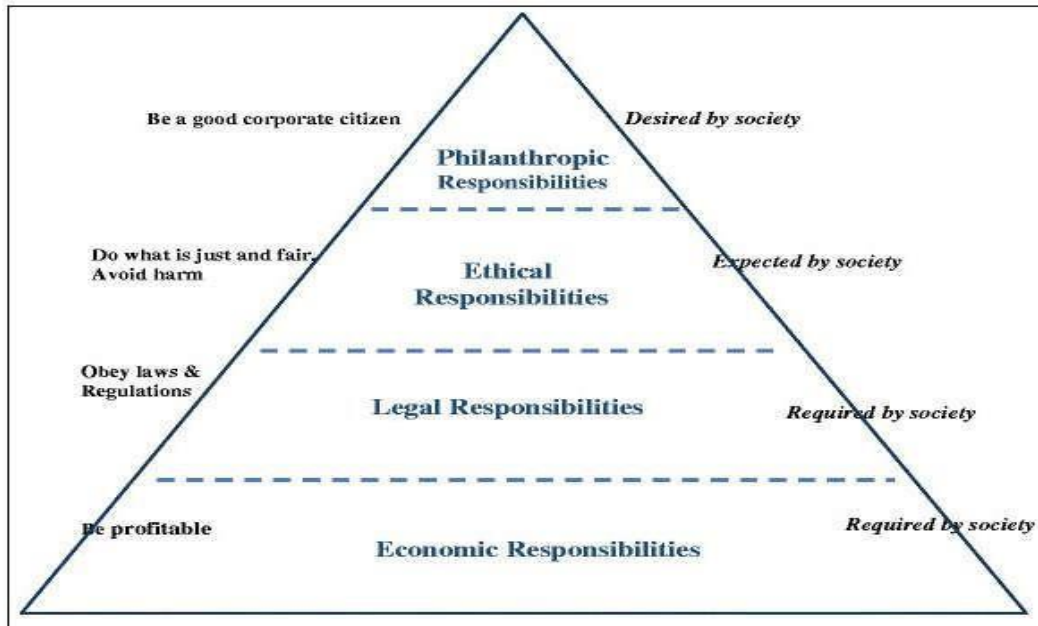
responsibility in their operations, with the aim to make organizations transparent in their operations and accountable for any wrong doing. Along with traditional functions of financial institutions, CSR was then put into major functions with aim to efficient allocation and risk management (Tzu-Kuan Chiu, 2013). It is hereby worthwhile to state that during the crisis of 2008, performance of Islamic banks operating in Gulf Cooperation Countries was not much affected as compared to conventional banks of that time (Alshammari, 2017).

According to Szegedi (2014), CSR in banking companies is an attitude ahead from return on investment and profit maximization, towards a people's community concept who interact in more social and natural environment. Carroll's (1991) pyramid for CSR (shown in Fig.1) is a widely used concept which encompasses different layers of social responsibilities like legal, ethical and philanthropy along with economic portion. Which means that companies have to focus on their economic goals but with the essence of legal formalities, comply with ethical norms and setting discretionary targets. But banking

financial sector responded late to all these (Vigno&Nicolai, 2009). Still it is more important for banking sector to incorporate CSR activities in its business strategies to remain legitimate and competitive (Scholtens, 2006). In the view of Tzu Kuan Chiu (2013), CSR in banking and financial sector is ethical and socially responsible conduct beyond the provision of risk management services, efficient asset allocation and protecting the interest of depositor and owner, which simply means to make banking and financial sector accountable and transparent.

Unlike other sectors of economy, banking sector is connected with variety of stakeholders including depositors, borrowers, investors, owners, managers, employees and government regulators. Hence banking sector is considered as riskier and more desirous to CSR. The areas of CSR in banking sector also differ from other economies like, taking responsibility while depositing money, held responsible while lending depositor's money, responsible investment and likewise stopping money laundering and stepping against corruption efforts are also major areas of expected CSR activities from banking sector (Vigano & Nicolai, 2009).

