Corporate social responsibility of Islamic financial institutions and businesses

Optimizing charity value

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Abstract

Purpose – As per Islamic business ethics, corporate social responsibility (CSR) of the business organizations and Islamic financial institutions (IFIs) should be seen as a benefit rather than a cost. The intense commitment of Islam to justice and brotherhood demands that business organization should take care of some of the needs of the community. Therefore, there is needed that the IFIs should create a congenial atmosphere of strategic linkage between Islamic charity organizations and business companies. The main purpose of this paper is to study the current practices of CSR of the business organizations as well as IFIs and to explore further scope of optimizing charity value.

Design/methodology/approach – The study evaluates the CSR of the businesses and IFIs based on secondary sources information and develops a model which creates a strategic link between Islamic charity organizations and business companies.

Findings – A collective approach of businesses, IFIs and awqaf/charitable foundations would increase the flow of corporate resources into the social sector.

Originality/value – In order to fulfill the role of CSR and to optimize charity value, the businesses should build up non-profit infrastructure to achieve their objectives more cost-effectively. On the other hand, the Islamic charities can also get benefits by using the commercial infrastructure of the business organizations and to make contributions more effectively in the social sector. There is no inherent contradiction between improving competitive context of business and making a sincere commitment to bettering society.

Keywords Charity, Corporate social responsibility, Financial institutions, Islam

Paper type General review

Introduction

Corporate social responsibility (CSR) has grown enormously in the last 25 years and most business organizations feel to give in charity. The business organizations involving charitable giving and reflecting the highly competitive environment of the 1990s has been termed “strategic charity.” It involves corporate giving which serves dual purposes: contributing funds to charitable causes while simultaneously benefiting the firm's financial bottom line and enhancing business political legitimacy (Hemphill, 1999, p. 57). “Strategic charity” has become an accepted practice that allows a corporation to satisfy altruistic impulses to contribute in charitable causes while serving the bottom line. In this way the corporate community investment has emerged through the objectives of CSR programmes and business organizations some times take care of neighbor through its philanthropic responsibility programmes (Carrol, 1979).

Pure charity is concerned with assistance to education, arts and culture, health and social services, civic and community projects. While “strategic charity” combines pure
philanthropy and business sponsorship with giving programmes that are directly or indirectly linked to business objectives. One of the characteristics of the “strategic charity” is a joint sponsorship of one or more corporations’ programmes to implement through purposefully created charity foundations in order to optimize the charity value (Post et al., 1996, p. 484). For example, in 2006 Warren Buffett donated US$37 bn to Bill Gates Foundation for charity work in the area of health care, education and other socio-economic activities all over world especially for the underdeveloped African countries.

Growing awareness of and demand for investing in accordance with Islamic ethical principles on a global scale have been catalyst towards making the Islamic banking and financial system as a flourishing industry. This is also a reflection of increasing wealth and capacity of investors, both Muslim and non-Muslim, to seek and invest in new investment products that serves their needs. The Islamic financial institutions (IFIs) earn profits as the other business firms earn profits. Many people say that IFIs should have involved “strategic charity” activities. Business of IFIs including Islamic banks is based on Shari’ah principles which need the IFIs to operate with the commitment of social responsibility.

While this paper will look at, in brief what business organizations as well as IFIs have contributed in charity, there is also a need for more study about current practices of CSR and to suggest how they can optimize the charity value. Given the current haziness surrounding corporate or company’s charitable activities, this seems an appropriate time to address the most basic research questions: Is there any IFIs business case for CSR? How the corporations engage in charity activities? What should be strategy of IFIs in CSR issues and how corporate body can contribute to optimize charity value? These are the issues which will be addressed in the paper. The paper proceeds as follows. We have discussed about methodology of the study and reviewed the literature related to CSR of business and charity with special reference to Islamic charity as well as IFIs business cases. We have also discussed about the strategic context of IFIs in CRS and then discussed how to optimize the charity value. Lastly, we drawn conclusion of the paper.

