



Corporate Social Responsibility Disclosure: A Study of Islamic banks in Malaysia and GCC Countries

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Abstract

The primary aims of this research is to investigate the CSR disclosure practice among Islamic banks in Malaysia and GCC. In fulfilling the research aims, annual reports of GCC Islamic banks for the period 2013 have been analyzed using manual content analysis; which involves 9 observations. The CSR disclosure index is constructed based on 12 dimensions using AAOIFI standard no 7, 2010. The analysis shows a low level of average CSR disclosure (46%) than expected. Whereas, the highest level of CSR disclosure score is 67% and the lowest is 25 % among the sample Islamic banks. The current study suggests that there is a need for improving the current CSR disclosure practice in GCC Islamic banks by imposing additional constraints on the banks management to increase the level of awareness regarding to CSR disclosure issues. The findings provide an important implication to the body of knowledge, as they pave the ways for further investigation in CSR practices among Islamic banks. It's also provide an important implication for AAOIFI as a regulatory body to enhancing the CSR disclosure practice among Islamic banks, and at the same time remain competitive in the global banking industry.

Keywords: AAOIFI, Corporate Social Responsibility (CSR), Content analysis, Disclosure Level, Islamic banks

1. Introduction

The IFIs (Islamic Financial Institutions) can be defined as any institution that plays the role of the financial intermediary that strictly abides by the provisions of the *Shariah*, and it is not limited to Islamic banks and Islamic insurance (AAOIFI, 2010). In this study, the researcher decide to narrowly focus in Islamic banking industries which operates in GCC countries (United Arab Emirates (UAE), Bahrain, Qatar, Kuwait, Saudi Arabia and Oman) and Malaysia due to their same nature of business and functions. In general, Islamic banking is a banking activities which is based on *Shariah* principles and represent the absolute ethical codes of Islamic religion and code of conduct. These Islamic codes impose strong social obligations on Muslim individuals and organizations (Maali et al, 2003). According to the figure release by the Banker (2013), global Islamic assets held by commercial Islamic bank exceeded US \$1.8 trillion in 2013 and it is expected to growth positively in 2014. Financial institutions, both Islamic and conventional, have a significant role in the society and they are expected to be more socially responsible to their stakeholders. Due to religious identity, Islamic banks are expected to be more socially responsible to the community or society rather than conventional financial institution (Farak, Mallin, & Ow-Yong, 2014).

CSR from the Islamic point of view represents one's accountability to God (*Allah*), it's also comprehends one's accountability to society Maliah (2000) and therefore it can be construed as promoting social justice and social responsibility. A firm which are operating in Islamic surroundings is expected to fulfil the *Maqasid Shariah* (objective of *Shariah*) and conscious of the impact of community activities (Abdullah & Furqani, 2012; Rosly, 2010). *Maqasid shariah* or the objectives of *Shariah* is the

foundation for the *Shariah* rules and regulations; it provides the knowledge, understanding and justification for the principles of *Shariah* (Dusuki, 2009). According to Mohammad & Shahwan, (2013) *Maqasid Shariah* constitute all the elements to human nature (*fitrah*) and it's also stresses on the five main basic needs of human being namely as protection of life (*Al-Hayah*), protection of religion (*Ad-Deen*), protection of mind (*Al-Aql*), protection of wealth (*Al-Mal*) and protection of dignity (*Al-Muruah*). The main aim of *Maqasid Shariah* is to benefit and protect the Muslims, discipline and structure the living of the Muslims according to the Islamic teachings as pronounced in the *Quran* and *Hadith*.

From general point of view, the corporate social responsibility (CSR) can be defined as a concerned about the way in which companies meet the obligation both to their employees and community (Luan, 2005). Whereas, in the Islamic point of view, the CSR can be described as a relation of leader (*Khalifah*) in fulfils its obligation to the God (*Allah*) and to the community. Therefore, social role is an important element for Islamic banks, where prior research (Amin, Rahman, Jr, & Hwa, 2011; Farag et al., 2014) described Islamic banks as banks having a social face towards the community. This role is mainly a reflection of the importance of upholding the Islamic principles upon which these banks operate and how they address these social issues (Maali et al., 2003). Hence, the bank needs to disclose all related information regarding its social activities to the public. Hence, the communities are expecting an enhancement in transparency, greater involvement in solving social issues and improved ethical behavior from the Islamic banks.