Figure 3 Carroll's CSR Pyramid



Source: available via license: CC BY 4.0

### Islamic Banking Concepts

All the commercial banks, either these are conventional or Islamic get into operations with the aim to increase shareholders wealth by two ways; one by offering wide variety of services to individuals and businesses and second collect payments like charges, fees or interest on the products or services they offer (Krohn, 2017). Like all other business organizations banks are also thought to be socially responsible and are required to maintain ethical behavior or services. Here we will discuss Islamic banking products and services in the light of Carroll's CSR pyramid. But before going into CSR adoption by Islamic banks; first we will have to look on the basic principle over which these Islamic banks operate and are separated from conventional banks, which is interest (say Riba in Islam). It is very much clear that interest (Riba) is prohibited in Islam and in the Quran Surah Al-Bakara (279) it is declared that dealing in interest is like a war with Allah Almighty and His

Messenger Muhammad (Peace Be Upon Him) (Ahmad, *et al.*, 2011).

In another place in Quran (the Holy book of Muslims), it is said that "O you believer, do not eat up the amounts acquired through Riba (interest), doubled and multiplied. Fear Allah, so that you may be successful, [130] and fear the fire that has been prepared for the disbelievers. [131] Obey Allah and the Messenger, so that you may be blessed. [132]" (Surah Al 'Imran, verses 130-132). Not only Islam but in Bibal also "Allah The Almighty" also forbidden interest and said that "If one of your countrymen becomes poor and is unable to support himself among you, do not take interest of any kind from him but fear your God that your countryman may continue to live among you. You must not lend him money at interest or sell him food at a profit." [Leviticus, 25:35-37]". Even the Prophet Jesus (Peace be Upon Him) also said that "Give to the one who asks you, and do not turn away from the one who wants to borrow from you". [Matthew 5:42, NIV Bible]".

Now a question arise that why interest was prohibited in Islam, Chirstanity and Judasim by Allah “The God” and His Messengers (Peace be upon him) and how its costs affect lives of human being? Answer to this question is not simple and has many dimensions including social and economic; first giving money on the basis of greed and selfishness results in elimination of spirit of sympathy and brotherhood among society, second the borrower is exploited which creates stress and depression for him due to mounting debt, third the rich people (who lend money) become richer and richer while poor people (who borrow money) become more poor and poor which creates cracks between societies (Abu Bakar, 2018). Among the economic drawbacks of interest, major one is the inflation rate which ultimately result in increased prices of goods and services and that is the point where central banks have to intervene and impose high monetary policy rates which become hurdle for corporate borrowing and restrict economic growth (Csiszar, 2018). In another study conducted by Arshad and Ali (2016), it was revealed that there is tradeoff between interest rate over inflation rate and unemployment in short term analysis. Also, interest has negative effect over exchange rate.

### **Research Methodology**

In this study Carroll’s CSR pyramid is being taken as a benchmark for the principles of Islamic finance over which Islamic banking operations base. There are four main components of CSR pyramid i.e. economic, legal, ethical and philanthropic. Which are discussed one by one in comparison with Islamic banking products and operations. A ready literature has been reviewed and results of different studies has been discussed in the light of both CSR pyramid

(components) and Islamic banking operations. It has been tried to find the fact that whether or not Islamic finance inhale the concepts of social responsibility in its core (or base). Level of unbiased was set high during whole study.

### **Results and Discussions**

#### **Comparison of Islamic Banking (Carroll’s CSR Pyramid)**

In CSR pyramid, core and major component is economic responsibility. When collectively talked about society and economic system; banks have major responsibility of moving funds between lenders and borrowers by reducing costs with the aim to efficient allocation of funds to boost up economic growth (Driga & Dura, 2014). Being financial intermediaries’ banks have to collect money from general public by encourage saving and make maximum funds available to the productive units of economy. Islamic banks in these regards are not only playing key role in economic growth (Kalim et al., 2016), but are also generating lot of revenue for their stockholders; which can be evidenced in a study initiated by Ramlan and Adnan (2015) in Malaysia hence resulted that Islamic banks are profitable than conventional banks. The study further revealed that return on assets (ROA) and return on equity (ROE) were the major contributors in bank’s profitability. In a similar kind of study carried out by Ullah *et al.*, (2017), also found that Islamic banks were more economically secure than both small and large commercial banks in Pakistan.

