

**Islamic Corporate Social Reporting Practices and the Link with
Financial Performance in the Malaysian Islamic Banking Industry**

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Abstract

The main aim of this thesis is to contribute to a better understanding of corporate social reporting (CSRep) and economic performance from an Islamic perspective in the context of Malaysia. This study develops an integrated framework to help provide a more complete picture of Islamic CSRep. The proposed framework is tested to understand the CSRep practices of Malaysian Islamic banks. This study also investigates the extent of CSRep practices of Islamic banks in Malaysia before and after the governance standards on Corporate Social Responsibility (CSR) conduct and disclosure, were introduced at the end of 2009 by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). The study deals with quality and quantity of CSRep in annual reports and stand-alone CSR reports. As previous studies that specifically examine the relationship between CSR and financial performance in Islamic banking are limited, this study first explores the relationship between CSRep and traditional financial measures that are commonly used in Western studies, focusing on efficiency of cost, revenue and profit. In addition however, the study explores the link between CSRep and socio-economic accounting measures which are more aligned with the socio-economic objectives of Islamic banks. The findings obtained from this study suggested that Islamic CSRep in Malaysian Islamic banks, in general, is still low but increasing in quantity and improving in quality. The major focus of disclosure in the annual reports and CSR reports of Islamic banks is employees. Malaysian Islamic banks are to some extent reflecting Islamic principles as expected from the CSRep framework, but not wholly. The analysed data provides evidence that quality and quantity of CSRep in Malaysian Islamic banks has increased since the introduction of AAOIFI standards on CSR, even though the standards are not compulsory. There is limited support that CSRep is related to financial performance and socio-economic performance, however there is some evidence that CSRep when measured according to the Standards is related to socio-economic indicators, particularly the profit sharing ratio and *Zakat* performance ratio. The study also found that Islamic banks in Malaysia tend to be more liberal in their *Shariah* interpretation in order to be competitive and because of the multicultural nature of their constituents. Hence, the key contributions to the literature of this study are the use of socio-economic performance variables as additional empirical elements and to provide a contextual understanding of Islamic CSRep through the use of a multicultural country setting.

Declaration

I certify that this thesis does not incorporate without acknowledgement any material previously submitted for a degree or diploma in any university; and that to the best of my knowledge and belief it does not contain any material previously published or written by another person except where due reference is made in the text.

.....

Nurliana Md Rahin

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Table of Contents

| | |
|---|------------|
| Abstract..... | II |
| Declaration..... | III |
| Acknowledgements..... | IV |
| Chapter 1: Introduction | 12 |
| 1.1 Introduction | 12 |
| 1.2 Background and Research Problem | 13 |
| 1.3 Research Questions | 18 |
| 1.4 Research Objectives | 22 |
| 1.5 Scope and Methodology..... | 23 |
| 1.6 Contribution of the Research | 24 |
| 1.7 Organisation of Remaining Chapters | 28 |
| Chapter 2: Corporate Social Responsibility, Corporate Social Reporting Research and the Banking Industry | 30 |
| 2.1 Introduction | 30 |
| 2.2 Corporate Social Responsibility (CSR): The Historical Background and Development..... | 31 |
| 2.2.1 CSR: 1800s to 1950s | 31 |
| 2.2.2 CSR: 1950s to 1980s | 34 |
| 2.2.3 CSR: 1990s to Date..... | 37 |
| 2.3 Corporate Social Responsibility: Definition and Concept | 41 |
| 2.4 The Theories of Corporate Social Responsibility | 45 |
| 2.4.1 Social Contract Theory | 45 |
| 2.4.2 Legitimacy Theory | 46 |
| 2.4.3 Stakeholder Theory..... | 47 |
| 2.4.4 Political Economy Theory | 48 |
| 2.4.5 Agency Theory | 49 |
| 2.4.6 Institutional Theory..... | 49 |
| 2.4.7 The Accountability Concept | 50 |
| 2.4.8 Mapping CSR Theories | 51 |
| 2.4.9 Criticism of CSR Theories..... | 52 |
| 2.5 Corporate Social Reporting (CSRep)..... | 53 |
| 2.6 A Review of Studies that Investigate CSR and CSRep..... | 55 |
| 2.6.1 CSR and CSRep studies in developed countries | 55 |
| 2.6.2 CSR and CSRep studies in developing countries..... | 58 |
| 2.6.3 Summary of CSR and CSRep studies | 61 |
| 2.7 Corporate Social Responsibility in the Banking and Finance Industry | 62 |

| | | |
|-------|---|----|
| 2.8 | <i>A Review of Studies that Investigate CSR and CSRep Practices in Banking and Finance Industry</i> | 65 |
| 2.8.1 | CSR and CSRep-Focused Studies on Banks..... | 65 |
| 2.8.2 | Other CSR studies that include banks..... | 69 |
| 2.8.3 | Summary of CSR and CSRep studies in the Banking and Finance Industry..... | 70 |
| 2.9 | <i>Malaysia: Culture, Economic and Regulatory Environment</i> | 71 |
| 2.9.1 | CSR and CSRep studies in Malaysia..... | 72 |
| 2.9.2 | CSR and CSRep studies in Malaysian Banking and Finance Industry..... | 74 |
| 2.10 | <i>Chapter Summary</i> | 76 |

Chapter 3: Corporate Social Responsibility and Corporate Social Reporting from an Islamic Perspective77

| | | |
|---------|---|-----|
| 3.1 | <i>Introduction</i> | 77 |
| 3.2 | <i>Influence of culture and religion on CSR and CSRep</i> | 77 |
| 3.3 | <i>CSR in Islam</i> | 81 |
| 3.3.1 | Ethical Principles in Islam..... | 84 |
| 3.3.1.1 | Unity of God (Tawhid)..... | 84 |
| 3.3.1.2 | Equilibrium (Al-Adl)/ Justice (Adalah)..... | 85 |
| 3.3.1.3 | Free Will (Ikhtiyar)..... | 86 |
| 3.3.1.4 | Responsibility (Fardh)..... | 87 |
| 3.3.1.5 | Vicegerency (Khilafah) / Trusteeship (Amanah)..... | 87 |
| 3.3.1.6 | God’s Arrangement (Rubbiyyah)..... | 89 |
| 3.3.1.7 | Growth and Purification (Tazkiyah)..... | 89 |
| 3.3.2 | Islamic Business Ethics..... | 89 |
| 3.4 | <i>Corporate Social Reporting (CSRep) in Islam</i> | 94 |
| 3.4.1 | Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)..... | 96 |
| 3.5 | <i>Islamic banking</i> | 98 |
| 3.5.1 | Islamic banking in Malaysia..... | 102 |
| 3.5.2 | Islamic banking and CSR..... | 103 |
| 3.6 | <i>Review of Studies that Investigate CSR and CSRep from an Islamic Perspective</i> | 106 |
| 3.7 | <i>Chapter Summary</i> | 113 |

Chapter 4: CSR and Financial Performance 114

| | | |
|-----|---|-----|
| 4.1 | <i>Introduction</i> | 114 |
| 4.2 | <i>The Relationship of CSR and Financial Performance</i> | 114 |
| 4.3 | <i>CSR and Financial Performance: The Banking Industry</i> | 119 |
| 4.4 | <i>CSR and Financial Performance: Islamic Perspective and Islamic Banks</i> | 120 |
| 4.5 | <i>Chapter Summary</i> | 124 |

Chapter 5: Theoretical/Conceptual Framework 125

| | | |
|-----|---------------------------|-----|
| 5.1 | <i>Introduction</i> | 125 |
|-----|---------------------------|-----|

| | | |
|-------|---|-----|
| 5.2 | <i>The Core: Islamic Ethical Principles</i> | 125 |
| 5.3 | <i>Relationships and Obligation in Islam</i> | 127 |
| 5.3.1 | Man and Allah | 127 |
| 5.3.2 | Man and Human Beings | 128 |
| 5.3.3 | Man and Environment | 128 |
| 5.4 | <i>Social Relations System in Islam</i> | 131 |
| 5.4.1 | Accountability | 132 |
| 5.4.2 | Social justice | 134 |
| 5.4.3 | Ownership and trust | 136 |
| 5.5 | <i>Expectations/Applications in Corporate Social Reporting of the Islamic Ethical Principles</i> 138 | |
| 5.5.1 | Expectations and Application of Reporting of the Unity (<i>Tawhid</i>) Principle | 139 |
| 5.5.2 | Expectations and Application of Reporting of the Equilibrium Principle | 140 |
| 5.5.3 | Expectations and Application of Reporting of the Free Will Principle | 142 |
| 5.5.4 | Expectations and Application of Reporting of the Responsibility Principle | 142 |
| 5.6 | <i>The Model of Corporate Social Reporting in Islam</i> | 147 |
| 5.7 | <i>Social Pressure</i> | 153 |
| 5.8 | <i>Financial Performance or Economic Consequences</i> | 156 |
| 5.9 | <i>Incorporating CSR Theories in the context of Islam</i> | 157 |
| 5.10 | <i>Summary of the Conceptual Framework</i> | 158 |
| 5.11 | <i>Chapter Summary</i> | 162 |

Chapter 6: Research Methodology163

| | | |
|---------|--|-----|
| 6.1 | <i>Introduction</i> | 163 |
| 6.2 | <i>Research Design</i> | 163 |
| 6.3 | <i>Sample Selection</i> | 164 |
| 6.4 | <i>Content Analysis</i> | 165 |
| 6.4.1 | Unit of analysis | 167 |
| 6.4.2 | Instruments | 169 |
| 6.4.3 | Measurement of CSRep Variables | 176 |
| 6.4.4 | Disclosure Media Analysed | 178 |
| | Annual Reports | 178 |
| | Stand-alone CSR Reports | 178 |
| 6.5 | <i>Pre-testing</i> | 179 |
| 6.5.1 | Inter-coder reliability | 181 |
| 6.5.2 | Second Round Pre-testing | 190 |
| 6.6 | <i>Qualitative Analysis</i> | 192 |
| 6.7 | <i>Regression Analysis</i> | 192 |
| 6.7.1 | Financial Performance Variables | 193 |
| 6.7.1.1 | Traditional Financial measures | 193 |
| 6.7.1.2 | Socio-economic Accounting Measures | 194 |
| 6.7.2 | Control Variables | 195 |

| | | |
|---------|--|-----|
| 6.7.3 | Hypotheses Development | 197 |
| 6.7.3.1 | The influence of AAOIFI Governance Standards No.7: CSR conduct and disclosure for IFIs | 197 |
| 6.7.3.2 | The relationship between CSRep and financial performance | 198 |
| 6.7.4 | Multiple Regression Model | 204 |
| 6.7.4.1 | Quality of CSRep | 206 |
| 6.7.4.2 | Quantity of CSRep | 207 |
| 6.7.4.3 | Issues of Multiple Regression Modelling | 207 |
| 6.8 | Chapter Summary | 208 |

Chapter 7: Corporate Social Reporting of Islamic Banks & the Influence of AAOIFI Standards on the CSR Disclosure: Empirical Findings & Discussion209

| | | |
|---------|--|-----|
| 7.1 | Introduction | 209 |
| 7.2 | Descriptive Statistics of Corporate Social Reporting | 209 |
| 7.2.1 | Descriptive Statistics of CSRep based on the Framework | 210 |
| 7.2.2 | Descriptive Statistics of CSRep based on AAOIFI Standards | 215 |
| 7.2.3 | Descriptive Statistics of Pre AAOIFI Standards (2007-2009) | 219 |
| 7.2.4 | Descriptive Statistics of Post AAOIFI Standards (2010-2011) | 222 |
| 7.2.5 | The Trend of CSRep..... | 226 |
| 7.2.6 | Summary of Descriptive CSRep in Annual Reports..... | 230 |
| 7.3 | Normality and Univariate Tests | 231 |
| 7.3.1 | Normality Testing of Pre and Post AAOIFI Standards Data..... | 231 |
| 7.3.2 | Univariate Non-parametric Test: Wilcoxon Signed-Rank Test..... | 235 |
| 7.3.3 | Univariate Parametric Test on Paired Samples T-test | 239 |
| 7.3.4 | Summary of Univariate Tests Results of CSRep in Pre- and Post- Standards | 240 |
| 7.4 | Qualitative Analysis..... | 241 |
| 7.4.1 | CSRep based on the Framework..... | 241 |
| 7.4.2 | CSRep based on AAOIFI Standards | 248 |
| 7.4.3 | CSRep: Pre AAOIFI Standards and Post AAOIFI Standards..... | 251 |
| 7.4.4 | Summary of Qualitative Analysis of CSRep in Annual Reports | 253 |
| 7.5 | Case Studies of CSRep in Stand-alone CSR Reports..... | 254 |
| 7.5.1 | Form- and Meaning-oriented Content Analysis in Case Studies..... | 258 |
| 7.5.2 | Case Studies of CSR Reports | 262 |
| 7.5.2.1 | CIMB Islamic Bank Berhad (CIMBIBB) | 262 |
| 7.5.2.2 | Kuwait Finance House (Malaysia) Berhad (KFHMB)..... | 265 |
| 7.5.2.3 | RHB Islamic Bank Berhad (RHBIBB) | 275 |
| 7.5.3 | Summary of Case Studies in CSR Reports | 279 |
| 7.6 | Chapter Summary | 283 |

Chapter 8: The Relationships between Corporate Social Reporting and Financial Performance in Islamic Banking Industry: Empirical Findings & Discussion..... 284

| | | |
|-----|--------------------|-----|
| 8.1 | Introduction | 284 |
|-----|--------------------|-----|

| | | |
|---|---|------------|
| 8.2 | <i>Descriptive Statistics</i> | 284 |
| 8.3 | <i>Normality Testing</i> | 286 |
| 8.3.1 | Test for Normality - Dependent Variables | 287 |
| 8.3.2 | Test for Normality – Independent Variables | 289 |
| 8.3.3 | Transforming CSRep Data (Dependent Variables)..... | 291 |
| 8.3.4 | Transforming Financial Data (Independent Variables) | 294 |
| 8.4 | <i>Correlation Results among Variables</i> | 296 |
| 8.5 | <i>Regression Analysis</i> | 297 |
| 8.5.1 | Cross-sectional Regression Analysis | 297 |
| 8.5.2 | Panel Regression Analysis | 298 |
| 8.5.2.1 | Model Selection: Pooled OLS or Panel Model; REM or FEM | 300 |
| 8.5.2.2 | Endogeneity | 301 |
| 8.6 | <i>Regression Results</i> | 302 |
| 8.6.1 | CSRep Quality based on Framework..... | 303 |
| 8.6.2 | CSRep Quantity based on the Framework | 306 |
| 8.6.3 | CSRep Quality based on AAOIFI Standards | 311 |
| 8.6.4 | CSRep Quantity based on AAOIFI Standards..... | 316 |
| 8.6.5 | Hypotheses | 322 |
| 8.7 | <i>Results Discussion</i> | 324 |
| 8.8 | <i>Chapter Summary</i> | 325 |
| Chapter 9: Discussions, Implications and Conclusions | | 327 |
| 9.1 | <i>Introduction</i> | 327 |
| 9.2 | <i>Summary of Research Findings</i> | 327 |
| 9.2.1 | The Nature and Extent of CSRep in Malaysian Islamic Banks | 328 |
| 9.2.2 | The Influence of AAOIFI Governance Standards on CSR Disclosure in Malaysian Islamic Banks | 335 |
| 9.2.3 | The Relationship between CSRep and Financial Performance in the Islamic Banking Industry | 337 |
| 9.2.4 | Balancing Social Responsibility and Pursuit of Profits of Islamic Banks | 339 |
| 9.3 | <i>Research Implications & Contributions</i> | 342 |
| 9.3.1 | Summary of Major Research Contributions | 343 |
| 9.3.2 | Practical Implications | 344 |
| 9.3.3 | Social/Policy Implications..... | 345 |
| 9.4 | <i>Research Limitations</i> | 346 |
| 9.5 | <i>Suggestions for Future Research</i> | 348 |
| 9.6 | <i>Conclusions</i> | 349 |
| References..... | | 350 |
| Appendices..... | | 367 |

List of Figures

| | |
|--|-----|
| Figure 3-1: The Relationships between Culture, Societal Values, and The Accounting Subcultures | 79 |
| Figure 3-2: Accounting Dimensions and Measurement and Disclosure | 80 |
| Figure 5-1: The Conceptual Framework of Corporate Social Responsibility in Islam | 126 |
| Figure 5-2: Islamic Corporate Social Disclosure Model based on Tawhidic Paradigm | 129 |
| Figure 5-3: Social Relations Framework | 137 |
| Figure 5-4: Diagram of the Conceptual Framework of Corporate Social Reporting in Islam | 161 |
| Figure 7-1: Average Quality Score by Year | 226 |
| Figure 7-2: Average Quantity Score by Year..... | 227 |
| Figure 7-3: Average Quality Score by Banks..... | 228 |
| Figure 7-4: Average Quantity Score by Banks | 229 |
| Figure 7-5: Histograms of Pre-Standards Data (2007-2009)..... | 232 |
| Figure 7-6: Histograms of Post-Standards Data (2010-2011)..... | 234 |
| Figure 8-1: Histograms of Untransformed CSRep Data | 288 |
| Figure 8-2: Histograms of Transformed CSRep Data | 292 |
| Figure 8-3: Regression Model Selection..... | 301 |
| Figure 9-1: Summary of Relationships between CSR, Performance and CSRep | 337 |
| Figure 9-2: Summary of Balancing CSR and Performance | 341 |

List of Tables

| | |
|---|-----|
| Table 2-1: The Chronology of CSR Development from 1950s to 1980s | 37 |
| Table 2-2: The Chronology of CSR Development from 1990s to Date | 41 |
| Table 2-3: Four Characteristics in CSR Definition | 42 |
| Table 3-1: The Four Main Sources in Islamic <i>Shariah</i> | 82 |
| Table 3-2: Summary of Islamic Business Ethics in Business Practices | 91 |
| Table 3-3: Some examples of business ethics principle in Islam | 92 |
| Table 3-4: Obligations and Rights of Different Stakeholders from an Islamic Perspective ... | 93 |
| Table 3-5: Islamic Banking Products..... | 102 |
| Table 4-1: Summary of Findings of Research into the Relationship between CSR and Financial Performance | 116 |
| Table 4-2: Research into the Relationship between CSR and Financial Performance in Malaysia | 119 |
| Table 5-1: Summary of accountability from an Islamic perspective..... | 133 |
| Table 5-2: Summary of Fundamental Islamic Ethical Principles that Constitute the Framework of Corporate Social Reporting in Islam..... | 144 |
| Table 6-1: List of Islamic banks in Malaysia..... | 165 |
| Table 6-2: Islamic CSRep Categories Used in Previous Studies..... | 170 |
| Table 6-3: Content Analysis Instrument Categories Based on the Islamic Corporate Social Reporting Framework | 171 |
| Table 6-4 Content Analysis Instrument Categories Based on AAOIFI Standards on CSR | 174 |
| Table 6-5: CSRep Quality Measures | 177 |
| Table 6-6: Quality Coding for <i>Shariah</i> Supervisory Board Category | 187 |
| Table 6-7: Quantity Coding for <i>Shariah</i> Supervisory Board Category..... | 188 |
| Table 6-8: Results of Inter-coder Reliability Test of Quality Measurement (Pre-test Round 1) | 189 |
| Table 6-9 Results of Inter-coder Reliability Test of Quantity Measurement (Pre-test Round 1)..... | 189 |
| Table 6-10: Results of Inter-coder Reliability Test of Quality Measurement (Pre-test Round 2)..... | 190 |
| Table 6-11: Results of Inter-coder Reliability Test of Quantity Measurement (Pre-Test Round 2)..... | 191 |
| Table 6-12: The List of Traditional Financial Variables | 193 |
| Table 6-13: The List of Socio-economic Accounting Variables | 195 |
| Table 6-14: The List of Control Variables | 196 |
| Table 7-1: Statistics for CSRep based on the Framework (QUALITY) (N=83, N Missing=2).211 | |
| Table 7-2: Statistics for CSRep based on Framework (QUANTITY) (N=83, N Missing=2) | 213 |
| Table 7-3: Statistics for CSRep based on Standards (QUALITY) (N=83, N Missing=2) | 216 |
| Table 7-4: Statistics for CSRep based on Standards (QUANTITY) (N=83, N Missing=2) | 218 |
| Table 7-5: Statistic for CSRep Quality in Pre AAOIFI Standards (N=50, N Missing=1)..... | 220 |
| Table 7-6: Statistics for CSRep Quantity in Pre AAOIFI Standards (N=50, N Missing=1)..... | 221 |
| Table 7-7: Statistics for CSRep Quality in Post AAOIFI Standards (N=33, N Missing=33).... | 223 |
| Table 7-8: Statistics for CSRep Quantity in Post AAOIFI Standards (N=33, N Missing=1) ... | 224 |

| | |
|--|-----|
| Table 7-9: Normality Tests of Pre-Standards Data (2007-2009)..... | 233 |
| Table 7-10: Normality Tests of Post-Standards Data (2010-2011) | 235 |
| Table 7-11: Wilcoxon Signed Ranks..... | 236 |
| Table 7-12: Test Statistics ^b | 237 |
| Table 7-13: Wilcoxon Signed Ranks..... | 238 |
| Table 7-14: Test Statistics ^b | 238 |
| Table 7-15: Paired Samples T-Tests..... | 239 |
| Table 7-16: Hypotheses Test Summary | 240 |
| Table 7-17: List of Stand-alone CSR Reports for Islamic Banks in Malaysia | 254 |
| Table 7-18: Comparing Statistics for CSRep based on the Framework in Stand-alone CSR Reports and Annual Reports | 259 |
| Table 7-19: Comparing Statistics for CSRep based on the Standards in Stand-alone CSR Reports and Annual Reports | 260 |
| Table 8-1: Statistics for the Independent Variables (<i>N</i> valid=83, <i>N</i> missing=2) | 285 |
| Table 8-2: Tests of Normality of Untransformed CSRep Data | 289 |
| Table 8-3: Normality tests statistics for Independent Variables | 290 |
| Table 8-4: Test of Normality of Transformed CSRep Data..... | 293 |
| Table 8-5: Independent Variables Transformation | 294 |
| Table 8-6: Transformed Financial Data | 295 |
| Table 8-7: Summary of tests | 303 |
| Table 8-8: Summary of test results: logQLYFRAME | 304 |
| Table 8-9: Model for logQLYFRAME | 305 |
| Table 8-10: Summary of test results: logQTTFRAME..... | 307 |
| Table 8-11: Model for logQTTFRAME..... | 308 |
| Table 8-12: Summary of test results: logQLYSTAND | 312 |
| Table 8-13: Model for logQLYSTAND | 313 |
| Table 8-14: Summary of test results: logQTTSTAND | 316 |
| Table 8-15: Model for logQTTSTAND | 317 |
| Table 8-16: Summary of Panel Regression Results..... | 320 |
| Table 8-17: Summary of Hypotheses Testing Results..... | 322 |

List of Abbreviations

| | |
|----------------|--|
| AAIOFI | Accounting and Auditing Organisations for Islamic Banks and Financial Institutions |
| ACCA | Association of Chartered Certified Accountants |
| AFBB | Asian Finance Bank Berhad |
| AFIBB | Affin Islamic Bank Berhad |
| ALIBB | Alliance Islamic Bank Berhad |
| AMIBB | Amlslamic Bank Berhad |
| ARBMB | Al Rajhi Banking & Investment Corporation (Malaysia) Berhad |
| BANKOWN | Bank ownership |
| BIMB | Bank Islam Malaysia Berhad |
| BMMB | Bank Muamalat Malaysia Berhad |
| BNM | Bank Negara Malaysia (Central Bank of Malaysia) |
| CIMBIBB | CIMB Islamic Bank Berhad |
| CR | Capital ratio |
| CSR | Corporate Social Responsibility |
| CSRep | Corporate Social Reporting |
| CTIR | Cost to income ratio |
| DEWR | Directors-employees welfare ratio |
| EDR | Equitable distribution ratio |
| EONCAPIBB | EONCAP Islamic Bank Berhad |
| EPS | Earnings per share |
| FRS | Financial Reporting Standards |
| FRS <i>i</i> 1 | Presentation of Financial Statements of Islamic Financial Institutions |
| FUL | Full Islamic bank |
| HLIBB | Hong Leong Islamic Bank Berhad |
| HSBCAMB | HSBC Amanah Malaysia Berhad |
| IBS | Islamic Banking Scheme |
| IFIs | Islamic Financial Institutions |
| IIVNII | Islamic investment vs non-Islamic investment |
| INVNIN | Islamic income vs non-Islamic income |
| KFHMB | Kuwait Finance House (Malaysia) Berhad |
| LR | Liability ratio |
| MIA | Malaysian Institutes of Accountants |
| MIB | Maybank Islamic Berhad |
| OCBCABB | OCBC Al-Amin Bank Berhad |
| OE | Overhead expenses |
| OIAA | Operating income to asset |
| PIBB | Public Islamic Bank Berhad |
| PSR | Profit sharing ratio |
| RHBIBB | RHB Islamic Bank Berhad |
| ROA | Return on assets |

| | |
|-----------|--|
| ROE | Return on equity |
| SAW | <i>Subhanahu Wa-Ta'ala</i> , meaning “peace be upon him” |
| SCSB | Standard Chartered Saadiq Berhad |
| SPSS | Statistical Package for the Social Sciences |
| SSB | <i>Shariah</i> Supervisory Board |
| TA | Total assets |
| SWT | <i>Sallallahu 'Alaihi Wa Sala</i> , meaning “be He glorious and exalted” |
| YEARSTAND | Year either before or after the Standards introduction |
| ZPR | <i>Zakat</i> performance ratio |

Glossary

| | |
|--------------------------|--|
| <i>Al-Quran</i> | The revelation from <i>Allah</i> SWT |
| <i>Amanah</i> | Trust |
| <i>Bai’Bithaman Ajil</i> | Deferred payment sale agreement |
| <i>Bay</i> | Sales |
| <i>Bay Inah</i> | Buy-back sales |
| <i>Falah</i> | Success |
| <i>Fard kifayah</i> | Religious duty |
| <i>Gharar</i> | Uncertainty |
| <i>Hadith</i> | The deeds, sayings or tacit approval of the Prophet Muhammad SAW |
| <i>Halal</i> | Lawful |
| <i>Haram</i> | Unlawful |
| <i>Ibadah</i> | Worship of Allah/prayer |
| <i>Ijarah</i> | Hire/leasing agreement |
| <i>Ijma’</i> | The consensus of opinion by the majority of Muslims scholars |
| <i>Maysir</i> | Gambling |
| <i>Mudharabah</i> | Profit-sharing agreement |
| <i>Murabahah</i> | Cost-plus agreement |
| <i>Musarakah</i> | Profit and loss sharing agreement |
| <i>Qard Hassan</i> | Benevolent loan |
| <i>Qiyas</i> | The analogy reasoning deducted from Al-Quran, Hadith and Ijma’ |
| <i>Riba</i> | Usury/interest |
| <i>Sadaqah</i> | Charity |
| <i>Shariah</i> | Islamic law |
| <i>Sunnah</i> | The deeds, sayings or tacit approval of the Prophet Muhammad SAW |
| <i>Tawhid</i> | Unity of God |
| <i>Ummah</i> | Community in a religious sense |
| <i>Wadiah</i> | Guaranteed custody |
| <i>Waqf</i> | Endowment |
| <i>Zakat/Zakah</i> | Religious levy/almsgiving |

Chapter 1: Introduction

1.1 Introduction

The social responsibility of business is an important concept that has been linked to the economic survival of firms, due to its impact on reputation, resource flows and stakeholder relations. While much research indicates that corporate social responsibility (CSR), particularly in developed economies, is motivated by the desire for legitimacy or for enhanced reputational effects, a small number of studies have investigated cultural and/or religious influences. The latter studies are mainly in developing economies, and this study contributes to that literature by examining how Islamic values may be expected to manifest themselves in the reporting of Islamic business organisations.

This study will examine the corporate social reporting (CSRep) practices of Malaysian Islamic banks (IBs), which will then be explored for its relationship with financial performance. It is observed that researchers have tried to develop a normative standard for Islamic accounting and reporting (Gambling and Karim, 1986, Baydoun and Willett, 1994, Willett and Sulaiman, 2001, Lewis, 2001), and also corporate social reporting based on Islamic principles (Haniffa, 2002, Maali et al., 2006). However, these prior studies tend to remain scattered which discourages a systematic and coherent discussion of Islamic corporate social reporting. One major contribution of this study is to establish an integrated conceptual framework of corporate social reporting from an Islamic perspective.

An empirical study is also important to understand whether the Islamic principles as the core framework are being applied in corporate social responsibility activities (Mohammed, 2007) and articulated through corporate social reporting. The study investigates the extent of CSRep practices of Islamic banks in Malaysia before and after the introduction of the governance standards on CSR conduct and disclosure by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) at the end of 2009.

According to Masruki et al. (2010), financial performance is important to the banks themselves in order for them to survive as an Islamic bank. As such, the final contribution of this study is to explore Islamic corporate social reporting and its relationship with financial performance to see whether Islamic banks balance their social responsibility and the pursuit of profits. This thesis will present evidence that CSR reporting in Malaysia is increasing in both quality and quantity and that the introduction of a non-mandatory CSR standard has had some influence on reporting. The findings will also show that while there appears to be little relationship between CSRep and traditional financial performance variables, there is a link to performance variables of a more socio-economic nature.

This chapter introduces the study with the background section outlining the emergence of CSR and CSRep and the link with financial performance in Islamic banks. The importance of Islamic banks to report social information is briefly explained. This background section also highlights the gaps in the Western and Islamic social reporting literature. Following this, the research problem and research questions arising from the research problem are highlighted. Justification for the research is then discussed. The chapter concludes with the structure of the thesis.

1.2 Background and Research Problem

Stakeholders are increasingly demanding that corporations practice corporate social responsibility (CSR). Stakeholders pressure corporations to be more responsible to investors, consumers, employees, government and others who are affected by the corporations' operations. These stakeholders demand that corporations help society in various ways ranging from social issues, such as poverty to environmental concerns. As a response to CSR, corporations have to design and establish structures, policies, programs and processes to ensure CSR can be applied (Wood, 1991). Stakeholders are also demanding that corporations report their social and environmental performance, requiring corporations to use

corporate social reporting (CSRep) as a mechanism to discharge their duty of accountability (Gray et al., 1987). In this study,

In the case of corporations such as Islamic banks, CSR is an important part of the banks' operations. Islamic banks operate based on Islamic law (*Shariah*) whereby among the rules are the prohibition of interest which is considered as usury (*riba*), prohibition of speculation and uncertainty (*gharar*), and prohibition of gambling (*maysir*) (Lewis, 2001). In Islam, the issues pertaining to interest and unfair trading practices are considered as social issues because *Shariah* (Islamic law) specifically addresses these matters that potentially can affect the well-being of the community (Maali et al., 2006). CSR should be practiced by Islamic banks since their activities involve important social issues in society. A major part of Islamic banks' activities reflect Islamic principles, including social accountability and socio-economic justice (Maali et al., 2006). The Islamic CSRep information is important to Muslim stakeholders to help them in making financial decisions and assessing whether their actions comply or not with *Shariah* (Harahap, 2003). The disclosure of Islamic CSR is consistent with objectives of Islamic accounting, i.e. "to assist in achieving socio-economic justice (Al-falah) and recognise the fulfilment of obligation to God, society and individuals concerned, by parties involved in the economic activities viz. Accountant, auditors, managers, owner, government, etc. as a form of worship" (Harahap, 2003, p.77). As such, there is growing pressure on Islamic banks for them to demonstrate the accountability and commitments via disclosure of information on social as well as environmental matters (Haniffa and Hudaib, 2004).

The operations of Islamic banks based on *Shariah* should go beyond profit maximization, where the main aims of Islamic banks are social obligations, brotherhood, justice and fairness (Masruki et al., 2010). Islamic banks are obliged to report financial performance information as well as information relating to the attainments of proper and sufficient conformity to *Shariah*, and social and environmental concerns as a whole to their stakeholders (Masruki et al., 2010). The disclosure of this information would not only help Muslim stakeholders in financial decisions but also help them to assess whether their actions as investors,

accountants, auditors, managers, government, etc, comply or not with *Shariah* regulations, as Muslims' daily actions are part of worship to God (Harahap, 2003).

Although a religious or social aspect is the main role of Islamic banking, the financial aspect is also important as Islamic banks play a dual role (Al-Mograbi, 1996). A number of studies have examined the link between CSR and financial performance (Gelb and Strawser, 2001, Moore, 2001, Waddock and Graves, 1997, Patten, 1991). However, there are no conclusive findings about the direction and strength of the link (Allouche and Laroche, 2006). It is also vague whether more social responsibility leads to better financial performance or whether better financial performance leads to more funds be committed to social responsibility (Allouche and Laroche, 2006). Simpson and Kohers (2002) argue that empirical evidence from a single industry such as banking can provide additional insights into the investigation of the link between CSR and financial performance. Masruki et al. (2010) examine the link between CSR and financial performance in Islamic banks and found a positive relationship only with size, but not leverage and profitability. Thus Masruki et al. (2010) suggest future research to add more financial variables in order to get further insights of the relationship between CSR and financial performance in Islamic banks.

CSR has also gained attention in the Malaysian Islamic banking industry. In Malaysia, the Islamic banking system has rapidly developed over the past three decades to fulfil the financial needs of Muslim society and also non-Muslims who want to avoid interest-based conventional banking (Dusuki and Dar, 2007). According to Bank Negara Malaysia's¹ 2010 annual report (BNM, 2010), the assets of Islamic banking had increased to RM 350.8 billion (USD 116 billion) and constituted 21 percent of the total banking system of the country. Generally, Malaysian managers' opinions of CSR are no different to Islamic concepts of CSR, providing evidence that Islamic concepts are relevant and could influence the CSR policies and strategies in Malaysia (Siwar and Hossain, 2009). However, a previous study suggests that CSRep of Islamic banks in Malaysia is still low (Harahap and

¹ Bank Negara Malaysia is Central Bank of Malaysia

Gunawan, 2006). In addition, the Islamic CSRep studies that use top *Shariah*-approved companies listed in the Bursa Malaysia² also show that disclosure of Islamic CSRep still falls short of expectations (Othman et al., 2009, Ousama and Fatima, 2010). Furthermore, it is interesting to study CSRep by Malaysian Islamic banks because they are unique and different from Middle Eastern Islamic banks. Many Malaysian Islamic banks are subsidiaries of conventional banks, where conventional banks have control over the Islamic banks' operations.

Researchers in the past noted gaps in the Western and Islamic accounting literature (Napier, 2009, Rodinson, 1974). However, recently, Western capitalism has moved toward a model which adopts socially responsible behaviour in business operations. Western business has begun to become more socially responsible, more ethical and more stakeholder-oriented (Williams and Zinkin, 2005). As such, the current trends in Western accounting practices have seen the emergence of Sustainability Accounting, Value Added Accounting, Socio-Economic Accounting, and Environmental Accounting (Harahap, 2003). In the past, Western capitalism focused more on competition, materialism, shareholder dominance and profit maximization, which certainly contradicts with the Islamic approach (Williams and Zinkin, 2005). Islam emphasises *Shariah* compliance in business practices and the Islamic accounting system promotes social obligations, brotherhood, justice and fairness (Baydoun and Willett, 1997, Lewis, 2001). The recent transition of the Western business model and Western accounting systems toward a system that also considers justice, fairness, and ethical practices, shows some potential to build a bridge with Islamic accounting systems (Williams and Zinkin, 2005). However, Islamic accounting systems also require Islamic business organisations to display Islamic values such as the religious levy (*zakat*), prohibition of unlawful dealings according to *Shariah*, benevolent loans (*Qard Hassan*), prohibition of usury (*riba*) and etc. (Harahap, 2003, Maali et al., 2006). Western accounting systems are not set up to include these Islamic values-related items, but the recent standards formulated by the Accounting and Auditing Organization for Islamic Financial

² Bursa Malaysia is formerly known as Kuala Lumpur Stock Exchange

Institutions (AAOIFI) could be a starting point that may lead to set of disclosure criteria that can be used by Islamic business organisations (Harahap, 2003).

AAOIFI is an international standard-setting organisation for Islamic finance based in Bahrain, which has published a total of 40 standards covering the areas of accounting, auditing, ethics, and governance for Islamic financial institutions (AAOIFI, 2010a). Although AAOIFI standards were formulated based on Western accounting, AAOIFI is working to improve the set of CSR disclosures so that they are more relevant to the nature of Islamic banking. At the end of 2009, AAOIFI introduced the Governance Standard relating to CSR conducts and disclosure for Islamic financial institutions and this governance standard was enforced in 2010 (AAOIFI, 2010b). The regulators in Malaysia refer to the substance of AAOIFI standards when formulating their standards for Islamic financial institutions (AAOIFI, 2010a, MASB, 2006).

From the above discussion, it can be seen that CSR and CSRep are not new concepts in Islam, but there is a need to develop a framework of social reporting from an Islamic perspective. A number of studies have considered the concept of CSR from an Islamic perspective (Abdallah and Murtuza, 2005, Al-Mograbi, 1996, Beekun and Badawi, 2005), and others have examined Islamic CSRep practices (Aribi and Gao, 2010, Farook and Lanis, 2005), but the integration of these two concepts is rare. This study develops an integrated framework to help provide a more complete picture of Islamic corporate social reporting (CSRep) in order to fill this gap. Furthermore, the study also investigates the extent of CSRep practices of Islamic banks in Malaysia before and after the governance standards on the CSR conduct and disclosure for Islamic financial institutions, which was introduced at the end of 2009 by AAOIFI. Therefore, this study would benchmark Islamic CSRep based on both, the framework and the AAOIFI governance standards.