Methodology and literature review
Methodology
The methodology is the methods for determining what is real and it provides arguments which support various preferences entertained by the scientific community for certain rules of intellectual procedure (Montague, 1952). The present study draws from secondary sources of the literature and designed to investigate and produce knowledge about the CSR of business organization and how to optimize the charity value of the IFIs in particular and business’s in general. We searched literature related to our study and referred various books, journals in the area of CSR of the corporations and allied subjects. Annual reports of some of the IFIs, material produced by charitable organizations, etc. have also been referred. We did not test any hypothesis in the study. Davis and Parker (1979) state that: “Some topics are not amenable to hypotheses statements. For example, conceptual development and comparative analysis are not usually able to be stated as hypothesis... and therefore the research methodology can be clarified and defined by restating the topic in terms of a set of objectives for the research” (p. 24).
Literature review

Davis and Blomstrom (1975) define “CSR” as the obligation of the internal corporate decision makers to “take action which protects and improves the welfare of society as a whole along with their own interests” (p. 6). While CSR does not negate earning a profit, it does require corporations to balance the benefits to be gained against the cost of achieving those benefits. According to Post et al. (1996): “Corporate social responsibility means that a corporation should be held accountable for any of its actions that affect people, their communities, and their environment” (p. 37).

One of the most visible ways a business can help a community is through corporate charity. The economist Milton Friedman arguing in a 1970 New York Times Magazine article[1] says that the only “social responsibility of business is to increase its profits.” He argues that the corporation is an instrument of the stockholders who own it. If the corporation makes a contribution, it prevents the individual stockholder from himself deciding how he should dispose of his funds. Friedman (1970) further says that if charitable contributions are to be made, it should be made by individual stockholders or, by extension, individual employees and not by the corporation. The way most corporate charity is practiced by the corporate sector, Friedman may be right. But it is fact majority of this type corporate contribution programmes are diffused and unfocused (Levy, 1999). Most consist of numerous small cash donations given aid to local civic causes (Guernsey, 1999). These piecemeal contributions often reflect the personal beliefs and values of executives or employees of the company rather than being tied to well think social or business objectives. Naturally, jointly or collective charity work of Corporation with Charity (Awqaf) Foundation in any social project differs from a corporation’s direct token donation that it is funded in a different manner and has a different philosophy.

Under US federal regulations, charity foundations must give away 5 percent of its assets a year. The United Way, a national charity organization in USA that funnels funding to charities through a payroll-deduction system, has been in existence since the 1920. With the creation of the Community Chest in the 1920s, the forerunner of today’s United Way, charitable contributions moved from the individual philanthropist's contributions to charity to corporation donations. There are many success stories of its charity work.

In 1913 J. D. Rockefeller donated $183 million to start the Rockefeller Foundation. “The point to emphasize is that these business leaders believed that business had a responsibility to society that went beyond or worked in parallel with their efforts to make profits” (Post et al., 1996, p. 41). For example, in 1997 Ted Turner, founder of CNN, made one of the largest philanthropic donations to a specific cause when he donated $1 billion to the United Nations’ Children’s Fund. He then challenged wealthy business people to follow his lead to promote human welfare and goodwill. On 16 September 1999 Bill Gates created $1 billion “Gates Millennium Scholarship” designed to create college scholarships for black, Hispanic and American Indian students (Levy, 1999).

Above mentioned collective business charities are only exceptional cases because “strategic charities” model is not followed by entire corporate sector. In general, according to contemporary business terms, first, social and economic objectives are separated and distinct, so that a corporation’s social spending comes at the expense of its economic results. Second, there is the assumption that corporations, when they address social objectives, provide no greater benefit than is provided by individual donors. It is true that these assumptions of the corporate sector is reasonable when corporate contributions are unfocused and piecemeal (Sternberg, 2000). Furthermore,
exercising social responsibility by businesses is seen as a cost, and cost implies a reduction in the net profits, and this in turn can be considered to be against the interest of the business (Guernsey, 1999). From this perspective, it can be understood why business organizations limit their time and other resources for meeting their social responsibilities.

In order to make the business organizations in complying and fulfilling their social responsibilities, some kind of legislation is required. To implement this legislation, there is involvement of cost. In turn, this may reduce social responsibility to a legal obligation and, which over time, weakens the importance of it being viewed as a moral obligation. Furthermore, the drawback is that the law which may act as a deterrent, it cannot reach all spheres of business responsibility, and hence can be undermined. To ensure that business organizations fulfill their social responsibilities, the external mechanisms of control are relied upon.