In another study conducted in Sudan, profit and loss sharing (PLS) mode of financing offered by Islamic banks bring positive change in both financial performance indicators i.e ROA and ROE (Elgadi and Yu, 2018). Profitability of Islamic banks also concluded by Siraj and Sudarsanan (2012) in

their study while analyzing data of 6 Islamic and 6 conventional banks from Gulf Cooperation Council Countries. A study initiated by Alzoubi (2015), to compare 10 Islamic and 33 Conventional banks across Kuwait, Saudi Arabia, United Arab Emirates and Jordan from 2007 to 2013; resulted that there is no significant profitability difference both but simultaneously observed that assets of Islamic banks increased 170% more than conventional bank's assets. Same kind of results also presented by Brown (2003) in his study while analyzing sample drawn from 19 countries during 1998 to 2001 and stated that performance of Islamic banks varied across countries. From above studies carried out by different researchers it is easy to say that Islamic banks are growing rapidly with the passage of time, and the profitability of Islamic banks is (if not more) equal to conventional banks. So, the Islamic banks are fulfilling the first and main component of Carroll's CSR pyramid and seems wisp of competition with conventional banks.

Talking about legal responsibility of Carroll's CSR pyramid in Islamic banking and finance, it means the rules and regulations followed by Islamic banks for their operations. In practical, conventional banks generally follows Basel rules formulated by Basel Committee whereas Islamic banks are regulated under the 27 standards, technical notes and guiding principles formulated by Islamic Financial Standard Board (IFSB) established officially in 2002 based in Kuala Lumpur Malaysia. According to Fares (2015), Islamic banks in different countries are governed by different rules like, in Malaysia and Indonesia conventional banks are encouraged to setup Islamic window or an Islamic banking subsidiary following guideline principles by IFSB (Islamic Financial Services Board).

Where is in Jordan, Bahrain and Palestine conventional and Islamic banks are fully separated. It is stated by the author that like in Pakistan and Iran; only Islamic banks are encouraged to operate but contrary to this statement it is a fact that Islamic banks in Pakistan have only 13% share in total banking assets by June 2018 (Bhatti, 2018).

During practice, central banks of different countries (where Islamic banking has remarkable share) govern Islamic banks same as conventional banks, means that they generally compel them to follow Basel guidelines but it is also true that Islamic banks were not kept in mind while policies made by the Basel Committee and they concentrate on conventional banking because most of the member of Committee belongs to central banks of non-Muslim majority countries (Perry & Rehman, 2011). Generally Islamic banks regards the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and IFSB rules/standards. A group of Islamic scholars called Shariah Advisory Board (SAB) also govern the bank's activities individually and formulate policies to comply with Shariah rulings. SAB of any bank is first, responsible of adopting Shariah law by the bank and second make Shariah compliant products for the bank to compete conventional banks or remain in the financial market. Shariah law in Islam is comprise of guidelines extracted from Quran (Book of God) and Hadith (sayings of Prophet Muhammad) and core of the Shariah law is to pay full submission to God where The God expects transparency, trustworthiness and responsibility in dealing with others.

These three characteristics (transparency, trustworthiness and responsibility) are the basis elements of corporate governance in an organization and hence Islamic banks base

on good/ethical governance structure (Shanmugam, 2006). In addition, SAB of Islamic bank govern all the financial matter in view of Shariah as well as mandatory statutory regulations. Ethics or ethical management now a days is being incorporated in core business strategies by the businesses at world level. Considering the religious teaching of any religion, Islam also teaches honesty, truthfulness and trustworthiness like all other religions. Talking about the ethical aspect of Islamic banking, it is noted that business ethics are vital part of operations, procedures and approaches used in the Islamic banking (Gilani, 2015). According to Bozovic (2007), the system of ethical banking is based on responsibility, equity, accountability and sustainable development. Beyond this, it is believed that ethical banking has emerged from Islamic banking and is the core of Islamic finance; where interest is prohibited and Gharar (uncertainty) is avoided to be cash out.