There are limited studies that specifically examine the relationship between CSR and financial performance in Islamic banking, even though Islamic banks are always expected to play a dual role, i.e. a social role and a financial role (Al-Mograbi, 1996). Hence, in this study, the disclosure of CSR is explored for its relationship

with financial performance to see whether Islamic banks balance their social responsibility and the pursuit of profits. The discussion on the importance of CSRep practices by Islamic banks and the need for further insights of the relationship of CSR and financial performance in Islamic banks are considered in the development of the research questions, objectives and hypotheses in this thesis.

In sum, the general research problem being addressed in this study is to what extent does an Islamic perspective and the introduction of AAOIFI standards on CSR disclosure improve corporate social reporting and economic performance of Islamic banks in Malaysia?

1.3 Research Questions

In order to explore further the general research problem, this study specifically attempts to answer the following four questions:

- i. What is the nature and extent of CSRep by Malaysian Islamic banks?
- ii. To what extent does the AAOIFI standard on CSR disclosure influence the corporate social reporting practices of Islamic banks in Malaysia?
- iii. What is the relationship between Islamic corporate social reporting and financial performance in the Islamic banking industry?
- iv. Do Islamic banks balance their social responsibility and their pursuit of profits?

These four research questions are developed and explained in more detail in the remainder of this section.

Although there have been some studies about CSRep practices in Malaysia (e.g., Adnan et al., 2010, Amran and Devi, 2007, Hamid, 2004) and CSRep practices of Malaysian Islamic business organisations (e.g., Othman and Thani, 2010, Muhamad and Rahin, 2009, Masruki et al., 2010), literature reviews indicate that fewer empirical studies have been done attempting to explore in-depth the nature and extent of CSRep of Malaysian Islamic banks especially in terms of quality and

quantity of reporting. With the exception of the quality and quantity study of CSRep practices of Islamic banks in Malaysia, Indonesia and Australia performed by Harahap and Gunawan (2006), all the prior studies have been concerned with only the presence of CSRep items. For example, Othman and Thani (2010) only measure CSRep in terms of whether the items are disclosed or not disclosed without considering the quality of reporting (such as whether it is provided in narrative terms, monetary terms and/or quantitative terms). Harahap and Gunawan (2006) do study the quality of CSRep in Islamic banks but their study does not focus on the practices in Malaysia, because includes Indonesia and Australia. In addition, the quality measures used by Harahap and Gunawan (2006) consider that qualitative disclosures as being of higher quality than quantitative disclosures, because they see that qualitative disclosure can provide adequate information for stakeholders making better decisions relating to the social and environmental issues. This study, however, will employ quality measures which indicate that quantitative disclosure together with qualitative disclosure signifies higher quality. Qualitative disclosure alone is regarded as low quality because according to Hammond and Miles (2004), “qualitative disclosure...are more discursive and self-laudatory” (p.75).

In addition, all the prior studies on Islamic CSRep practices have not clearly discussed the issues of CSRep with respect to CSR concepts that are derived from Islamic principles deduced from four Islamic sources i.e. the Holy Quran, Prophet Muhammad, Muslim scholars’ consensus, and analogy deduced from the earlier three sources (Muwazir and Muhamad, 2006). Through examining the content of annual reports and websites of Islamic banks in Malaysia, this study endeavours to determine the extent and nature of their CSRep practices and whether Islamic principles that are claimed are being applied in Islamic banks are reflected in their CSRep. This study provides a general picture of CSR in Islamic banks through reporting and determines what issues were being reported by benchmarking with a model developed for this study based on the previous studies, and also against the AAOIFI standards framework. This will be discussed further in Chapter 5 and Chapter 6. The first research question of the study is therefore identified as:

RQ1: What is the nature and extent of CSRep by Malaysian Islamic banks?

There are some empirical studies have been conducted to benchmark CSRep practices with the AAOIFI standards (e.g., Al-Baluchi, 2006, Ahmad Nadzri, 2009). With exception of the study done by DinarStandard and Istithmar (2010), the prior studies have been concerned with the general AAOIFI standards, and not specifically the governance standard on CSR disclosure issued by AAOIFI in 2010. The DinarStandard and Istithmar (2010) survey was performed by the organisations of DinarStandard and Dar Al Istithmar with the support of AAOIFI to benchmark the released AAOIFI standards relating to social responsibility with Islamic financial institutions' CSR practices. The survey was self-administered by the respondents who were required to answer whether their institutions have CSR policies as recommended by AAOIFI (DinarStandard and Istithmar, 2010). The findings show that Islamic financial institutions are starting to show concern about most social responsibility aspects (DinarStandard and Istithmar, 2010). However, the independence of the report is undermined because it was done with the support of AAOIFI. This study intends to confirm the CSR disclosure as recommended by AAOIFI is being practiced by Islamic banks by examining the extent and nature of CSRep of Malaysian Islamic banks before and after AAOIFI standards on CSR disclosure were issued in 2010. As AAOIFI standards are not mandatory in Malaysia, and are just used as a guideline by Malaysian regulators (AAOIFI, 2010a), this study is merely able to examine the influence of the released AAOIFI standard on CSR disclosure on CSRep practices of Malaysian Islamic banks. Through comparing CSRep before and after the release of the AAOIFI standard on CSR disclosure, the study helps to reveal any improvement in CSRep practices. Thus, the second research question of the study is:

RQ2: To what extent do AAOIFI standards on CSR disclosure influence the corporate social reporting practices of Islamic banks in Malaysia?

Many Western studies have tested the relationship between CSR and financial performance (e.g., Moore, 2001, Patten, 1991, Waddock and Graves, 1997) and many scholars have studied the financial performance of Islamic banks (e.g.,

Masruki et al., 2011, Samad, 2004, Ariff et al., 2009). However, studies that specifically examine the relationship between CSR and financial performance in Islamic banking are limited, except for Al-Baluchi (2006) and Masruki et al. (2010). The study by Al-Baluchi (2006) and Masruki et al. (2010) are not in-depth as both studies used the presence or absence of CSRep as the CSR measure, and financial measures were limited to profitability, size and leverage. Since little is known about the link between CSR and financial performance specifically in Islamic banks, this study explores the relationship between CSRep and traditional financial measures that are commonly used in Western studies, focusing on efficiency of cost, revenue and profit. In addition, the study also explores the link between CSRep and socio-economic accounting measures which are more aligned with the socio-economic objectives of Islamic banks. The socio-economic accounting measures are alternative financial measures that evaluate the effectiveness of the Islamic banks in managing the resources entrusted to them with regard to the concerns of stakeholder welfare as a whole (Hameed et al., 2004). These socio-economic accounting measures were developed because of the weaknesses in conventional financial measuring methods, which focus heavily on the needs of shareholders and creditors (Hameed et al., 2004). Hence, the third research question is stated as below:

RQ3: What is the relationship between Islamic corporate social reporting and financial performance in the Islamic banking industry?

Prior studies indicate that Islamic banks play a dual role; first as a social justice facilitator and second as a financial service provider (Al-Mograbi, 1996). In their social role, Islamic banks are responsible for adherence to *Shariah* rules and principles that focus on moral and social justice, hence they set an example to the community they serve and who observe their activities (Maali et al., 2006). In their financial role, Islamic banks are responsible for providing financial needs according to Islamic law (*Shariah*) and are required to control large funds and revenues which then enable them to carry out their social role (Maali et al., 2006). One of the severe threats to the Islamic banking industry is *Shariah* compliance risk whereby banks fail to comply with the *Shariah* rules and principles, which in turn results in

customers having doubts about the Islamic bank's products and services (Ahmad Nadzri, 2009). According to Ahmad Nadzri (2009), most of the Islamic banks are relatively small compared to conventional banks and there are even a few Islamic banks that fail to make any profit. Competition in the banking industry may drive some Islamic banks to capitalist thought which includes promoting profit maximization (Ahmad Nadzri, 2009). In order to carry out the social roles in redistributing wealth and eradicating poverty, Islamic banks should consider their activities and decisions beyond profit maximization (Kamla and Rammal, 2010), hence Islam encourages only reasonable profit (Baydoun and Willett, 2000). However in reality, Islamic banks have common characteristics with conventional banks in that they offer products and services neglecting the poor and aiming at profit maximization (Khan, 1994 cited from Kamla & Rammal, 2010). Therefore, this study investigates whether Islamic banks play a dual role as a social justice facilitator as well as financial service provider, and balance the both roles.

RQ4: Do Islamic banks balance their social responsibility and their pursuit of profits?

Based on the research questions, the focus of this study is CSRep. However, this study also uses and discusses CSR as the background to the study. Moreover, various literature uses CSRep and CSR disclosure as a proxy to measure CSR (see for example, Anderson and Frankle, 1980, Abbott and Monsen, 1979, Aras et al., 2010, Saleh et al., 2008).

1.4 Research Objectives

Research objectives are an advanced level of research questions, as they are highly focused and measurable (Sekaran and Bougie, 2010). Research objectives communicate the purposes and outcomes for research. The objectives of this research are arrived from the research questions developed in the section 1.3. In order to address the research questions, the following research objectives are considered:

- i. To review prior literature on corporate social reporting from an Islamic perspective.
- ii. To develop an integrated conceptual framework of Islamic corporate social reporting.
- iii. To analyse the annual reports of Islamic banks to determine the quantity and quality of corporate social reporting.
- iv. To benchmark corporate social reporting practices of Islamic banks with the AAOIFI standards on CSR conduct and disclosure.
- v. To analyse the financial performance of Islamic banks using traditional financial measures (i.e. measured by cost efficiency, revenue efficiency and profit efficiency financial ratios).
- vi. To analyse the financial performance of Islamic banks using socio-economic accounting measures (i.e. alternative financial measures that evaluate the effectiveness of the Islamic banks in managing the resources entrusted to them with regard to the concerns of the stakeholders' welfare as a whole).
- vii. To examine the link between corporate social reporting practices and financial performance of Islamic banks.

1.5 Scope and Methodology

One of the objectives of the study is to present an integrated conceptual framework that explains corporate social reporting from an Islamic perspective. This study constructs the framework through the deductive method by learning from the studies and frameworks of prior scholars in Islamic CSR and CSRep. After learning the relevant Islamic principles and concepts and discovering what has been learned about CSRep in Islam, a structure for an integrated conceptual framework of Islamic social reporting is developed.

This study is conducted on Malaysian Islamic banks only, in order to enable some comparisons with similar studies in other countries. The scope of the study is restricted to the 17 Islamic banks that are listed on the Central Bank of Malaysia website. The annual reports and CSR reports of the Islamic banks are collected from their respective corporate websites. The data required for corporate social reporting practices are obtained through the examination of annual reports and CSR reports of Malaysian Islamic banks from 2007-2011, including their websites in 2012.

The study uses content analysis to measure the corporate social reporting of Islamic banks. In this study, two sets of content analysis instruments are prepared to obtain data for CSRep. The first instrument is constructed based on a framework of Islamic CSRep developed in this study. The second instrument is constructed based on the AAOIFI standards on CSR disclosure.

Two types of measures are used in this study; (i) number of Islamic CSRep items expressed as a score, and (ii) the volume of Islamic CSRep expressed in terms of word counts. The first measurement captures the nature and quality of Islamic CSR disclosure and the second measurement captures the extent and quantity of disclosure.

As this study tests for the link between corporate social reporting practices and financial performance of Islamic banks, a multiple regression is used to examine the link. Several hypotheses are deduced from reviewing the corporate social reporting and financial performance literature. The hypotheses of the study are formally stated in Chapter 6.

1.6 Contribution of the Research

The study of corporate social reporting in the context of Islam and Islamic banking in Malaysia is valuable for a number of reasons.

First, this study contributes to the extant literature on CSR, particularly what the western and Islamic strands of CSR research might learn from each other. With the rapid development of the Islamic banking system, society is becoming more aware of the role of Islamic banks in socio-economic justice and is starting to pay attention to the banks' social responsibility activities (Haniffa and Hudaib, 2004). Islamic banks are also aware of their implicit social contract, as their initial establishment is to fulfil collective religious obligations (*fard kifayah*) for the community (Mohammed, 2007). As a response, Islamic banks report information about their social performance to various stakeholders. The disclosure of social information would help Muslim stakeholders in financial decisions and also help them to evaluate whether their actions as respective stakeholders, comply or not with *Shariah*, since all Muslims' actions in their daily life are a form of worshipping God (Harahap, 2003).

As there is a great deal of research that examines corporate social reporting (CSRep) practices in developed countries particularly in the USA and UK, CSRep is considered as a western phenomenon. However, there is limited research on CSRep of developing countries and even less from the perspective of Islam. Research studies in developing countries such as Malaysia mostly refer to western literature to explain CSRep in local corporations (e.g., Ahmad and Sulaiman, 2004, Haron et al., 2004), in which the western theories may not reflect the cultural aspects and local behaviours and may be unusual to the business environment in a developing country (Amran and Devi, 2007).

As Islam is the official religion of Malays that is the biggest ethnic group in Malaysia, Islam does shape the cultural and business environment in Malaysia (Muhamad, 2006). Furthermore, the current Islamic CSRep literature is scattered which deters a coherent discussion in this research area (Mohammed, 2007). Since the most important markets of the Islamic banking sector are in developing countries including Malaysia, the need to create a framework that explains CSRep from an Islamic perspective is important as it helps to explain the influence of Islam on CSRep especially in Islamic and emerging countries (Mohammed, 2007). This

study develops a conceptual framework that explains CSRep in terms of religion as an internal force, and public pressure and economic consequences as external forces, in an integrated framework. This integrated framework is based on previous literature (i.e. Maali et al., 2006, Muwazir and Muhamad, 2006, Mohammed, 2007), and the study contributes a model of Islamic CSRep which can facilitate better understanding of the religious factors influencing CSR disclosure and the economic consequences for Islamic business organisations. In this study, the contribution to the extant literature is that western firms could learn how the inclusion of religion and spiritual ideas influences the CSRep of Islamic business organisations. In addition, Islamic reporting firms could also learn from the CSR experiences of western and developed countries which are perceived to be leaders in CSR and CSRep.

Second, there is an expectation gap between community and industry practitioners as a result of a lack of disclosure among Islamic banks to inform society about their socially responsible activities. The stakeholders expect Islamic banks to disclose social information because respective stakeholders are personally accountable to God for where they invest resources and time (Farook, 2007). Thus, the stakeholders expect Islamic organisations that hold their resources in trust to disclose social information to ensure them of what extent their investment of resources has been fruitful in an Islamic way (Farook and Lanis, 2005). However, previous studies show that Islamic banks disclose social information below expected levels (Maali et al., 2006). The non-disclosure among Islamic banks does not mean that they are not carrying out CSR activities. The lack of proper accounting standards may discourage industry practitioners to disclose social information (Naser et al., 2006). As such, the regulators such as MASB³ and AAOIFI are working out disclosure standards for Islamic financial institutions (MASB, 2009,

³ Malaysian Accounting Standards Board (MASB). MASB is an independent authority which is established under the Financial Reporting Act 1997 to develop and issue accounting and financial reporting standards in Malaysia. The MASB comprises eight members who are appointed by the Minister of Finance and are representatives from the accounting profession, commerce, analysts, solicitors and academia.

AAOIFI, 2010b), so that the information needs of stakeholders can be met without limiting the reports to the information needs of particular groups of stakeholders. Therefore, it is important to fill the expectation gap by benchmarking CSRep practices of Islamic banks with the AAOIFI standards on Corporate Social Responsibility Conduct and Disclosure that were released in early 2010. As the standards were recently released, there is less academic literature that studies AAOIFI standards on CSR. The current study may contribute to reducing the expectation gap between stakeholders and industry practitioners through benchmarking Islamic banks' CSRep with AAOIFI standards.

Third, the study contributes to filling the gap that exists in the social reporting literature and financial performance literature particularly from an Islamic perspective, by examining the link between CSRep and the economic performance of Islamic banks. Currently, there are studies done by Masruki et al. (2010) and Al-Baluchi (2006) that examine this relationship but their studies are not comprehensive enough to explain the relationship. Investigating the extent and nature of CSRep by Islamic banks and its relationship with economic performance is of benefit to standard setters for assessing the effectiveness of the standards, and to Islamic banks for improving their performance. If a relationship can be found between CSRep and financial performance, a better evaluation may be made of the influence of AAOIFI standards on CSR disclosure and an Islamic bank may assess economic performance in both traditional financial and socio-economic ways.

Fourth, the study contributes to discussion on the effectiveness of Islamic banks' CSRep data by investigating the quality of social information provided by Islamic banks. It is observed that most prior studies have been concerned with the presence of CSRep disclosure only (e.g., Maali et al., 2006, Farook and Lanis, 2005). The current study should improve management understanding of the importance of providing quality social information. Therefore, the study may encourage the management to supply better quality social information to the stakeholders.

1.7 Organisation of Remaining Chapters

This study is structured into seven chapters. The First Chapter introduces the general area of study of the thesis. The background section outlines the emergence of CSR and CSRep and the link with financial performance. This section also highlights the gaps in the Western and Islamic social reporting literature. The importance of Islamic banks reporting social information is briefly explained. The problem statement, specific research questions and objectives of the study are described and the study is justified at the end of the Chapter.

Chapter Two reviews the development of CSR in the Western literature. The concepts and theories of CSR from a Western perspective are explained. This second Chapter also discusses the concept of CSRep and then reviews the prior studies that investigate CSR and CSRep. This Chapter specifically explains CSR and CSRep in the banking and finance industry and reviews the empirical studies that include the industry in their sample.

Chapter Three reviews the CSR and CSRep literature from an Islamic perspective. This Chapter also highlights criticisms of CSR theories in the Western and Islamic literature. The international accounting and auditing standards board for Islamic financial institution is introduced in the Chapter. This Chapter also discusses the key features and characteristics of Islamic banking, and the social role of Islamic banks. The empirical studies that investigate CSR and CSRep in Islamic business organisations are reviewed.

The Fourth Chapter reviews the relationship between CSR and financial performance. This Chapter also explains CSR and financial performance from an Islamic perspective.

The Fifth Chapter presents the theoretical framework used in this study that begins with the Islamic principles and then focuses on the concepts in Islam that are applicable in CSR and CSRep studies. Chapter Five also highlights the importance of social pressure on Islamic business organisations to be involved in CSR and to disclose social information. The economic consequences of CSRep are described. This Chapter develops a conceptual model that depicts the religion as an internal

force and includes social pressure (from stakeholders) and economic consequences in an integrated framework, which provide the theoretical context of this study.

Chapter Six outlines the research methodology. The Chapter begins with the methods that are employed to conduct the study. This chapter elaborates on the sample, data collection procedure, pre-testing and analysis techniques that are used in the study.

Chapter Seven and Chapter Eight provide the research findings, report the statistical results and summarize the findings. The research findings and analysis outcomes are also discussed.

Chapter Nine includes the overall conclusion of the findings of the study. Limitations and suggestions for future research of the study are also covered in this chapter. Finally, the implications of the study are discussed, including the theoretical and practical contributions that this research has made.

Chapter 2: Corporate Social Responsibility, Corporate Social Reporting Research and the Banking Industry

2.1 Introduction

The previous chapter provides some background on the notions of corporate social responsibility (CSR) and corporate social reporting (CSRep) in Islam, especially for Islamic banks. It shows how CSR is an important part of Islamic banks' operations as their activities reflect Islamic principles, which emphasise social accountability and socio-economic justice. In addition, the disclosure of CSR is needed to demonstrate accountability and to show that their activities are consistent with the objectives of Islamic accounting.

The former chapter also highlights that CSR and CSRep have the potential to reduce the gaps and build a bridge between Western accounting and Islamic accounting. Following the transition of the Western business model and Western accounting systems toward justice and ethical practices, most of the current concepts and theories pertaining to CSR and CSRep have been developed in America and Europe and therefore reflect their cultural background. Although this study considers a developing country specifically, it is important to review the Western CSR and CSRep literature, before reviewing the corporate social responsibility and reporting research that takes an Islamic perspective.

By providing a brief review of the concepts of history and development of CSR in the West, this chapter will show that some notions that the Western oriented concepts lack a wider perspective from other cultural and religious settings, such as Eastern and Islamic worldviews, and also ignores issues specific to developing countries. As such, some CSR and CSRep concepts that originated from the West may not be sufficient for Islamic banks and other Islamic business organisations.

In this study, CSR is discussed as background; however the focus of the study is CSRep. This chapter begins by giving some historical background of Western CSR.

Then, the definitions and concepts of CSR in the current Western literature are discussed. This chapter also discusses the theories that are commonly used to explain CSR. Next, the definition and the notion of CSRep are discussed. This is followed by a review of CSR and CSRep studies in developed and developing countries, and also on the conventional banking industry. As this study focuses on a specific country i.e. Malaysia, the last section of this chapter discusses the Malaysian environment and also reviews CSR and CSRep studies in Malaysia.

2.2 Corporate Social Responsibility (CSR): The Historical Background and Development

2.2.1 CSR: 1800s to 1950s

In the West, concerns about social problems have been mainly the responsibility of government for many centuries. According to Drucker (1984), in the early 18th century there was no other social institution available to solve social problems other than the government, though charity and fairness activities at that time were also contributed by the aristocracy's noblesse oblige (Marrewijk, 2003). Social responsibility at that time was not the main consideration of business as it came under the protection of common law (Davis, 1960). This legal protection gave business an excuse for showing little interest in social problems such as worker wages and safety.

However, business practices related to social responsibility can be traced to the modern period of history (i.e. the Age of Enlightenment), when the incorporation of business enterprises started around the end of 18th century to the 19th century. There were a few businessmen at that time who took the initiative to address social responsibility in their business practices. The several forms of socially responsible activities in the Enlightenment era were "philanthropic donations to charity, service to the community, enhancing employee welfare and promoting religious conduct" (Banerjee, 2007 p.5). Drucker (1984) names two businessmen in America as among the first businessmen in the world to initiate social responsibility through business practices and who became social reformers. They were Andrew Carnegie who was born in 1862 and Julius Rosenwald who was born in 1835

(Drucker, 1984). Both businessmen showed different approaches to address responsibility towards society.

Carnegie was a very successful American businessman. He viewed business from the perspective of an owner and believed in the social responsibility of wealth. His philosophy was “the sole purpose of being rich is to be a philanthropist” (Drucker, 1984, p.53). In his time, he financed a public library (Drucker, 1984) and universities through his Foundation (Mohammed, 2007).

Rosenwald was another successful American businessman especially in the farm business, who had bought Sears Roebuck & Company (i.e. a retail business). He viewed his business more from the perspective of a manager and believed in the social responsibility of business. His philosophy was “you have to be able to do good to do well” (Drucker, 1984, p.54). The way Rosenwald committed to social responsibility was very different from Carnegie and was more indirect and also implicit. Rosenwald believed that the wealth of Sears Roebuck could only come from its customers (i.e. the farmers). Therefore he saw the need to increase the wealth of the farmers through the development of their skills, productivity and competence. As a result, Sears Roebuck, which at the time Rosenwald bought it was near-bankrupt, and after the social reforms grew faster, became the most profitable enterprise in America and also among the biggest commercial companies in the world (Drucker, 1984).

In the early 20th century, the public had become aware that social problems had to be engaged with by institutions other than government. The reason is because government had very slow political processes so it took time before any successful result of its social programs could be seen (Drucker, 1984). For example:

- (i) It took 80 years before America’s program of agricultural education and research began to revolutionize American farming and farm productivity (Drucker, 1984)
- (ii) It took 20 years before every American at work was covered by Social Security (Drucker, 1984)

Some social problems and needs have a different level of urgency which means certain problems could not wait to go through the slow course of political processes (Friedman, 1970). Also in the 20th century, employees' safety and compensation laws had started to be enforced. The employers were facing pressure from the law to show substantial concern for their workers' wages and safety issues (Davis, 1960).

Following these laws and social pressure faced by corporations in the early 20th century, the most classical essay on social responsibility, written in 1932 by Dodd Jr questioned for whom are the corporate managers trustees. Dodd Jr (1932) asserts that corporate managers are fiduciaries to the corporation, i.e. "an association of stockholders formed for their private gain and to be managed by its board of directors solely with that end in view"(p.1145). The directors and corporate managers are obligated to run the business and make the contracts, with the sole purpose of maximizing the profits of the owners or the stockholders. However Dodd Jr (1932) also acknowledged that the law favours the interests of employees, consumers, and others – which therefore limits the right of stockholders and managers to find ways to maximize profits for their stockholders. Dodd Jr (1932) suggested that corporate managers accept the change in law and public opinion towards business by revising their methods of doing business and management of the corporation, in a way which can fulfill the responsibilities to the community as well as the ultimate responsibilities to the stockholders. However, these business responsibilities to the community must be addressed by the corporate managers on a voluntary basis and not because of the coercion of the regulations (Dodd Jr, 1932).

Based on a few notable examples as discussed, corporations responded and acknowledged their social responsibilities because they were obligated to comply with the law and public policy. They also responded voluntarily to market demands that reflected consumer values and social tastes. Corporate social responsibility emerged to be a key business management, marketing and accounting concern. By the mid-point of the 20th century, corporate social responsibility was being

discussed in America and Europe by business management experts and being considered in business literature (Mohammed, 2007).

2.2.2 CSR: 1950s to 1980s

The first comprehensive discussion of CSR in the Western literature emerged in the 1950s (for example Bowen, 1953, Davis, 1960, Levitt, 1958).

Bowen (1953) was among the writers who initiated the wide-ranging discussion of CSR and marked the modern discussion of the topic. He believes that businesses are the centers of power, therefore their decision making and actions can affect the society in many ways (Carroll, 1999). He emphasises that social responsibility can guide business in the future (Carroll, 1999). He also argues that social institutions drove economic outcomes (Banerjee, 2007).

Levitt (1958) however considers CSR as dangerous. Levitt (1958) describes social responsibility as “ a happy new orthodoxy, a prevailing vogue, a new tyranny of fad and fancy” that could harm business interests (cited in Banerjee, 2007, p.5). A kind of ill neofeudalism can exist if a corporation presumes a considerable measure of social responsibility for employee welfare (Levitt, 1958).

Davis (1960) in a notable work entitled *Can Business Afford to Ignore Social Responsibilities*, disagrees with Levitt (1958) and believes in the idea of involving social responsibilities in business decisions. The emerging power of corporations was evident through the 19th and early 20th centuries. Davis (1960) observes that economic power and social power are like a package, with growing economic power came social power. From this fact, Davis (1960) presents three implications: “social responsibilities of businessmen need to be commensurate with their social power” (p.71), “the avoidance of social responsibility leads to gradual erosion of social power” (p.74), and “continued vitality of business depends upon its vigorous acceptance of socio-human responsibilities along with socio-economic responsibilities” (p.74). He proposes that corporations have a choice either to use the power responsibly or to lose it. If a corporation does not use their power

responsibly, he expects the result would be losing power and control, with substantial impact on society (Cragg et al., 2009).

Friedman (1970) shares a similar opinion to Levitt (1958) on the danger of corporate social responsibility. He opines that broadening the responsibilities of managers beyond profit maximization conditioned by respect for the law and local ethical custom, is simply inviting managers to take the risk of undertaking tasks for which they are not trained and are not mandated. By giving an example of inflation, Friedman (1970) presumes if a manager is allowed to spend stakeholders' money to contribute to fighting inflation, his actions will not bring inflation to an end as he was selected on the qualification to run the corporations and not as an expert on inflation. In fact Friedman (1970) believes that the profit motive itself provides the social responsibility of business and that society is best served when corporations maximize shareholder value. Friedman's opinion on CSR is narrow with its focus on profit maximization. Cragg et al. (2009) think the narrow opinion of CSR has clear strengths whereby any stakeholder group will have the capacity to ensure that the managers carry out responsibilities of the corporation efficiently and effectively if their responsibilities are kept to ensuring profit maximization. It is interesting that Friedman (1970) also warns that CSR could be used as window-dressing. He claims that for reasons of self-interest, managers may cloak their actions and argue it as an exercise of social responsibility, when in fact they are trying to buy community goodwill. According to Friedman (1970), "...in practice the doctrine of social responsibility is frequently a cloak for actions that are justified on other grounds rather than a reason for those actions" (p.5). Friedman (1970) also questions whether a corporation or a business firm is itself the kind of entity that can properly be said to have social or ethical responsibilities. He believes that a business cannot have responsibilities and that only people have responsibilities.

This subject of business entity was addressed by French (1979) in his work entitled *The Corporation as a Moral Person*. French (1979) argues that corporations are moral agents and can be appropriately held morally responsible for their actions. When corporate actions come from a decision-making process which undergoes appropriate corporate structures, policies and procedures, they are considered as

the decision of the corporation itself. Therefore, it is appropriate for the corporation to hold the responsibilities and not be the responsibility of an individual manager (French, 1979).

In another early contribution to the CSR discussion, Drucker (1984) believes that business responsibilities of corporations and their social responsibilities are interwoven elements of good management. Corporations that take CSR seriously do better financially than corporations that ignore CSR considerations in their strategic planning and their operations (Drucker, 1984). He suggests that the motivation for socially responsible behavior is self-interest as in the original text he stated “in the next decade, it will become increasingly important to stress that business can discharge ‘its social responsibilities’ only if it converts them into ‘self-interest’”(Drucker, 1984, p.59). He also asserts that the emerging needs of human beings both individually and collectively will only be achieved if they are undertaken by business. Business will only undertake social needs if it views the needs as business opportunities and not as obligations.

The chronology of CSR development from 1950s to 1980s is shown in Table 2-1. This period was dominated by profit motivations, and it seems that a theory of the obligation of business to society was the main basis for most discussion of CSR in the 1950s to 1980s. This obligation theory took place because business was viewed as an instrument of society while managers were viewed as public trustees whose main job was to balance the competing demands of employees, customers, suppliers, communities, and shareholders (Banerjee, 2007).

Table 2-1: The Chronology of CSR Development from 1950s to 1980s

| Authors & Date | CSR Development in 1950s to 1980s |
|---------------------------|---|
| Bowen (1953) | Social institutions drive economic outcomes |
| Levitt (1958) | Social responsibility is an accepted belief that could harm business interests |
| Davis (1960) | Economic power and social power come together |
| Friedman (1970) | The sole social responsibility of business is to maximize profits, but must conform to the law and local moral norm |
| French (1979) | Corporations are moral agents who are responsible for their actions and inactions |
| Drucker (1984) | Social responsibility of business is an effective strategic management of a corporation |

2.2.3 CSR: 1990s to Date

CSR developments in the 1950s to 1980s focused more on a simple philanthropy approach in discharging societal commitments and a theory of business obligation to society. However, in the 1990s, the discussion of CSR moved to the next level which is more strategic (Banerjee, 2007). This strategic approach is described as the efforts of the corporation to attach social programs to its corporate objectives (Banerjee, 2007). A number of frameworks for CSR emerged, and these are reviewed below.

CSR does not view business and society as separate units; however these two units are rather viewed as intertwining. Wood (1991) believes that a corporation is anticipated by society to operate appropriately and to yield socially responsible outcomes in its all actions. Society has certain expectations on the businesses, firms and managers. Wood (1991) analyses these levels of expectations and suggests three CSR principles; the principle of legitimacy at the institutional level, the principle of public responsibility at the organisational level, and the principle of managerial discretion at the individual level. The legitimacy principle “defines the institutional relationship between business and society and specifies what is expected of any business” (Wood, 1991, p.696). The public responsibility principle “confines a business’s responsibility to those problems related to the firm’s activities and interests, without specifying a too-narrow domain of possible action” (Wood, 1991, p.696). The managerial discretion principle “defines managers’

responsibility to be moral actors and to perceive and exercise choice in the service of social responsibility” (Wood, 1991, p.696).

Wood (1991) then links CSR principles to corporate social responsiveness. Corporate social responsiveness focuses on the action of corporations. Corporations will have to design and establish structures, policies, programs and processes in order to ensure CSR can be applied at the institutional level, organisational level and individual level (Wood, 1991). Corporate social responsiveness processes highlight the issue of stakeholder management, environmental scanning and issues management. In other words, corporate social responsiveness strengthens and supports the realisation of CSR.

From the CSR principles and corporate social responsiveness, Wood (1991) offers a complete model of corporate social performance. Corporations will have to measure corporate social performance by evaluating the effectiveness of their social policies and programs through their impacts on the stakeholders at each of the levels of institutional, organisational and managerial at which CSR operates (Wood, 1991).

Frederick (1994) claims that CSR can be understood as three stages of development. Firstly, a normative ‘corporate social responsibility’ (CSR1) whereby CSR is viewed as “corporations’ obligation to work for social betterment” (Frederick, 1986, p.4). He then finds that the CSR1 moves from a philosophical approach to a managerial approach by enabling CSR1 through ‘corporate social responsiveness’ (CSR2) (Frederick, 1994). Embracing CSR2 will allow the corporation to react to social forces. Frederick also believes that an attachment of an ethical base at the managerial level is required in the study of business and society, so he introduces the notion of ‘corporate social rectitude’ (CSR3) (Frederick, 1986). CSR3 considers that social and ethical decisions are expected in business activities (Frederick, 1986).

Recently, CSR has been developed to describe the business-society relationship in terms of ‘corporate citizenship’. Corporate citizenship distinguishes a corporation as being a ‘good’ or ‘bad’ citizen (Banerjee 2007). Banerjee (2007, 2008) describes

'bad' citizens as corporations which are involved in tobacco, manufacturing weapons and polluting the environment. These 'bad' citizen corporations are eliminated from socially responsible investment portfolios (Banerjee, 2007). Wood and Logsdon (2002) find that the corporate citizenship concept is narrower, more voluntaristic, and locally oriented compared to the CSR concept. They assert that the CSR concept is too vague, too American bound and it is too hard for a company working in many cultural settings to relate to the CSR concept. However the relationship between the CSR concept and the corporate citizenship concept is still under debate among scholars. Some scholars view both concepts as synonymous (e.g. Waddock, 2001), others argue that corporate citizenship is focused on the values of the internal organisation while CSR is more related to the corporate actions that result in externalities (e.g. Birch, 2001). Some works claim that corporate citizenship is concerned more about a bounded set of stakeholders, as opposed to CSR which is more concerned with the interest of all stakeholders and of society at large (e.g. Wood and Logsdon, 2002).

Wood and Logsdon (2002) also discuss corporate citizenship in terms of business citizenship. A business citizen is described as not only confined to adhere to local rules but must also react to the collective norms of a global community (Wood and Logsdon, 2002). This business citizenship applies especially to multinational corporations which are encouraged to conform to local practices, however the set of local community norms across the globe are various (Wood and Logsdon, 2002). Therefore business citizenship which assumes a global view would promote the corporation to ensure the policies, processes and structures are consistent with values across all cultures (Wood and Logsdon, 2002). Hence in a globalized economy, CSR is not alien but a significant part of modern business.

CSR can be an effective strategic management tool of a corporation. However, Porter & Kramer (2006) observe that the current CSR approaches are separated from business and strategy. They feel that this fact could be an obstacle for a corporation to take opportunities to benefit society. Therefore, Porter and Kramer (2006) propose a strategic CSR framework which could be a source for developing the core competencies of a corporation and to make CSR activities the root of a

sustainable competitive advantage. They conclude that firms need to explore value chain social impacts and the social dimensions of the competitive context instead of focusing on generic social issues (Cragg et al., 2009).

The chronology of CSR development from 1990s to date is shown in Table 2-2. Generally since the 1990s, CSR has been viewed strategically, hence corporations integrate social concerns into their values and operations in an accountable manner. A consensus has not been reached on an agreed definition of the concept, and so the literature and its definition are reviewed in the next section.

As can be seen from the preceding review, the historical context of CSR is mostly rooted from the studies in America and Europe which shows that it lacks a broader view of other parts of the world. This provides motivation for the current study to consider CSR and CSRep from an-other perspective i.e. an Islamic perspective, and in a developing country. As will be shown in the next Chapter, some of the conceptions reviewed above are still relevant and are incorporated into the CSR framework used in this study, but there is also a need to incorporate other aspects.

Table 2-2: The Chronology of CSR Development from 1990s to Date

| Authors & Date | CSR Development in 1990s to Date |
|---------------------------|---|
| Wood (1991) | The corporate social performance: <i>CSR principles</i> <ul style="list-style-type: none"> • Principle of legitimacy • Principle of public responsibility • Principle of managerial discretion <i>Processes of social responsiveness</i> <ul style="list-style-type: none"> • Stakeholder management • Environmental scanning • Issues management <i>Outcomes of corporate behavior</i> <ul style="list-style-type: none"> • Social policies • Social programs • Social impacts |
| Frederick (1994) | Three stages of CSR: <ul style="list-style-type: none"> • Corporate social responsibility (CSR1) • Corporate social responsiveness (CSR2) • Corporate social rectitude (CSR3) |
| Wood & Logsdon (2002) | Corporate (or Business) citizenship |
| Porter & Kramer (2006) | Strategic CSR framework |

2.3 Corporate Social Responsibility: Definition and Concept

As seen above, corporate social responsibility (CSR) has been debated extensively and this has resulted in several definitions of CSR (Gray et al., 1987, Bowen, 1953, Votaw, 1972, Davis, 1973, Davis and Blomstrom, 1975, Carroll, 1979, Frederick, 1986, McWilliams and Siegel, 2001, Fox et al., 2002, Marrewijk, 2003, Waddock, 2008) (refer Appendix 1). The definition of CSR is difficult to describe and means different things to different authors.