In contrast, from an Islamic perspective, CSR exercised by business organization or IFIs is seen as a benefit rather than a cost. Islamic business ethics has given different dimension and an important strategic way to think about charity works (Abu-Sulayman, 1976). In fact, Islam takes an integrated view of individuals and society. It also broadens the frame of problem definition in terms of scale, scope and time horizon. The intense commitment of Islam to justice and brotherhood demands that business organization should take care of some of the needs of the community. Islamic charity is almost the only virtue which is sufficiently appreciated by mankind. For those who give in charity, men and women, and a loan to God a beautiful loan, it shall be increased manifold (to their credit) and they shall have, (besides) a liberal reward (Al-Qur’an, 57, p. 18). God deprives usury of all blessing, but will give increase for deeds of charity (Qur’an, 2, p. 276). By spending in charity, the wealth does not decrease... (Muslim Hadith). In other words, costs (in different forms) that are pushed onto society will come back as greater benefits for business organizations. The institution of zakah, that is, a wealth tax comprising compulsory charitable-giving for specially designated groups in society, facilitates the care of all members of society. According to Islamic business ethics, the rich are not the real owners of their wealth; they are only trustees. They must spend wealth in accordance with the terms of the trust, one of the most important of which is fulfilling the needs of the poor (Naqvi, 1981).

**Empirical evidence from literature.** Recent emphasis on CSR and more overt association business benefit do have implications for charities. Furthermore, the CRS should not be viewed in a narrow sense – solely in meeting legal obligations. Rather, in addition, consideration should be given to meeting spiritual and moral obligations by drawing on the inner resources and the deeper positive emotions such as mercy and compassion which nurture a sense of duty towards others and a caring attitude (Parvez and Ahmad, 2005). Human beings, and by extension businesses, cannot live by bread alone. Besides economic needs, social and spiritual needs should also be taken into consideration while addressing CSR. In the broader context the business organization is an integral extension of the family and community. This is primarily related to a better understanding on both sides of the reasons that they might work together for meaning charity for greater interest of both business and communities. During golden rules of both first Caliph Abu Bakar and second Caliph Omar, there was the worthy but rather unfocused “pious businessmen” syndrome where the corporate donation was bestowed upon a grateful and suitably humbled charity.

In the 1990s, a number of Islamic banks have been established whose objectives are directed towards social equality, eradication of usury as well as distribution profit out
of their banking business. A public statement issued by International Association of Islamic Banks (IAIB) (1990) clearly outlined: “The Islamic banking systems involves a social implication which is necessarily connected with the Islamic order itself, and represents a special characteristic that distinguishes Islamic banks from other banks based on other philosophies. In exercising all its banking or development activities, the Islamic bank takes into prime consideration about social implications that may be brought about any decision or action taken by bank. Profitability – despite its importance and priority – is not therefore sole criterion or the prime element in evaluating the performance of Islamic banks, since they have to match both between the material and the social objectives that would serve the interests of the community as a whole and help achieve their role in the sphere of social mutual guarantee. Social goals are understood to form an inseparable element of the Islamic banking system that cannot be dispensed with or neglected” (IAIB (1990) quoted from Al-Omar and Abdel-Haq, 1996, p. 27).

We see that a vast majority of FTSE Islamic index and Dow Jones Islamic index companies now offer volunteering and giving schemes in charities. Recently, more sophisticated relationships have been developed; for example cause-related marketing campaigns that link contribution to charity to product sales. High-profile versions have included Islamic Bank Brunei Berhad’s Computers for educational institutions and Islamic Bank Berhad Malaysia’s community welfare issues, have been many examples. In these relationships the banking product has linked to the community initiative or charity brand with the overt intent of mutual benefit.

Businesses do not function in isolation from the society around them. In fact, their ability to compete depends heavily on the circumstances of the locations where they operate. Improving education, for example, is generally seen as a social issue, but the educational level of the local workforce substantially affects a company’s potential competitiveness. Well-established Islamic publishing companies like Iqra International’s Books for Schools in USA and donation of books for building community libraries by the Islamic Foundation in UK are such examples.