Because interest per se is a moral evil and is root cause of continuously increasing difference rich and poor. In modern American economy, interest is plight for poor, as they have to bear high costs for loan and ultimately does not allow them productivity growth (Lewison, 1999). Whereby, Islamic banks in these regards are thought as development institutions, which not only safeguard the funds of investors but also provide capital to needy institutions without charging any cost, simply on investment or partnership basis both on pre-agreed profit/loss sharing basis. So Islamic banks may be thought as finance house, which directly take part into economic activities and help economic growth and every dollar spent is first taken into consider its economic viability of the funded

project. Conventional banks on the other hand, act as loan houses; where money is taken at low interest rate and lend at higher interest rate to make their own profits. Means conventional banks does not take part in any productive activity, rather for making money through speculation and keeping their self away from any risk.

The possible reason behind the phenomenon is that, as and when conventional banks can make more money from speculative activities or interest income then why these should face the difficulties of pricing policy, management relations, labor costs, etc to earn low possible profits from productive activities (Toutouchian,

2009). Philanthropic portion of Carroll's CSR is placed at top of figure, which aims at taking high priority of society's need of acting as good corporate citizen. Whereas, society is comprised of organization's employee, general public and other local communities which may include all living creature. This portion is considered of high importance and desirability by society after meeting rest of responsibilities (Gitman and McDaniel, 2002). But according to a theory presented by Waldman *et al.*, (2004) states that perceptions of executive leadership of a firm directly affect the state of inclination towards CSR and the companies where are CEOs already stimulated towards CSR are strategically involved in CSR activities. Decker & Sale (2009), also presented advocacy results of this theory and were of the view that CSR is a voluntary activity, which is now a common practice of banking sector for better reputation.

### **Conclusions and Recommendations**

The concept of social responsibility has been turned more strategic, because the expectation of today's societies has been changed from social to sustainable

development. Now the degree of involvement of banks in CSR activities may turn their reputation into good or bad. Financial sector, now a days is very keen to keep more social and natural environment with its customers. Comparison of widely used measure of social responsibility i.e. Carroll's CSR pyramid, in this study resulted that Islamic banking principles are emerged from the concept of social responsibility. As core of Islamic banking is "Prohibiting of Riba (interest)" from all banking activities, which ultimately affect the social and economic wellbeing of societies by abolishing selfishness and greed among customer and vendor. Whereas promotes spirit of the sympathy, brotherhood, reduces stress and maintain equal distribution of wealth among rich and poor by providing equal opportunities to poor for growth, whereas providing capital to suppressed sectors of economy to increase productive activities at low cost.

In economic dimension of CSR pyramid, Islamic banks takes deposits from customers and allocate funds to needy sectors of economy at either profit/loss sharing basis or sale/purchase agreements, hence eliminating interest from society because interest may increase inflation rate, dominate economic growth and widen gap between rich and poor. In the legal aspects, Islamic banks generally follow rules/guidelines formulated by AAOIFI and IFSB which are in parallel to Basel committee rules followed by conventional banks. A group of Shariah scholars (Shariah Advisory Board) appointed by each Islamic bank individually, help banking management to formulate Shariah compliant products and ensure transparency, reliability and sense of responsibility. Ethical practices are also core of Islamic finance which ensures accountability, equity and sustainable development, as it is thought that

ethical banking has been emerged from Islamic financial concept. Because in general, Islamic finance tries to avoid interest-based financing where Gharar (uncertainty) is tried to be avoided and presence of both (interest & uncertainty), promote greed among people and is plight for poor.

Islamic banks in today's society are acting as good corporate citizen and are trying to fulfill the needs of society, but the degree of inclination towards social activities mainly depends upon the top management which is totally responsible of social spending. In the light of above literature, it has been concluded that Islamic banks (in the operations and products) are more inclined towards the concept of social responsibility as compared to conventional ones. And are acting as developing institutions rather than loan houses. (The results of this study cannot be used as base for the investment and capital budgeting decisions by anyway). This paper is of theoretical in nature and can be further broaden by taking data on CSR activities from the conventional and Islamic banks to make comparison. The impact of Islamic banking operations can be analyzed over economic productivity to find out comprehensive results; with the aim to find degree of effectiveness/efficiency. Therefore, this study is expected to provide suitable guidelines to policy makers in revisiting their policies towards development of Islamic banks around the country and globally.

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