From the definitions of CSR provided by various scholars, three key aspects of CSR can be identified. First, CSR entails corporate commitment towards society, through the management of CSR policies and actions. The results of CSR policies and actions can determine the social performance of a corporation (Banerjee, 2007). Second, the activities of CSR should go beyond obeying the law. If a corporation is adhering to the law, it is not considered as a socially responsible corporation. In fact the corporation is simply meeting the legal requirement in order to avoid penalty. Thus CSR activities should exceed its 'minimum obligation' (Banerjee, 2007). Third, CSR comprises discretionary activities and should be

undertaken on a voluntary basis. No law should impose the implementation of CSR on any corporation at any level, whether locally, regionally, nationally, or internationally (Banerjee, 2007).

Carroll (1979) believes that CSR must include the elements of economic, legal, ethical, and discretionary responsibility in the business operations. These four elements of responsibility are useful to define CSR which addresses the whole business obligation towards society. The four characteristics in the definition of CSR described by Carroll (1979) are defined in Table 2-3

Table 2-3: Four Characteristics in CSR Definition

| Element | Definition |
|----------------------------------|---|
| (a) Economic responsibility | indicates that a corporation has a responsibility to maximize profit |
| (b) Legal responsibility | suggests that a corporation must remain within the law |
| (c) Ethical responsibility | requires a corporation to behave in an ethical way, even though it is not required by law |
| (d) Discretionary responsibility | focuses on the corporations' activities of donations to the community |

Source: Carroll (1979)

In a later paper, Carroll (1991) modified discretionary responsibility and renamed it philanthropic responsibility. He also introduced a pyramid of CSR which portrays a building-block relationship between the four responsibilities. According to the importance and priorities chain, economic responsibility is placed as the fundamental building block of the pyramid, and this is followed by legal responsibility and ethical responsibility, and at the top of the pyramid is philanthropic responsibility (Carroll, 1991). In the pyramid of global CSR, Carroll (2004) considers both economic responsibility and legal responsibility as CSR which are *required* by global capitalism and global stakeholders, respectively. Meanwhile ethical responsibility and philanthropic responsibility are respectively *expected* and *desired* by global stakeholders.

The areas or elements that are covered by CSR also vary depending on the studies reviewed. Moir (2001) urges that some CSR areas could be adopted in social

responsibility policies and reporting practices of business, such as plant closures, employee relations, human rights, corporate ethics, community relations and the environment. Moir (2001) also highlights the CSR areas that reporting guidelines in Europe recommend, which include the workplace for employees, the marketplace for customers and suppliers, environment, community, ethics and human rights. A study of CSR regulations and local practices in several European countries by Dubigeon (2006) found that a CSR report should contain the following categories of CSR:

- Employment
- Working time
- Other labor-related elements
- Social dialogue
- Safety and hygiene conditions
- Training
- Employment and integration of disabled workers
- Social initiatives
- Local impacts of the company's activities
- Relations with civil society
- Relations with suppliers
- Development of operations in foreign countries
- Consumption or resources, emissions and waste
- Biodiversity
- Environmental protection policy
- Environmental expenditure

The debate about CSR among scholars, consultants and managers has also introduced some related concepts such as corporate sustainability, corporate citizenship, business citizenship, sustainable development, sustainable entrepreneurship, corporate philanthropy, Triple Bottom Line, and business ethics [see, for example Marrewijk (2006), Wood and Logsdon(2002), and Sharfman (1994)]. Horrigan (2010) asserts that there are various fundamentals and layers of meaning in these CSR related concepts and presents some distinctions and criticisms of the CSR definitions and concepts.

The current CSR definitions and concepts tend to be jurisdiction-oriented according to the level of development of economies resulting in different CSR meanings from the perspectives of developed economies and developing economies (Horrigan, 2010). Horrigan (2010) also points out that CSR is used as “a cloak for an underlying and usually anti-business social reform agenda” (p.38). The business is forced or demanded to carry out social responsibilities which go beyond the corporations’ core relations with their managers and investors (Horrigan, 2010). The definitions and concepts of CSR are also problematic as they tend to bias towards specific interests (Marrewijk, 2003). Management will only choose the CSR views which fit their specific situation and challenges. Marrewijk (2003) opines that the CSR definition and concept must be aligned with the corporation’s strategy in order to respond to the challenges of the environment in which it operates. Other problems with the current CSR definition, include the vague and meaningless social definitions, and overlapping and diversity in CSR terms and concepts (Horrigan, 2010, Marrewijk, 2003).

The context of this study is CSR of Islamic banks in Malaysia. From the above discussion, we understand that the current CSR definitions and concepts emerged from the moral values based on the foundations of Western society. However, the discussions of CSR definitions and concepts suggest that CSR is generally about the commitment of the corporation to not harming society and to contribute to the wellbeing of all stakeholders as expected by society. This more general understanding of CSR is relevant to the context of this study, i.e. Islamic banks, as they have both a social and financial commitment towards Muslim society and to operate as commanded by God. Therefore, in this study, the following broad definition will be used:

CSR is defined as the commitment of corporations to not harming society and to contribute to the wellbeing of all stakeholders as expected by God and society.

2.4 The Theories of Corporate Social Responsibility

Scholars have created and used several theories to examine and explain CSR. Some theories combine different approaches and use the same terminology with different meanings (Garriga and Melé, 2004). Some theories cannot be considered as distinct theories, because they have been developed from a similar philosophical background and provide complementary and overlapping perspectives (Islam and Deegan, 2008).

The following sections briefly review the theories commonly used in CSR research. Some aspects of these theories are used in this study's conceptual framework, but an additional perspective is added that is context specific. Therefore, the theoretical perspective used in this study is fully outlined in Chapter 5.

2.4.1 Social Contract Theory

Among the theories that are often used by scholars to examine the motivations of corporations to be involved in CSR is social contract theory. Gray, Owen, & Maunders (1996) depict society as "a series of social contracts between members of society and society itself" (cited in Moir, 2001, p.19). The social contract suggests that corporations are assumed to bear some indirect commitments towards society (Garriga and Melé, 2004). This implicit social contract between corporations and society requires corporate managers to run the business operations in socially responsible ways which are implicitly anticipated by society (Moir, 2001).

Donaldson & Dunfee (1994) offer an 'Integrative Social Contract Theory' which considers the socio-cultural and ethical contexts in business decision making. The 'Integrative Social Contract Theory' is developed from two sources, i.e. a macrosocial contract and a microsocial contract (Donaldson and Dunfee, 1994). A Macrosocial contract is a universal social contract which means it is universally relevant to business activity, for example human rights obligations (Donaldson and Dunfee, 1994). The Macrosocial contract is also fundamental and basic in nature because social issues such as human rights obligations are fundamentally expected by the community to be provided by business (Donaldson and Dunfee, 1994). Donaldson & Dunfee (2000) describe the fundamental principles of the macrosocial

contract as 'hypernorms' which "are discernible in a convergence of religious, political and philosophical thought" (p.441). Meanwhile, a microsocial contract emphasises the specific form of business involvement in the social contract (Moir, 2001, Donaldson and Dunfee, 1994). It focuses on the business response to activity in the local community (Cragg et al., 2009). Donaldson & Dunfee (2000) relate the microsocial contract with 'authentic norms' which "are based upon the attitudes and behaviours of the members of their source communities" (p.441). An authentic norm has to match the hyper-norms in order to become a legitimate norm, which then can be attached to the members of the community (Donaldson and Dunfee, 2000). This extended Social Contract Theory integrates normative and empirical elements of management that helps in understanding CSR (Cragg et al., 2009). It is also relevant to understanding religious and cultural aspects of CSR, so will be discussed further in Chapter 5.

The notion of the social contract underlies most of the theories used to investigate and explain CSR and CSResp, such as legitimacy theory and stakeholder theory.

2.4.2 Legitimacy Theory

The theory that is commonly used by scholars to explain the engagement of corporations in CSR, and in particular the reporting of CSR is Legitimacy Theory. Legitimacy is defined as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs and definitions" (Suchman, 1995, p.574). Legitimacy Theory posits that if the corporation does not appear to operate within the bounds that are considered appropriate by society, then society may act to remove the corporation's right to continue operations (Haron et al., 2004). In essence, society, which grants a license and mandates a power for a corporation to operate, would expect the corporation to use that power responsibly. Thus, Legitimacy Theory is closely related to the notion of power and responsibility discussed by Davis (1960, 1973). "Society grants legitimacy and power to business. In the long run, those who do not use power in a manner which society considers responsible will tend to lose it" (Davis, 1973, p.314). As discussed above, this conception draws on social contract theory. Society will withdraw its social contract

unless the organisation undertakes particular strategies to use their power responsibly.

2.4.3 Stakeholder Theory

Stakeholder Theory is another theory that is often utilized by the scholars in CSR studies. This theory analyses those groups of stakeholders to whom the corporations should be responsible and often pose a challenge to be managed by corporate managers (Moir, 2001). A stakeholder is classically defined as “any group or individual who can affect or is affected by the achievement of the organisation’s objectives” (Freeman, 1984, p.46, cited in Moir, 2001). According to Henrique (2000), different corporations can have different lists of stakeholders because they can decide who are their appropriate stakeholders. A typical list of stakeholders usually includes employees, local community, customers, shareholders and suppliers. Some corporations incorporate the public, pressure groups, and even the environment into their stakeholder list. Clarkson (1995) classifies these stakeholders into two main groups; (i) primary stakeholders are defined as “one without whose continuing participation the corporation cannot survive as going concern” (p.106), and (ii) secondary stakeholders who are “those who influence or affect, or are influenced or affected by the corporation are not essential for its survival” (p.106).

Deegan, Rankin, & Voght (2000) divide Stakeholder Theory into two branches; the ethical branch and the managerial branch. The ethical branch states that all stakeholders have the right to be treated equally by a corporation and does not involve any stakeholder power issues (Deegan *et al.*, 2000). The issues of stakeholder power are the main focus in the managerial branch. The managerial branch infers that corporations will react to the powerful stakeholders or those who have substantial impact on the corporation, on an asymmetric basis (Deegan *et al.*, 2000). As some powerful stakeholders control the critical resources of the corporation, the corporate manager will attempt to please these stakeholders by providing all the information demanded by them (Ullmann, 1985). Islam and Deegan (2008) find overlap between the managerial branch of Stakeholder Theory and Legitimacy Theory. They justify the overlap by citing Gray *et al.* (1996) who

state that corporate managers attempt “to manage (or manipulate) the stakeholders in order to gain their support and approval, or to distract their opposition and disapproval” (p.45). The overlapping of Stakeholder Theory and Legitimacy Theory is also discussed by Mitchell, Agle, & Wood (1997) who develop the stakeholder identification and salience model and find that stakeholders have more than one of each of the elements of power, legitimacy and urgency. It is expected that corporations would be most interested to react to those legitimate, powerful and urgent stakeholders.

2.4.4 Political Economy Theory

According to Gray, Kouhy, & Lavers (1995), the overlapping concepts of Stakeholder Theory and Legitimacy Theory can be explained by them both being part of Political Economy Theory. In their original words, “Stakeholder Theory and Legitimacy Theory are... seen as two (overlapping) perspectives... which are set within a framework of assumptions about Political Economy”(Gray et al., 1995 p.52, quoted in Woodward et al., 2001).

Ratanajongkol, Davey, & Low (2006) inform us that the notion of Political Economy Theory is that politics, economics and society are inseparable. Political Economy Theory focuses on perspectives which are linked to a broad range of interconnected political, economic and social influences (Gray et al., 1996, Ratanajongkol et al., 2006). This political economy concept proposes that management perceives and provides the information which is needed to influence societal opinion (Woodward et al., 2001). The approach in Political Economy Theory is proactive in nature whereby corporate managers plan to control and manipulate society and to form the world in accordance with managerial views (Woodward et al., 2001). The approach of Legitimacy Theory, on the other hand, is reactive in nature whereby corporate managers take appropriate actions to justify the operations of the corporation which was granted a mandate by society to exist (Woodward et al., 2001). The main concern of Political Economy Theory is to influence society, whilst for Legitimacy Theory, the major concern is accountability. Both of these concerns of corporations will involve stakeholder theory whereby corporations identify societal interest groups, the views of whom the corporation

may wish to manipulate towards supporting corporate actions or, to whom the corporation might be believed to be accountable (Woodward et al., 2001).

2.4.5 Agency Theory

Woodward et al. (2001) also explain that the concepts of Legitimacy and Political Economy primarily explicate corporate social responsibility using an Agency Theory framework. Agency Theory arises as there is relationship between shareholders of companies who act as 'principals' and managers of companies who act as their 'agents' (Fama and Jensen, 1983). Agency Theory suggests that both parties attempt to maximize their own interest and return, which then becomes a potential conflict between the two parties (Haron et al., 2004). According to Friedman (1970), CSR is a manipulation mechanism used by managers in order to advance their own interests at the expense of shareholders. He argues that if a corporation is involved in CSR, it is a symptom of an agency conflict between the interests of managers and shareholders (Friedman, 1970). On the other hand, Woodward et al. (2001) argue that CSR based on the framework of Agency Theory is either a reactive action to societal pressures (i.e. a legitimacy explanation) or a proactive action that is managerially driven (i.e. a political economy explanation). In the reactive position, the principals/shareholders are predominant whereby they grant the license and power to a corporation to exist, while the agents/managers are subordinate to run the corporation in order to justify its existence (Woodward et al., 2001). However in a proactive position, agents are more predominant as they set the agenda to persuade society to support corporate actions, and the principals are subordinate and will be persuaded by the managers (Woodward et al., 2001).

2.4.6 Institutional Theory

Another theory which also overlaps with Legitimacy Theory and Stakeholder Theory is Institutional Theory (Islam and Deegan, 2008). Institutional Theory explains that stakeholders expect and pressure corporations to adopt particular organisational structures and particular operating and reporting policies (Islam and Deegan, 2008). Institutional Theory is regarded by Holder-Webb, Cohen, Nath, & Wood (2009) as embodying another variant of Political Economy Theory. The concept of Institutional Theory suggests that corporate managers carefully choose policies and

propagate information which can bring society's attention towards a favourable management view and can distract their attention from notorious and improper activities (Holder-Webb et al., 2009).

Institutional Theory is closely related to the isomorphism concept. "Isomorphism refers to the adaptation of an institutional practice by an organisation" (Dillard et al., 2004, p.509, quoted in Islam and Deegan, 2008). Isomorphic behaviour involves an institutional convergence process (Dacin, 1997). Therefore, it can be seen that within different institutions or organisations, there is close similarity between their institutional practices (Islam and Deegan, 2008). "The greater the dependence of an organisation on another organisation, the more similar it will become to that organisation in structure, climate, and behavioural focus. Such a process is referred to as coercive isomorphism" (Islam and Deegan, 2008, p.856). Meanwhile, Campbell (2007) draws on insights from the perspective of institutional and political economy theories to understand the reason why a corporation engages in socially responsible corporate behaviour. He finds that the reasons include institutional environments like well-enforced state regulation, effective industrial self-regulation, and established codes of conduct. In addition the 'watchdog' role of nongovernmental and independent organisations can mediate the association between basic economic conditions and corporate behaviour which therefore encourages corporations to behave in a socially responsible manner (Campbell, 2007).

2.4.7 The Accountability Concept

When considering CSRep, Stakeholder Theory and Legitimacy Theory are closely related to the concept of accountability. Organisations are accountable to a larger society, whereby the accountability of corporations is towards numerous special interest stakeholders. Accountability is defined as "the duty to provide an account ... or reckoning of those actions for which one is held responsible" (Gray et al., 1996, p.38). The 'accountor' should provide information to the 'accountee', and that forms an effective accountability framework (Burritt and Welch, 1997). Provision of information empowers the accountee in a process which helps "to expose, enhance and develop social relationships" (Gray, 1992, p.423). Roberts

(1991) describes accountability as a type of social relation that represents action interdependence and the interdependence always contains both strategic and moral elements. There are multiple stakeholders with an interest in the accountability of a corporation and, therefore, a number of accountees, each with a different interest in the outcomes of the corporation's activities. Hence, the accountant is held to account for actions taken and consequences incurred (Burritt and Welch, 1997).

2.4.8 Mapping CSR Theories

As can be seen from the preceding review, there are a number of overlapping and competing theories that attempt to explain CSR by corporations.

Garriga & Melé (2004) provide a map of the main CSR theories by grouping them into four dimensions, namely instrumental theories, political theories, integrative theories, and ethical theories. Instrumental theories focus on attaining economic objectives and creating wealth through strategies like shareholder value maximization, competitive advantage and cause-related marketing (Garriga and Melé, 2004). The second dimension, i.e. political theories, focuses on the business-society interactions, business power and its intrinsic responsibility which are explained through the notions of corporate constitutionalism, integrative social contract theory and corporate citizenship. Corporate constitutionalism describes how businesses hold social responsibilities acquired from the social power that they possess, which is similar to the concept discussed by Davis (1960), i.e. social power comes with social responsibilities. The third dimension is integrative theories, which focus on how businesses meet social demands by incorporating social values into business operations. Businesses integrate social demands through approaches like issues management, public responsibility, stakeholder management and corporate social performance. Lastly, ethical theories focus on the 'right thing' that is necessary for business to do in attaining a good society (Garriga and Melé, 2004).

In their findings, Garriga and Melé (2004) suggest a need to form a new theory that integrates the four dimensions of CSR theories which is able to overcome the

limitations of the current CSR theories that fail to explicitly specify the implications of each approach.

2.4.9 Criticism of CSR Theories

From the theories discussed above, it can be concluded that the implicit obligations of business in terms of CSR are difficult to achieve if there is no pressure and influence in place. The constraint on achieving CSR aims is that many corporations implement CSR at best, motivated by human ethical or moral reasoning (Gray et al., 1996, Haniffa and Hudaib, 2004). But human ethical and reasoning alone are not adequate to motivate the implementation of CSR and to achieve CSR aims. The ultimate aims of CSR especially the implicit obligations could be best achieved if they were driven by sacred, spiritual and religious thoughts (Haniffa and Hudaib, 2004).

Some other criticism of CSR and CSRep theories is that they are derived from secularist worldview which is merely based on human rationality and argument. Thus, the theories are more aligned to materialistic approach to life as well as relative and always changing (Dusuki, 2008). For example, social contract theory is criticized for its relativity, as society's preferences always change that would require renegotiation between businesses and society to adapt the change in preferences (Donaldson and Dunfee, 1994). While Dusuki (2008) criticizes that legitimacy theory creates dilemma to the corporations as they need to modify their behaviour according to society's expectation. However, there is no standard manner in human behaviour as there is no absolute ethical conduct that can guide the corporations in social responsibility (Dusuki, 2008).

The concepts of spirituality, religious, eternal and absolute are missing from the Western literature on CSR, but are fundamental to many Eastern societies. This is what the current study will use as the framework of CSR and CSRep, by incorporating Islamic perspective as religious thought to motivate CSR obligations. This framework, and its relationship to the existing theories discussed above is presented in Chapter 5.

2.5 Corporate Social Reporting (CSRep)

From the preceding discussion of CSR, we understand that society is increasingly requiring the corporation to bear responsibility for a broad range of complex and pressing social and economic issues. Various stakeholder groups are putting pressure on corporations and are demanding that the corporations report their social and environmental performance as well as their financial results (Labelle et al., 2006). In CSR, the fundamental obligation is to identify and provide the information demanded by these stakeholders. Therefore, corporations have to address the issues of reporting on their social and environmental performance and this emphasises the need for accountability to society (Douglas et al., 2004)

Corporate social reporting (CSRep) is how corporations communicate their social responsibility to their stakeholders. Gray et al. (1987, p.4) define corporate social reporting (CSRep) as:

“...the process of communicating the social and environmental effects of organisations’ economic actions to particular interest groups within the society and to society at large. As such, it involves extending the accountability of organisations (particularly companies), beyond the traditional role of providing a financial account to the owners of capital, in particular, shareholders. Such extension is predicated upon the assumption that companies do have wider responsibilities than simply to make money for their shareholders”.

CSRep plays an important role as a mechanism to discharge the duty of accountability. In essence, CSRep is related to accounting for CSR and the issue of “triple-bottom line” reporting. Corporations have to account for their economic, social, and environmental responsibility and to provide information about performance of those three responsibilities, in order to legitimate their existence to civil society (Dubigeon, 2006). CSRep involves explicit transparency about the actions and inactions of a corporation by the issuance of an external report; a social report, an environmental report, or a triple bottom-line report (Waddock, 2006). In current practice, corporations can audit their social and environmental performance in any manner they wish, report as much or as little of what they

discover as they wish, and utilize whatever format that suits them (Waddock, 2006). Most companies also generally focus their report of social responsibility only on positive activities (Waddock, 2008).

The inconsistency in CSRep results in difficulties for stakeholders in understanding social information and comparing social performance between different organisations, which suggests a need for reporting standardization. Begun in 1997, the Global Reporting Initiative (GRI) invited a huge network of experts from various stakeholder groups, including business, non-governmental organisations, labour unions, accountancy and other organisations from around the globe, to join a multi-stakeholder alliance in order to collect inputs and search for consensus in CSRep (GRI, 2008). The inputs from the alliance were used to develop and improve the GRI sustainability reporting framework which provides common guidelines for environmental, social, governance or sustainability reporting (Waddock, 2008). The GRI reporting guidelines are relevant to all sizes, sectors and geographic regions of organisations because the guidelines offer guidance and standard social disclosures, that outline the foundation content of sustainability reporting (GRI, 2008). Since then the GRI has become a globally recognised standardized social, sustainability or non-financial reporting framework which is similar to generally acceptable accounting principles for financial reporting (Waddock, 2008). The adoption of the GRI reporting framework among organisations is still on a voluntary and flexible basis (GRI, 2008). However, organisations which adopt the GRI reporting framework will enable stakeholders to do cross-company, cross-industry, and cross-country comparisons on CSRep (Waddock, 2008).

Although an important global framework, for this study, GRI is not used to study the CSR reporting of Islamic banks in Malaysia as there is a more specific CSR standard available. This study uses the reporting standards based on Accounting, Auditing and Governance Standards for Islamic Financial Institutions or known as AAOIFI which will be discussed further in Chapter 3 and Chapter 5.

2.6 A Review of Studies that Investigate CSR and CSRep

This section reviews the studies that have been conducted to analyse the practices of CSR and CSRep. Firstly, this section reviews CSR and CSRep studies that have been done in developed countries in order to provide a general background to CSR reporting practice. Then, CSR and CSRep studies which were conducted in developing countries are reviewed as these are relevant to this study which is also conducted for a developing country. A summary of CSR and CSRep studies is provided at the end of this section, with a discussion of how the issues are relevant to this study.

2.6.1 CSR and CSRep studies in developed countries

The majority of research on CSR has been conducted in Western developed countries, most commonly the USA, UK and Australia, and also Europe. A number of factors have been shown to influence the volume of disclosures such as size, industry, stakeholders and economic performance. This section provides a brief review of indicative studies. Gray et al. (1995) conducted a longitudinal study from 1979 to 1991 to investigate the trends and developments of CSR disclosure in the UK. The authors found significant changes in CSR disclosure trends during the period. However, Gray et al. 's (1995) study provides evidence that UK companies viewed CSR disclosure as a trivial activity and they did not seriously adopt CSR disclosure activities as part of their practices. However at the same time, UK companies had increased disclosure on social and environmental issues over the study period (Gray et al., 1995).

Roberts (1992) undertook a CSR study of 80 major corporations in the USA which were examined by the Council of Economic Priorities (CEP) throughout the years 1984 to 1986. In the study, the sampled corporations come from seven different industries, namely automobile, airline, oil, food, health/personal products, hotel, and appliances/household products industry, which the author categorized into high profile industries and low profile industries (Roberts, 1992). Roberts (1992) confirmed the application of stakeholder theory in explaining the influential factors on CSRep in USA corporations. He found that stakeholder power, strategic posture,

and prior economic performance are significantly associated with CSRep levels (Roberts, 1992). He also believes that the relationship between stakeholder power, strategic posture, economic performance and CSRep might be affected by corporate age and industry classification (Roberts, 1992).

Maignan and Ralston (2002) explore the corporate websites of corporations in the USA, UK, France, and The Netherlands, in a study examining the pattern of CSR issues being disclosed on corporate websites. The CSR issues that are emphasised in this study include CSR principles, processes, and stakeholder issues (Maignan and Ralston, 2002). The selected corporations in the study comprise corporations from the industries of transportation, technology, services, wholesale/retail, chemical, food/agriculture and others. The authors find different enthusiasm levels shown by corporations across four countries in dealing with, and disclosing, socially responsible issues (Maignan and Ralston, 2002). In displaying dedication towards CSR, the corporations from different countries are found to recognise diverse CSR principles, processes and stakeholder issues (Maignan and Ralston, 2002). The authors also find that corporations in the USA and UK are more enthusiastic in communicating CSR issues than French and Dutch corporations (Maignan and Ralston, 2002).

For developed countries that are located in the Asia Pacific, an example is the study by Gao, Heravi and Xiao (2005) who explore the patterns of CSRep in Hong Kong (HK) through the examination of annual reports for the period 1993 to 1997. The study showed that, CSRep of HK corporations increased throughout the five years. The level of CSR disclosure mainly depends on the size of corporations and industry membership (Gao et al., 2005). The study also provides evidence that HK corporations are less concerned about the environment, protecting the safety and health of employees at the workplace and energy conservation. The annual reports of HK corporations show poor disclosure in the Environment and Health and Safety categories, and no disclosure in Energy category (Gao et al., 2005).

A number of studies have been conducted on specific industries. Adams and Kuansirikun (2000), for example, investigate the pattern of CSRep in the annual

reports of UK and German corporations, particularly in the chemical and pharmaceutical industries between the years 1985 and 1995. In the period of eleven years, disclosure of CSR by both countries in terms of volume increased. CSR reporting by German corporations is found to be more advanced and they report more information than UK corporations especially for the environmental category. The differences in the nature of CSRep between the two countries throughout the eleven-year period are mainly due to the absence of environmental regulations in the UK, and the relationships between industry and government, culture, and social and political pressure groups (Adams and Kuansirikun, 2000).

Guthrie, Cuganesan and Ward (2008) studied CSRep in the food and beverage industry in Australia in an effort to develop an industry-specific social and environmental reporting framework. After exploring the annual reports and corporate websites, the authors discover that most corporations in the Australian food and beverage industry tend to report more social information relating to industry-specific issues (Guthrie et al., 2008). The methods used to report social information are considerably different between corporations but primarily narrative disclosure is preferred by many (Guthrie et al., 2008). The corporations favour reporting social information on corporate websites than in annual reports, and also report different types of information in those two mediums of disclosure (Guthrie et al., 2008).

A study for focus and standardized sustainability reporting was conducted in the largest 100 companies in the United Kingdom and Finland (Fifka and Drabble, 2012). The authors study not only the extent of reporting and the media of disclosure, but also include the reporting standards and guidelines. Fifka and Drabble (2012) find mixed results for the impact of culture and environment on the focus of reporting and the application of standards, and the impact is limited. The authors also reveal that a culture-oriented shareholder does not influence of more reporting on economic issues, and the strength of environmentalism does influence the extent of environmental reporting (Fifka and Drabble, 2012).

There have been a number of studies that consider the banking and finance industry specifically, which are particularly relevant to this study. These are reviewed in detail in Sections 2.7 and 2.8 below.

From the preceding review, the studies of CSR and CSRep in developed countries seem to focus more on CSR principles and processes and also on a more strategic focus. Disclosure levels are increasing in most developed countries, and variables of influence appear to be mainly size, industry and performance. The discussion of the findings will be further summarized in Section 2.6.3.

2.6.2 CSR and CSRep studies in developing countries

Research on CSR in less-developed countries is sparse, but it is notable that studies are increasing. For example, Al-Khater and Naser (2003) explore the opinion of different user groups of annual reports in Qatar regarding the accountability process. The respondents were also asked their opinion about the prospect of CSR information being reported in annual reports (Al-Khater and Naser, 2003). The results show the users in Qatar are interested in seeing more CSR disclosure in annual reports as a component of the accountability process by a corporation, and as such, they believe that legislation plays an important role in promoting the establishment of CSR disclosure (Al-Khater and Naser, 2003). In this way, all groups in Qatar society would be entitled to, and have the opportunity to, have access to the social information of a corporation. The authors mention that users of annual reports in Qatar are not concerned with the way corporations are communicating CSR information, it may either be included in the board of directors' statement or in a separate CSR section within the annual report, as long as the CSR information is accessible by the corporate information users (Al-Khater and Naser, 2003).

Katsiolouides and Brodtkorb (2007) conducted a questionnaire survey to explore the awareness of CSR in United Arab Emirates (UAE) corporations. The data on CSR awareness among UAE corporations are drawn from all private sectors in the Non-Free Zone of the Dubai economy (Katsiolouides and Brodtkorb, 2007). The authors focus the CSR awareness study on three key aspects of CSR: environment, community affairs, and consumer protection. Generally, the study finds that most

UAE corporations have a sense of CSR awareness (Katsiolouides and Brodtkorb, 2007). Regarding the environment, many corporations in UAE adhere to the general legal requirements related to the environment but they do not really commit to engage in extended environmental activities such as evaluating environmental impact, considering the impacts of supply chain on the environment, or setting indicators to avert destructive activities to the environment (Katsiolouides and Brodtkorb, 2007). On community affairs, a majority of UEA corporations commit to be involved in the community which their operations serves, for example through winning projects that could benefit society (Katsiolouides and Brodtkorb, 2007). In terms of consumer protection, many corporations assess the performance of consumer services using consumer complaints as a key measure (Katsiolouides and Brodtkorb, 2007). Importantly, the authors sense a significant influence of Islam as an official religion in the UAE, regarding the business responsibilities to environment, community affairs, and consumer protection, in which heeding such responsibilities can determine considerably the success of a business (Katsiolouides and Brodtkorb, 2007).

Islam and Deegan (2008) present a case study of CSRep practices of a major textiles organisation in Bangladesh, i.e. the Bangladesh Garment Manufacturers and Exporters Association (BMGEA). The authors interviewed senior officers from BMGEA, which is involved in clothing manufacture and export, in order to gain an in depth understanding of CSRep disclosures through exploring social and environmental expectations and pressures faced by the textiles corporations that operate within a developing country (Islam and Deegan, 2008). According to Islam and Deegan (2008), the Bangladeshi textiles industry is often criticized by the international media and NGOs for issues related to sweatshops, human right abuses, child labour, and poor safety and health of people in the workplace. In addition, a textiles organisation such BMGEA has business transactions with global buying corporations such as Reebok, Nike, H&M, and others (Islam and Deegan, 2008). The multinational buying corporations embrace strict social codes of conduct and require that BMGEA also adhere to the codes of conduct, whereby failing could result in orders cancellation. Therefore, the textiles industry in

Bangladesh faces high anticipation and social pressure from powerful stakeholders which include the agents of multinational buying corporations, the International Labor Organisation (ILO), UNICEF, NGOs, and US and EU Governments, specifically concerned about dealing with social issues (Islam and Deegan, 2008). Through the study, it was found that the Bangladeshi textiles industry reacts to the pressure of powerful stakeholders through adopting operating policies and codes of conduct which are comparable to the practices of the powerful stakeholders in developed countries. This is known as coercive isomorphism in institutional theory (Islam and Deegan, 2008).

In Thailand, a longitudinal analysis of CSR disclosure by Ratanajongkol et al. (2006) of the top 40 Thai companies over the years 1997, 1999 and 2001 reveals that the volume of CSR disclosure has increased. The study also finds that Thai companies in different industries focus on different themes of CSR disclosures, but generally human resources is the theme that is being given the most emphasis (Ratanajongkol et al., 2006). However the trends throughout the five years show a discrepancy within different industries (Ratanajongkol et al., 2006). The different trends of CSR disclosure in Thailand in the study are explained through multiple perspectives. The authors explain that the increasing trend of CSR disclosure by Thai companies in the service sector and properties sector is due to legitimacy theory (Ratanajongkol et al., 2006). Thai companies in the finance sector show a decreasing trend of CSR disclosure and that can be explained by economic conditions as a recession occurred in 1998 (Ratanajongkol et al., 2006). The trend of fluctuating CSR disclosure by Thai companies in the manufacturing industry is explained by the political economy theory and management self-interest (Ratanajongkol et al., 2006)

A study of CSR disclosure and corporate reputation has also been conducted in Libya using stakeholder theory (Bayoud et al., 2012). The authors examined annual reports of 40 Libyan companies to obtain CSR disclosure level and conducted questionnaires survey among managers and employees to measure corporate reputation. Bayoud et al. (2012) find that CSR disclosure level in Libya has increased

due to the stakeholders pressure. The authors also note that managers and employees perceive that CSR disclosure is a signal of improved CSR conducts and therefore influences the corporate reputation (Bayoud et al., 2012). Their study confirms that high CSR disclosure level has strong relationship with corporate reputation for stakeholder groups (Bayoud et al., 2012).

There have been some studies undertaken in Malaysia, the context for this study, and these are reviewed below in Section 2.9.1.

Overall, the trend in developing countries as in developed countries, is increasing disclosure. The limited literature also shows that, stakeholders influence, emerging economic conditions and industry are influencing factors.

2.6.3 Summary of CSR and CSRep studies

In the previous sections, the studies of CSR and CSRep in developed and developing countries were reviewed, and a number of important issues identified. In developed countries, as expected, both CSR and CSRep disclosures are more advanced in terms of volume and quality. The studies on CSR and CSRep in developed countries have moved forward to scrutinize the reasons, motivations and influences on CSRep such as economic performance, strategic position and stakeholder issues. The companies in developed countries place emphasis more CSR principles and processes.

In developing countries, CSR is less prevalent compared to developed countries. Studies in some countries like Qatar and UAE have just started to analyse the existence of CSR information in their companies' annual reports and the awareness of CSR in their corporations. A developing country like Bangladesh, where globalization and business activity are likely to have dramatic, positive and negative impacts on social and environment, their CSR themes are concerned more about poverty, hunger and disease, child labour, equal opportunities for women, and a healthier environment. While in Thailand, a developing country where the economy is rapidly expanding and offering lucrative market growth for business, is

dealing with how to increase the CSR disclosures and this depends heavily on political reforms and economic development of the country.

There are other studies on developing countries, particularly in the area of environmental reporting, but the general trends are similar. It is clear that, CSRep is at an emergent stage but it is firmly on the agenda of corporations in these countries.

While Malaysia is a developing country similar to Thailand, and CSRep practices in the country are expected to be more or less the same, the main difference between these two countries is the culture, especially religion, which can also influence CSRep practices. As this thesis is in the context of Malaysia, it aims to contribute to a better understanding of CSRep practices in Malaysia from an Islamic perspective. Specific information about the Malaysian context and a review of further studies are provided in Section 2.11.

2.7 Corporate Social Responsibility in the Banking and Finance Industry

Studies have shown that industry is an important determinant of CSR reporting. As the context of this thesis is the banking industry, it is important to consider the role of CSR in this industry, and also to review studies of CSRep by banks and other financial services organisations.

Banks and other financial institutions play a significant role in dictating the economic growth, stability and sustainability of economies of a nation (Decker and Sale, 2009). The banking and finance industry performs core functions to facilitate economic activity (Decker and Sale, 2009). The financial market can affect a large number of economies and also individuals' financial lives (Chatterjee and Lefcovitch, 2009). Ordinary people, even those without financial risk knowledge, can make good use of the facilities that banks and other financial institutions offer, like credit cards, bank loans and a variety of other credit sources (Chatterjee and Lefcovitch, 2009). Finance is a foundation of all societal development as investment will make societies more thriving and well-off (Ogrizek, 2002). Many believe that

the support of financial innovation will grant the opportunity to the people to create a sustainable future (Ogrizek, 2002)

Banks are also involved in financial contracts which deal with people's assets and money (Decker and Sale, 2009). These financial contracts are managed by bankers who engage with information asymmetry and uncertainty (Decker and Sale, 2009). Therefore, Decker and Sale (2009) believe that trust plays an important role in banking business operations. In the banking and finance industry, trust is a strategic matter. There will be fatal effects not only to the industry but also to the macro economy if trust does not exist in bankers (Decker and Sale, 2009). Thus, to ensure trust towards bankers and banking, the industry would have to operate in an ethically responsible way (Decker and Sale, 2009). By committing to social responsibility, the banking industry would not just gain trust but also reputation. Schanz (2006) as cited by Decker and Sale (2009), explains that "reputation represents trust capital that is acquired through addressing corporate performance, addressing society's concerns and meeting or exceeding stakeholders' expectations" (p.137).

There are several reasons that make it important for bankers to heed reputation issues. First, the banking industry deals with other people's money which symbolizes their safekeeping and wellbeing (Decker and Sale, 2009). Second, the banking industry is synonymous with the practice of usury⁴ which was forbidden by Christianity during medieval times (Decker and Sale, 2009, Gambling and Karim, 1986). Usury is also forbidden by other religions like Islam and Judaism (Gambling et al., 1993, Visser and Macintosh, 1998). However, usury has become accepted over time in order to suit capitalist expansion, commercialization and international trade. Usury in the Western definition gradually shifted from one referring to any loan with an interest charge to one referring to a loan with an excessive interest rate. In Islam, the prohibition of usury is well established since the teachings of the

⁴ Usury is defined as "*the practice of charging financial interest in excess of the principal amount of a loan*", however in more recent time; usury is interpreted as "*interest above the legal or socially acceptable rate*" (Visser and McIntosh, 1998, p.175).

prophet Mohammed in early 600 A.D., and to this day interest is prohibited and is not integrated into the Islamic economic system⁵ (Gambling and Karim, 1986, Visser and Macintosh, 1998). Third, bankers face an image problem as they often have been indicted by watchdogs for committing the 'five deadly sins' (Ogrizek, 2002). The five deadly sins which can harm the reputation of many banks are 'arrogance, greed, myopia, complacency, and inconsistency' (Ogrizek, 2002). Therefore, CSR of a bank is intrinsic in its business function within society, thus banks need to be part of, or within, the community it serves in order to build or restore trust and proximity (Ogrizek, 2002). Establishment of a bank within a community will make people feel confident and comfortable to deposit their money as they are dealing with an institution that is close to their community (Ogrizek, 2002). Decker and Sale (2009) who discuss CSR from a sociological perspective also agree that trust in banks can ease the intricacy of social relations and ambiguity in the relationship between bankers and the community.