The more social improvement relates to a company’s business, more it leads to economic benefits as well. In establishing a Networking Academy, for example, Islamic Bank Bangladesh Ltd has focused not on the educational system overall, but on the training needed to produce young competent persons – a particular kind of education that made the most difference to competitive context of Islamic Bank Bangladesh Ltd. Furthermore, it has established Islamic Bank Foundation which established a number of schools of International standard in the different places in Bangladesh. The Ibn Sinha Group of the Islamic Bank Bangladesh Ltd established specialized as well as general hospitals which are providing healthcare service to the poor with nominal fees.

In 1995, bank has initiated rural poverty elevation programme under its Rural Development Scheme (RDS). To handle this scheme, Islamic Bank Bangladesh Ltd has introduced Islamic microfinance programme through its rural branches to bring all the villages of Bangladesh under the coverage of this scheme (IBBL; Annual Report, 2004). As on 31 December 2004, all most 4,700 villages have been covered under the Islamic microfinance programme. Bank invested to the tune £727,000,000 in income generating activities such as poultry, goat and milk cow rearing, vegetable cultivation, etc. based on either maharaja or musharakh mode of finance. Islamic microfinance programme runs on homogeneous group basis. About 350,000 group members were benefited with this scheme. This success story indicates that in the longrun, social and economic goals are not inherently conflicting but integrally connected.
Looking at attitude of IFIs in respect of CSR, as researched by Sairally (2005) revealed that 84.4 percent of the IFIs were fully aware of social commitment. In her survey, some 20 percent of the questionnaires, 48 IFIs responded from 19 countries. Out of total responses, 27.8 percent were associated with community’s issues such as funding in the income generating activities in the poor area. On the other hand, 13.9 percent of the respondents were concerned with other ethical issues while 5.6 percent were concerned with “sustainable development.”

In their study Dusuki and Dar (2005) examined the perception of stakeholders in respect of CSR of Islamic banks with Malaysian sample on 12 attributes. The indicators were:

1. product price factor;
2. customer service quality;
3. convenience (parking facility, interior comfort, etc.);
4. location being near home or work place;
5. friendly personnel factor;
6. knowledgeable and competent personnel factor;
7. Islamic working environment;
8. economic and financial reputation;
9. respect for human rights;
10. Islamic reputation and image;
11. involvement in community affairs (giving donation, scholarship, etc.); and
12. environmental practice and impact factor.

These criteria were examined using factor analysis. Their results indicated that customer’s selection of Islamic banks were predominantly a combination of Islamic and financial reputation and quality service offered by the banks. Overall, the factor analysis indicated that CSR factor was considered as one of the important factors in making a judgment and decision to patronize Islamic banks. Their results are consistence with earlier studies (Haron et al., 1994; Abbas et al., 2003).

Turning to employee attitudes, as researched by Hassan (2004) found that: 79 percent of employees of IFIs favored that they would not work for an organization in whose values they did not believe; 55 percent chosen their current organization because they believed in what it did and stand for; 99 percent cared if their organization acted responsibly; and 70 percent of employees expressed interest in taking part in employer community schemes. These examples are closely associated with CSR of the IFIs.

**Strategic context of IFIs in CSR**
The IFIs exercise considerable influence over most areas of economic activity, from the individual struggling to mortgage repayments, to the directors of a large company or a multinational and analysts at the company Annual General Meeting. As a stakeholder of corporation or companies, IFIs are usually the most powerful, yet have frequently been ignored from the perspective of CSR. Thus it is not surprising that the IFIs have rarely used their influence for CSR matters to their clients. This situation represents a potential opportunity, particularly useful in view of the fact that the IFIs have recognized that CSR is not supposed to be different from other businesses run by
Muslims. Therefore, it is imperative to see where IFIs can motivate to their corporate clients in respect of CSR. The main customer groups are reviewed below.

**Large companies**

Islamic banks are substantial lenders to large companies, and also providing a variety of financial services, such as transaction processing and treasury management, etc. Their ability to influence in respect of social responsibility to the larger corporations cannot be denied. Some companies may be more subject to Islamic bank influence such as private companies (unlisted) or those with tightly held shares, smaller listed companies, etc. In this field, the Islamic banks can impose a variety of conditions relating to CSR, through conditions and covenants on lending. The CSR impact assessments can be a useful tool for identifying company in CSR track record and suggesting CSR practices.