This study attempts to look at the issue on how far, does Islamic banks in GCC and Malaysia disclose its corporate social responsibility information's and its compliance with the guideline issued by AAOIFI, 2010. Thus, this study tries to examine the extent of CSR disclosure in the Islamic bank annual reports in

2013 to get a clear view of the CSR disclosure practice. Additionally, this study tries to look at the trend of CSR disclosures, whether the bank improves its CSR disclosure and whether CSR disclosure is affected by some external events such as financial crisis in 2007 to 2008 which also known as *Subprime mortgage crisis*. A study by (Rahman, 2010b) shows that the level of CSR disclosure among Islamic bank in Malaysia are not effected due to the financial turmoil crisis in 1997. During that time BHB (Bank Islam Holding Berhad) currently known as BIMB had been incorporated and its need to disclose more information especially CSR activities to build up a good image attracting an investor and the public to place their money in that bank.

2. Literature review

The concept of disclosure is highly related to the concept of accountability: in an Islamic context, the community has a right to know on how organizations that exist in the community affect their well-being. The duty to disclose the truth information is a very important issue in Islamic context, and this duty applies to all businesses as much as to individuals (Maali, Casson, & Napier, 2006). This duty is clearly emphasized in Quran: "and cover not truth with falsehood, nor conceal the truth when you know" (Quran 2:42). In Islam, God (*Allah*) is omniscient. God says "I know what ye reveal and what ye hide" (Qur'an, 4:33) and also "He (God) knows what is manifest and what is hidden" (Quran, 87:7). From this Quranic verses, it shows on how important the concept of accountability in Muslims life and how they are accountable for every actions in this world.

Accountability to *Allah* implies accountability to society, the duty to disclose the truth is owed to the society as well as to *Allah*. The requirement for Muslims to disclose the information is intended to help the community to know the effect of any activities or a business on its wellbeing. Muslims are responsible for their actions and must take into account this responsibility towards the society in where they live as their actions affect the society (Ali Aribi, Zakaria and Arun, 2014; Belal, A., Abdelsalam, O., and Nizamee, 2014; Al-Mograb, 1996, p. 20).

This is highlighted in many of the Quranic verses and the *Hadith*. God says "of their goods take alms that so thou mightiest purify and sanctify them" (Quran, 9:103). The requirement to pay *Zakah* is a clear example of such obligation to show how Islam concern with an issue of CSR in the community. The Quran clearly specifies eight uses for *Zakah*: "The alms (*Zakah*) are only for the *Fuqara'* (the poor), and *Al-Masakin* (the needy) and those employed to collect (the funds); and to attract the hearts of those who have been inclined (towards Islam); and to free the captives; and for those in debt; and for Allah's Cause, and for the wayfarer (a traveler who is cut off from everything); a duty imposed by Allah. And Allah is All-Knower, All-Wise." (Quran 9:60). The information provided by Islamic business institution such Islamic banks in addition to showing its compliance with the *Shariah*, it should therefore support the socio-economic justice among the community. Islamic banks are expected to enhance their transparency, greater involvement in solving social issues and improved ethical behavior in conducting their business.

A number of studies have investigated the CSR disclosure practice by Islamic banks using content analysis and disclosure index method (see: Belal, A., Abdelsalam, O., and Nizamee, 2014; Farag, Mallin, & Ow-Yong, 2014; Platonova, 2014; Rahman & Bukair, 2013, Abdul Rahman, Md. Hashim, & Abu Bakar, 2010; Farook et al., 2011; Haniffa and Hudaib, 2007; Maali et al., 2006). Maali et al. (2006) investigated the extent of social activities disclosed by 29 Islamic banks in different countries. They compared the disclosures of such activities with social practices that Islamic banks are expected to adopt that are particularly relevant to society. The expected social practices were then combined into a benchmark for social reporting by Islamic banks.