Using Carroll's (1979) CSR elements, Decker and Sale (2009) explain the relationships of banking and bankers' social responsibility with society. They describe that the banks' economic and legal responsibilities are *required* by society because those responsibilities relate to the existence of banks and are also determined by regulation. The banks' ethical responsibility is described as *expected* by society because it is derived from expectations that the banks would conduct their operations with honesty, professional integrity, transparency and accountability, i.e. the values that form trust towards banks and bankers (Decker and Sale, 2009). Philanthropic responsibility is *desired* by society as this ethical expansion is part of a bank's social role which can create social reputation for the bank within the community (Decker and Sale, 2009).

⁵ The terminology 'usury' and 'interest' are used interchangeably (Visser and McIntosh, 1998). See, Visser and McIntosh (1998) for more discussion on usury from the perspectives of different religions.

2.8 A Review of Studies that Investigate CSR and CSRep Practices in Banking and Finance Industry

After reviewing the issues of CSR in the banking and finance industry, it is important to know the current CSR and CSRep practices in this industry. This section firstly reviews CSR and CSRep studies specifically on the banking or other financial services sectors. It then reviews studies of CSR and CSRep that are more general, but include the banking industry in their sample.

2.8.1 CSR and CSRep-Focused Studies on Banks

This subsection highlights the review of CSRep studies that focus on banks and other financial institutions as the main sample of the study. For example, Decker and Sale (2009) investigate the opinion of bankers on CSR and also the social responsibility of bankers in the United Kingdom (UK) through interviews with five banking officers and one officer from a building society. Using a sociological perspective, the authors find that the bankers' opinion on CSR varies according to organisational cultural dimension (Decker and Sale, 2009). However, the bankers generally view CSR as a competitive advantage tool and many of them disagree that CSR should be legislated (Decker and Sale, 2009). The authors also find two sociological issues about CSR in the banking industry. The first issue is related to the banking professionals who possess greater power than the client as information asymmetry exists in the financial contract (Decker and Sale, 2009). Secondly, religious issues relating to the banking professionals, and differences in culture can bring to the establishment of different types of banks such as Islamic banks (Decker and Sale, 2009). However the authors find that due to global liquidity, Islamic banks are exposed to equity and real estate risks as they tend to adopt asset-backed investment. The authors also note that Western banking is less conservative and wealth pursuit has become the social goal. As such, there is imbalance between the two banking systems.

Thompson and Cowton (2004) conduct a questionnaire survey and semi-structured interviews with senior managers of banks in the UK to determine whether environmental information is considered by the bankers when making a decision to

finance a project. They find that more than half of the respondents factor environmental information into a lending decision (Thompson and Cowton, 2004). The bankers informed the authors that they eschew providing finance to those corporations with a bad environmental record and those that are related to environmentally high risk and sensitive industries (Thompson and Cowton, 2004). The bankers are aware that environmental issues can create risks for the banks' lending portfolio and weaken the portfolio, therefore they demand environmental information from the corporation (Thompson and Cowton, 2004). In order to obtain the environmental information, the most common source used by the bankers is the annual report, followed by information obtained on company visits and from personal interviews (Thompson and Cowton, 2004). When the bankers were asked about current environmental disclosure, their response was that the current disclosure practices are still not sufficient to enable them to make environmentally conscious lending decisions (Thompson and Cowton, 2004).

Coupland (2006) analyses the corporate websites, particularly the financial and CSR web-based reports, of the banking sectors in the UK, to examine the language used by the banks to communicate CSR information and also how the banks place these web-based reports on their websites. Using a discourse analytic approach, particularly media analysis techniques, Coupland (2006) uncovers that UK banks use language which is influential, believable and controlling to report CSR information. The banks employ accounting terms and language in CSR reports for the purpose of legitimacy, by associating the procedures of accounting and auditing in the process of monitoring CSR activities and performance (Coupland, 2006). This legitimate image in the reports is required because CSR legitimacy is related to financial risk evaluation (Coupland, 2006). The author also examines the locations of financial reports and CSR reports, and the ease of access to these reports on the banks' websites (Coupland, 2006). For the purpose of bringing different viewers to different sections of the website, the CSR report is placed separately from the financial report (Coupland, 2006). In fact, the CSR report is placed remotely from financial information, and is even included under headings which are vaguely linked with CSR issues. Coupland (2006) suggests the banks which provide CSR reports

tend to make CSR information seem not very important compared to financial information, by dividing the attention of their website's viewers and also a greater number of 'clicks' before the viewers can access a downloadable CSR report. For instance, potential investors can access financial information through an easy click on the label directly linked to financial report, while the CSR report can be accessed and downloaded only after several 'clicks' (Coupland, 2006). Therefore, Coupland (2006) disagrees that the issuance of a stand-alone CSR report indicates the banks have increasingly and appropriately taken account of CSR issues.

Douglas et al. (2004) explore CSR disclosure in annual reports from the year 1998 to 2001 of six banks and four international financial institutions in Ireland. The authors also extend their investigation of CSR disclosure on the websites of the six Irish banks to 2002 (Douglas et al., 2004). In the study, they employ the framework of four-state i.e.: Rejection (State 1), Rhetoric (State 2), Behaviour (State 3), and Responsiveness (State 4) (Douglas et al., 2004). The authors find Irish banks widely report the issues of corporate governance and human resources in the annual reports (Douglas et al., 2004). However issues relating to community and environment are not covered in the annual reports (Douglas et al., 2004). The authors also find that the website is a more convenient medium for Irish banks to report their CSR information compared to annual reports, and as such they report more CSR information on their websites (Douglas et al., 2004). For the international banks, the authors discover that the banks in the sample report CSR information mostly in the category of community involvement, corporate governance, and human resources (Douglas et al., 2004). The result that international banks report community-related issues is in line with the study by Newson and Deegan (2002) who discover that multinational companies offer information relating to global concerns and expectations and not to information demanded by people in the companies' home country.

Branco and Rodrigues (2006) investigate the CSR disclosure in annual reports in 2003 of Portuguese banks, then compare this with the CSR information that the banks reported on their websites in 2004. Using legitimacy theory, the authors'

results show that Portuguese banks prefer to report more CSR information in their annual reports than on the websites (Branco and Rodrigues, 2006). They also find that for both annual reports and websites, the category of community involvement is the most frequent type of CSR information being reported by Portuguese banks (Branco and Rodrigues, 2006). In annual reports, Branco and Rodrigues (2006) discover that the category of environmental and human resources are more often reported because the annual reports are aimed at investors and also employees which is the most significant resource to the organisation. While on websites, the category of products and services and community involvement are more common since the websites can reach customers and the larger public (Branco and Rodrigues, 2006). The authors also confirm their hypothesis that more visible banks, i.e. banks with larger number of branches and listed banks are more interested and willing to disclose CSR information in order to develop their corporate reputation and image (Branco and Rodrigues, 2006).

Evangelinos, Skouloudis, Nikolaou and Filho (2009) examine the social or sustainability reports of Greek banks to analyse the social reporting strategies practiced by the banks based on the benchmark of the Global Reporting Initiative (GRI) and the Deloitte Touchè Tohmatsu (DTT) sustainability reporting scoring systems. The authors discover most Greek banks obtain a low score with less than 50% for both scorecards (Evangelinos et al., 2009). The low level of adherence to the GRI and DTT sustainability requirements provides evidence that Greek banks do not broadly disclose issues of a social and environmental nature in their reporting practices (Evangelinos et al., 2009).

In the case of CSR disclosure among banks and other financial institutions in developing countries, the practice of disclosing CSR information is generally low. For example, Hossain and Reaz (2007) examine the annual reports of 38 banks that are listed on the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE) in a search for the extent of voluntary disclosure, including CSR disclosure practices, in India by looking its relationship with company characteristics. The authors find that the disclosure of voluntary information in Indian banks is

significantly influenced by the company's size and assets-in-place (Hossain and Reaz, 2007). However, the other characteristics such as a bank's age, banks with multiple stock exchanges, banks with subsidiaries, and board composition do not influence voluntary disclosure (Hossain and Reaz, 2007).

Khan, Halabi and Samy (2009) investigate CSRep by Bangladeshi banks as well as the opinions of users of annual reports about issues related to CSR disclosure. In the case of a developing country such Bangladesh, the banks do report CSR information in various categories on a voluntary basis (Khan et al., 2009). The most disclosure provided by Bangladeshi banks is information on the human resource category. Half of the banks disclose information about their social contributions and also their separate foundation dedicated to social activities, however the disclosure in this category is not sufficient (Khan et al., 2009). A survey of the users' opinion on CSR disclosure finds the users support CSR reporting by the banks but they think the current CSR disclosure practices are inadequate to enable them to make an assessment on CSR of the banks (Khan et al., 2009). The users also believe the most important CSR category to be reported by the banks should be disclosure related to "responsibilities performed towards public health, safety and facilities for the community" (Khan et al., 2009, p.353).

2.8.2 Other CSR studies that include banks

Some CSR studies include multiple industries in their sample. This subsection outlines the CSR studies that include the banking industry as one of the multiple industries and compare the CSRep results of banking industry with other industries.

Zeghal and Ahmed (1990) explored CSR disclosure in regulated industries by employing the sample of banks and petroleum companies in Canada over the years 1981 and 1982. Using a mass communication framework, the authors reviewed CSR disclosure of companies in the regulated industries through their annual reports, advertisements and brochures (Zeghal and Ahmed, 1990). For the results of CSR disclosure by Canadian banks, Zeghal and Ahmed (1990) find that human resources is the category with the most disclosure in annual reports, products is the most

important disclosure category for advertisements, and for brochures, community involvement is the most disclosed category made by banks.

Clarke and Gibson Sweet (1999) study CSRep in the annual reports and publications of separate reports of the top 100 companies in the UK. The authors focus their CSRep study only on two aspects, i.e. community involvement and environmental issues (Clarke and Gibson Sweet, 1999). They find that banks are the companies which emphasise the disclosures of community involvement information (Clarke and Gibson Sweet, 1999). The banks however report little information on environmental issues as banking activities are assumed to impinge less on environment (Clarke and Gibson Sweet, 1999).

Tsang (1998) investigated CSR disclosure practices in the banking, hotel, food and beverages industries in Singapore. The authors uncover that the highest number of companies which report CSR information are from the banking industry (Tsang, 1998). In this longitudinal study, Tsang (1998) however finds companies in the banking industry report less CSR information compared to companies in other industries.

While in Jordan, Abu-Baker and Naser (2000) review CSRep in the annual reports of companies listed on the Amman Financial Market. They discover that human resources and community involvement are the most disclosed categories made by companies in the banking and finance industry (Abu-Baker and Naser, 2000).

2.8.3 Summary of CSR and CSRep studies in the Banking and Finance Industry

In general, the literature shows that the banking industry takes a keen interest in CSR issues, and their major focus appears to be on secondary stakeholders, with most disclosure being on community related issues. Reputation and brand are important influential factors, and in emerging economies, CSRep by banks is less evident.

As studies of CSR in banking in developing countries are limited, this thesis helps to fill the gap by focusing on Malaysia. Before reviewing the research that has been

conducted on CSR in Malaysia, it is important to provide the context and background of Malaysia, which is provided in the next section.

2.9 Malaysia: Culture, Economic and Regulatory Environment

Malaysia is a multi-racial country where the main ethnic groups consist of the *Bumiputras*⁶ (65.8 percent), Chinese (25.7 percent), and Indians (7.5 percent) (Statistics, 2012). In this country, each ethnic group prefers to maintain its ethnic identity. Malaysia has a unique history which resulted from colonization in 1511 by the Portuguese and was followed by others, including the Dutch, British and Japanese. Malaysia gained its independence from the British in 1957. British colonization is a significant contributory factor in shaping the present Malaysian social, legal, political and economic environment (Amran and Devi, 2008).

In multiracial countries, the prevailing societal values may not reflect the values of the nation as a whole, especially if each racial group has chosen to maintain its own ethnic identity and values. In the context of Malaysia, accounting disclosure practice may reflect not only differences in societal values based on the race and religion⁷ of the two main ethnic groups involved in business (namely, the Chinese and Malay), but also as a result of government economic policy⁸ (Haniffa and Cooke, 2002).

In terms of economic development, since the independence days Malaysia has been involved with international trade. Malaysia began as an exporter of commodities (such as tin and rubber) and agricultural products, and then evolved

⁶ Bumiputra is an official terminology widely used in Malaysia to refer to ethnic Malays and other indigenous ethnics.

⁷ Religion often follows ethnic lines, with most Muslims being Malays. The dominant religion in Malaysia is Islam, whose followers (mainly Malays) make up 61 per cent of the population. The large Chinese population in Malaysia practices a mix of beliefs, with influences from traditional Chinese religions such as Buddhism and Daoism. Hinduism is practiced by the majority of Malaysian Indians.

⁸ In 1969 there were riots involving Malays against the Chinese ethnic group which led to affirmative action in the following year which was called the New Economic Policy. The New Economic Policy institutionalized positive discrimination in favour of bumiputras by offering concessions in terms of grants, trade, education and certain jobs.

to industrialization by manufacturing light manufactured goods (Siddiquee, 2006). In the early 1980s, the new government which was led by Dr. Mahathir Mohamed (former Prime Minister of Malaysia) had changed the policy and opted for heavy industrialization. This was done through partnerships with foreign partners and the inflow of foreign direct investments (FDIs). The involvement of foreign affiliates has nurtured significant development to the Malaysian economy. Henceforward, Malaysian economy boomed to become one of the fastest growing economies in Southeast Asia. (Amran and Devi, 2008).

In terms of regulatory environment especially regarding disclosure regulations, Malaysian companies must refer to requirements that are provided by Malaysian Financial Reporting Standards (MFRS) and Bursa Malaysia (Kuala Lumpur Stock Exchange - KLSE). According to Bursa Malaysia's Listing Requirements, it is mandatory for all listed companies to disclose corporate responsibility performance in their annual reports. However, there is no specific statutory requirement for companies in Malaysia to disclose social information to the public although a number of initiatives encourage corporations to report. For example, in 1990, the Bursa Malaysia, the Malaysian Institute of Accountants (MIA), the Malaysian Institute of Management (MIM) and the Malaysian Institute of Certified Public Accountants (MICPA) launched the National Annual Corporate Report Award (NACRA) to promote and enhance presentation and reporting of financial and other information. In the same year, Bursa Malaysia also initiated "The Kuala Lumpur Stock Exchange Corporate Awards". The initiative was aimed at encouraging companies to demonstrate high standards of corporate governance, disclosure and transparency.

2.9.1 CSR and CSRep studies in Malaysia

In the early 1980's, CSRep in Malaysia was almost non-existent (Teoh and Thong, 1981) (cited in Tee et al., 2007). By the latter part of that decade, the practice of reporting social issues by Malaysian companies was slowly making its presence felt, although primarily through foreign-owned companies (Andrew et al., 1989). More recently, a number of local corporations have also begun practicing CSRep.

Among the earliest studies of CSR in Malaysia is by Teoh and Thong (1984) who explore the managers' awareness on CSR and CSRep. Teoh and Thong (1984) find that all the interviewed managers aware the social roles of their business organisations, and the major focus of disclosure was activities related to employee. They also find social activities that Malaysian companies gave attention are related to human resource development and products/services to consumers, rather than community services and environmental conservation. According to Teoh and Thong (1984), Malaysian local-owned companies are less prepared to CSR compared to foreign-owned companies, especially from the United States and Britain which are more progressive in CSR commitment.

In comparison with the practice of social and environmental reporting in the annual reports with the countries in the Asia Pacific region, Williams (1999) discovers that the amount of disclosure by Malaysian companies are significantly less than companies in Singapore, Thailand and Philippines. For the study of CSRep on websites, Williams and Ho (1999) finds that Malaysian companies release less corporate social information on their websites compared to Singaporean and Australian companies. The authors suggest the reasons of less disclosure on Malaysian corporate website may be inefficient communication network as Malaysia is still a developing nation and the reliance on electronic business is not as rapid as in Singapore and Australia. The authors also find Malaysian companies report social information which reflects national concern, rather than global concern (Williams and Ho, 1999).

In a longitudinal study from 1995 to 1999, Jamil et al. (2002, 2003) consider that disclosure level in Malaysia is low as less than 30 percent of companies studied disclose CSR every year. The most popular theme is human resources and the preferred location to disclose CSR is the Chairman's Statement, followed by the Financial Statement and the Director's Report (Jamil et al., 2002, Jamil et al., 2003).

The examination of annual reports of 250 largest companies in Malaysia reveals that social and environmental disclosure has improved but it is still in infancy stage if compared to the Western countries (Thompson and Zakaria, 2004). The authors

also find that most of the disclosures are narrative and non-quantitative, while the least reported theme is the environment. Thompson and Zakaria (2004) argue the reasons of low CSR disclosure in Malaysia are due to the lack of government and public pressure, and lack of perceived benefits and costs that companies have a significant impact on the environment.

Amran and Devi (2007) undertook a study to examine whether institutional theory can explain CSRep in Malaysia, through interviews with senior officers of ten Malaysian corporations. The authors confirm that institutional theory is valid for explaining Malaysian CSRep practices given that the local corporations must meet demands by related institutional parties, for instance, the influence of the foreign business partners and the government's aspirations to disclose CSR all have an impact (Amran and Devi, 2007). The Malaysian corporations need to accord with the practice of the related institutional parties because the local corporations' economic success depends on those parties (Amran and Devi, 2007). The study also suggests that coercive pressure from the requirements of law can encourage the recognition of CSRep among Malaysian corporations, make CSRep a part of business common practice, and promote consistent reporting (Amran and Devi, 2007).

Amran et al. (2013) admit the local communities in Malaysia still have lack understanding of the concept and importance of CSR. Using a stakeholder theory, Amran et al. (2013) propose a framework of how the government can help to empower the local communities to become salient and powerful stakeholders. The authors claim that pressure from the local communities and powerful stakeholders can drive to better CSR and firm performance (Amran et al., 2013)

2.9.2 CSR and CSRep studies in Malaysian Banking and Finance Industry

Based on the study by Hamid (2004) who examines annual reports of banks and finance companies in Malaysia employing legitimacy theory, the banks and finance companies mostly and commonly disclose only in the category related to products and services in their annual report. The author also analyses the relationship of CSR disclosure to the companies' characteristics and discovers that CSR disclosure in

Malaysian banks and finance companies is positively related to their size, listing status and age. However, there is no relationship between profitability and CSR disclosure by banks and finance companies in Malaysia (Hamid, 2004).

Zakaria and Dewa (2010) explore the annual reports, websites and also CSR reports of six banks in Malaysia in order to analyse the pattern and type of CSR disclosure in the Malaysian banking industry. In general, the pattern of CSR disclosure across the banking industry in Malaysia is similar whereby most banks in the sample disclose CSR information relating products and services, employees and community involvement (Zakaria and Dewa, 2010). This CSR disclosure pattern suggests that Malaysian banks have started to show concern about various CSR categories and do not only focus on the products and services category (Zakaria and Dewa, 2010). The CSR programs in Malaysian banks are also almost identical to each other, for example, they generally include donations, charity, employees' development, environment conservation and corporate governance (Zakaria and Dewa, 2010). The authors find a difference only in the method or format used to report CSR information (Zakaria and Dewa, 2010). In the annual reports, Malaysian banks allot around two to five pages for CSR reporting and also include some attractive photographs, reviews and newspaper cuttings related to CSR accomplishments (Zakaria and Dewa, 2010). Most of the CSR information provided by the banks is found to be not quantified which verifies that CSR disclosure in Malaysia is mostly self-complimentary (Zakaria and Dewa, 2010). The Malaysian banks also tend to report CSR information broadly as CSR reporting activity is commonly ad-hoc (Zakaria and Dewa, 2010).

In the context of financial services sector in Malaysia, Muwazir (2011) conducted a survey to measure perceptions about Carroll's (1991) CSR elements among top and executive managers in the sector. The author finds that the respondents ranked ethical responsibilities as the most important CSR element. The study also discovers that local and global forces, corporate image, economic performance, and culture are the four main drivers for financial services in Malaysia to practice CSR. Muwazir (2011) also note significant differences in opinions between

bumiputra and non-bumiputra respondents which suggests that culture has significant impact on perception and behaviour towards CSR, as such recommends a unique CSR model to cater CSR practices in Malaysia.

2.10 Chapter Summary

In this chapter, the historical background, the development and the theories of Western CSR have been reviewed, including the CSR and CSRep definitions and concepts. The chapter also reviews the CSR and CSRep studies that have been conducted in developed and developing countries. In addition, some studies of CSR and CSRep that focus on the banking industry are reviewed. The last part of the chapter highlights specific information about Malaysia which is the context of this thesis, including a review of CSR and CSRep studies that have been done on Malaysian companies and banks. The main findings of the literature review in this chapter are that:

- Various definitions, concepts and theories of CSR are depends to the context of the study
- CSRep is increasing in all countries.
- Major factors that influence reporting appear to be size, industry and economic context.
- Stakeholder demands are important factors in the decision to report and where that reporting occurs.
- CSRep in developing countries is more influenced by socio-economic factors such as economic condition, culture and religion.

As the context of this thesis revolves around the Islamic perspective, the following Chapter 3 will review literatures on CSR and CSRep from an Islamic perspective.

Chapter 3: Corporate Social Responsibility and Corporate Social Reporting from an Islamic Perspective

3.1 Introduction

The previous chapter provides some background and discussion of CSR and CSRep from a Western perspective and reviews the literature on CSR in developing countries. This chapter discusses how CSR and CSRep are viewed from an Islamic perspective.

3.2 Influence of culture and religion on CSR and CSRep

Before discussing CSR and CSRep from the viewpoint of Islam, it is essential to explain what is culture and religion, and how these could influence CSR and CSRep. Tylor (1929), a founder of modern anthropology, regards culture as the knowledge, belief, art, morals, law, custom, and any other capabilities and habits that are acquired by man as a member of society. Culture is also defined as learned behaviour (Violet, 1983). This definition of culture as learned behaviour distinguishes it from natural reactions to environmental factors. The former is generally determined through genetic codes while the latter is a product of man's activities (Violet, 1983).

Faruqi (1989) contends that the very essence and core of culture is religion. Geertz (1973, p.90) defines religion as; *“a system of symbols which acts to establish powerful, pervasive, and long-lasting moods and motivations in men by formulating conceptions of a general order of existence and clothing these conceptions with such an aura of factuality that the moods and motivations seem uniquely realistic”*. Religious behaviours, beliefs and experiences are simply part of the culture, and are regularly transmitted from generation to generation in the same way as any other customs (Argyle and Beit-Hallahmi, 1975).

Every society has a religious dimension, which is shared and expressed in all aspects of the social life of individuals: their laws, their customs and habits (Gilkey, 1981). According to Faruqi (1989), religion is the lens through which all

understanding and thinking takes place, making it the foundation of all decisions and actions. As such, religious ideas and practices have always been at the centre of human activities. Religion, therefore, can reasonably be seen as a part of the overall set of cultural values of a society (Sulaiman and Willett, 2003).

Hofstede (1984) introduces the national cultural values of Power Distance, Uncertainty Avoidance, Individualism and Masculinity. He emphasises that his cultural values relate to the characteristics of nations. Hofstede (1984) recognises the existence of different cultural groups within a country based on ethnic and religious differences (which he termed 'subcultural groups').

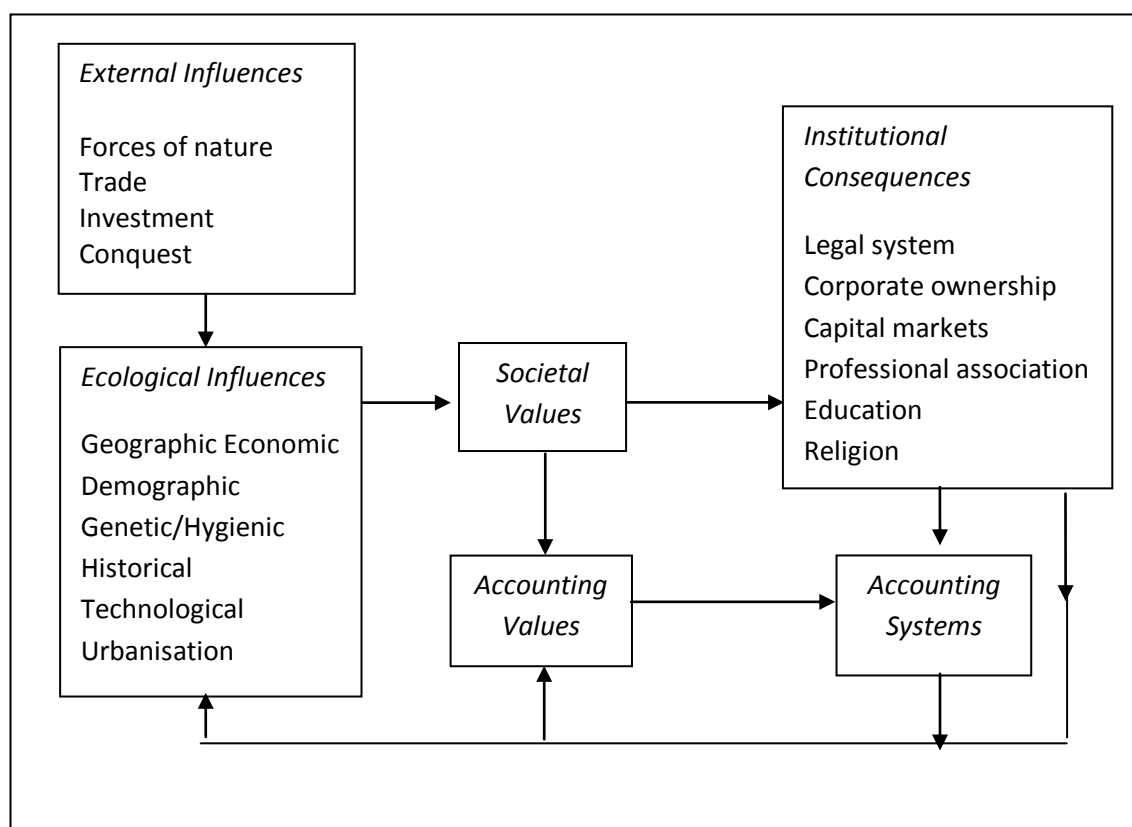
A number of authors have researched the relationship between religion and business ethics (Gambling and Karim, 1991, Calkins, 2000, Epstein, 2002, Brammer et al., 2007). The studies show that religion could influence managers' ethical judgments. According to Hunt and Vitell (1986), an individual's personal religion influences views of situations, alternatives and consequences of business behaviour, including corporate social responsibility. Brammer, Williams and Zinkin (2007) investigate the possible link between religious value and individual attitudes towards corporate social responsibility. They analyse 17,000 respondents' attitudes towards CSR from 20 countries, and the respondents are divided according to their religious faiths, namely Buddhist, Hindu, Jewish, Muslim, Roman Catholic, Other Christian, Roman Orthodox, Other, Agnostic and No Religion, in order to study how different are individual attitudes to CSR across religions (Brammer et al., 2007). They find that religion may be a significant factor which influences individual opinions towards CSR (Brammer et al., 2007). Thus, the attitudes of individuals towards the broad concept of CSR and towards various CSR areas would be diverse across religions (Brammer et al., 2007).

Prior research also finds that there is high probability the decisions of corporate managers are influenced by religion in a community where religion plays a prominent role (Kennedy and Lawton, 1998). McGuire et al. (2012) confirm that local community religiosity does affect corporate managers' decisions on CSR

because the religious environment of the community is an important part of the culture where managers live and work.

After understanding that religion influences corporations' CSR decision, it is important to discuss that religion also influences the accounting systems, particularly the disclosure and reporting of CSR (CSRep). Gray (1988) models a framework, provided in Figure 3-1, that identifies the relationship of culture and religion with accounting systems.

Figure 3-1: The Relationships between Culture, Societal Values, and The Accounting Subcultures



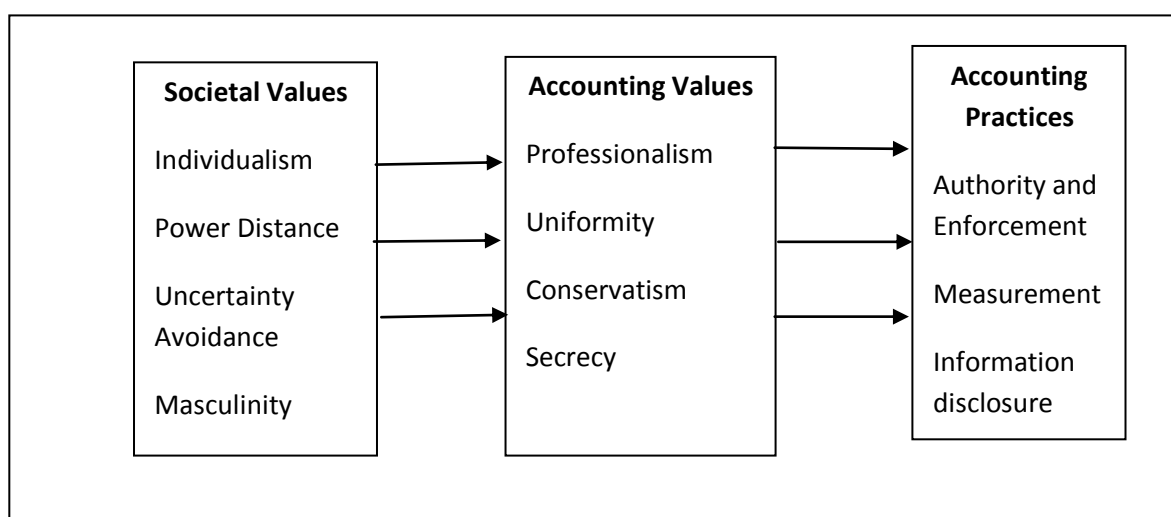
Source: Gray (1988)

In the model, the cultural or societal values are influenced by ecological factors that are derived from external factors such as natural forces, trade, investment and conquest. These societal values have institutional consequences in the given structures of religion, legal system, political system, education, and so on. The societal values are later expressed at the level of the accounting subcultures, which the accountants' attitude is expected to be related to, and derived from societal

values. Gray (1988) links Hofstede's (1984) national cultural values to the accounting sub-cultural values of Professionalism, Uniformity, Conservatism, and Secrecy and to the form accounting systems may take (Gray, 1988). The institutional consequences and accounting system reinforce both the accounting sub-cultural values and ecological influences.

Gray's (1988) theory was extended by Radebaugh and Gray (1993), by tracing the impact of accounting values on the different dimensions of accounting practices. Figure 3-2 represents a more detailed framework identifying the specific linkages between Gray's accounting values and different dimensions of accounting practice (which includes disclosure).

Figure 3-2: Accounting Dimensions and Measurement and Disclosure



Source: Radebaugh and Gray (1993)

In Baydoun and Willett's (1995) study using the Hofstede-Gray theory, they support that cultural values (and thus religion) affect accounting practices through the way institutions are organised and the processes that they use. As religion is an aspect of culture that can affect a person's beliefs, they play a role in decisions related to managing a corporation and the ways that a person responds to reporting and disclosure. Archambault and Archambault (2003) agree that religious belief is a part of the culture which has an impact on the corporate disclosure, and they propose a model of culture, national and corporate systems that influence accounting

disclosure and reporting of corporations. Dyreng et. al (2012) also find that religion and social norms play a role in corporate reporting.

From the reviewed studies, it can be understood that religion is an organised system of beliefs, in belief in, or worship of, God (Geertz, 1973). Religious beliefs include the cause, nature and purpose of the universe and involve prayer and ritual. Religion is based on beliefs about everything such as life and death, good and evil, pain and suffering, and so on which form a culture. Religion and culture influence the managers' behaviour in making ethical decisions and also influence corporate reporting. It is also noted that individual attitudes towards CSR are diverse across religions. In Chapter 2, the view was presented that profit maximization can also be considered CSR because society is best served when corporations maximize shareholder value (Friedman, 1970). However in the Islamic tradition, ethical and social activity is placed ahead of individual profit maximization (Hamid *et al.*, 1993). Therefore, the following section discusses CSR from an Islamic viewpoint and an overview of studies on CSR and Islamic business organisations is presented next.

3.3 CSR in Islam

Islam believers are called Muslims. The word Muslim means 'one who submits' to God (*Allah SWT*⁹) (Sulaiman and Willett, 2003). As such, submission and obedience is the most natural and apposite response by Muslims (Sulaiman and Willett, 2003). Muslims believe in *Tawhid* (the unity of God), His Angels, the Holy *Quran*, His Prophets, the Day of Judgment and Predestination.

Besides being a religion, Islam is also a way of life i.e. a social order with a complete code of life (Al-Buraey, 1990). *Shariah* (Islamic moral law) is a code of behaviour for a Muslim. The principle of *Shariah* is based on four main sources, shown in Table 3-1.

⁹ SWT stands for "*Subhanahu Wa-Ta'ala*", meaning "be He glorious and exalted"

Table 3-1: The Four Main Sources in Islamic *Shariah*

| Islamic sources | Description |
|-----------------------------|---|
| (i) Holy <i>Quran</i> | the revelation from <i>Allah</i> SWT |
| (ii) <i>Hadith / Sunnah</i> | the deeds, sayings or tacit approval of the Prophet Muhammad SAW ¹⁰ |
| (iii) <i>Ijma'</i> | the consensus of opinion by the majority of Muslims scholars |
| (iv) <i>Qiyas</i> | the analogy reasoning deducted from the earlier three sources for contemporary issues that are not directly referred in those sources |

Source: Muwazir and Muhamad (2006)

The *Shariah* caters for every aspect of a Muslim's life, e.g. spiritual, economic, political and social, and faithful execution of duties and obligations (Hassan and Harahap, 2010). The three interrelated dimensions of *Shariah* are outlined as the faithful execution of duties and obligations, particularly fulfilment of the duties and divine obligations to Allah (*huququ-Allah*), obligations to fellow human beings and His creations (*huququl-ibad*), and obligations to oneself (*huququl-shakhseea*) (Haniffa and Hudaib, 2004). Fulfilling of all those duties and obligations is obliged for all Muslims and is regarded as *Ibadah* (worship of Allah) as Allah says in the *Quran*:

"O you who believe! Fulfil (all) your obligations" (Al-Quran 5:1)¹¹

The existence of various duties and obligations as well as a range of contractual relationships in human life under *Shariah*, leads Muslims to completely appreciate the concept of *uqud* (contracts) in accordance with Islamic teachings, requiring that their actions and inactions should be always driven by spiritual considerations (Haniffa and Hudaib, 2004).

Muwazir and Muhamad (2006) explain the dimensions of *Shariah* under the basic Islamic concept of *Tawhid* (the unity of God) whereby man needs to uphold a good relationship with God (*hablun min Allah*), with human beings (*hablun min al-nas*),

¹⁰ SAW stands for "*Sallallahu 'Alaihi Wa Salam*", meaning "peace be upon him"

¹¹ *Surah Al-Maidah: Verse 1*

and with the environment. The dimensions of *Shariah* or various contractual relationships in human life show that the tenets of corporate social responsibility should be not alien in Islam. The *Shariah* promotes social justice and welfare in society for the sake of God in order to seek God's blessings with the ultimate aim of achieving success (*falah*) in this world and the Hereafter (Hassan and Harahap, 2010).

From the *Shariah*, the rights and obligations of Muslim individuals and organisations with respect to others are clearly defined by religion. The rights and obligations of individuals and organisations in Islam are not imposed by secular law which is exposed to change, nor subject to personal views (Maali et al., 2006). The responsibilities in Islam are well defined, do not change over time and are not affected by different theories as Islam is a religion which is complete (*syumul*) and relevant to all times and places. In the Islamic context, social responsibilities of individuals derive from the word of God and from His prophet Muhammad's *Hadith*, and these also apply to business organisations (Maali et al., 2006).

From the Islamic perspective, the perceived relationship of individuals and corporations with God is based on the concept of *Tawhid* (the unity of God). *Tawhid* is a fundamental Islamic principle which forms the relationship of individuals and corporations with God, and shapes the concept of accountability in Islam. In an Islamic framework, all people, and businesses, are accountable to God on the Day of Judgement for their actions and inactions during their lives. The word *Hisab* (account) is repeated more than eighty times in different verses of the *Quran* (Askary and Clarke, 1997). "Business enterprises, both managers and providers of capital, are accountable for their actions and inactions both inside and outside their firms. Accountability in this context means accountability to the *Ummah* (community)" (Lewis, 2001, p.113). The concept of accountability in Islam is explained further in Section 3.6.1. Islam also emphasises the concept of social responsibility. The wide use of the term *Akhowa* (brotherhood/sisterhood) in Islamic societies is a clear example of emphasis on social responsibility (Maali et al., 2006).