**Small and medium enterprise (SMEs)**

The IFIs are the most significant source of financing to SMEs. The Islamic banks can impress to the SMEs in the following areas:

*Influence management through lending arrangements*

When lending to SMEs, the Islamic banks consider the quality of management and employer-employee relation and employees service conditions, which can include other CSR factors. The Islamic banks can be explicitly factor in CSR considerations when deciding whether to extend investment facility, in conditions they impose on lending and in the terms they offer.

*Supporting companies with infirmities*

The IFIs are a major source of information for companies, particularly SMEs in the Islamic countries, and there is potential for IFIs to act as a conduit of information in the CSR area.

*Specialist environmental financial services*

There is scope for Islamic banks to develop Islamic financial products (such as green product), which contribute to the environment, such as energy efficiency loans or leasing of environmental technology. Furthermore, an Islamic financial service company might identify with organizations developing financial literacy and debt management. A utility company might work with key charities to reduce fuel poverty. This type of example is closely associated with corporate action on CSR.

In our forgoing discussion we have seen that CSR is applicable to the entire corporate sector including IFIs. There is no reason why one business will differ in CSR from others when all the dimensions of the CSR are in consonance with Islamic business ethics. IFIs function as a business organizations. Therefore, it will be appropriate that charitable works (beyond zakah and qard al hasan) of IFIs and other corporate sectors may be initiated through specially established social welfare or charitable organizations. Islamic banks/financial institutions are powerful stakeholders of the larger and smaller companies as well as substantial lenders. Hence, IFIs are able to influence to the larger and smaller companies in respect of social responsibility. On the other hand, they will be able to create congenial atmosphere for strategic link between Islamic charitable organizations and business companies.
How to optimize charity value by corporate sector and charity foundations

Understanding the link between Islamic charity and competitive context of business will be helpful to identify where they should focus their corporate giving. This understanding may also help to find the ways in which Islamic charity creates value and how they can achieve the greatest social and economic impact through their contributions. There are four ways in which Islamic charitable organizations can create social value. They are: selecting the best grantees, signaling other donors, improving the performance of grant recipients and advancing knowledge and practice in the field. These efforts will build on one another: increasingly greater value will be generated as a donor who will move up the ladder from selecting the right grantees to advancing knowledge (please see Figure 1 – How to optimize charity value). The same principles apply to corporate giving, pointing the way to how corporate charity can be most effective in enhancing competitive context. Focusing on the four principles also will ensure that corporate donations will have greater impact than donations of the same magnitude by individuals.

Selection of grantees

Majority of the charity activities by the charity foundations involve giving money to other organizations that actually deliver the social benefits. Impressive results may be achieved by a donor, largely to be determined by the effectiveness of the recipient. Selecting a more effective grantee or partner organization will lead to more social impact.

Selecting the most effective grantees in a given field is not easy. It may be obvious which charitable organizations raise the most money, have the greatest prestige, or manage the best development campaigns. But such factors may have little to do with how well the grantees will use contributions. Extensive and disciplined research is usually required to select those recipients that will achieve the greatest social impact. Individual donors rarely have the time or expertise to undertake such serious due diligence. Islamic Charity Foundations (for example, Muslim Aid UK, Islamic Relief Worldwide) are far more experts than individuals, but they have limited staffs. Corporations, on the other hand, are well positioned to undertake such research if their philanthropy is connected to their business and they can tap into their internal capabilities, particularly the financial, managerial and technical expertise of employees. Whether through their own operations or those of their suppliers and customers, corporations also often have a presence in many communities across a

Figure 1.
How to optimize charity value
country. This can provide significant local knowledge and the ability to examine and compare the operation of non-profit.

The International Islamic Charitable Organization, Jeddah, Saudi Arabia for example, uses its overseas partner organization’s offices to identify elementary education projects to fund. The Dubai Islamic Bank assembles team of employees with diverse management and financial skills to examine the inner-city economic development organizations that its foundation supports. The teams visit each non-profit, interview management, review policies and procedures, and report to the Dubai Islamic Bank Charity Foundation on whether support should be continued and, if so, where it should be directed. This level of attention and expertise is substantially greater than most individual donors, Islamic bank charity foundations, can muster.