Using content analysis, they found that actual corporate social disclosure practice is far below the expectations of the pragmatic benchmark of disclosure levels based on the *Shariah* principles. They also concluded that banks complying with mandated matters such as paying *Zakah* and adopting AAOIFI standards tend to provide more disclosures than non-compliant banks, and most banks disclose CSR information to construct a positive image. From the analysis; they note that most banks Islamic banks tend to highlight CSR disclosures information that related to Islamic reality values such as charitable activities.

3. Theoretical perspectives of csr disclosure

3.1. Agency Theory

The most dominant of all the disclosure theories is agency theory and it has been referred widely in many disclosure studies. This theory basically refers to a principal and agent relationship, Jensen and Meckling (1976) defined the agency relationship as a contract under which a principal or more engage an agent to perform a service on their behalf. They also identified the three types of agency costs which associated with agency problem. First: monitoring costs that incur by giving certain incentives to the agent which motivates him to act for the principal interests. Second: bonding costs which occur when using additional resources by the agent to make sure that their actions will not be against the principal's interests. Third, the residual loss: that results by the reduction of principal's welfare.

The application of agency theory in the discussion of CSR disclosure has been described as "not only empirically implausible but also highly offensive" (Gray et al., 1995). They considers such failures to be a significant motivation factor relating to the initial uptake of CSR disclosure and they refute its predication that a morally failure form of short term self-interest motivates all actions. Agency theory suggests that where there is a separation of ownership and control of a firm, the potential for agency costs exists from the conflicts of interest between principals (owners/firm) and the agents (managers) (Hossain et al., 1995). Each party, make a decision based on its self-determined goals (Ince, 1998). Therefore, agency costs, which include the cost of monitoring and controlling, are incurred by the principal, and bonding costs are incurred by the agent. From the agency theory perspectives, companies (management) are motivated to disclose more information voluntarily to convince the stakeholders that they are behaving optimally on the stakeholders' behalf, consequently reducing agency costs.

4. Methodology

The present study utilized the quantitative approach, yearly financial report of the sample Islamic banks, have been collected from Bank scope Database. Other data such as charitable activities and social responsibility in the index and details of their data which are not available in the financial report are collected from the banks newsletter and website. Then the data have been manually analyzed using un-weighted content analysis method.

In conducting this study, the researcher took precautionary measures to enhance the validity and the reliability of the analysis. Prior studies argues that content analysis is not considered reliable if it is conducted only once or only by one specific person (Neuendorf, 2002 and Rosmaini et al. 2009). Adopted method used by (Aribi & Gao, 2010; Farook, Hassan, & Lanis, 2011), the index items have been double check by the researcher to ensure that the items represented what we intended it to represent. Then, the researcher examined the items of the index and decided what that specific item was intended to measure (Beattie and Thomson, 2007). The 12 dimensions of the CSR index are developed based on governance standard No.7, issued by AAOIFI which relate to

CSR disclosure requirement for IFIs and prior research(Nu et al. 2014; Sakib 2015; Sarea & Hanefah 2013; Belal, A., Abdelsalam, O., and Nizamee 2014; Ali Aribi,Zakaria and Arun 2014; Farag et al., 2014; Maali et al., 2006; Haniffa and Hudaib, 2007; Rashid et al., 2013; Besar et al., 2009. Form the research knowledge, AAOIFI, 2010 is the latest available standard produced by AAOIFI during this research conducted. To enhance the reliability of the instrument, the index items are coded and checked twice to ensure it is free from any potential discrepancies(Taliyang & Jusop, 2011). During the coding process, the researcher ensure that the same coder is consistent overtime when coding the same item of the indices (stability).It is to make sure that the coders produce the same and accurate results when coding the same item(reproducibility).