3.3.1 Ethical Principles in Islam

According to Willett and Sulaiman (2001), the fundamental difference between Islam and modern capitalism arises from their respective ethical perceptions. Modern capitalism views religion and business affairs secularly whereby those two affairs stay separate. However, in Islam, every material achievement is an outward expression designed to achieve a spiritual objective that eventually gives meaning to existence (Sulayman, 1993). A further discussion of Islamic ethical principles could systemize and summarise the concept of social responsibility and justice in Islam and differentiate it from modern capitalism (Mohammed, 2007).

Mohammed (2007) asserts four fundamental ethical principles that bring a unique Islamic perspective. The four fundamental ethical principles are Unity, Equilibrium, Free Will and Responsibility. An earlier scholar, Naqvi (1981), also has the same opinion that the four fundamental principles can summarise Islamic ethical philosophy. In a similar vein to Naqvi's ethical principles, Chapra (1992) asserts that the Islamic worldview is based on three fundamental principles: Unity (*Tawhid*), Vicegerency (*Khilafah*) and Justice (*Adalah*). Ahmad (1979) argues that an Islamic economic system is rooted in the basic philosophical concepts of Unity, Vicegerency, God's Arrangement (*Rubbubiyyah*), and Growth and Purification (*Tazkiyah*). These are now discussed in detail.

3.3.1.1 Unity of God (Tawhid)

According to Siddiqi (1981) and various other writers (e.g. Al-Buraey, 1990, Chapra, 1992), the concept of Unity of God is known as *Tawhid*. *Tawhid* is the basis on which the Islamic worldview and strategy are founded (Chapra, 1992). Unity differentiates the Creator from the created, requiring unconditional surrender of man to God's Will. According to Sulaiman and Willett (2003), unity is a concept where the political, economic, social and religious aspects of an individual's life are integrated into a homogeneous whole, consistent from within the individual himself or herself as well as integrated with the vast Universe. The doctrine of Unity preserves the absolute monotheism of Islam where God's sovereignty is

recognised (Naqvi, 1981). This dominates Islamic belief and practices and consequently affects how Muslims view religion. To Muslims, Islam is viewed as integral to the state, law and society. This viewpoint differs from the modern Western perspective that regards religion as separate from the world affairs (Esposito, 1991). In Islam, business organisations should adopt a broader view of corporate social responsibility that derives from the principle of *Tawhid*, which signifies three relationships namely, relationship between man and Allah (*hablun min Allah*), relationship between man and human beings (*hablun min annas*) as well as relationship between man and environment or the nature (Muhamad et al., 2007). *Tawhid* connotes the unity of all God's creations in the worship of God and due respectful recognition of all existence and also due appreciation of interdependency and interconnectedness between all (Kamla et al., 2006).

“Seest thou not that to Allah bow down in worship all things that are in the heavens and on earth,- the sun, the moon, the stars; the hills, the trees, the animals; and a great number among mankind?” (Al-Quran 22:18)¹²

3.3.1.2 Equilibrium (Al-Adl)/ Justice (Adalah)

The principle of Equilibrium (*Al-Adl*) prescribes the relationship amongst individuals. Related to Equilibrium is the concept of justice. From the perspective of the absolute, this refers to the supreme attribute of God. In *Al-Quran*, God Himself promises justice for all:

“On no soul doth God place a burden greater than it can bear.” (Al-Quran 2:286)¹³

From the perspective of social action, Equilibrium is the binding moral commitment of individuals in society to uphold a delicate balance between individual rights and responsibility towards the *ummah* (Sulaiman and Willett, 2003). Accordingly, in Islam, everyone is ultimately accountable to God and this accountability also

¹² *Surah Al-Hajj: Verse 18*

¹³ *Surah Al-Baqarah: Verse 286*

encompasses accountability to society (Sulaiman, 1998, Baydoun and Willett, 1994).

Although Naqvi (1981) explains the principle of Equilibrium in the context of justice (*Adalah*), Equilibrium can also be considered as a reflection on the concept of balance in Islam (Chapra, 1992). For example, the following verse in the *Al- Quran* explicitly deals with a Muslim's need to balance worldly affairs with the hereafter.

“But seek with the wealth which Allah has bestowed on thee, the Home of the Hereafter, nor forget thy portion in this world.” (Al-Quran 28:77)¹⁴

Rodinson (1974) defined Islamic justice as a “state directed in accordance with the principles revealed by God, treating all believers as equal before the Divine Law, practising within the Muslim community an advanced form of mutual aid” (p.26). The bonds of brotherhood/sisterhood would be a hollow concept if social justice and social responsibility did not exist (Chapra, 1992). Islam's commitment to brotherhood/sisterhood and justice demands that all God-given resources are at the disposal of every individual. Accordingly, wealth should not remain concentrated within a few individuals.

3.3.1.3 Free Will (Ikhtiyar)

One of the most original contributions of Islam to social philosophy is the concept of a "free" person and the principle of Free Will is derived from this concept (Naqvi, 1981). Islam recognises human freedom as applying both to the individual and the collective and emphasises a correct balance between the two (Naqvi, 1981). Thus, the Islamic concept of freedom differs from that of Western social philosophy. The concept of private property in Islam helps clarify the Islamic concept of freedom further (Sulaiman and Willett, 2003). Islam does not accord an unqualified sanction to an individual's right of private property for real ownership of property belongs to God and man holds property in trust for which he is accountable to Him (Naqvi, 1981, Siddiqi, 1981). Naqvi (1981) argues that the precondition of an Islamic society

¹⁴ *Surah Al-Qasas: Verse 77*

is the removal of the conflict between private and social interests. Further, he emphasises that if human freedom is God-given and individuals act in accordance with the ethics of this freedom, the element of coercion involved in reconciling private and social interests should be minimal.

3.3.1.4 Responsibility (Fardh)

The fourth ethical principle is Responsibility (Naqvi, 1981). Responsibility limits the Free Will principle. The principle of Responsibility sets limits to what a person is free to do by making him/her responsible for every deed. As such, individualism in the Western sense is constrained in Islam (Naqvi, 1981). As emphasised earlier, in Islam, there should be no contradiction between individual freedom and collective freedom. The difference between the two is bridged by the sense of social consciousness and responsibility (Sulaiman and Willett, 2003). Thus, one's freedom of choice is exercised with a conscious effort to ensure that the wider interests of the community are safeguarded (Sulaiman and Willett, 2003).

3.3.1.5 Vicegerency (Khilafah) / Trusteeship (Amanah)

The concept of *Khilafah* (vicegerency) defines a person's status and role, specifying the individual's responsibilities to himself and his responsibility to the *ummah*¹⁵. Chapra (1992) suggests that the concept of *khilafah* has four implications.

The first implication is universal brotherhood/sisterhood where mutual sacrifice and cooperation are the social order. Such a social order allows the development of the entire human potential. Accordingly, from the perspective of business enterprises, competition is encouraged if it is healthy, raises efficiency, and helps promote the well-being of society. Competition that results in jealousy, ruthlessness and destruction must be avoided (Chapra, 1992).

The second implication of *khilafah* is that the individual is regarded as the trustee of God's resources (Chapra, 1992). Humankind is the representative of Allah SWT

¹⁵ *Ummah* means community in a religious sense. The *Ummah* concept counters an excessive selfishness and individualism beyond morality (Kamla, 2006).

on earth and as such Allah has entrusted humankind with stewardship of Allah SWT's resources (Shamim and Nesarul, 2010).

"I will create a vicegerent on earth" (Al Quran 2:30)¹⁶

The concept is related to *Amanah* (trusteeship) where humankind is only a trustee and Allah is the absolute owner. This leads to a totally different meaning from how private ownership is understood in the secular world. Although private ownership is recognised in Islam, ownership is not absolute (Sulaiman and Willett, 2003). The property owner recognises the responsibility of using resources in a manner that will provide benefits not only to himself or herself but more importantly, to society (Chapra, 1992). Humankind as trustees should manage the resources of Allah SWT to their best capabilities which can create benefit to the community as a whole and also provide maximum added value in the form of social responsibility (Shamim and Nesarul, 2010).

The third implication of *khilafah* is the emphasis on a humble lifestyle (Chapra, 1992). A lifestyle of extravagance may result in unnecessary pressure on resources which in turn may lead to the inability to satisfy the basic needs of society (Sulaiman and Willett, 2003). For example, managers are allowed to utilize every means in pursuit of profit making but Islam disallows profit maximization at the expense of other stakeholders and requires them to minimise unnecessary pressures on resources (Ullah and Jamali, 2010)

Fourthly, *khilafah* implies the concept of human freedom in Islam. An individual's freedom to act is not curtailed by any other individual but is constrained by the bonds of social responsibility (Sulaiman and Willett, 2003). Hence there is a qualification as to what individual freedom entails in Islam. As Naqvi (1994) contends, unlimited freedom goes hand in hand with unlimited responsibilities. Consequently, it is unbelievable that anyone would want that unlimited freedom. The concept of *khilafah* explained by Chapra (1992) is similar to Naqvi's (1981) ethical principles of Free Will and Responsibility.

¹⁶ *Surah Al-Baqarah: Verse 30*

3.3.1.6 God's Arrangement (Rubbuiyyah)

Rubbuiyyah refers to God's arrangement for directing things towards a perfect state of human sustenance (Ahmad, 1979). Consequently, Muslims believe that there are sufficient resources to sustain everybody to achieve God's perfect plan for the universe (Ahmad, 1979). This is in conflict with the basic tenet of neoclassical economic theory that goods are in short supply (Gambling and Karim, 1991). It is in the context of this divine arrangement that human efforts take place. Because goods are adequately provided by God for every being, greed and self-interest should not exist (Sulaiman and Willett, 2003).

3.3.1.7 Growth and Purification (Tazkiyah)

The meaning of *Tazkiyah* is similar to *zakat*; that is, growth and purification (Ahmad, 1979). Muslims believe that the mission of all the Prophets was to perform the *Tazkiyah* of human beings in relationship with God, with others, and with society (Ahmad, 1979). Gambling and Karim (1991) assert that this concept is of great importance in Islamic economic theory. *Tazkiyah* endorses the ideas of change and expansion (Ahmad, 1979). It also requires an individual to expend the best efforts in order to achieve a better material life. However, material well-being must lead to social justice and the spiritual enhancement of society (Sulaiman and Willett, 2003).

After understanding various ethical principles in Islamic teachings, it is important to know how these ethical principles should be applied in daily life, especially in business activities, as this thesis explores if and how these concepts influence the social responsibility reporting of business. The next section will therefore discuss the business ethics from an Islamic perspective.

3.3.2 Islamic Business Ethics

In Islam, the fundamental code of moral behaviour is in accordance with Islamic jurisprudence concerning the lawful (*halal*) and unlawful (*haram*). These lawful and unlawful codes of conduct are essential elements of social responsibility and justice, and part of Islamic faith. Observing them will not only lead to a happy state of affairs in this world but also holds the promise of rewards in the Hereafter. The

moral behaviour includes, for example, trustworthiness, generosity, fair treatment of workers, moderation, public interest and avoidance of evil practices such as hoarding, interest, cheating etc. (Lewis, 2006).

The business principles of Islam embrace dealing with fairness and honesty. To ensure fairness in business, there should be a free market because Islam prohibits price fixing and monopolies. The market should be free to avoid people from being exploited by the more powerful in business transactions. Hoarding is also prohibited because it forces the price to increase in times of scarcity and makes profit at the expense of others. Business dealings should be done with honesty, by revealing any defects in selling goods, by not lying about the weight or quality of the goods and by not dealing in stolen goods (Lewis, 2006). Products and services should be useful and not harmful in accordance with Islamic law. Islam prohibits alcohol, gambling, pornography, illegal drugs and anything which is harmful to society, and therefore trading and investment in those activities are also prohibited in Islam (Lewis, 2006).

According to Lewis (2001), Islamic ethics should be observed in all aspects of business practices such as in trade and commerce, production, distribution, social responsibilities, property rights and contract law, as summarized in Table 3-2.

Table 3-2: Summary of Islamic Business Ethics in Business Practices

| Business practice | Description |
|------------------------------|--|
| Trade and commerce | Trade and commerce are encouraged, but Muslims should not prioritise money or business duties, and neglect religious duties. All trading must be stopped during the <i>azan</i> (call for prayer) time and during the Friday congregational prayer time. The trading should contribute to the benefit of community, source of income for the poor and/or generate job opportunities. |
| Production | Every individual should work and produce as Prophet Muhammad's saying: 'Never be lazy and helpless'. The economic achievement should be through hard work and assumption of risk. |
| Distribution and consumption | The consumption pattern should be moderate and balance. Luxury and poverty are decried. The economic system is balanced out through <i>zakat</i> (almsgiving or religious levy). If the <i>zakat</i> source is limited, it is a religious duty (<i>fard kifayah</i>) for the rich and affluent to give charity. |
| Social responsibilities | The welfare of the community is over the individual rights. People are allowed to earn living in a fair and profitable way without exploitation or at the expense of others. <i>Zakat</i> must be collected and spent for the benefit of society. |
| Property rights | God is the absolute owner and people are trustee who have the right to use the natural resources for the benefit of mankind. But Islam respects private property which may be acquired through inheritance, purchase, gift, or by taking up common property and things on it. |
| Contract law | Islam provides freedom of contract as long as terms do not conflict with the <i>Shariah</i> . The contract law applies in four root transactions of: (1) sales (<i>bay</i>), transfer of the ownership or corpus of property for a consideration; (2) hire (<i>ijarah</i>), transfer of the usufruct (right to use) of property for a consideration; (3) gift (<i>hiba</i>), gratuitous transfer of the corpus of property; and (4) loan (<i>ariyah</i>), gratuitous transfer of the usufruct of property. |

Source: Lewis (2001, p.108-111)

The various Islamic ethical principles discussed in the previous section and Islamic business ethics, are essential to be practiced in business activities. Table 3-3 describes the Islamic sources mainly from *Al-Quran* and *Hadith* which have been categorized into Islamic ethical principles, and from these ethical principles, the

expected business practices according to Islamic teachings are deduced (Aribi and Gao, 2010).

Table 3-3: Some examples of business ethics principle in Islam

| Ethical principle | Related business practice |
|---|--|
| <p>Unity</p> <p>“God does command you to render back your trusts to those to whom they are due” (Al-Quran 4:54)</p> <p>“Give just measure and weight, nor withhold from the people the things that are their due... ” (Al-Quran 11:85)</p> <p>“I will be foe to three persons on the day of judgement, one of them being the one who, when he employs a person that has accomplished his duty, does not give him his due” (Hadith or saying of the prophet Muhammad SAW)</p> <p>“No Arab has superiority over a non-Arab and no non-Arab has any superiority over an Arab; no dark person has superiority over a white person and no white person has superiority over a dark person. The criterion of honour in the sight of God is righteousness and honest living” (Hadith or saying of the prophet Muhammad SAW)</p> | <p>Fulfilling obligations and trust in business relationships and workplace</p> <p>Give full measure and weight</p> <p>Employee fair treatment, equal opportunity and non-discriminatory behaviour</p> |
| <p>Equilibrium/Justice</p> <p>“... do not outbid one another in order to raise the price, fairness in contract negotiation ... don't enter into a transaction when other have already entered into that transaction and be as brothers one to another” (Hadith or saying of prophet Muhammad SAW)</p> | <p>Fairness in contract negotiation</p> |
| <p>Free Will/Vicegerency</p> <p>“The acquisition of knowledge is a duty incumbent on every Muslim, male and female” (Hadith or saying of prophet Muhammad SAW)</p> | <p>Importance of knowledge seeking, research and development, scientific activities and training programme</p> |
| <p>Responsibility/Vicegerency/Trusteeship</p> <p>“God likes that when someone does anything, it must be done perfectly well” (Hadith or saying of prophet Muhammad SAW)</p> <p>“He who cheats is not one of us” (Hadith or saying of prophet Muhammad)</p> | <p>Excellence and quality of work</p> <p>Whoever knows of a defect in something is obliged to disclose it</p> |

Source: Adapted from Aribi and Gao (2010, p.74)

Also, in the light of the Islamic ethical principles, Islamic business ethics could satisfy the relationships of different stakeholders to the corporation as shown in Table 3-4. Ullah and Jamali (2010) contend that Islamic ethical principles are concerned with the benefit of the community as a whole while protecting the self-interest of the shareholders.

Table 3-4: Obligations and Rights of Different Stakeholders from an Islamic Perspective

| Stakeholder | Description | Related Islamic Ethical Principle |
|--------------------|--|--|
| Shareholder | <p><i>Rights:</i> Profits, personal property, control</p> <p><i>Obligation:</i> Transparency, ethical activities, fairness, investment in <i>Halal</i> businesses</p> | <p>Trusteeship</p> <p>Justice, Trusteeship, Unity</p> |
| Employees | <p><i>Rights:</i> Fair compensation, dignified life, good working conditions regarding safety, fair work load, secrecy, training and development</p> <p><i>Obligations:</i> No cheating in work, optimal utilization of time and skills, privacy of company policies, working as a Trustee of owners</p> | <p>Justice, Trusteeship, Unity</p> <p>Justice, Trusteeship</p> |
| Supplier | <p><i>Obligations:</i> Declaration of quality, exact quality and quantity, safety, hygienic production process, fair prices, no hoarding, provision of Halal products and services</p> <p><i>Rights:</i> fulfilling contracts by the company regarding credit and other terms</p> | <p>Justice, Unity</p> <p>Justice, Unity</p> |
| Customers | <p><i>Obligations:</i> fulfilling contracts by the company regarding credit and other terms</p> <p><i>Rights:</i> Declaration of quality, exact quality and quantity, safety, hygienic production process, fair prices, no hoarding, provision of Halal products and services</p> | <p>Justice, Unity</p> <p>Justice, Unity</p> |
| Competitors | Fair competition | Justice, Trusteeship, Unity |
| Environment | Stewardship | Trusteeship |

Table 3-4 (continued)

| | | |
|-----------|--|--|
| Community | <p><i>Obligations:</i> Considering the company as a community member and helping it succeed. Meeting contractual obligations</p> <p><i>Rights:</i> Clean environment, employment, health, education, no discrimination, company meets all its obligations as a member of the community</p> | <p>Justice, Unity</p> <p>Justice, Trusteeship, Unity</p> |
| The Poor | <p>Although they don't contribute anything substantial to the company, yet, they have the right, in form of <i>Zakat</i>, to monetary benefits from the company and other stakeholders</p> | <p>Justice, Trusteeship, Unity</p> |

Source: Ullah and Jamali (2010, p.625)

From Table 3-4, it is evident that the rights and obligations of each stakeholder which, according to Islamic business ethics, are also consistent with the principles of CSR. However, the reporting of CSR (CSRep) is similarly important and religion, including Islam, could influence CSRep. Therefore, this concept is considered next.

3.4 Corporate Social Reporting (CSRep) in Islam

There are a few studies that focus on corporate social reporting (CSRep) from an Islamic perspective which have been undertaken (see, for example Maali et al., 2006, Muwazir and Muhamad, 2006, Sudarma et al., 2010) .

A notable work on CSRep from an Islamic viewpoint is discussed by Maali et al. (2006) using the framework of social relations. According to Maali et al. (2006), social relations in Islam are formed by accountability, social justice and ownership concepts. Alternatively, Muwazir and Muhamad (2006) offer an Islamic corporate social disclosure model based on the paradigm of *Tawhid* which emphasises the three interrelated relationships between man and Allah SWT, man and fellow human beings, as well as man and environment. They divide the theme of Islamic corporate social disclosures into these three interrelated relationships of the *Tawhidic* paradigm. The CSRep framework by Maali et al. (2006) and model by

Muwazir and Muhamad (2006) are used to develop the conceptual framework for this study and will be discussed further in Chapter 5.

The literature on corporate social reporting from an Islamic perspective is added to by the work of Sudarma, Triyuwono, Ludigdo and Meutia (2010) using Enterprise Theory¹⁷. According to Sudarma et al. (2010), Enterprise Theory fits with the discussion of corporate social reporting in Islam because the theory emphasises the aspects and values of social, justice, truth, honesty, trust and accountability. However, Sudarma et al. (2010) believe that the Enterprise Theory is spiritually lacking as the theory is constituted merely by worldly principles. As such, Sudarma et al. (2010) think it is necessary to modify Enterprise Theory in accordance with *Shariah* to enable an Islamic corporate social reporting discussion and thus offer *Shariah* Enterprise Theory. *Shariah* Enterprise Theory is an enterprise theory which constitutes the value of the unity of God or *Tawhid* as its core (Sudarma et al., 2010). In Islam, the unity of God (*Tawhid*) is a basis that believes in God's sovereignty as Creator and that He is the ultimate Owner of all resources in the world. The unity of God as a core value of *Shariah* Enterprise Theory signifies that God's mandate is the key source for an enterprise to conduct its operations (Sudarma et al., 2010).

The literature described above provides the basis of the theoretical framework for Islamic CSRep used in this thesis, and developed in Chapter 5. In order to help Islamic business organisations with reporting however, the Accounting and Auditing Organization for Islamic Financial Institutions, or AAOIFI, was established in 1991, and their standard on CSR also provides a framework for CSRep. This

¹⁷ Enterprise theory is a concept of value added in production, whereby an enterprise is viewed as a social institution which performance of operations is evaluated by "its contribution to the flow of output to the community" PURDY, D. E. 1983. The enterprise theory: an extension. *Journal of Business Finance & Accounting*, 10, 531-541. *ibid.*. The value added concept in Enterprise Theory refers to the value created in production which emphasises the output flow rather than sales, as such social performance of an enterprise is assessed by production operation. The accounting of Enterprise Theory is a production-based value added statement that incorporates the gross income analysis or distribution of income in the statement which measures the flow and distribution of production among the participants of the organisation. *Ibid.*.

organisation and their CSR standard is discussed next, and is revisited in relation to its use in this thesis in Chapter 6.

3.4.1 Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

In practice, Islamic business organisations such Islamic banks, legitimate their Islamic banking products and activities to gain the confidence of Muslims through corporate reporting, and this is often in accordance with the guidelines/standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) (Kamla, 2009). AAOIFI is an international standard setting organisation for Islamic financial institutions (IFIs) based in Bahrain and established in 1991, and is responsible for development and issuance of standards on accounting, auditing, ethics, governance, and *Shariah* standards for the Islamic finance industry (AAOIFI, 2011a). AAOIFI is an independent international organization and is supported by institutional members which include Islamic financial institutions, central banks, accounting standards boards, accounting and audit firms, and other participants from the international Islamic banking and finance industry, worldwide (AAOIFI, 2011a). At present, AAOIFI consists about 200 members from 40 countries (AAOIFI, 2011a).

The objective of AAOIFI is “to develop accounting and auditing thoughts relevant to Islamic financial institutions; to disseminate accounting and auditing thoughts relevant to Islamic financial institutions and its applications through training, seminars, publication of periodical newsletters, carrying out and commissioning of research and other means; to prepare, promulgate and interpret accounting and auditing standards for Islamic financial institutions; and to review and amend accounting and auditing standards for Islamic financial institutions” (AAOIFI, 2011b, p.1). The AAOIFI standards are not mandatory but Islamic financial institutions are encouraged to implement the AAOIFI standards in order to increase the confidence of users of their financial statements in the information that is produced and issued by Islamic financial institutions. The countries that have adopted AAOIFI include;

Bahrain, Jordan, Lebanon, Qatar, Sudan and Syria. In Malaysia, AAOIFI standards are not mandatory, but Malaysian regulators and relevant authorities have issued some guidelines that are based on AAOIFI's standards and pronouncements. The Malaysian Accounting Standards Board (MASB) is listed as an observing member of AAOIFI and there are several Malaysian Islamic financial institutions (IFIs) which are associate members of AAOIFI (AAOIFI, 2010a). MASB allows Malaysian IFIs to consider the AAOIFI requirements if there is a matter that is not dealt with by MASB approved accounting standards, but there is guidance that may be found in AAOIFI standards (MASB, 2014). MASB also accepts, if appropriate, the inclusion of additional disclosures required under AAOIFI standards (MASB, 2014).

At the end of 2009, AAOIFI issued Governance Standards No. 7 which is on corporate social responsibility conduct and disclosure for Islamic financial institutions (AAOIFI, 2010a, AAOIFI, 2010b). AAOIFI defines CSR for Islamic financial institutions as "all activities carried out by an IFI to fulfil its religious, economic, legal, ethical and discretionary responsibilities as financial intermediaries for individuals and institutions" (AAOIFI, 2010b, p.1). Each responsibility of an Islamic financial institution (IFI) is further explained by AAOIFI as shown in the following table:

| Responsibility | Description |
|----------------------------------|--|
| (a) Religious responsibility | the overarching obligation of IFIs to obey the laws of Islam in all its dealings and operations |
| (b) Economic responsibility | the obligation for Islamic banks to be financially viable, profitable and efficient |
| (c) Legal responsibility | the obligation of IFIs to respect and obey the laws and regulations of the country of operation |
| (d) Ethical responsibility | the obligation of IFIs to respect the mass of societal, religious and customary norms which are not codified in law |
| (e) Discretionary responsibility | the expectation from stakeholders that IFIs will perform a social role in implementing Islamic ideals over and above the religious, economic, legal and ethical responsibilities |

Source: (AAOIFI, 2010b, p.1)

Thus, disclosure of information on non-financial matters or corporate social and environmental reporting is not only an essential element of corporate transparency

and good governance, but for IFIs is important to demonstrate the accountability towards religious, economic, legal, ethical and discretionary responsibilities. In the Governance Standards on CSR, AAOIFI provides guidance on disclosure requirements that are mandatory for incorporation into a CSR report, within the annual report, or separately, and includes the disclosure of policy for screening clients, policy for dealing with clients, earnings and expenditure prohibited by *Shariah*, policy for employee welfare and policy for *Zakat*.

AAOIFI also provides the recommended disclosure of CSR that may be made by the Islamic financial institutions to satisfy the information needs of stakeholders, and includes the disclosure of a policy for social, development and environment¹⁸ based investment quotas, policy for par excellence customer service, policy for micro and small business and social savings and investments, policy for *Qard Hasan*, policy for charitable activities, and policy for *Waqf* management.

As mentioned above, the AAOIFI standards are used in this study to develop a framework for the coding instrument for analysis of CSRep by Malaysian Islamic banks. This will be discussed further in Chapter 6.

3.5 Islamic banking

The analysis subject in this study is Islamic banks in Malaysia, therefore, it is important to understand what Islamic banking is. According to Lewis (2001), some key features of Islamic banking include:

- i. the absence of interest-based (*riba*) financial transactions;
- ii. the payment of religious levy or almsgiving (*zakat*);
- iii. the prohibition of the production of goods and services which contradict the value pattern of Islam (*haram* or unlawful transactions); and
- iv. the avoidance of economic activities involving gambling (*maysir*) and uncertainty (*gharar*).

¹⁸ AAOIFI has also provided environmental obligations for IFIs. AAOIFI gives examples that relate to environment disclosure such as reduction in tree logging, reduction in environmental greenhouse gases and increase in recycling.

Firstly, interest (*riba*) is forbidden in Islam as it appears explicitly in the Holy *Quran*.

“O ye who believe! Devour not usury, doubled and multiplied; but fear Allah; that ye may (really) prosper” (Al-Quran 3:130)¹⁹

Unlike conventional banking that is interest-based, Islamic banking operates on profit and loss sharing. Instead of charging or paying interest, Islamic banks invest mainly in trade and industry that satisfies *Shariah* requirements, either directly or in partnership with others, and then share the profits (Lewis, 2001). This concept of Islamic banking arises as interest (*riba*) is prohibited but trade and profit-loss sharing is permissible in Islam (Obaidullah, 2005). The Holy *Quran* stipulates:

“Allah hath permitted trade and forbidden usury” (Al-Quran 2:275)²⁰

Islamic banks do not charge and pay interest because all Islamic banking products are based on trade, instead of loans with interest. For all financing products, Islamic banks emphasize more on substance over the form, which is a *Shariah* based mode of financing. As such, Islamic banks charge profit-loss sharing, mark-up costs and administration fees, depending on the types of Islamic banking products (refer to Table 3-5). For deposit-taking products, Islamic banks give *hibah* (gift) to the depositors as an appreciation; however *hibah* is a discretionary power of Islamic banks.

Secondly, *zakat*, or religious levy, is compulsory in Islam for both individual and business organisations. The purpose of *zakat* is for the redistribution of income and wealth. Islamic banks should establish *zakat* fund for collecting the funds and distributing them to the poor or through other religious institutions (Lewis, 2001).

Thirdly, the activities of Islamic banks should not contradict Islamic values. Islamic banks cannot finance activities or items forbidden (*haram*) in Islam, such as

¹⁹ Surah Al-Imran: Verse 130

²⁰ Surah Al-Baqarah: Verse 275

gambling businesses, pornography, trade of alcoholic beverages and pork meat (Lewis, 2001).

Fourthly, the economic activities of Islamic banks should not entail gambling (*maysir*) and uncertainty (*gharar*). Al-Quran condemns gambling and prohibits any business activities which contain any gambling element.

“Satan’s plan is (but) to excite enmity and hatred between you, with intoxicants and gambling, and hinder you from the remembrance of Allah”

(Al-Quran 5:90-91)²¹

Any economic activities which entail elements of unqualified uncertainty or speculation (*gharar*) are also prohibited. *Gharar* means “to undertake a venture blindly without sufficient knowledge or to undertake an excessive risky transaction” (Lewis, 2001, p.119). An example of *gharar* is trading in futures on the stock market.

It is understood that the main difference is that conventional banks operate on the concept of pre-fixed interest and Islamic banks on profit-sharing. One example of the profit-sharing arrangements that are undertaken by Islamic banks is *Mudharabah*. *Mudharabah* is defined as contract whereby the financier (*Rab al-mal*) contributes and entrusts his or her funds to the entrepreneur (*Mudarib*), to manage a business activity or venture (Obaidullah, 2005). The profit is shared between the two parties in pre-agreed ratios. In the case of losses, the liability is borne by the financier, unless negligence or mismanagement can be proven then the entrepreneur may be liable for the losses and may make necessary compensation to the financier (Obaidullah, 2005).

In Islamic banking operations, a *Mudharabah* contract is extended to include three parties; the depositors as financiers, the banks as an intermediary, and the entrepreneur who needs the funds. This extended contract is called a two-tier *Mudharabah* contract, whereby the first *Mudharabah* is between the depositor and bank, and the second *Mudharabah* is between the bank and the entrepreneur.

²¹ Surah Al-Maidah: Verse 90-91

The bank plays the role of both an entrepreneur when receiving funds from depositor in the first *Mudharabah*, and also as a financier when entrusting the funds to entrepreneurs in second *Mudharabah*. The first *Mudharabah* draws on the saving side to mobilize the funds from depositors whereby the bank acts as the entrepreneur and the depositor as the financier. While the second *Mudharabah* draws on the investment portfolio side to utilize and invest the funds, with the banks now as the financier and the entrepreneur as user of the funds. The profits of Islamic banks are derived from the difference between the profit-share received from the entrepreneur under the second *Mudharabah* and the profit-share paid to the depositors under the first *Mudharabah* (Obaidullah, 2005).

The form of profit-loss sharing agreement that is recognised in Islam and practised by Islamic banks is *Musyarakah*, which is when two or more people contribute their resources to invest in an enterprise. The profit is shared between the parties in pre-agreed ratios and the loss is shared according to capital contribution (Sarker, 1999). All partners have a stipulated role of management and participation, whether or not all partners actually participate (Lewis, 2001).

Arrangements like *Mudharabah* (profit sharing) and *Musyarakah* (profit-loss sharing) would not contain the elements of unqualified uncertainty or speculation (*gharar*). The Islamic agreements could avoid *gharar* when the arrangements are transparent by ensuring all parties agree in advance all details of the contract, such as the profits and risk sharing and the qualified uncertainties (Sarker, 1999). The transparency of the arrangements could also be reached by ensuring the clarification of ownership so that it is undisputed (Sarker, 1999). Islamic banks would not carry a high level of risk because the arrangements promote risk sharing between the financier (provider of capital) and the entrepreneur (the user of funds).

Some other forms of Islamic agreements that are practiced by Islamic banks are shown and summarised in Table 3-5.

Table 3-5: Islamic Banking Products

| Islamic Agreement | Clarification | Purpose | Banking Products |
|---------------------------|-------------------------|-----------------------------------|--|
| <i>Wadiah</i> | guaranteed custody | for deposit-taking products | current deposits, savings deposits |
| <i>Mudharabah</i> | profit-sharing | investment deposits | general and special investment accounts, project financing, sell and buy back agreements |
| <i>Murabahah</i> | cost-plus | for financing facilities | working capital financing, bonds, commercial papers |
| <i>Bai' Bithaman Ajil</i> | deferred payment sale | for house financing | Housing loan, negotiable instrument of deposit, commercial property financing, credit card, umrah financing, project financing |
| <i>Ijarah</i> | Leasing | for leasing and vehicle financing | leasing of machines, vehicle financing, financing syndication, bonds |
| <i>Musyarakah</i> | profit and loss sharing | for project financing | project financing, share financing, unit trust financing, financing syndication |

Source: (KPMG, 2010)

3.5.1 Islamic banking in Malaysia

In Malaysia, separate Islamic legislation and banking regulations exist side-by-side with those for the conventional banking system. The legal basis for the establishment of Islamic banks was the Islamic Banking Act (IBA), which came into effect on 7 April 1983. The IBA provides BNM with powers to supervise and regulate Islamic banks, similar to the case of other licensed banks (KPMG, 2010).

The first Islamic bank established was Bank Islam Malaysia Berhad, which commenced operations on 1 July 1983. The need arose from the fact that more than 61% of the population is made up of Muslims. On 1 October 1999, a second Islamic bank, namely Bank Mualamat Malaysia Berhad was established. Apart from Islamic banks, other financial institutions also offer Islamic banking services through the "Islamic Banking Scheme" (KPMG, 2010). The Islamic banking system is not limited to Muslims only, it is open to both Muslims and non-Muslims alike.

Currently, Malaysia has a significant number of fully-fledged Islamic banks including several foreign owned entities, conventional institutions that have established Islamic subsidiaries, and also entities that are conducting a foreign currency business (BNM, 2011). There are about 17 Islamic banks in Malaysia in total, where 11 of them are local-controlled institutions and the remaining 6 are foreign-controlled institutions. In 2013, Islamic banking assets are 25 percent of the total assets of the Malaysian banking system (Nelson, 2014). Islamic financing constituted about 27.5 percent of total bank financing, while Islamic banking deposits accounted 26.6 percent of the deposits of the Malaysian banking system (Nelson, 2014).

It is interesting to study Malaysian Islamic banks because they are unique and different from Middle Eastern Islamic banks as many Malaysian Islamic banks are subsidiaries of conventional banks, where conventional banks have control over the Islamic banks' operations. Furthermore, the government also has a stake in some Malaysian Islamic banks or is the parent company of some Islamic banks. Some Islamic banks that are listed as government-linked companies (GLCs) include Bank Islam Malaysia and Bank Muamalat. There are also conventional banks that control the Islamic banks which are also listed as GLCs, for example, Maybank Berhad, CIMB Bank, Ambank, etc. In Malaysia, GLCs are defined as companies that have a primary commercial objective and in which the Malaysian Government has a direct controlling stake (Khazanah Nasional Berhad, 2014). A controlling stake refers to the Government's ability (not just percentage ownership) to appoint BOD members, senior management, and make major decisions (e.g. contract awards, strategy, restructuring and financing, acquisitions and divestments etc.) for GLCs either directly or through government-linked investment companies (Khazanah Nasional Berhad, 2014).

3.5.2 Islamic banking and CSR

Islamic banks have a special religious and financial position in society. Religiously, Islamic banks have a responsibility to comply with the form and substance of

Islamic law in all aspects of their operations. This is because they are in a representative and exemplary religious position, whereby they represent the interests of their stakeholders and at the same time are exemplars to their stakeholders. This implies that all aspects of their operations should be conducted in a permissible or recommended manner while no aspect of their operations should ideally be conducted in an impermissible or not recommended manner. If it is conducted in an impermissible or not recommended manner, it has an obligation to disclose to its stakeholders the reasons for that particular conduct (Farook, 2007).

Financially, Islamic banks are intermediaries which mobilize funds from investors and allocate funds to projects and other investments. In this context, it is the responsibility of Islamic banks to mobilize funds from permissible and recommended sources and invest funds in permissible and recommended projects. Further, Islamic banks are also in an exemplary position as financial intermediaries and hence can significantly impact the conduct of the IFIs stakeholders in terms of the ideal Islamic investment and allocation process (Farook, 2007).

It is for these two reasons that Islamic banks have a particular social responsibility compared to individuals. For instance, individuals have limited capacity to avoid *riba* in financial systems that are overwhelmingly based on *riba*. Hence, Islamic banks were created to avoid this form of impermissible activity. This can be extended to recommended types of activities such as the allocation of funds for the purposes of the benefit of society or to alleviate poverty. These activities can only be performed in a limited extent by individuals due to minimal scale economies, but are recommended for individuals through charity and helping those who are destitute. The overall theme encouraged by Islam is one of assisting those who are in a relatively disadvantaged position in society because of circumstances. In this context, Islamic banks can perform these functions profitably and efficiently because of the sheer scale of their operations compared to individuals (Farook, 2007).