**Signaling other donors**

Islamic charity organizations/foundations can publicize the most effective based level non-governmental organizations (NGOs) and promote them to other donors, attracting greater funding and thus creating a more effective allocation of overall charity spending. Corporations bring uniquely valuable assets to this task. First, IFIs and business firm’s corporate reputations often command respect, becoming imprimaturs of credibility for grantees. Second, they are often able to influence a vast network of entities in their cluster, including customers, suppliers and other partners. This gives them far greater reach than individual donors or even most NGOs. Thirdly, companies often have access to communication channels and expertise that can be used to disseminate information widely, swiftly and persuasively to other donors.

It is very important to send signal to other donors in corporate charity because it mitigates the free rider problem. Collective social investment by participants in a cluster can improve the context for all players. It also reduces the cost borne by each one. By leveraging its relationships and brand identity to initiate social projects that are funded by others, a corporation improves the cost-benefit ratio. By tapping each company’s distinctive expertise, collective social investment can be far more effective than a donation by any one company.

**Performance improvement of grant recipients**

By improving the effectiveness of Awqaf Foundations, IFIs/corporations create value for society, increasing the social impact. While selecting the right grantee improves society’s return on a single contribution, and signaling other donors improve the return on multiple contributions. Improving grantee performance can also increase the return on the grantee’s total budget.

The corporations/IFIs will have the ability to work directly with awqaf/charity foundations, non-profits/NGOs and other partners. Here, the IFIs can play a good role of facilitators to bring corporation or companies with their unique assets and expertise that individuals and foundations lack. These will enabling them to provide a wide range of non-monetary assistance that is less costly and more sophisticated than the services most grantees could purchase for themselves. Because the corporations typically make long-term commitments to the communities in which they operate, they can work closely with local awqaf/charity foundations over the extended period of time needed for meaningful organizational improvement.

The Dubai Islamic Bank took advantage of its corporate expertise in launching its Community Renaissance Initiative. Recognizing that its major markets are in cities of United Arab Emirates, Dubai Islamic Bank decided to focus on inner-city economic
revitalization as perhaps the most important way to improve its context. The bank combined its charity contributions with its expertise in financial services, such as small business services, inner-city lending, home mortgages and venture capital. The bank personnel provided technical advice and small business financing packages to local companies as well as home mortgages and home-buyer education programmes.

Advancing knowledge and practice

Innovation drives productivity in the non-profit sector as well as in the commercial sector. The greatest advances come not from incremental improvements in efficiency but from new and better approaches. The most powerful way to create social value, therefore, is by developing new means to address social problems and putting them into widespread practice. The expertise, research capacity and research unit of corporate sector (including IFIs) can help to charity foundations in creating new solutions that they could never afford to develop on their own. Just as important as the creation of new knowledge is its adoption in practice. The know-how of corporate leaders, their clout and connections, and their presence in communities create powerful networks for the dissemination of new ideas for addressing social problems.

By tying corporate charity work to its business and strategy, a company can create even greater social value in improving grantee performance than other donors. Charity (awqaf) Foundations too would be benefited. They would see an increased and more predictable flow of corporate resources into the charity to fulfill the CSR. Just as important, they would develop close, long-term corporate partnerships that would better apply the expertise and assets of the for-profit sector to achieve social objectives. Just as companies can build on the non-profit infrastructure to achieve their objectives more cost-effectively, non-profits can benefit from using the commercial infrastructure.

Conclusion

Business exists to make a profit for its stockholders and those contributions to various causes affect profits. However, businesses should have some social responsibilities. Corporations and IFIs must decide if the long-term gains will justify making a contribution to a non-profit cause. Collective approach of corporations, IFIs and awqaf/charitable foundations would increase the flow of corporate resources into the social sector. It is important; they should develop close, long-term corporate partnerships that would better apply the expertise and a portion of the profit of the corporations to achieve social objectives. Just as companies can build on the non-profit infrastructure to achieve their objectives more cost-effectively, non-profits/Islamic charities can benefit from using the commercial infrastructure. There is no inherent contradiction between improving competitive context of business and making a sincere commitment to bettering society. Indeed, as we discussed that if a company’s charitable work is linked to its competitive context, the greater the company’s contribution to society will be. It needs to be systematically pursued in such a way that CRS will optimize the value which can offer corporate sector a new set of competitive tools that will justify the investment of resources. At the same time, it can unlock a vastly more powerful way to make the world a better place.

Note

1. This has been referred from Friedman (1999).
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