5. Results and discussion

The current study shows that mean score of CSR(D/CSR disclosure) information is 46% of total disclosure score. Our result is higher than other studies that exploring CSR(D for IBs. For example; Farook et al., 2011 found that the mean CSR(D for the 47 banks is 17%. Maali et al. (2006) reported a mean disclosure of 13%. . In this studies,the highest general disclosure score is 8 items, which represent 67% out of total score and the lowest score is 3 items which represent 25% of total disclosure score.The general disclosure score are develop based on 12 dimensions of AAOIFI,2010 standards which cover both mandatory and voluntary items. Mandatory CSR(D items consists of an information towards an employee welfare,earling and expenditure prohibited by Shariah,late repayment and insolvent clients and Zakat.

From the analysis,the researcher find that the highest level of mandatory CSR(D are 3 out of 4 items,which is by Qatar Islamic Bank. On the other hand, the lowest score of mandatory CSR(D disclosure are 1 out of 3 items which is by Sharjah Islamic Bank and Ithmaar Islamic Bank.From the researcher observation,most of the Islamic banks tends to disclose on Zakat information in their annual reports rather than other mandatory items.While the mean score of voluntary CSR(D disclosure by sample Islamic banks are 3.44 items which represent 43% out of total mandatory CSR(D score.The highest score are by Sharjah Islamic bank and Baraka Islamic bank, 5 out of 8 CSR(D voluntary items are found in their annual report.The researcher find least information in RHB Islamic banks annual report,only 1 out of 8 voluntary items disclose in their annual report. Overall,from the general disclosure results,the researcher found that the level of disclosure among sample Islamic banks are relatively lower than expected,the findings are in line with a previous study conduct by Kamla (2013); Ullah (2013); Vinnicombe (2012) and Sakib (2015). Islamic banks on average complied 0.46 with AAOIF,2010 standards.

6. Conclusion

It can be conclude that, Islamic banks have to enhance their CSR(D disclosure practice to ensure that its operations and activities are in line with Islamic banking principles. Islamic Banks are expected to fulfil its inherent in their character as an "Islamic" bank. This paper aims to explore the disclosure level of CSR(D disclosure for Islamic banks using manual content analysis. Based on the analysis, our disclosure scores show that the extent of disclosure is 46% which is out of our expectations. However; our result for CSR(D disclosure (46%) is higher than results for Maali et al., 2006. In the other side; our results is consist with Haniffa and Hudaib, 2007; Hassan and Harahap, 2010; Ullah and Jamali, 2010 who found gap between expectations and actual disclosure about CSR(D and conclude that CSR(D disclosure for Islamic banks is very low. Several studies indicate that Islamic banks are not completely

fulfilling their social role in accordance with the prescriptions of Islam (Aggarwal and Yousef, 2000; Maali et al., 2006). Based on our result; we conclude that Islamic banks are mainly shaped and focused on economic incentives more so than religious and social norms (Aggarwal and Yousef, 2000).Our findings have contributed to the policy implications. Our the empirical evidence indicates that the level of CSR(D disclosure was relatively low (46%) even though AAOIFI Standard No.7 provides a template for Islamic banks to adopt in terms of CSR(D conduct and disclosure. Therefore policymakers are expected to be more aggressive in encouraging Islamic banks to adopt AAOIFI Standard No.7 as a benchmark for CSR(D disclosure.

There are several limitations inherent in this study. This study used only focus on full-fledged Islamic banks as a sample. Therefore, the results may not extend across other IFIs such as Takaful companies and other financial institutions. Due to the time constrains, this study only focus on the sample of 9 Islamic banks in 2013, therefore future study might consider time series data as conducted by Belal et al., 2014 who explore ethical reporting of Islamic Bank Bangladesh for 27 using time series data. Through exploring CSR(D disclosure using a time series data, future research can contribute more clear information regarding to CSR(D disclosure trends and practice among Islamic banks.r

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