With an increasing number, and awareness, of Islamic values and investment, individual Muslim investor would want their investment to be *Shariah* compliant and socially responsible. They would need their saving to be invested in Halal business and therefore invest their savings in Islamic banks with expectations that the Islamic banks will take care of and comply with, *Shariah* principles. The Islamic banks are liable to invest only in those corporations that meet the *Shariah* expectations of the depositors. The target corporations should be scrutinized on their observance of Islamic law, for example, they should not deal in interest, alcohol, pork, human rights violations, pornography, gambling, etc. Islamic banks are also not allowed to invest in those corporations that damage the natural environment and do not provide any compensation for it. The role of Islamic banks is that they should build a portfolio of corporations that can be classified as a “*Shariah-compliant portfolio*”. Being *Shariah-compliant* ultimately means being socially responsible in its broader sense (Ullah and Jamali, 2010).

The nature of responsibility of Islamic banks can further be distinguished from charitable organisations which exist in Islamic societies, which are also a function of individual social responsibility. Charitable organisations only redistribute wealth, while Islamic banks have the dual ability to redistribute wealth and allocate wealth to selective investments that contribute to the betterment of society. It is this allocation power that differentiates Islamic banks from other institutions and indeed bestows upon it special responsibilities (Farook, 2007).

However, it is widely cited that Islamic banks generally only perform a part of their social responsibility. Islamic banks are widely accused of having generally ensured their operational status by avoiding negative actions or unlawful activities, while only minimally and variedly conducting recommended activities.

This may be a function of two overlapping issues. The first issue is that Islamic banks are unsure of what is expected of them based on Islam other than to avoid *riba* and *gharar*. In this confusion their approach to social responsibility varies widely based on individual Islamic bank preferences. The second issue is that, even if it is assumed that Islamic banks are conducting their social responsibility

activities, they may not be informing the rest of society through disclosure, leading to an expectations gap. This may be despite the fact that Islamic banks are complying to the fullest extent of their abilities with Islamic notions of social responsibility (Farook, 2007).

3.6 Review of Studies that Investigate CSR and CSRep from an Islamic Perspective

There are number of studies undertaken on Islam and CSR. However, the studies of CSRep from an Islamic perspective which have been undertaken are still limited, although they are growing.

In the area of Islamic CSR studies, Mohammed (2007) investigates whether the extent of CSR practices in Islamic banks is aligned with an Islamic CSR framework by interviewing senior management of six Islamic banks located across the world (Malaysia, United Arab Emirates (UAE), Saudi Arabia and United Kingdom). The author finds that CSR practices of Islamic banks and an Islamic CSR framework are aligned largely due to legal requirements to comply with *Shariah* and not because of a genuine understanding of CSR (Mohammed, 2007).

Siwar and Hossain (2009) explore Malaysian managers' perceptions of CSR and the Islamic concept of CSR. The authors obtain managers' opinions through questionnaires sent to 50 listed corporations in Malaysia and received 40 completed questionnaires (Siwar and Hossain, 2009). They find that the Islamic concept of CSR and managers' opinion of CSR are not different, providing evidence that Islamic concepts are relevant and could influence the CSR policies and strategies in Malaysia (Siwar and Hossain, 2009).

Williams and Zinkin (2005) study the attitudes of Muslim and non-Muslim stakeholders towards CSR through a survey of stakeholder attitudes to CSR across 21 countries. The results show that non-Muslim are more concerned about CSR compared to Muslims (Williams and Zinkin, 2005). The authors explain that Muslims might face pressures due to high standards of CSR required by *Shariah* and

also from the stakeholders, and they feel that Islamic business ethics is truly consistent with the ideal CSR notion (Williams and Zinkin, 2005). Therefore, Muslims are reflected as fail to meet the standards of CSR as required by *Shariah*.

Williams and Zinkin (2010) also provide evidence that Islamic teachings on business ethics are in line with the CSR notion by comparing Islamic principles with the UN Global Compact's 'Ten Principles' of responsible business. They find the Islamic principles are consistent with the principles of the UN Global Compact, and that the religion goes beyond the human principles, having more comprehensive ethical standards and enforcement mechanisms (Williams and Zinkin, 2010).

In the area of reporting, an earlier study of CSRep from an Islamic perspective was executed by Gambling and Karim (1986), who consider social accounting in the case of an Islamic society. They present alternative models of religion, society and accounting theory, namely the personal model, colonial model and orthodox model. The personal model describes how God conveys His messages through the *Quran* and the *Hadith* to each individual man and woman, which brings Islam and the *Shariah* into the heart of the people (Gambling and Karim, 1986). The colonial model suggests that the Muslim government or Muslim king might rule the Country or the State according to Islamic principles (Gambling and Karim, 1986). Lastly, the orthodox model, proposes a notion that God conveys His messages through the *Quran* and the *Hadith* to the nation, whereby a national culture, including a national accounting theory is defined by a national priest and would influence the personalities of the people making them within the *Shariah* (Gambling and Karim, 1986).

Abdallah and Murtuza (2005) discuss how the notion of CSR and the principles of Islam can work well together for financial accountability and performance measurement. However, their discussion of the compatibility between CSR and the principles of Islam focuses more on the case of multinational corporations (Abdallah and Murtuza, 2005). They argue that CSR and Islamic principles can exist together successfully, making Islamic values and ethics more familiar not only for non-Muslims but Muslims themselves (Abdallah and Murtuza, 2005). Increasing the

compatibility between CSR and Islamic principles would bring the Middle Eastern and Islamic countries in other regions closer and reduce the gaps that they have in cultural and ethical values (Abdallah and Murtuza, 2005). They also suggest that all Islamic countries set their accounting principles and auditing standards for financial accountability, and their governance be grounded by the Islamic principles, so that their credibility and conformity will be improved (Abdallah and Murtuza, 2005).

Most empirical studies of CSRep from an Islamic perspective only emerged after the year 2000. Haniffa and Hudaib (2004) conduct a study on the annual reports for 2002 of five Islamic financial institutions in four countries in the Gulf region in order to investigate the variety and extent of disclosure practices in the context of the *Shariah* concept of *Uqud* (contracts). Haniffa and Hudaib (2004) explore the influence of *Uqud* on Muslim managers, auditors and the *Shariah* Supervisory Boards in disclosing information to users of their annual reports. They find some problems in disclosure practices of Islamic financial institutions which are low in volume, short on precision, and inconsistent in reporting the information (Haniffa and Hudaib, 2004). The results provide evidence that the current disclosure practices of Islamic financial institutions fail in their role to communicate the fulfilment of duties and obligations as required by *Shariah* for the Muslim users and also fail to demonstrate accountability (Haniffa and Hudaib, 2004).

Haniffa and Hudaib (2007) extend their earlier study in the Islamic CSRep area by carrying out a longitudinal survey on annual reports of seven Islamic financial institutions (IFIs) in the Gulf region over the period of three years (2002-2004). They investigate whether there is any gap between the *communicated* and *ideal* ethical identities based on an Islamic ethical business framework using an *Ethical Identity Index (EII)* (Haniffa and Hudaib, 2007). The results show that only one Islamic bank scores the average *EII* mean, meaning the discrepancy between the communicated and ideal ethical identities is average (Haniffa and Hudaib, 2007). However, the other six Islamic banks' *EII* mean scores reveal that their gap between the *communicated* and *ideal* ethical identities is very large (Haniffa and Hudaib, 2007). The authors discover that the largest discrepancy is related to the ethical dimensions of: commitments to society; disclosure of corporate vision and mission;

contribution to and management of *zakat*, charity, and benevolent loans; and information regarding top management (Haniffa and Hudaib, 2007). The discovery of lacking disclosures in those dimensions that are expected to be disclosed more by the Islamic banks provides evidence of the failures of Islamic banks in playing their role as social and economic institutions as well as demonstrating justice and accountability to society and to God ultimately (Haniffa and Hudaib, 2007).

Maali et al. (2006) conduct an empirical study of Islamic social reporting that includes a sample outside the Gulf region by surveying the CSRep practices in 29 annual reports for the year 2000 of Islamic banks located in 16 countries. They also develop an Islamic social disclosure benchmark which is derived from Islamic principles and then compared the benchmark with the empirical findings of actual social reporting practices of Islamic banks (Maali et al., 2006). The authors find all Islamic banks in the sample ignore the disclosures related to the environment and also related to the treatment of insolvent clients (Maali et al., 2006). However, most banks disclosed a *Shariah* Supervisory Board report (Maali et al., 2006) as it is necessary assurance to the users that the bank operations are carried out in accordance with *Shariah*. Overall, the social disclosure practices of Islamic banks are significantly below the expected level of disclosure practices (Maali et al., 2006). Interestingly, the authors discover that Islamic banks which opt to comply with AAOIFI standards tend to disclose more social information compared to non-compliant Islamic banks (Maali et al., 2006).

Farook and Lanis (2005) explore the annual reports of 47 Islamic banks from 14 countries in a search for the determinants of Islamic banks' social disclosures using legitimacy and political economy theory. They tested the relationships between CSR disclosure and socio-political factors as well as corporate governance mechanisms (Farook and Lanis, 2005). The results of the regression show that the level of CSR disclosure by Islamic banks is significantly influenced by political rights and civil liberties, the Muslim population, the rights of investment account holders, and corporate governance variables (i.e. *Shariah* Supervisory Boards (SSB), number of SSB members, cross-SSB members, members with doctorate qualifications and reputable scholars as an SSB member) (Farook and Lanis, 2005).

Kamla and Rammal (2010) examine ten Islamic banks' annual reports and websites attempting to explore reporting by Islamic banks related to their social justice role and wealth distribution in society. The authors specifically investigate whether Islamic banks report information that points out their activities and contributions to achieve social justice, equality and poverty elimination in the societies they operate in (Kamla and Rammal, 2010). Their findings show that Islamic banks in the study have not made any disclosures which reflect their interest in equitable redistribution of wealth and/or poverty eradication in society, providing evidence that Islamic banking actualities significantly diverge from its theoretical claims (Kamla and Rammal, 2010).

The organisations of DinarStandard²² and Dar Al Istithmar²³ with the support of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) carried out a study to benchmark the released AAOIFI standards relating to social responsibility with Islamic financial institutions' CSR practices (DinarStandard and Istithmar, 2010). They sent questionnaires to the CEO of 154 Islamic financial institutions across the world and received 29 completed questionnaires (DinarStandard and Istithmar, 2010). The respondents were required to answer whether their institutions have CSR policies as recommended by AAOIFI (DinarStandard and Istithmar, 2010). The findings show that Islamic financial institutions are starting to show concern on most social responsibility aspects but its level varies between institutions (DinarStandard and Istithmar, 2010). There is similarity with Kamla and Rammal's (2010) study on the role of social justice by IFIs, whereby this report recommends that the IFIs embrace the their role in social justice as they have the ability to redirect funds from the capital rich to the capital deficient to ensure the redistribution of wealth in the long run (DinarStandard and Istithmar, 2010). However, the independence of the report may be undermined because it was done with the support of AAOIFI.

²² DinarStandard is a research and advisory firm specializing in emerging Muslim markets such as Islamic banking and finance, halal, OIC market, ethical and social entrepreneurship.

²³ Dar Al Istithmar is a high-profile Islamic finance advisory firm.

Aribi and Gao (2010) investigate whether Islam is a factor that influences CSR disclosure by Islamic financial institutions (IFIs) through a comparison with CSR disclosure by conventional financial institutions (CFIs). The authors compare the annual reports of 21 IFIs with 21 CFIs operating in the Gulf region to study the influence of Islam by comparing two different types of financial institutions operating in same political, social and economic setting (Aribi and Gao, 2010). Their findings show that the level and the extent of CSR disclosure between IFIs and CFIs is significantly dissimilar, in terms of Islamic items and information disclosed by IFIs, for example, *Shariah* Supervisory Board, *Zakat*, charity and donations, and benevolent loans (Aribi and Gao, 2010). Interestingly, Aribi and Gao (2010) find that IFIs plan to disclose more negative news compared to CFIs, which could be explained by the influence of Islam on CSR disclosure.

Harahap and Gunawan (2006) explore CSR disclosure practices in three different countries by comparing the annual reports of Islamic banks in Indonesia and Malaysia with the annual reports of community banks in Australia. The authors expect the Islamic banks to play a similar role to community banks because both provide services specifically to their community in an improved way compared to other financial institutions (Harahap and Gunawan, 2006). The results show the score for CSR disclosure by community banks in Australia is the highest both for quantity and quality of disclosure, providing evidence that CSR disclosure practices of Islamic banks in Indonesia and Malaysia are still low (Harahap and Gunawan, 2006). This comparative study of Islamic banks and community banks under different settings also reveals that culture, economy and government have a significant role to play in promoting the practices of CSR (Harahap and Gunawan, 2006).

As most previous Islamic CSRep studies use a sample of Islamic banks, Othman, Thani and Ghani (2009) employ a sample of 56 top *Shariah*-approved companies listed in the Bursa Malaysia²⁴ to investigate the determinants that may influence Islamic social reporting by a company. However the sample excludes companies in

²⁴ Bursa Malaysia is formerly known as Kuala Lumpur Stock Exchange

financial sector from the study. The authors examine the annual reports of the companies for a period of three years from 2004 to 2006 and then test the relationships between the companies' characteristics and Islamic social reporting (Othman et al., 2009). They find that Islamic social reporting by a company is significantly influenced by three company characteristics i.e. size, profitability and board composition, while the type of industry is not a factor that influences the company to report Islamic social information (Othman et al., 2009).

Ousama and Fatima (2010) also examine the annual reports of the largest 50 *Shariah*-approved companies on Bursa Malaysia to explore their extent of voluntary disclosure practices. The authors divide voluntary disclosure into three kinds; overall, conventional, and Islamic disclosure (Ousama and Fatima, 2010). Their study also excludes companies in financial services from the sample because their business operations and regulations are different from other companies (Ousama and Fatima, 2010). The results show that *Shariah*-approved companies disclose voluntary conventional items more than Islamic items, providing evidence that voluntary disclosure of especially Islamic items among *Shariah*-approved companies still falls short of expectations (Ousama and Fatima, 2010).

Similar results of insufficient Islamic items in the annual reports of *Shariah*-approved companies are also found by Ibrahim et al. (2013). Ibrahim et al. (2013) suggest the management of the companies to disclose more items than related to *Zakat*, *Shariah* Supervisory Board, Underlying Philosophy and Values, and Islamic Terminology and Value if the management wish to distinguish their companies from others.

Generally, the disclosure of CSR or CSRep in Islamic business organisations is still low and less than expected. Other than low disclosure, some problems within the disclosure practices of Islamic banks are that they are short of precision and are inconsistent in reporting the information. Therefore, this study will examine the current level of CSRep practices to determine whether they have been improved or not. The current study will also examine the precision and consistency of CSRep, especially after AAOIFI standards on CSR were introduced by looking at the quality

and quantity of reporting pre- and post- the introduction of the CSR standard at the end of 2009.

3.7 Chapter Summary

This chapter has reviewed the concept of corporate social responsibility in Islam, and identified a number of studies that have considered the relationship between CSR and CSRep by Islamic organisations, specifically Islam banks. The major themes identified include that there is still improvement in CSR reporting needed by Islamic banks, and the introduction of a CSR standard by AAOIFI has potential to influence the practice.

The final area of consideration important for this thesis, is the relationship between CSR and financial performance, so this will be reviewed in the next Chapter.

Chapter 4: CSR and Financial Performance

4.1 Introduction

The purpose of Chapter 4 is to present a literature review of the relationship between CSR and financial performance. As the sample used in this thesis is banks, some empirical evidence of the relationship between CSR and financial performance in the banking industry as a specific focus is provided. Most importantly, this chapter presents some discussion and review of studies that have been carried out on CSR and financial performance from an Islamic perspective, in particular, on Islamic banks.

The variables used in these studies are briefly reviewed here as they provide the basis from which the measures of financial performance are developed in this thesis. However, Chapter 6, which presents the methodology, will provide further details and justification for the measures chosen.

4.2 The Relationship of CSR and Financial Performance

Over the past twenty years or so, there have been a number of studies undertaken on the links between CSR and companies' financial performance by researchers, policy makers and societal bodies. However, many of these studies have produced contradictory empirical results, with some discovering that CSR does affect financial performance either positively, negatively or both (see, for example Verschoor, 1998, Gelb and Strawser, 2001, Waddock and Graves, 1997, Moore, 2001) , while others find only a weak link or no link at all (Patten, 1991, Aras et al., 2010).

Those conflicting results may be due to methodological limitations. One of the limitations is lack of uniformity when measuring both CSR and financial performance variables (Allouche and Laroche, 2006). According to Allouche and Laroche (2006), different studies use different measures of CSR, for example, social disclosure/content analysis, CSR values and attitudes (questionnaire surveys), reputational indices, pollution indices, and data produced by rating agencies (eg.

KLD). Similarly, measures that are used for financial performance include accounting indicators, stock market indicators and mixed indicators (Allouche and Laroche, 2006).

Another problem that may lead to the conflicting results of investigations into the relationship between CSR and financial performance is the meaning of CSR used in the study. Often, CSR is referred to as either social performance or social disclosure. Ullman (1985) distinguished social performance and social disclosure, where social performance is defined as “an organisation’s responses to anticipated or existing social demands” (p.541) and social disclosure is reporting social policies, programs and activities, including social costs²⁵. Therefore, there are three relationships that should be explored, i.e. social performance and social disclosure, social performance and financial performance, and social disclosure and financial performance (Ullmann, 1985). Ullman (1985) also added that a lack of theory and insufficiency in empirical databases currently available are also among the reasons that may contribute to the contradictory results of studies of the relationship.

Regardless of the limitations that lead to the conflicting results, it is important to appreciate the findings of existing studies of the CSR and financial performance relationship. Table 4-1 summarizes the research findings to date.

²⁵ CSR is usually measured by social performance or social reporting. Ullman (1985) makes clear distinction between social performance and social reporting. Thus, there is a point that CSR and CSRep are different, but related. This study focuses on CSRep and discusses CSR as a related concept important to the study background.

Table 4-1: Summary of Findings of Research into the Relationship between CSR and Financial Performance

| Researcher (s) | CSR measures | Financial measures | Remarks |
|--|--|--------------------------------------|---------------------------------|
| <i>Positive relationship</i> | | | |
| Anderson and Frankle (1980) | Social performance disclosure | Market indicators | Weak relationship |
| Waddock and Graves (1997) | Kinder, Lydenberg, Domini (KLD)'s rating scheme | Accounting indicators: profitability | Simultaneous relationship |
| Verschoor (1998) | Commitment to ethics in annual report | Accounting and market indicators | Strong relationship |
| Gelb and Strawser (2001) | Association for Investment Management and Research Corporate Information Committee Reports (AIMR Reports)'s Rankings | Market indicators | Financial disclosure related |
| <i>Negative relationship</i> | | | |
| Vance (1975) | Moskowitz ratings of social responsiveness | Market indicators | For contemporaneous performance |
| Moore (2001) | Social performance obtained from annual reports, factsheets from Ethical Investment Research Service (EIRIS), Advertising Standards Authority, Independent Television Commission, Christian Aid and the Ethical Trading Initiative | Accounting indicators | |
| <i>Curvilinear relationship</i> | | | |
| Barnett and Salomon (2006) | SRI fund screening | Market indicators | U-shaped |

Table 4-1 (continued)

| | | | |
|---------------------------|----------------------------------|-----------------------|--|
| No relationship | | | |
| Freedman and Jaggi (1988) | CEP evaluation | Accounting indicators | Before industry segmentation and size adjustment |
| Aras et al. (2010) | CSR disclosure in annual reports | Accounting indicators | |

By analysing the social disclosure with relation to beta and return on investment (ROI), Anderson and Frankle (1980) found a weak but positive association for socially disclosing firms, which outperformed non-disclosing firms. Waddock and Graves (1997) found simultaneously positive relationship or virtuous cycle, as social performance depends on good financial performance and financial performance depends on good social performance. Verschoor (1998) found that management commitment to ethical and socially responsible behaviour is strongly positively related with favourable financial performance. Gelb and Strawser (2001) also found a positive relationship where firms which socially engage provide more informative and more extensive financial disclosure.

However, Vance (1975) who used students' and executives' ratings, found a negative relationship with the stock market. Moore (2001) also obtained negative results for the relationship especially for contemporaneous social and financial performance. But for the prior-period financial performance, they found it to be positively related with subsequent social performance (Moore, 2001).

CSR and financial performance could also have a curvilinear or U-shaped relationship, and Barnett and Salomon (2006), who studied socially responsible investment (SRI) funds found a curvilinear relationship between social screens and financial returns. They observed that when there is increased number of social screen used, financial returns would decrease but later go to moderate and rise as the number of social screens goes to the maximum (Barnett and Salomon, 2006).

Among the studies that show causality between CSR and financial performance (for example, Waddock and Graves, 1997, Orlitzky, 2006), Orlitzky (2006) discusses the determinants of the link between CSR and financial performance which he states can be explained as a virtuous cycle. The author describes that the benefits from improved social performance can lead to better financial performance, and vice versa. Among the benefits that are gained through corporate social performance are enhanced organisational reputation, increased internal efficiencies, increased competitors' costs, the development of innovative cultures that suit the social environment, the attraction of better employees, the ability to generate more revenue, and reduced business risk, whereby these benefits are the causal determinants of corporate financial performance (Orlitzky, 2006). However as the link between corporate social performance and corporate financial performance is a virtuous cycle, corporate financial performance could be the main antecedent of corporate social performance. Better financial performance can provide the reverse causal determinants such as slack resources and normative obligation among managers to offer philanthropic activity and service to the community, which then can improve social performance (Orlitzky, 2006).

However, some authors have found there to be no relationship between CSR and financial performance. Freedman and Jaggi (1988) studied pollution disclosure and financial ratios, and found no relationship between them. Only after segmenting by industry and size, did the results show a positive association (Freedman and Jaggi, 1988). Aras et al. (2010) also found no relationship in companies listed on the Istanbul Stock Exchange, finding only relationship between CSR and company size (Aras et al., 2010).

For Malaysia which is the context of this study, there is very limited research on the relationship between CSR and financial performance. Among the studies is one by Saleh et al. (2008) who tested 200 publicly listed companies in Malaysia and found a positive relationship between CSR and financial performance but, in the long term, there is limited evidence of a significant relationship. In another study, Saleh

et al. (2011) find that there is a positive and significant relationship between CSR and financial performance in Malaysian listed companies, particularly in relation to disclosures about employees and community involvement. This supports other studies which find a relationship generally, such as Mahoney and Roberts (2007) who found a positive relationship for Canadian companies.

Table 4-2: Research into the Relationship between CSR and Financial Performance in Malaysia

| Researcher (s) | CSR Measures | Financial Measures | Findings |
|-----------------------|---|----------------------------------|---|
| Leng (2004) | Corporate governance from KLSE handbook | Accounting indicators | Positive and curvilinear relationship |
| Saleh et al. (2008) | Modified KLD index | Accounting and market indicators | Positive relationship, limited to short-term only |
| Saleh et al. (2011) | CSR disclosure | Accounting and market indicators | Strong, positive relationship |

Table 4-2 summarizes the studies of relationship between CSR and financial performance in Malaysian companies. The next section will discuss the relationship between CSR and financial performance in particular industry, i.e. banking.

4.3 CSR and Financial Performance: The Banking Industry

According to Griffin and Mahon (1997), samples from multiple industries could be one of the reasons that contributes to contradictory results of studies of CSR and financial performance. Therefore, it could be useful to concentrate on a single industry. Simpson and Kohers (2002) claim that empirical evidence from a single industry can provide additional insights into the investigation of the link between CSR and financial performance, and another advantage of concentrating on a single industry is that more comprehensive specific financial performance measures, due to the distinctiveness of the industry, can be taken into account (Simpson and Kohers, 2002).

In the case of banking, Simpson and Kohers (2002) used data from a sample of commercial banks in the US. The Community Reinvestment Act (CRA) rating was

used as a social performance measure as a CRA rating is developed for each commercial bank, and the financial measures used in the study are return on assets and loan losses. Simpson and Kohers (2002) found corporate social performance was positively related with corporate financial performance.

Another study on the banking industry by Menassa (2010), studied 24 commercial banks in Lebanon using content analysis of annual report as the CSR measure, and net profit and return on equity (ROE) as financial performance measures. The result shows net profit and ROE as profitability measures are strongly positively associated with CSR.

Carnevale et al. (2012) analysed 130 European-listed banks using social report publication as the CSR measure, and accounting variables and stock price as financial measures. From the entire sample, there is no significant relationship between the publication of the social report and the stock price. After carrying out a cross-country analysis, the results in some countries show positive relationship between publication of a social report and stock price (Carnevale et al., 2012). Carnevale et al. (2012) also believe that the social report provides more information to the investors and is complementary to the financial statement.

Generally, it appears that a positive relationship is a universal phenomenon in the banking industry. This study however, investigates the Islamic banking industry specifically, so the next section will discuss CSR and financial performance of banks from an Islamic perspective.

4.4 CSR and Financial Performance: Islamic Perspective and Islamic Banks

Islam and capitalism both view the pursuit of profits as important as this is consistent with the natural human tendency²⁶ to acquire wealth (Maududi, 1986).

²⁶ In Islam, it is considered a natural human tendency to acquire wealth but should be at an appropriate level (sufficient for the needs only) and not at the expense of others. Islam believes greed is not a natural human tendency because in Islam, every human is free from sins when they are born on this world. Greed exists because of the influence of upbringing and is formed by satan (an evil force and the enemy of God).

However, profit is not the sole motive in Islam. Islam, as discussed earlier in this thesis, emphasises the achievement of a balance between the pursuit of profits and social responsibility (Willett and Sulaiman, 2001). Islamic banks have a dual role, i.e. a financial role and a social role, whereby profit is essential for the survival of Islamic banks but it is not the sole motive as at the same time they should shoulder the role of redistribution of income and poverty eradication (Maali et al., 2006).

Ariff et al. (2009) analysed the financial performance of Islamic banks in 21 Muslim-majority countries. They measure financial performance by the efficiency of cost, revenue and profitability. Cost efficiency ratios include the cost to income ratio and net interest expense to average assets. Revenue efficiency ratios include other operating income to average assets and net interest margin. Profit efficiency ratios include ROE and ROA (Ariff et al., 2009). The study found that Islamic banks tend to have steady cost efficiency and volatile revenue efficiency. But on average, the financial performance of the Islamic banks is similar to the conventional banks across the countries. However, in a similar study that focuses on Malaysia, Masruki (2011) found Islamic banks are less profitable but have better liquidity compared to conventional banks, but with regards to efficiency, Islamic banks is more profit efficient than conventional banks in Malaysia (Masruki et al., 2011).

As discussed earlier, Islamic banks have a dual role so should not focus only on their financial role but should also focus on their social role. Therefore, Hameed, Wirman, Alrazi, Nazli and Pramono (2004) propose some socio-economic accounting performance measures which could be used by Islamic banks to evaluate their economic or financial performance as these are more in line with their established objectives. According to Hameed et al. (2004), Western developed performance measures such as ROI measures are based on the utilitarian positivist paradigm and target mainly financial performance. Islamic banks are established to achieve certain socio-economic objectives in line with the notion of establishing social justice. Some alternative performance measures which could be used by

Islamic banks which are more in line with their established objectives are their profit sharing ratio, *zakat* performance ratio, equitable distribution ratio, directors-employees welfare ratio, Islamic investment vs Non-Islamic investment, and Islamic income vs Non-Islamic income.

There is still limited research on the relationship between CSR reporting and financial performance in Islamic banks. The study of the relationship has just started in recent years, especially after 2010. Most previous studies of Islamic banking were focused only on CSR activities and CSR reporting of Islamic banks, but most likely after AAOIFI released a guideline on CSR in 2010, researchers have begun to extend the research to look into the relationship with financial performance.

The earliest research on the relationship of CSR and financial performance in the Islamic banking industry is, to the author's knowledge, by Masruki et al. (2010) who examined Malaysian Islamic banks using content analysis and used leverage, size, working capital and ROA as financial measures. Masruki et al. (2010) found a positive relationship with size, but there is no relationship with leverage and profitability. Thus Masruki et al. (2010) suggested future research is needed which adds more financial variables in order to get further insights of the relationship of CSR and financial performance in Islamic banks.

A different result is yielded in another study of Malaysian Islamic banks by Arshad et al. (2012) about the effect of Islamic CSR on corporate reputation and performance, where CSR was found to be positively related with profitability. The authors measure Islamic CSR by disclosure in annual reports and also measure corporate reputation by the index that was developed based on the RepTrak™ model, Bursa Malaysia CSR Framework and GRI Guidelines. Their corporate performance is measured by ROA, ROE and firm size. Arshad et al. (2012) found that Islamic CSR disclosure is positively related with corporate reputation and performance which indicates that disclosure from an Islamic perspectives is

important for their business strategies to promote better reputation and performance.

A similar result to that found for Malaysian Islamic banks, is also found in a study conducted on Egyptian Islamic banks (Megeid, 2013). Megeid (2013) studied two major Islamic banks in Egypt to test the effect of service quality on financial performance and CSR. In the study, CSR is measured by CSR expenditures or commitments that are obtained from the Bankscope database and financial performance is measured by profitability and operation efficiency. The authors reveal that CSR which includes service quality positively influences customer satisfaction, which then leads to better financial performance (Megeid, 2013). In another study, El Mosaid and Boutti (2012) examine the Islamic CSR disclosure and performance relationship of eight Islamic banks from different countries. However, their findings show that Islamic CSR disclosure has no relationship with ROA and ROE (El Mosaid and Boutti, 2012).

A further study of the impact of CSR on profitability was conducted by Iqbal et al. (2013) for Islamic banks in Pakistan. Iqbal et al. (2013) measure CSR by disclosure of education, health and donations in the annual reports and profitability is measured by ROA, ROE and EPS. The authors find that there is positive relationship between CSR and profitability (Iqbal et al., 2013).

Fitrijanti and Alamanda (2013) studied the influences on the disclosure of Islamic Good Corporate Governance (GCG) in Indonesian Islamic banks. The authors discover that social performance, *zakat* performance and financing risk are the main factors for better disclosure of GCG. In the study, social performance, which was measured by *Qard Hassan* minus non-Halal income, indicates that higher *Qard Hassan* and less non-Halal income could lead to better GCG disclosure (Fitrijanti and Alamanda, 2013).

Abdul Rahman (2012) examined the relationship between religious ethical values and earnings quality in Malaysian companies. The author finds that *Shariah* is

significantly negatively related with abnormal discretionary accruals, abnormal cash flow, and abnormal discretionary expenses. However, *Shariah* is found to be positively related with accounting conservatism. Thus, the results describe *Shariah* as a good monitoring instrument to control managerial opportunism and manipulation, and hence improve the earnings quality.

Although several studies have explored the relationship between CSR and financial performance from an Islamic perspective and on Islamic banks, the research in this area is very new and in its infancy stage. In order to fill the gap in the literature, this thesis examines CSRep by Islamic banks in Malaysia (using content analysis), and considers a number of financial variables to represent financial performance. In addition, as this thesis has a particular focus on the dual financial and social role of Islamic banks, therefore socio-economic performance measures to be used as alternative financial measures, in line with the research by Hameed et al. (2004). These will be discussed further in the methodology chapter (Chapter 6).

4.5 Chapter Summary

This chapter provided the final element of the literature review of this thesis, linking the concept of CSR and CSRep to financial performance. The chapter shows that studies of Islamic Banks, particularly in Malaysia, are limited and therefore there is a need to conduct further research in this area. This thesis contributes to this research, and the next chapter, Chapter 5 provides the conceptual framework employed, followed by the methodology used in Chapter 6.

Chapter 5: Theoretical/Conceptual Framework

5.1 Introduction

This chapter provides the conceptual framework which will be employed in this thesis. A conceptual framework provides the concepts from the literature used to establish evidence to support the need for the research question.

In exploratory research a conceptual framework is defined as providing “loosely defined descriptive categories”, whereas in explanatory research it is the development of “formal hypotheses” (Shields, 1998, p.203). This thesis is predominantly exploratory as it is one of few studies in the area and explores the nature of CSR and CSRep by Islamic banks. Thus, the conceptual framework presented here expounds the concepts that are used to develop a framework upon which the analysis of CSRep will be based.

The thesis also has an explanatory aspect, and therefore the hypothesis development is provided in Chapter 6.

5.2 The Core: Islamic Ethical Principles

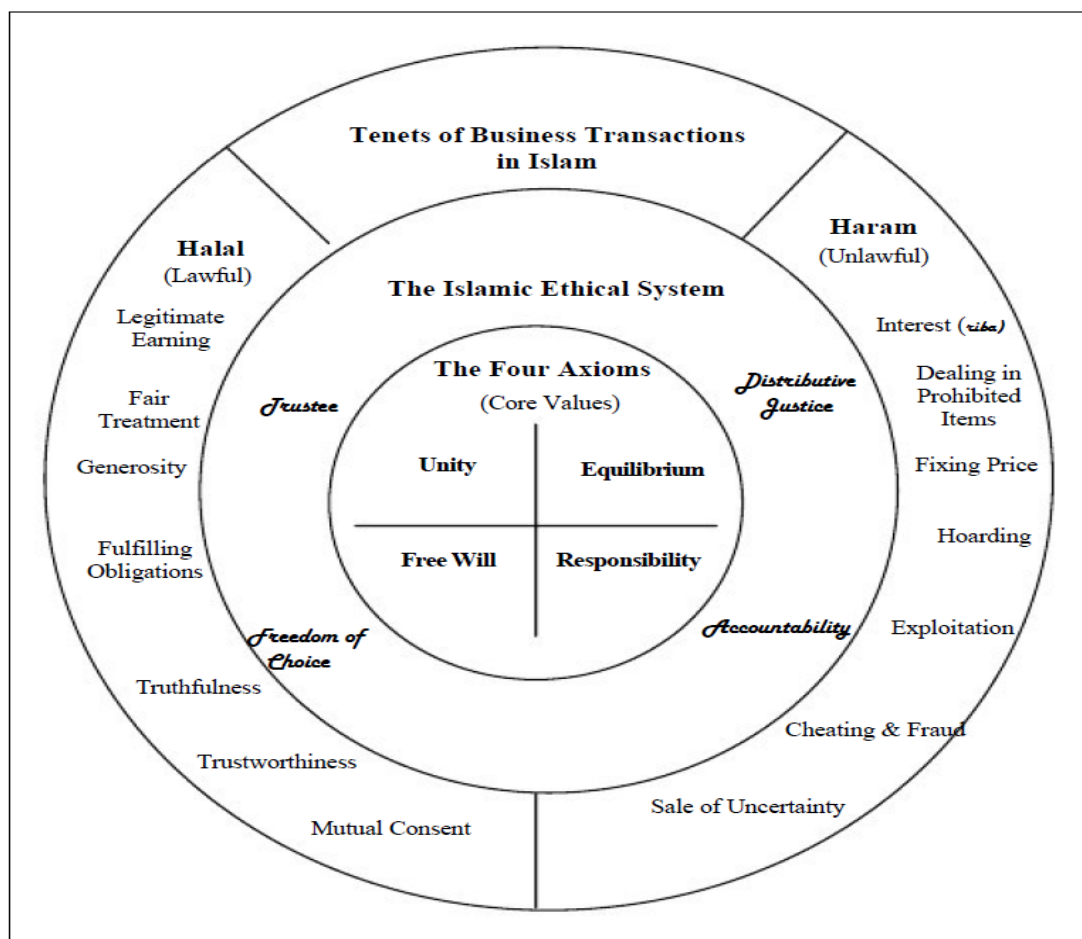
In Chapter 3, numerous Islamic ethical principles were introduced and discussed. The chapter explained that Unity (*Tawhid*) is the basis of Islamic teachings. In an Islamic business organisation²⁷, the main influence on corporate social reporting should be the fear of God, which is a religious reason that is closely related to the belief in the unity of God (*Tawhid*), and that is also the basis of other Islamic ethical principles and practices.

From several Islamic ethical principles that were discussed in Chapter 3, this study adopts the Islamic ethical principles which are used by Mohammed (2007) as the core of the conceptual framework. The reason for choosing Mohammed’s (2007) Islamic ethical principles is because Mohammed (2007) tested the application of

²⁷ An Islamic business organisation is an organisation that runs its business in accordance with Islamic law.

these ethical principles with respect to the CSR of Islamic banks, which is the sample used in the current study. As demonstrated in Figure 5-1, Mohammed (2007) proposed a conceptual framework of CSR in Islam, whereby the core of the framework is the four Islamic ethical principles that comprise Unity (*Tawhid*), Equilibrium (*Al-Adl*), Free Will (*Ikhtiyar*) and Responsibility (*Fardh*).

Figure 5-1: The Conceptual Framework of Corporate Social Responsibility in Islam



Source: Mohammed (2007)

Mohammed's (2007) framework provides the core of the conceptual framework used for this study (Section 5-9). However, while Mohammed (2007) emphasises the application of Islamic principles in business practices which represent CSR practices, he does not include corporate social reporting (CSRep) which is essential to display the existence of Islamic ethical systems in the business operations and also to discharge the social responsibilities in a way that is promoted by Islam.

Mohammed's (2007) framework is systematic in explaining the CSR practices for Islamic business organisations but the omission of CSRep does not allow for society to assess the social performance of business. This study draws upon and expands Mohammed's (2007) framework to provide a more holistic one that includes CSRep. Therefore the principles and concepts that he includes will be discussed later in this chapter when the comprehensive framework is presented.

From the reviewed studies in Chapter 3, it can be seen that Islamic ethical principles are closely related to Muslims' obligations toward God, human beings and the environment. In the current study, these three obligations will be included in the framework of Islamic CSRep. This is because society needs to assess the extent of the application of Islamic ethical principles in business practices especially in dealing with the relationships or obligations that are stipulated in *Tawhid*, i.e. relationships with Allah, human beings and the environment. The next section explains each of the relationships or obligations that Muslims should observe.

5.3 Relationships and Obligation in Islam

The relationships or obligations in Islam around the life of Muslims must be dealt with according to the Islamic ethical principles. As outlined in the previous chapter, according to Muwazir and Muhamad (2006), *Tawhid* encompasses three relationships or obligations in Islam i.e. man and Allah, man and human beings, and man and environment. Man in this context refers to a person of either sex, male or female. Muwazir and Muhamad (2006) offer an Islamic corporate social disclosure model based on the paradigm of *Tawhid* which emphasises these three interrelated relationships, and these are briefly described below.

5.3.1 Man and Allah

The relationship of man with Allah involves a sense of love and obedience, complete trust and thoughtfulness, peace and appreciation, steadfastness and active service. Allah is Almighty who knows everything that is hidden or unhidden by human beings. Therefore, it creates the fear of God among Muslims that makes

them aware of every action, as actions are closely being watched and recorded in God's book of judgment (Muwazir and Muhamad, 2006).

The relationship of man and Allah is free from any intermediaries and is explained clearly in the *Quran*:

“He knows what is in the heavens and on earth; and He knows what ye conceal and what ye reveal: yea, Allah knows well the (secrets) of (all) hearts.” (Al-Quran 64:4)²⁸

Therefore, Muslims are aware that *Allah* SWT is always watching, thus they have to ensure that they observe the *Shariah* requirements in all aspects of their life.

5.3.2 Man and Human Beings

The relationship between man and other human beings should be based on trust, truthfulness, fairness, respect of law, kindness and tolerance. Every Muslim should always be socially conscious by being generous to dependents and fulfilling their legitimate needs. In term of business organisations, management should respect the right of all parties involved such as shareholders, employees, and suppliers. Muslim action towards others must be in a form of *amal salih* (good deeds) which is the key to the attainment of *al-falah* (Muwazir and Muhamad, 2006).

5.3.3 Man and Environment

Islam asserts that God has created this world and other creations for humans' life. However, humans are warned not to do mischief in this world. From an Islamic perspective, the deployment and utilization of natural resources for business purposes should ensure that no damage is done to the environment. As a vicegerent of Allah, a Muslim businessman is expected to preserve and protect their natural environment (Muwazir and Muhamad, 2006). *Allah* SWT says:

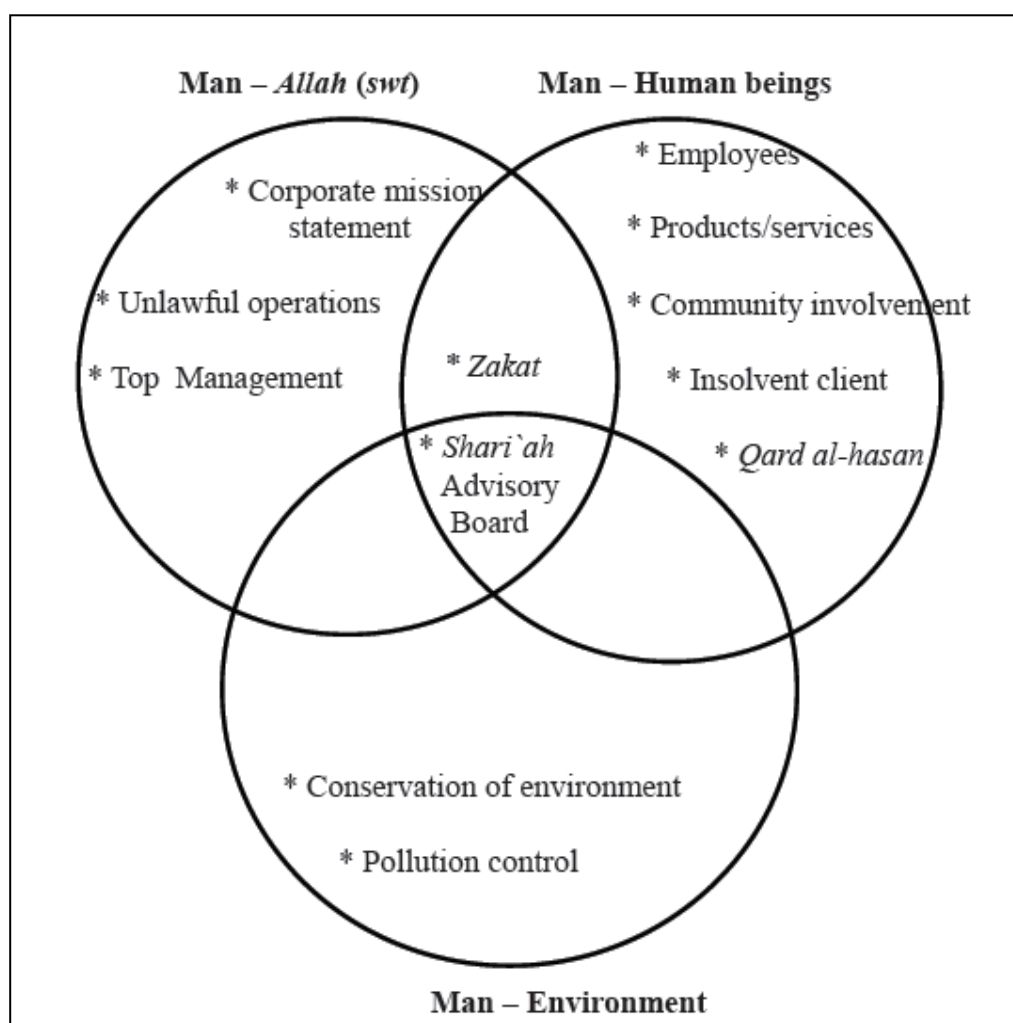
“And remember how We made you inheritors after the `Ad people and gave you habitations in the land: ye build for yourselves palaces and castles in (open) plains, and carve out homes in the mountains: so bring to remembrance the benefits (ye

²⁸ Surah At-Tagabun: Verse 4

have received) from Allah, and refrain from evil and mischief on the earth.” (Qur’an, 7:74)

The Muwazir and Muhamad (2006) Islamic corporate social disclosure model based on those three interrelated relationships, which initiate and shape a broader view of CSRep among Islamic business organisations, is shown in Figure 5-2.

Figure 5-2: Islamic Corporate Social Disclosure Model based on Tawhidic Paradigm



Source: Muwazir and Muhamad (2006)

Based on Muwazir and Muhamad’s (2006) model, disclosures relating to the Corporate mission statement, Unlawful operations and Top management are

categorized under the Man-Allah relationship. This is because the mission statement must be aligned with the concept of accountability to *Allah* SWT and thus, should lead Islamic banks in the right direction. For Unlawful operations, Islamic banks should not be involved in any operation that violates Islamic *Shariah* principles. Thus, Islamic banks are required to disclose truthfully the details of their operations by properly describing what are *halal*, and what are *haram*. Top management as leaders/managers are accountable to *Allah* in the hereafter, therefore they are responsible to carry out the *amanah* entrusted to them.

Employees, Products/services, Community involvement, Insolvent clients and Qard *al-Hassan* are categorized under the Man-Human Beings relationship. Islam strongly emphasises social justice in dealing with employees, who should be treated as human beings (i.e. as assistants) and not merely as machines and tools. Products/services must not be harmful to human beings or not have bad consequences in this world and the hereafter. For Community involvement, Islamic banks are expected to contribute towards the betterment of the well-being of the society in which they operate and generate money. In case of Insolvent clients, Muslims are bound by brotherhood/sisterhood and should be considerate (*ihsan*) to other fellow brothers/sisters who are having financial difficulties. Thus, Islamic banks are expected to be lenient to debtors who face difficulties in paying their debts. Qard *al-Hassan* is provided to the individuals for socially beneficial purposes, thus it expresses the spirit of cooperation and brotherhood/sisterhood between debtors and creditors (Muwazir and Muhamad, 2006).

Disclosure relating to the environment is categorized under the Man-Environment relationship because Islamic banks are expected to preserve and not destruct the environment. *Zakat* is in between the Man-Allah and the Man-Human beings relationships. This is because *Zakat* is compulsory and purification for Muslims, and also has a sense of spiritual fulfilment. *Zakat* is also a tool designed to contribute a portion of wealth for use by other human beings, especially the poor and needy. The *Shariah* Supervisory Board (SSB) is in the middle of the three interrelated relationships because the SSB is responsible to monitor the Islamic banks' operations, ensuring that they are in compliance with *Shariah* principles that are

stipulated by the will of Allah. The SSB is also responsible for issuing a report to certify the *Shariah* compliance of the Islamic banks to their stakeholders, and that includes the environment.

This model in Figure 5-2 is based on the Tawhidic paradigm. As *Tawhid* (unity of God) is the foundation principle, the other Islamic principles that flow after *Tawhid* are also essential for managing the three relationships in Islam. However, their model does not highlight how the other Islamic ethical principles can contribute and strengthen corporate social disclosure of an Islamic business organisation. Thus, this study attempts to address the ethical foundational issues in Islam, using other scholars' work to further develop a conceptual framework of CSRep in Islam.

According to Harahap (2003), accounting is a part of *Tawhid* process. Haniffa and Hudaib (2001) argue that the objectives of Islamic accounting are: "to assist in achieving socio-economic justice (Al-falah) and recognise the fulfillment of obligation to God, society (including environment) and individuals concerned, by parties involved in the economic activities viz. accountants, auditors, managers, owner, government, etc., as a form of worship" (cited in Harahap, 2003, p. 77). Thus, the next section will discuss an accounting and reporting framework developed by Maali et al. (2006), which is based on a social relations system. As will be seen in Section 5.10 these concepts of relationships and obligations are incorporated into the final conceptual model used in this thesis.

5.4 Social Relations System in Islam

In managing the relationships with Allah, human beings and the environment according to the Islamic ethical principles, there needs to be a mechanism or a system to achieve success in those relationships. As shown in Figure 5-3 below, Maali et al. (2006) consider a social relations system which is also an appropriate framework to describe the context of social reporting by Islamic business organisations. The system includes the concepts of accountability, social justice and ownership-trust.

5.4.1 Accountability

Each individual Muslim holds a divine accountability to God as well as to community for all his or her daily activities (Lewis, 2006). As such accountability is vital to each Muslim's belief (Lewis, 2006). It is a responsibility of every Muslim to fulfil the duties and obligations as described in the Holy *Quran*. Each Muslim is obliged to fulfill the duties and obligations to Allah, to society, and to oneself as well as being accountable to Allah for what they have been entrusted with on the Day of Judgment (Haniffa and Hudaib, 2004). Allah entrusted this world, and all resources available on it, to human beings, therefore individuals must utilize this trust given by Allah according to *Shariah*. Every Muslim has an 'account' (*Hisab*) with Allah where all actions and inactions, good and bad are recorded in the account book of deeds and will be recorded until death (Lewis, 2006). The accounts of all people will be showed and scaled by Allah on the Day of Judgment. Therefore, all the individuals' performance in the present world will determine their success or failure in Hereafter (Lewis, 2006). Allah says in the Holy *Quran*:

"If Allah so willed, He could make you all one people: But He leaves straying whom He pleases, and He guides whom He pleases: but ye shall certainly be called to account for all your actions." (Al-Quran 16:93)²⁹

"We shall set up scales of justice for the Day of Judgment, so that not a soul will be dealt with unjustly in the least, and if there be (no more than) the weight of a mustard seed, We will bring it (to account): and enough are We to take account." (Al-Quran 21:47)³⁰

In a broader sense for economic and social purposes, 'account' (*Hisab*) in Islam also applies to a business enterprise whereby every action of both the management and capital providers are accountable. This is accountability to the community or society at large. According to Lewis (2001) and Lewis (2006), the accountability

²⁹ *Surah An-Nahl: Verse 93*

³⁰ *Surah Al-Anbiya': Verse 47*

concepts in Islam include full disclosure, record keeping, materiality, reliability, transparency and, assets and liabilities, as described in Table 5-1.

Table 5-1: Summary of accountability from an Islamic perspective

| Islamic Source | Related Accountability Concept |
|--|---------------------------------------|
| <p>“Now hast thou brought the truth.” (Al-Quran 2:71) “O ye who believe! Stand out firmly for justice, as witnesses to Allah, even as against yourselves, or your parents, or your kin, and whether it be (against) rich or poor: for Allah can best protect both. Follow not the lusts (of your hearts), lest ye swerve, and if ye distort (justice) or decline to do justice, verily Allah is well-acquainted with all that ye do.” (Al-Quran 4:135)</p> | <p>Full disclosure</p> |
| <p>“O ye who believe! When ye deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing Let a scribe write down faithfully as between the parties: let not the scribe refuse to write: as Allah Has taught him, so let him write. Let him who incurs the liability dictate, but let him fear His Lord Allah, and not diminish aught of what he owes... Disdain not to reduce to writing (your contract) for a future period, whether it be small or big: it is just in the sight of Allah, More suitable as evidence, and more convenient to prevent doubts among yourselves but if it be a transaction which ye carry out on the spot among yourselves, there is no blame on you if ye reduce it not to writing. But take witness whenever ye make a commercial contract; and let neither scribe nor witness suffer harm. If ye do (such harm), it would be wickedness in you. So fear Allah; For it is Good that teaches you. And Allah is well acquainted with all things. If ye are on a journey, and cannot find a scribe, a pledge with possession (may serve the purpose). And if one of you deposits a thing on trust with another, let the trustee (faithfully) discharge his trust, and let him Fear his Lord conceal not evidence; for whoever conceals it, – his heart is tainted with sin. And Allah knoweth all that ye do.” (Al-Quran 2:282)</p> | <p>Record keeping Materiality</p> |
| <p>“Allah doth command you to render back your Trusts to those to whom they are due; And when ye judge between man and man, that ye judge with justice: Verily how excellent is the teaching which He giveth you! For Allah is He Who heareth and seeth all things.” (Al-Quran 4:58)</p> | <p>Reliability</p> |

Table 5-1 (continued)

| | |
|---|-------------------------------|
| <p>“O my people! Give full measure and full weight in justice, and wrong not people in respect of their goods. And do not evil in the earth, causing corruption.” (Al-Quran 11:85)</p> | <p>Transparency</p> |
| <p>“But if you do (it) not, then be apprised of war from Allah and His Messenger; and if you repent, then you shall have your capital; neither shall you make (the debtor) suffer loss, nor shall you be made to suffer loss.” (Al-Quran 2:279)</p> | <p>Assets and liabilities</p> |

Source: (Lewis, 2001, Lewis, 2006)

Abdallah and Murtuza (2005) highlight the establishment of the *Hisba* institution which has a role to uphold and encourage accountability and also to eliminate economic exploitation. *Hisba* literally means “arithmetical problem”, “sum”, or “reward” (Abdallah and Murtuza, 2005). A *Hisba* institution can represent a core element of Islamic corporate governance (Lewis, 2006).

5.4.2 Social justice

Islam emphasises social justice and responsibility in all aspects of human life and society (Kamla and Rammal, 2010). As Muslims are bound by *Akhowa* (brotherhood/sisterhood), they have to look after and support each other in societies so that no individual will be treated unjustly (Maali et al., 2006). Muslims are prohibited to harm or prey on other people especially those who are weak, including any activity that leads to exploitation or injustice (Maali et al., 2006). If there is any Muslim whom is in difficulty or suffering injustice, it is a responsibility of other Muslims to help and release the individual from those troubles. As in a *hadith* mentioned by the Prophet Muhammad SAW:

“the Muslims in their mercy towards each other are like a body, if a single part of it complains the other parts would be affected” (Al-Bukhari).

Injustice and inequalities of wealth are strongly condemned in Islam. The Holy *Quran* clearly disapproves of the act of continual wealth distribution among the rich, where God says:

*“What Allah has bestowed on His Messenger (and taken away) from the people of the townships, - belongs to Allah,- to His Messenger and to kindred and orphans, the needy and the wayfarer; In order that it may not (merely) make a circuit between the wealthy among you. So take what the Messenger assigns to you, and deny yourselves that which he withholds from you. And fear Allah; for Allah is strict in Punishment.” (Al-Quran 59:7)*³¹

Islam strictly condemns any system in which the rich are cared for and the poor are left to suffer. As such, Muslims are encouraged in doing charity in order to eradicate poverty in the community. However, it is more meaningful if Muslims can give a hand to the needy and the poor in a way that guides them to become independent and self-supporting (Kamla and Rammal, 2010). As cited by Kamla and Rammal (2010), there is a related *hadith* where the Prophet Muhammad SAW gave a needy man an axe and asked him to cut wood rather than simply donate direct requirements to the man (Ahmed, 1991).

Islam also orders Muslims to treat all people with fairness and justice. God says in the Holy *Quran*:

*“Allah commands justice, the doing of good, and liberality to kith and kin, and He forbids all shameful deeds, and injustice and rebellion: He instructs you, that ye may receive admonition.” (Al-Quran 16:90)*³²

Social justice and equitable distribution of wealth are the core value in *Shariah* and thus the main role of the establishment of *Shariah* is achieving justice (Kamla and Rammal, 2010). The application and practices of *Shariah* are regarded as

³¹ *Surah Al-Hashr: Verse 7*

³² *Surah An-Nahl: Verse 90*

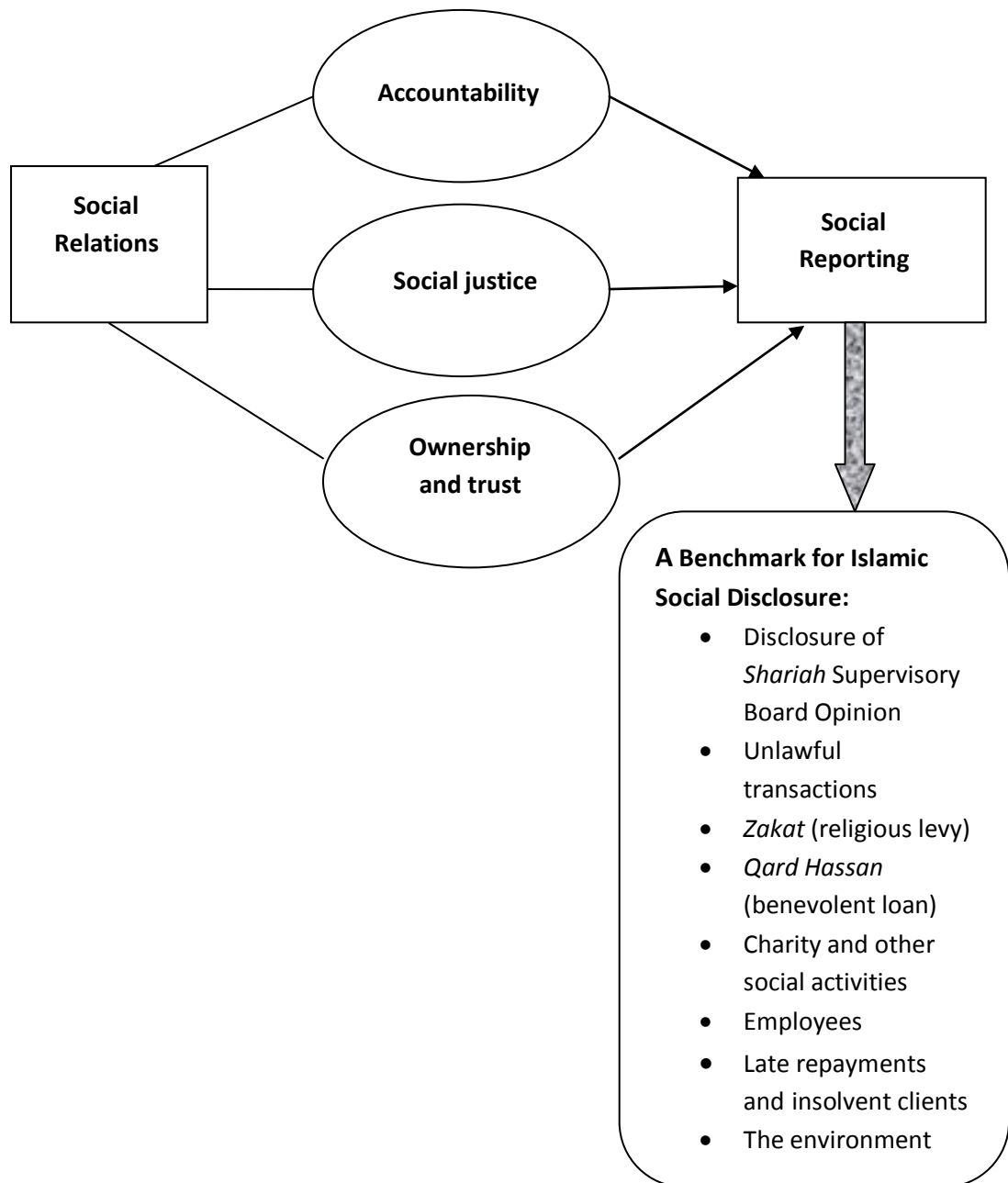
accomplished only if justice is attained (Kamla and Rammal, 2010). *Shariah* promotes social justice and welfare in society for the sake of God in order to seek God's blessings with the aim achieving success (*falah*) in this world and ultimate success in the Hereafter (Hassan and Harahap, 2010). As such, businesses in Islam are required to include justice in all dealings with employees, customers, suppliers, competitors and the community in which the businesses operate (Maali et al., 2006)

Shariah provides several tools for Muslims to ensure social justice, equitable power and wealth distribution can be achieved. The social justice and wealth redistribution tools are through the prohibition of *Riba* (usury), the requirement to pay *Zakat* (religious levy) and the provision of *Qard Hassan* (benevolent loans).

5.4.3 Ownership and trust

The concept of ownership and private property in Islam has different interpretations compared to that in the West (Sulaiman and Willett, 2003). For Muslims, ownership of wealth is not absolute. Individuals are only trustees; with the ultimate ownership of property belonging with God. God has appointed humanity as his vicegerent on earth and has entrusted humanity with stewardship of God's possession (Lewis, 2001). A person holds a delegated right of ownership and hence wields a limited authority over wealth in his or her possession (Ahmad, 1979). "The trustee-ownership principle implies that ownership should be exercised for the benefit of society as well as for the benefit of the owner" (Maali et al., 2006, p.272).

Figure 5-3: Social Relations Framework



Source: Maali et al. (2006)

From the understanding of a social relations framework, i.e accountability, social justice and ownership, Maali et al. (2006) develop a benchmark of corporate social disclosure for businesses which assert to operate in accordance with *Shariah* that encompasses the disclosure of *Shariah* Supervisory Board (SSB) opinion, unlawful

transactions, *Zakat* (religious levy), *Qard Hassan* (benevolent loan), charity and other social activities, employees, late repayments and insolvent clients, the environment, and other community involvement aspects (Figure 5-3).

Maali et al.'s (2006) framework emphasises the Islamic CSRep which is omitted in Mohammed's (2007) study. Some of the elements in Maali et al.'s (2006) social relations framework are similar to the elements of an Islamic ethical system proposed by Mohammed (2007) such as social justice, accountability and trust, however Mohammed's discussion is directed mainly towards CSR practices. Maali et al.'s (2006) framework however discusses social reporting as a medium to demonstrate social relations promoted by Islam, but it lacks clarity or content which directly encompasses the relationships described by Muwazir and Muhamad (2006). Thus, this study endeavors to enhance the social relations system developed by Maali et al. (2006), with the elements of Trustee-Ownership, Accountability, Social Justice and Freedom of Choice discussed in Chapter 3, that stem from the substance of Islamic ethical principles and relationships.

5.5 Expectations/Applications in Corporate Social Reporting of the Islamic Ethical Principles

As stated previously, the Unity of God (*Tawhid*) principle is the foundation principle and the other principles of Equilibrium, Free Will and Responsibility flow after *Tawhid*. As these three principles originate from the principle of Unity (*Tawhid*), it means they are commensurate with each other. Thus the Islamic principles should not be considered as discrete principles. Since the Islamic principles have been developed from a religious foundation, they provide complementary and overlapping perspectives in the expectation or application of corporate social reporting practices. The following sub-sections explain the expectations and application of each Islamic ethical principle in CSRep, by providing the inter-relationships between Islamic principles, relationships and obligations, and social relations system.

5.5.1 Expectations and Application of Reporting of the Unity (*Tawhid*) Principle

Tawhid is the foundation in Islam which contains the declaration of God monotheism through the statement of ‘there is no God but God’. It is a foundation belief in Islam about the unity of God as the Creator and it is from this belief that every other Islamic principles flows.

To recap, the principle of unity encompasses the basis for relations with God and all that exists regardless of humankind and other creations, which teaches humans to always take actions in a courteous and caring manner. According to the unity principle, Allah SWT owns all resources on this world and appoints human beings to be His vicegerent (*khalifah*). Humankind must utilize the resources granted upon them in accordance with *Shariah* and do so equitably. As trustee of Allah’s SWT resources on earth, human kind is expected to be trustworthy, not hoard wealth greedily, and be non-discriminatory. This is in line with the spirit of the ownership and trust of the social relations system. In fact, the concept of Trustee-Ownership is derived from the principle of Unity (*Tawhid*). Mankind should always realise that Allah entrusts them to manage the resources of this world. Therefore, as described in Table 5-2, it is expected that truthfulness and trustworthiness, not greedy wealth hoarding and no discrimination in any form, is applied in business practices. These practices are consistent with the purpose of the creation of mankind.

This is especially true for Islamic business organisations which should realise the divine mandate given by God and trust by the stakeholders to run the business operations. As such, corporate social reporting is appropriate to continuously gain trust from the stakeholders, and ultimately the trust from Allah SWT.

Therefore, we would expect to see the disclosure by Islamic organisations of, for example, *Shariah* Supervisory Board, information on products and services, and about employees. The disclosure of information on the *Shariah* Supervisory Board and disclosure of products and services would exhibit the organisation’s truthfulness in providing products and services that are *Shariah*-compliant together with its assurance. The practice of no wealth hoarding can be seen through the disclosure of products and services, whereby the policy and terms of the products

and services should be appropriately disclosed. This includes the disclosure of dealing with clients and customer service, to ensure that the organisation does not practice discrimination. Exploitation and discrimination are not acceptable in Islam, so through the disclosure of information about employees, especially related to wages and bonuses, education and training for employees, equal opportunities, working environment and policies relating to religious matters such as prayer time and place, it would help users in assessing whether the organisation acts justly and has no discrimination in its dealings with its employees.

In general, the disclosure of *Shariah* Supervisory Board information, disclosure of products and services and employees-related disclosure would enable society to assess the extent that the Islamic business organisations are practicing the principle of Unity.

5.5.2 Expectations and Application of Reporting of the Equilibrium Principle

Equilibrium is a principle that indicates a balanced sense in all aspects of human life. All creation in this world has an order and a purpose and is created in a state of dynamic balance. Allah SWT has provided humankind with the capacity to reason, so that we can maintain equilibrium in order to produce the best social order. Humankind as the vicegerent of Allah on this world is expected to maintain the equilibrium in society through social responsibility and justice.

The Equilibrium principle is mainly related to the relationship between man and human beings. Man or organisation is required to maintain equilibrium in all aspects, including socio-economic aspects in society, thus ensuring a harmonious society. Equitable distribution of wealth is an important aspect to achieve a balance in society, which ultimately would lead to social justice. As such, the Equilibrium principle derives the concept of Social Justice in the social relations system.

Therefore as denoted in Table 5-2, an Islamic organisation especially an Islamic bank, is expected to apply the practice of profit and loss sharing as well as benevolent loans in the business operations. Islam encourages the circulation of wealth through trade and prohibits interest or usury (*riba*). The Islamic business

organisation is encouraged to expand their capital through trade instead of expanding capital through lending on interest. Lending on interest is harmful to society because the lender who is likely to be wealthy lends money to the poorer borrower without the fear of loss, thus this brings a greater gap between the rich and the poor in society. The benevolent loan is essential for Islamic banks to distribute their profit to wider society. The Islamic bank which has extra profits in reserve can disburse the money as a benevolent loan. The benevolent loan can benefit society as well as foster equitable distribution of wealth.

Thus, the disclosure of social information related to equilibrium and social justice is important to denote an Islamic business organisation is socially just. We would expect that Islamic business organisations such Islamic banks would disclose information related to business and social savings and investments, *Zakat* and *Qard Hassan* (benevolent loan). The disclosure of business and social savings and investments indicates that Islamic banks practice the principle of equilibrium or distributive justice through profit and loss sharing on investments, especially related to socially motivated investments and projects, venture capital (*Mudharabah*), pawn-broking and micro-financing. The disclosure of information on these financing facilities will show strong commitment by Islamic banks towards social dimensions, and that they give priority to projects and investments which emphasise social contributions and stimulate equality and social justice in society. This is also similar to the disclosure of *Qard Hassan* (benevolent loan) which shows the bank's commitment to a social dimension that includes the disadvantaged segments in society. The disclosure of *Zakat* is important because it is a useful tool to ensure equality in distribution of wealth. *Zakat* is a religious levy which is compulsory for the rich to pay a considerable portion of wealth and then redistribute among the poor. The *Zakat* disclosure is also important for users to know whether the Islamic banks pay *Zakat* on business income and also *Zakat* on behalf of the shareholders and depositors.

5.5.3 Expectations and Application of Reporting of the Free Will Principle

The Free Will principle is the freedom to choose. Freedom of Choice in the social relations system is derived from the principle of Free Will. Mankind is given freedom from Allah to choose the way to manage the resources on this world. However, the freedom must be used in accordance with *Shariah* in order to gain blessing from Allah SWT.

The Free Will principle is related to the primeval nature of creation. This states that every man or woman has a state of intrinsic goodness and the conscious expression of this rests with humankind. Therefore, Muslim are expected to contribute to society, fulfill all obligation pertaining to their social responsibility and care for the less fortunate. As such, the free will principle closely explains how to manage the relationship of man with human beings and nature.

Therefore, Islamic business organisations are expected to disclose information on charity and other social activities, other community involvement aspects, late repayments/Insolvent clients, and conservation of the environment. The activities such as charities (*saddaqa*) and trusts (*waqf*) can fulfill the needs of the *ummah* or public at large. Thus, it is important for Islamic business organisations to disclose their role in enhancing economic development and addressing social problems, for example, housing, literacy, scholarships, etc., of the societies in which they operate (Maali et al., 2006). Islamic business organisations are also prohibited to be involved in any activity that might destroy or harm the environment. As such, information related to the use of resources and programs undertaken to protect the environment should be disclosed.

5.5.4 Expectations and Application of Reporting of the Responsibility Principle

The Responsibility principle establishes the tripartite relationship between God, humankind and the nature. According to Al-Quran, Allah SWT created everything for humankind and appointed us to be His vicegerent on this world. This role is one of trusteeship, which imposes a moral responsibility. This assumption of responsibility makes humankind accountable for their actions. Thus the

Responsibility principle derives the concept of Accountability in the social relations system.

The accountability of an individual Muslim or Islamic organisation can be divided into different dimensions when it refers to the relationships or obligations in Islam. The obligation of man to God is described as the vertical dimension of accountability. The obligation of man to society in regards to human beings or the environment, is considered as the horizontal dimension of accountability (Sobhani et al., 2010).

According to Ishaque (1978), the concept of accountability in Islam comprises the fundamental principles of full disclosure and social accountability, in which the latter is in fact a subset of the former (as cited by Sobhani et al., 2010). Social accountability means a Muslim and Islamic organisation is accountable to demonstrate social responsibility and promote social justice, and thus is expected to discharge their accountability through full disclosure. As such, it is difficult for a business organisation to be accountable if there is no disclosure or reporting.

In adherence to the Responsibility principle, Islamic business organisations are expected to demonstrate accountability, make management decisions based on *Shariah* and fulfill their responsibility as an organisation towards society. As such, we expect Islamic business organisations to disclose any unlawful transactions because accountability means to be faithful in every action. Management is accountable to ensure that the organisation operates in accordance with *Shariah* principles from top to bottom in the hierarchy. Management also needs to ascertain that the organisation is achieving both goals of commercial success and fulfillment of social responsibility. Therefore, we would also expect to see the disclosure of top management and corporate mission statements.

A summary of the expectations/applications in CSRep of the Islamic Ethical Principles can be found in Table 5-2.

Table 5-2: Summary of Fundamental Islamic Ethical Principles that Constitute the Framework of Corporate Social Reporting in Islam

| *Islamic Ethical Principles | *Proposition | *Key Features (Expectation/ Application in Business Practice) | Expectation in Corporate Social Reporting Practices | Issues Considered |
|------------------------------------|---|---|--|---|
| Unity | There is only one God – Allah (SWT) and everything in the earth belongs to Him. Man is considered as vicegerent of Allah (SWT) on earth and thus trustee of Allah’s (SWT) resources | Trustworthiness Avoid hoarding wealth avariciously Avoid discrimination | Disclosure of <i>Shariah</i> Supervisory Board | <ul style="list-style-type: none"> • Report of <i>Shariah</i> supervisory board opinion • Details regarding the members of <i>Shariah</i> supervisory board |
| | | | Disclosure of Products/services | <ul style="list-style-type: none"> • Statement of products/services approved by <i>Shariah</i> supervisory board • Statement about the details of products/services produced by the bank and their side effects • Statement indicating banks’ policy on marketing is in compliance with Islamic ethical values |
| | | | Disclosure of Employees | <ul style="list-style-type: none"> • Policies for wages and bonuses payment, education and training for employees, equal opportunities, and the working environment |

Table 5-2 (continued)

| *Islamic Ethical Principles | *Proposition | *Key Features (Expectation/ Application in Business Practice) | Expectation in Corporate Social Reporting Practices | Issues Considered |
|-----------------------------|---|---|---|---|
| Equilibrium | Various elements of life must be equilibrated to produce the best social order, which is a conglomeration of natural and social forces creating social harmony | Profit and loss sharing | Disclosure of <i>Zakat</i> | <ul style="list-style-type: none"> • Statement of sources and uses of <i>Zakat</i> • Balance of the <i>Zakat</i> fund, and reasons for non-distribution • <i>Shariah</i> supervisory board affirmation regarding the computation and distribution of the zakat funds |
| | | Benevolent loan | | Disclosure of <i>Qard al-Hassan</i> |
| Free will | As a trustee of Allah's (SWT) resources on earth, mankind has been given the free will to steer his/her own life. Unlike other creatures in Allah's (SWT) universe, humans can choose their behavior to either ethical or unethical | Contribution to the well-being of society | Disclosure of charity and other social activities | <ul style="list-style-type: none"> • Nature and the amount spent on charitable donations • Sources of funds used for charity |
| | | Fulfilling obligations to society | Disclosure of other community involvement aspects | <ul style="list-style-type: none"> • The role of banks in enhancing economic development and addressing social problems |
| | | Care for the less fortunate/downtrodden in society | Disclosure of late repayments/Insolvent clients | <ul style="list-style-type: none"> • Policy in dealing with late payments by clients and insolvent clients • <i>Shariah</i> supervisory board opinion regarding the permissibility of penalty charges on late payments |
| | | | Disclosure of conservation of environment | <ul style="list-style-type: none"> • Nature and amount of donations or activities for conserving the environment • Whether the bank has financed any projects that may directly or indirectly harm the environment |

Table 5-2 (continued)

| *Islamic Ethical Principles | *Proposition | *Key Features (Expectation/ Application in Business Practice) | Expectation in Corporate Social Reporting Practices | Issues Considered |
|-----------------------------|--|--|---|--|
| Responsibility | Every individual is accountable and ultimately responsible for his own actions | Accountability | Disclosure of corporate mission statement | <ul style="list-style-type: none"> Statement stating that the company's operations are based on <i>Shariah</i> principles and emphasising on the importance of earning halal (permissible) profit |
| | | Fulfilling the responsibility as an organisation towards society | Disclosure of unlawful transactions | <ul style="list-style-type: none"> Nature of the unlawful transactions Amount of revenue and expenses from the unlawful transactions Reasons for undertaking unlawful transactions How the banks disposed, or intend to dispose of revenues from unlawful transactions |
| | | | Disclosure of top management | <ul style="list-style-type: none"> Details of BOD members and management team Policy in appointing, re-appointment and dismissal of BOD/management team |

*adapted from Mohammed (2007)

5.6 The Model of Corporate Social Reporting in Islam

The preceding section has highlighted some expectations of CSRep practices and their related disclosure. These comprise the model of Islamic CSRep themes that should be disclosed by the Islamic banks, and used in the framework for the content analysis in this thesis. Each theme of each Islamic CSRep is summarized as follows:

Shariah supervisory board (SSB)

The main reason for having SSB is to ensure that Islamic banks conduct their business according to Islamic law and avoid transactions that contradict with *Shariah*. SSB³³ is an “in-house religious supervisor”. The appointed SSB members play an important role to serve as a check and balance and to provide assertion that the products and services produced by Islamic banks are *Shariah*-compliant.

Disclosure under SSB includes the report of SSB opinion, the details and background regarding the members of SSB including their remuneration, a statement certifying distribution of profits and losses are made according to *Shariah* law, statement of recommendations to rectify defects in products/services, and examination of documents.

Products/Services

The products or services offered by Islamic banks must not be harmful to society. Islamic banks should be transparent in disclosing products/services information. All information related to products/services which is relevant and useful should assist the users to assess the business operations and its responsibility towards society (Muwazir and Muhamad, 2006).

The Products/services theme concerns the qualitative aspects of the products/services, for example, product development, product and service quality, and marketing (Aribi and Gao, 2010). Islamic banks are expected to provide a

³³ An SSB is not same as the board of directors. The SSB supervises the activities of Islamic banks, reviews the contracts, provides an opinion about whether the agreements would be allowable under Islamic law, and thus certifies the Islamic banking product as being *Shariah*-compliant.

statement of products/services that are approved by the *Shariah* supervisory board, together with a description relating to the basis of *Shariah* concepts for each approved product/service. They should also provide a statement about the details of products/services produced by the bank and their side effects and also a statement that indicates banks' policy on marketing is in compliance with Islamic ethical values.

Employees

Islam emphasises social justice and fairness in dealing with employees. The Prophet Muhammad SAW said:

“Your employees are your brethren upon whom Allah (SWT) has given you authority. So if one has one’s brother under his control, one should feed him with the like of what one eats and clothe him with the like of what one wears. You should not overburden him with what he cannot bear, and if you do so, help him in his job.” Sahih Muslim Vol. 3, Hadith No.4093.

“Allah (SWT) says: “I will be an opponent to three persons on the Day of Judgement: One who makes a covenant in My Name, but he proves treacherous, One who sells a free person (as slave) and eats the price, and one who employs a labourer and gets the full work done by him but does not pay him wages”

Sahih al-Bukhari Vol. 3: Hadith No. 2.

The welfare and betterment of employees should be taken care of. Thus, Islamic business organisations should provide adequate training, maintain equipment in good working condition, maintain a safe working environment, provide protection in health and safety, treat employees fairly in terms of wages, working hours etc., promote equal opportunities, and invest in education and training (Aribi and Gao, 2010). Thus, they should disclose the policies for wages and bonuses, education and training for employees, equal opportunities, and the working environment.

Zakat (religious levy)

Zakat is an obligation of a Muslim to Allah, and also to society and the state. It is to purify the individual soul and also the wealth. It is unlike taxes³⁴ because it has a spiritual sense (Muwazir and Muhamad, 2006, Othman, 2013). *Zakat* is the most important tool to redistribute wealth to society. In countries where *Zakat* is not collected by the state, Islamic banks have the role of collecting the *Zakat* funds (as *Zakat* Collection Center) and they distribute them to the poor directly or through other religious institutions (Lewis, 2001). Islamic banks should also pay *Zakat* on their own business.

For disclosure of *Zakat*, Islamic banks should provide a statement of sources and uses of *Zakat*. Islamic banks should also disclose the balance of the *Zakat* fund, and reasons for non-distribution, including an affirmation by the *Shariah* supervisory board regarding the computation and distribution of the *zakat* funds.

Qard Hassan (benevolent loan)

Qard Hassan literally means good/benevolent loan. In Islam, *Qard Hasan* is really encouraged because the Quran mentioned that it is a good and beautiful loan to Allah Himself.

“Who is he that will loan to Allah a beautiful loan, which Allah will double unto his credit and multiply many times? It is Allah that giveth (you) Want or plenty, and to Him shall be your return.” (AlQuran 2:245)

Abu Amama said that the Prophet [pbuh] said: "In the night of the journey, I saw on the gate of heaven written, 'reward for sadqah (charity) is ten times and reward for qard hasan is eighteen times'. So, I asked the angel, how is it possible? The angel replied, "Because a beggar who asked might have already had something but a loanee did not ask for loan unless he was in need." [Ibn Majah & Ibn Hisham]

³⁴ *Zakat* is an obligation to Allah (it is compulsory in the Islamic religion) while tax is an obligation to the federal government or state. In Malaysia, *Zakat* is not made compulsory by the government but the government promotes *Zakat* by giving an income tax rebate and deduction to Muslim individuals and companies that paid *Zakat* (Othman, 2013).

Qard Hassan is a non-interest bearing loan. *Qard Hassan* is considered as one of the social contributions of Islamic banks toward society. Islamic banks are expected to show a statement of sources and uses of the *Qard* funds. They should also disclose the policies for providing *Qard* loans and for dealing with insolvent beneficiaries

Charity

Islam encourages Muslims to do charity (*saddaqa*). It is mentioned in the Holy Quran:

“And fear Allah (SWT) as much as you can, listen and obey; and spend in charity for the benefit of your own souls. And those saved from the covetousness of their own souls; they are the ones who achieve prosperity.” (Al-Quran 64:16)

Islamic banks should support charities. They should provide the nature and the amount spent on charitable donations, including the sources of funds used for charity.

Other community involvement aspects

Islamic banks should extend their charity, by being involved in community projects. The Prophet Muhammad SAW said:

“Every Muslim must pay sadaqah (charity). The companion asked, “What about someone who has nothing to give?” The Prophet replied, “Then let him do something with his two hands and benefit himself. That will be charity.” The companion asked, “But what if he cannot do that?” The Prophet replied, “Then he can help someone who is needy.” Again they asked, “But what if he cannot do that?” The Prophet replied, “Then he should enjoin the doing of good.” Still again they asked, “But what if he cannot do that?” The Prophet replied, “Then he should give respite from evil, for that is a form of charity.” Al-Bukhari’s Adabul Mufrad, Hadith No. 225

Thus, Islamic banks are expected to help with solving social problems, support community projects, participate in the management of public affairs, and play a

role in society that goes beyond profit maximization. In terms of disclosure, Islamic banks should report on their role in enhancing economic development and addressing social problems such as education and housing.

Late repayments and insolvent clients

According to *Shariah*, if a client is defaulting on payment due to poverty, then he must be given respite until he is in a position to pay (Maali et al., 2006). Allah SWT says:

“If the debtor is in a difficulty, grant him time till it is easy for him to repay. But if ye remit it by way of charity, that is best for you, if ye only knew”. (Al-Quran 2:280)

However, if the debtor is defaulting without any valid excuse (as is the general case), then the solution is not in charging him an extra amount as a penalty, as this will constitute *Riba*. Late payment fees, such a late charge, would be a form of interest. In Islamic Law, a debt that is owed by someone can neither be postponed for a higher amount nor penalized with a fee.

Therefore, Islamic banks should provide the details of their policy in dealing with late payments by clients and insolvent clients, including a statement of *Shariah* supervisory board opinion regarding the penalty charges on late payments.

The environment

In Islam, natural resources should not be abused, misused, destroyed and polluted, and these entire misdemeanours are against the divine arrangement.

“And when he goes away, he strives throughout the land to cause destruction therein and destroy crops and animals. And Allah (SWT) does not like mischievous act.” (Al-Quran, 2:205).

“And do no mischief on the earth, after it has been set in order, but call on Him with fear and aspiration. Indeed the mercy of Allah (SWT) is near to the doers of good.” (Al-Qu’an, 7:56).

Managers as the trustee of God's resources, should plan and have good pollution control, waste and recycling policy and energy conservation, and should not do things that harm the environment, but should undertake initiatives to promote environmental responsibility. For environmental disclosure, Islamic banks should disclose the nature and amount of donations or activities for conserving the environment, and should also report whether the bank has financed any projects that may directly or indirectly harm the environment.

Unlawful transactions

According to *Shariah*, unlawful transactions include transactions involving *riba*, *gharar* and *maysir* (Lewis, 2001). Islamic banks should not involve in any operation that violates Islamic *Shariah*. However, in some situations, Islamic banks may not be able to avoid such transactions, for example, an Islamic bank may have to deal in letter of credit transactions with a non-Islamic bank and the bank is required to pay interest on that transaction. According to Rosly (2005), Islamic banks are allowed to conduct unlawful transactions for certain limited situations, i.e. it must not be related to the core business of Islamic banks and it must be approved by the SSB. Islamic banks must also truthfully disclose the details of any unlawful transaction activities undertaken.

Therefore, Islamic banks should provide the nature of the unlawful transactions including the amount of revenue and expenses from these transactions, including the reasons for undertaking such transactions and how the banks disposed, or intend to dispose of, revenues from unlawful transactions (Maali et al., 2006).

Corporate mission statement

From an Islamic perspective, the mission statement must be aligned with the concept of accountability to *Allah (swt)* and thus, should lead Islamic banks in the right direction. Islamic banks should provide a statement stating that the company's operations are based on *Shariah* principles and emphasising the importance of earning *halal* (permissible) profit (Muwazir and Muhamad, 2006)

Top management

In an Islamic business context, leaders/managers must possess certain qualities to enable them to carry out duties as a 'trustee' of Allah SWT. Leaders/managers not only have to enforce *Shariah* but also are obliged to fulfill the expectation of the Muslim *ummah*. They are responsible to carry out the trust entrusted to them, and thus are required to manage the business operations in an effective and efficient manner.

Therefore, Islamic banks should provide the details of board of directors (BOD) and management team regarding their qualifications and remuneration, including the policy on appointment, re-appointment and dismissal of the BOD/management team.

These expectations regarding the disclosure of CSR information have been shown to come from various stakeholders. Organisations in an Islamic country, and in particular Islamic banks, may face specific pressure from their Muslim stakeholders, therefore this is an important element to include in a framework for CSRep in an Islamic context. Thus, discussion regarding Muslim stakeholders is presented in the next section.

5.7 Social Pressure

According to Hassan (2010) in his study of determinants of corporate social disclosure at the country level, social pressure is influenced by the economic level of the country and culture. An advanced economic level and the culture, including religion, shapes the perceptions of society and can increase society's attention towards social and environmental matters, which then in turn creates the social pressure on corporations regarding their social responsibility. Social pressure may influence the level of social disclosure in the country (Hassan, 2010). However, Hassan's (2010) study at the company level shows that the degree of social

pressure faced by a company depends on the industry and size of the company. As such, industry and size are usually used as proxy measures of social pressure (Patten, 1991). According to van Staden and Chen (2010), higher pressure from the stakeholders leads to higher disclosure quality.

In this study, social pressure is included in the framework as it is expected that Islamic business organisations face social pressure for corporate social disclosure, especially from Muslim stakeholders. The Islamic banking industry is expected to face greater social pressure as the Islamic financial institution plays dual roles, i.e. a social role and financial role. In their social role, Islamic banks take responsibility for complying with Islamic ways in its operations, thus setting an example for people in the community, who watch their activities. The banks, in their operations and activities, affect the perceptions and behaviour of individuals and businesses within the community, and thus accept the responsibility for social contribution and involvement in the community. In their financial role, the banks' control of large funds and revenues helps them in undertaking their social role.

The increasing awareness of powerful stakeholders on corporate social responsibility among Islamic financial institutions (IFIs) should help to coerce the IFIs to disclose their social responsibility policy and information. For example, major stakeholders of Islamic banks in Malaysia are comprised of institutions such as the Pilgrimage Fund Institution, Islamic state authorities, Islamic charity bodies, and so on. Therefore, management perceives that some external pressures are imposed upon them by particular stakeholder groups, and such pressures in turn impact their social reporting behaviours.

Even if Islamic financial institutions embrace the core values of Islamic ethical systems, the social pressure is necessary to ensure that Islamic banks continuously operate according to *Shariah*, and through corporate social reporting society can assess the extent of *Shariah* compliance and social responsibility being applied in the banks' operations. Social pressure is like a 'push' and a reminder to the corporations to always embrace the concept of social responsibility and be accountable to report all corporate information, both economic and non-economic,

as society can only know and understand the social aspects of operations and activities of banks through corporate social reporting. As Allah created and called human beings '*insan*'³⁵, which is an Arabic word derived from the word '*nasiya*' that literally means 'to forget', it is said to be human nature to always forget and make mistakes³⁶. Since Muslims are bound together by brotherhoods/sisterhoods, it is the responsibility of the Muslim community (*ummah*) to remind each other so that wrongdoers are aware of their mistakes and repent quickly and not dwell further on the wrongdoings.

Social pressure is, as such, a reminder from the *ummah* to the corporations to ensure the organisations do not dwell on capitalism that is obsessed with materialism and profit maximization. Social pressure is also a reminder to the management of corporations that they are trustees who are entrusted by God to run the corporation according to *Shariah*, and thus ensure all income generated from their operations are from *halal* sources and they will be able to be distributed to the community for socio-economic justice purposes. The *Haram* source of income is strictly condemned by the Prophet Muhammad SAW as he said in a *hadith*:

"There is no benefit for flesh that grew from Haram sources, except that Hell is a better place for that flesh."

Thus, social pressure is a call from the *ummah* to the corporations to enjoin what is right and forbid what is wrong.

Stakeholder pressure represents an external influence on the disclosure practices of Islamic business organisations; however, it is difficult to consider a holistic model for Islamic CSR without also considering the performance of the organisations under study. As such, the current study attempts to analyse the relationship

³⁵ Refer to *Al-Quran* 96:2 (*Surah Al-'Alaq*: Verse 2)

³⁶ Source: <http://www.bbc.co.uk/dna/h2g2/A4114009>

between CSRep and financial performance, so the next section highlights this final element be incorporated into the conceptual framework of this thesis.

5.8 Financial Performance or Economic Consequences

As presented in Chapter 4, a number of studies in the Western literature have paid attention to the link between CSR and economic and financial performance. It is likely that social and environmental activities, including social disclosure, can have relatively important financial consequences and may be influenced by the performance of the firm. Most of the Western studies focus on profitability (Allouche and Laroche, 2006) as the economic system based on capitalism emphasises profit maximization among producers and utility maximization among consumers to achieve an equilibrium price between supply and demand. This equilibrium price system however frustrates the realisation of socio-economic objectives which are supposed to be the aim of the Islamic business organisations' establishment.

Since little is known about the link between CSR and financial consequences in Islamic business organisations, financial performance is incorporated in the Islamic CSRep framework to examine the economic efficiency of profit and revenue maximization and also cost minimisation and whether it has a relationship with CSRep. Profitability is unarguably essential for the survival of Islamic banks and for competing with conventional banks. It is undeniable that pursuit of profits is part of human nature; however Islamic business organisation should also believe that profit is not the sole motive when doing business. The Islamic business organisations at the same time have roles in redistribution of income and poverty eradication. Therefore, it is appropriate to incorporate socio-economic accounting performance into the framework and to study its relationship with CSRep.

In summary, the current literature does not provide an integrated framework which could provide a complete picture of Islamic corporate social reporting and its context. Thus, this study attempts to propose an integrated and comprehensive

framework for corporate social reporting from an Islamic perspective, which incorporates the competing influences of Islamic values, expectations of reporting and performance, stakeholder pressures, and profit motives.

5.9 Incorporating CSR Theories in the context of Islam

In the Chapter 2, the literature has shown that CSR has become a significant part of modern business in a globalized economy, regardless whether it is advanced economy or an emerging economy, which certainly includes Malaysia and other Islamic countries. Frederick's (1986) notion of 'corporate social rectitude' (CSR3) considers social and ethical decisions to be expected in business activities, which is indeed aligned with an Islamic perspective. Chapter 2 also discusses some criticisms of Western CSR theories that mainly depend on human ethical and moral reasoning, are secular, have a materialistic approach, are relative and are always changing. These weaknesses in the Western CSR theories it is believed can be overcome if incorporated with spiritual or religious thought, regardless of any specific belief or religion. This study thus incorporates some conventional CSR theories an Islamic explanation in its conceptual model.

Particularly, this study discusses in the view of social contract theory and stakeholder theory. Incorporating social contract theory and stakeholder theory in the context of Islam, can overcome the weaknesses mentioned earlier as Islam offers holistic approach which is more enduring, eternal and absolute (Ahmad and Sadeq, 2002).

For Islamic business organizations, disclosing the Islamic CSR items is part of the *Uqud* (contracts) in Islam. The concept of *Uqud* is similar to Social contract theory, however, Islam stresses a comprehensive understanding of the various contractual relationships in human life and the fulfilment of obligations includes both explicit contracts and tacit contracts. In Islam, the faithful execution of all obligations of contracts, especially tacit contracts, is recognised as *ibadah* (worship Allah) (Haniffa and Hudaib, 2004). Through this social contract, an Islamic business organization is required to run their operations in socially responsible ways and ways implicitly

anticipated by society (Muslim stakeholders), but with enforcement mechanisms as Muslim and God's trustee to apply all Islamic ethical principles in all aspects of business operations.

The objective of Islamic accounting is to help Muslim stakeholders to obtain information that can help them to assess whether firms' actions comply with *Shariah*, achieve socio-economic justice and recognize the fulfilment of obligations, therefore Islamic banks should be responsible to Muslim stakeholders by analysing their information needs and managing their demands. In the relationship between an Islamic business organization and its stakeholders, any conflicting demands of stakeholders are able to be dealt and balanced by the Islamic ethical principles because each key ethical issue faced by multiple stakeholders can be prioritized using the Islamic approaches of justice, trust and benevolence (Beekun and Badawi, 2005). The Islamic ethical system seeks to respect the rights of stakeholders regardless whether they are from primary or secondary stakeholder groups. Islam promotes a multi-fiduciary stakeholder approach that regulates what various stakeholders of a business receive in accordance with their inputs. All Muslims must always remember his/her role as God's trustee on earth, and as such the responsibility of each stakeholder is heavily based on trust, equity, balance and benevolence.

5.10 Summary of the Conceptual Framework

The discussion in the previous sections attempts to explain how the conceptual framework of the current study is built. Figure 5.4 depicts the proposed conceptual framework for CSRep in Islam that is investigated in this study, encompassing the six elements outlined above. The model illustrates the complexities of studying CSR and CSRep in an Islamic context, and indicates the various relationships and expectations that form the basis of the methods chosen in Chapter 6 and the analysis presented in Chapters 7 and 8.

The circles provide the context for the analysis presented in Chapter 7. The inner circle of the diagram represents the core of the framework which is the Islamic

ethical system, that includes the principles of Unity (*Tawhid*), Equilibrium, Free Will and Responsibility. These four principles are adopted from the study of Mohammed (2007) who asserts that these principles constitute the systematic framework of corporate social responsibility in Islam. Thus, the Islamic socio-economic system is underpinned by these Islamic ethical principles. Unity (*Tawhid*) principle is particularly highlighted because it is an essential principle that derives other Islamic principles.

The second circle shows the relationships or obligations in Islam around the life of Muslims that must be dealt with according to Islamic ethical principles. These relationships or obligations in Islam are adopted from the study of Muwazir and Muhamad (2006) who propose an Islamic corporate disclosure model according to *Tawhid* which encompasses these three relationships or obligations. It is important to understand these relationships, as they held to define the characteristics of the expected CSR activities and disclosure.

The third circle is closely related to the relationships and obligations, and depicts the elements of the Islamic social relations system which stem from those relationships; Accountability, Social Justice and, Ownership and Trust, which are mainly adopted from the study of Maali et al. (2006). The element of Freedom of Choice as suggested by Mohammed (2007) is also included in the Islamic social relations system because it evolves from the Islamic ethical principle of Free Will which signifies that man has freedom to manage the resources on this world, even though the ultimate owner is God and man is merely a trustee.

The outer circle describes the disclosure items of corporate social reporting from an Islamic perspective which are adopted from Maali et al. (2006) and Muwazir and Muhamad (2006) and are used to prepare the framework for analysis of reporting in this thesis.

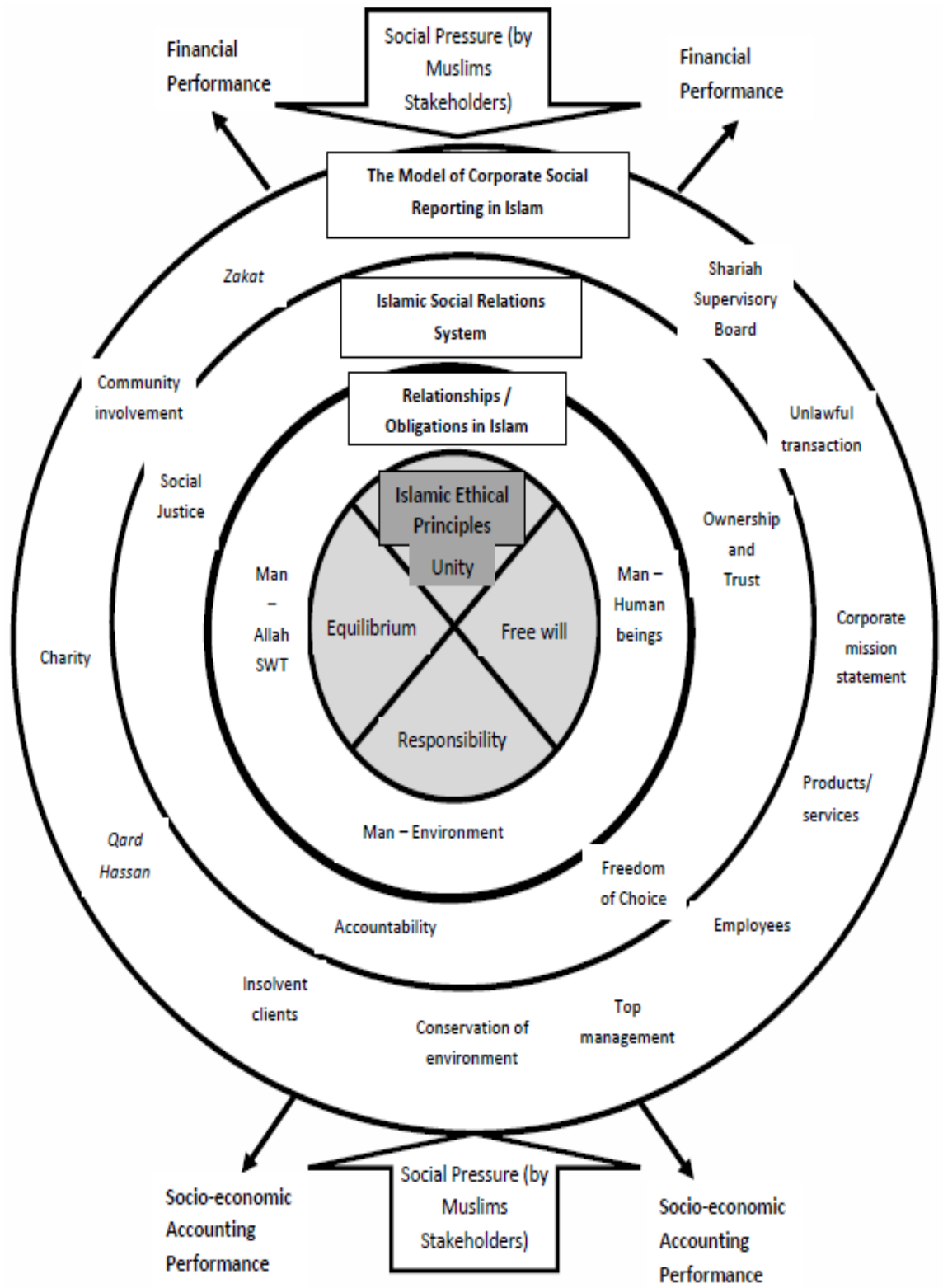
The arrows at the top and bottom of the model represent the relationships that are tested in Chapter 8. The arrows pointing inwards to the model, show the social pressure for corporate social disclosure which is expected to be faced by Islamic business organisations, especially from Muslim stakeholders. The arrows pointing

outwards at the top of the model show the possible link between CSR and traditional financial performance in Islamic business organisations, in terms of the economic efficiency of profit, revenue and cost maximisation, and their relationship with CSRep. The arrows pointing outwards at the bottom of the model represent the possible relationship between CSRep and socio-economic accounting performance of Islamic business organisations.

The proposed conceptual framework for CSRep from an Islamic perspective is presented in Figure 5-4.

Figure 5-4: Diagram of the Conceptual Framework of Corporate Social Reporting in Islam

(adopted and modified from (Mohammed, 2007, Maali et al., 2006, Muwazir and Muhamad, 2006)



Generally, this conceptual framework depicts the religious determinants that are the foundation of Islamic ethically-based CSRep and its link to socio-economic and financial performance. This framework provides the context in which this study is situated, and indicates where various concepts and constructs that are examined and tested in this study are located. As noted above, it provides a useful heuristic for interpretation of the results of the analysis presented in Chapters 7 and 8.

5.11 Chapter Summary

With the development of a model for CSR and CSRep, this chapter has defined the significant concepts used in this thesis, and provided the foundation of the framework for analysis of the reporting by Islamic banks in Malaysia.

The conceptual model described here is built based on the CSR literature and used as a basis for examining CSR reporting by Malaysian Islamic banks. The reporting framework for Islamic banking, AAOIFI, outlined in Chapter 3, is also used to analyse the reporting and a comparison undertaken.

The next chapter presents the methodology employed and the methods used to investigate the research questions, including hypothesis development and analysis techniques.

Chapter 6: Research Methodology

6.1 Introduction

This chapter outlines the methodology employed in this research. The chapter proceeds as follows: Section 6.2 explains the research design to answer the research questions of the study, while Section 6.3 discusses the sample selection. Sections 6.4 and 6.5 explain the content analysis and the pre-testing of the content analysis instruments. Sections 6.6 and 6.7 describe the qualitative analysis and the regression analysis, respectively. Lastly, Section 6.8 summarizes the chapter.

6.2 Research Design

Research must be designed according to the purpose of the study being conducted. The purpose of studies may be either exploratory or descriptive, or may be explanatory via hypothesis testing (Sekaran and Bougie, 2010). An exploratory study is carried out to explore a new area of organisational research when few studies might have been conducted in the area. In exploratory studies, some facts are already identified but in order to build a feasible conceptual framework, detailed information is required. Qualitative data which are obtained through observation and interviews are common in exploratory studies (Sekaran and Bougie, 2010). A descriptive study is undertaken to describe the characteristics of the phenomenon of interest in a certain situation. Quantitative studies which collect data such as frequencies, means and standard deviations, are descriptive in nature (Sekaran and Bougie, 2010). Whereas hypothesis testing studies examine the nature of relationships, or differences among groups, or the independence of variables in a situation (Sekaran and Bougie, 2010).

This study explores the extent and nature of CSRep of Islamic banks to determine whether Islamic principles that are claimed to be applied in Islamic banks are reflected in their CSRep. The examination of the extent and nature of CSRep of Islamic banks in Malaysia would also determine the quantity and quality of their reporting. Thus, this study is exploratory in nature, whereby the data are obtained

and analysed through content analysis, qualitative analysis and case studies. Some descriptive data are also collected.

This study explores the extent and nature of CSRep of Islamic banks before and after the issuance of AAOIFI standards, thus the data are collected at two different time points. Therefore, the study is longitudinal as it is carried out across a period of time.

This is also a study of the relationships between CSRep and financial performance of Islamic banks in Malaysia. Thus, hypothesis tests are conducted to explain the correlation between CSRep and financial performance in Malaysian Islamic banks, and to test whether potential causal relationships can be inferred. A regression analysis is employed to test these relationships.

6.3 Sample Selection

The population sampled is Islamic banks operating in Malaysia. There are 17 Islamic banks in Malaysia in total and 11 of them are local-controlled institutions with the remaining six being foreign-controlled institutions. Of the 11 local-controlled banks, two are Islamic banks which were established as fully-fledged Islamic banks from the beginning, namely Bank Islam Malaysia Berhad (BIMB) and Bank Muamalat Malaysia Berhad. Of the six foreign-controlled banks, two are international Islamic banks namely, Al-Rajhi Banking and Investment (Malaysia) Berhad and Kuwait Finance House (Malaysia) Berhad. The remaining Islamic banks are subsidiaries of conventional banks controlled by local and foreign institutions, which previously began their Islamic financial product businesses as Islamic banking windows of conventional banks, later converting to fully-fledged Islamic banking operations. All 17 Islamic banks in Malaysia comprise the sample for this study as shown in Table 6-1.

The data required for corporate social reporting practices are obtained through the examination of annual reports and CSR reports of the Malaysian Islamic banks from 2007-2011.

The sample for analysis can be classified into two groups;

- (1) The annual reports for 2007-2009, to obtain the data on CSRep before the introduction of AAOIFI standards on CSR at the end of 2009 (Pre-Standards).
- (2) The annual reports for 2010-2011, to obtain CSRep data after the issuance of AAOIFI standards on CSR (Post-Standards).

Table 6-1: List of Islamic banks in Malaysia

| No. | Islamic Banks | Ownership |
|-----|---|-----------|
| 1 | Affin Islamic Bank Berhad | L |
| 2 | Al Rajhi Banking & Investment Corporation (Malaysia) Berhad | F |
| 3 | Alliance Islamic Bank Berhad | L |
| 4 | AmIslamic Bank Berhad | L |
| 5 | Asian Finance Bank Berhad | F |
| 6 | Bank Islam Malaysia Berhad | L |
| 7 | Bank Muamalat Malaysia Berhad | L |
| 8 | CIMB Islamic Bank Berhad | L |
| 9 | EONCAP Islamic Bank Berhad | L |
| 10 | Hong Leong Islamic Bank Berhad | L |
| 11 | HSBC Amanah Malaysia Berhad | F |
| 12 | Kuwait Finance House (Malaysia) Berhad | F |
| 13 | Maybank Islamic Berhad | L |
| 14 | OCBC Al-Amin Bank Berhad | F |
| 15 | Public Islamic Bank Berhad | L |
| 16 | RHB Islamic Bank Berhad | L |
| 17 | Standard Chartered Saadiq Berhad | F |

Local (L), Foreign (F), Source: (BNM, 2011)

6.4 Content Analysis

Content analysis is used to measure the corporate social reporting of Islamic banks in this study. This method has been widely employed in the social disclosure literature (for example, Maali et al., 2006, Gray et al., 1987, Kuasirikun and Sherer, 2004). In a content analysis study, qualitative data are collected but the data are

analysed both qualitatively (developing categories or themes) and quantitatively (counting words or other unit of analysis) (Creswell and Clark, 2007).

Content analysis is a research methodology that codifies text into a smaller number of categories depending upon selected criteria, in order to draw valid deductions from the text (Weber, 1988). According to Holsti (1969), the characteristics of objectivity, systematic and generality are essential conditions for content analysis. *Objectivity* in the research process ensures that different coders would arrive at similar conclusions by applying explicitly formulated procedures. *Systematic* means “... that the inclusion and exclusion of content or categories is done according to consistently applied rules” (Holsti, 1969, p. 4). This ensures that text is coded and matched with some general standards of category development (Holsti, 1969). Lastly, *generality* means “... that the findings must have theoretical relevance” (Holsti, 1969, p. 5). Generality ensures the current findings are comparable with the findings and data from other documents or sources. In this thesis, pre-testing was conducted on the content analysis instruments to ensure the objectivity and systematic characteristics. The category development of the content analysis instruments is based on the thesis’s theoretical framework and thus, meets the generality criterion.

Weber (1988) provides useful guidelines on how to develop and test a coding instrument. The following are eight essential steps of content analysis (Weber, 1988, p.22-24):

- (1) Define the unit of analysis (e.g. word, sentence, paragraph)
- (2) Define the categories (i.e. coding instruments)
- (3) Test coding of a sample of text
- (4) Assess reliability
- (5) Revise coding rules (e.g. create rules that are not vague)
- (6) Repeat steps 3–5 until reliability is satisfactory
- (7) Code all text
- (8) Assess achieved reliability

These steps were followed in this thesis as discussed in the following sections.

6.4.1 Unit of analysis

The unit of analysis is defined as "... the basic unit of text to be classified" (Weber, 1988, p.22) into each category. Weber (1988) suggests six common choices of unit of analysis which include word, word sense, sentence, theme, paragraph and whole text. The unit of analysis is used to quantify disclosures.

Previous studies of CSRep (for example, Hackston and Milne, 1996, Ng, 1985) have used number of words, number of sentences, number of documents, proportion of a page, proportion of total disclosure and number of pages to measure the amount of CSR disclosure.

Milne and Adler (1999) recommend that number of sentences is the most reliable unit of analysis for coding the disclosure. As the issue of coding errors are dealt with through inter-rater reliability as well as counting errors, it is likely that number of sentences is an appropriate indicator for both coding and counting the disclosure amount (Milne and Adler, 1999). Milne and Adler (1999) add that sentences as a unit of analysis for both coding and counting can also offer comprehensive and meaningful data for further investigation. Some other justifications for using sentences as the basis to code and count the disclosures are as following; (i) sentences provide more accuracy than words (Hackston and Milne, 1996), (ii) sentences express a complete meaning but separating the sentences into the individual words is problematic in meaning (Hackston and Milne, 1996), and (iii) sentences may be used with less use of judgment (Unerman, 2000).

A number of arguments and justifications for each unit of analysis have been presented. For example, using page proportions as an indicator of CSRep quantity might not be accurate when the disclosures have different font sizes, graphics and margins (Hackston and Milne, 1996). The problem of number of pages arises when there are variations in page sizes between one annual report and another (Hackston and Milne, 1996). Number of sentences may overlook some relevant graphs and tables (Al-Tuwaijri et al., 2004). Unerman (2000) added the problem of sentences that "using sentences as the unit of measurement seems to ignore the possibility that differences in use of grammar might result in two different writers

conveying the same message by using a similar number of words and taking up a similar amount of space but using a different number of sentences” (p.675).

According to Unerman (2000), any content analysis study which uses measurement that captures words or sentences and numbers only and ignores graphics, may lead to results that fail to measure representation of the specialized area of CSR as a whole in many reports. Wilmshurst and Frost (2000) describe graphics as worth a thousand words. Any CSR disclosures in the form of photographs, charts or graphs are more powerful and more effective tools of communication (Unerman, 2000). Some stakeholders do not read every narrative disclosure in the annual report and only flick through it, quickly looking at the graphics (Unerman, 2000). However, to include graphics in the measurement involves a high level of subjectivity (Wilmshurst and Frost, 2000).

However, other studies have shown that various disclosure measures are highly correlated (e.g., Deegan and Rankin, 1996, Hackston and Milne, 1996). Hackston and Milne (1996) found a significant high correlation between the page proportions, number of pages and number of sentences. Haniffa and Cooke (2005) found high correlation between number of sentences and number of words, hence chose to report only word counts. While Deegan and Rankin (1996) tested disclosure amount using page proportions, number of pages and number of words and found high correlation between these three measures, they decided to report only the number of words in their study. Panchapakesan and McKinnon (1992) report high correlation between number of words and graphics.

In general, number of words is highly correlated with page proportions, number of pages, number of sentences, and graphics. Therefore in this study, the number of words was chosen as an appropriate unit of analysis to measure the quantity of disclosure, although sentences are used to determine context for correct classification. According to Holsti (1969), number of words is the smallest unit that is employed in the content analysis research. However, this smallest unit of measurement can be powerful and robust especially for a study examining the volume of disclosure (Zeghal and Ahmed, 1990). Word count is also more practical

and easier for categorisation (Hackston and Milne, 1996). The use of word counts can avoid inconsistencies when calculating the quantity of disclosure (Zeghal and Ahmed, 1990) and disclosure volume can be sought in greater detail (Unerman, 2000) which is in line with the exploratory nature of this study. Other studies that used word counts include Deegan and Gordon (1996), Deegan and Rankin (1996), Haniffa and Cooke (2005), and Wilmshurst and Frost (2000).

This study does not include graphics as a unit of analysis. This is partly because of the high correlation between number of words and graphics (Panchapakesan and McKinnon, 1992), even though graphics are powerful communication tools. The current study only counts any captions or description of graphics such as photographs, charts or graphs as part of the number of words.

6.4.2 Instruments

In content analysis, a rigorous instrument is important in order to draw valid inferences from the text. According to Weber (1988), the instrument must make sure that the classification procedure is reliable and consistent among different coders, and must use valid variables that represent what it is intended to measure. In this study, two instruments were developed, one is based on categories used in prior studies, (henceforth called 'Framework'), and another one is based on AAOIFI standards (henceforth called 'standards'). The reasons for developing two instruments are as follows:

- The 'Framework' is to investigate the extent and quality of CSRep over the period, and to determine whether CSRep has increased over time. This is based on categories developed from prior literature and the theoretical framework. This investigates general CSRep based on accepted themes.
- The 'standards' is to determine whether there has been a change in CSRep since the introduction of the AAOIFI standards in 2009. In order to determine whether the standards have had any influence, the instrument is applied both before and after their introduction.

Table 6-2 provides a summary of categories used in prior studies that examine CSRep from an Islamic perspective.

Table 6-2: Islamic CSRep Categories Used in Previous Studies

| Study | Categories Used |
|-----------------------------|---|
| (Haniffa and Hudaib, 2004) | Mission statement and corporate objectives Top management <i>Shariah</i> Supervisory Board Audit Product Employees Community Islamic values |
| (Maali et al., 2006) | <i>Shariah</i> opinion Unlawful transactions <i>Zakat</i> (religious levy) Charitable activities Employees <i>Qard Hassan</i> (benevolent loan) Environment Insolvent clients Other aspects of community involvement |
| (Muwazir and Muhamad, 2006) | Corporate mission statement Top management Unlawful operations <i>Shariah</i> Advisory Board <i>Zakat</i> Employees Products and services Community involvement Insolvent client/debtors <i>Qard al-Hasan</i> funds The environment |
| (Haniffa and Hudaib, 2007) | Vision and mission statements BODs and top management Product and services <i>Zakat</i> , charity and benevolent loans Commitments toward employees Commitments toward debtors Commitments toward society <i>Shariah</i> Supervisory Board |

Table 6-2 (continued)

| | |
|----------------------------|---|
| (Hassan and Harahap, 2010) | Ethical behaviour, stakeholder engagement, and customer relations (EBSE&CR) Good governance Interest-free, lawful products, and services <i>Shariah</i> Supervisory Board Development and social goal Employees Environment Research and development |
|----------------------------|---|

As discussed above, the data for CSRep of Islamic banks was benchmarked against the content analysis instrument which was constructed based on the Framework of Islamic CSRep in Chapter 5, and that was developed from the previous studies and literature on CSRep from an Islamic perspective. The instrument for content analysis based on Islamic CSRep Framework contains 12 categories which are shown in Table 6-3.

Table 6-3: Content Analysis Instrument Categories Based on the Islamic Corporate Social Reporting Framework

| Categories | Description |
|---|--|
| 1) Disclosure of <i>Shariah</i> Supervisory Board (SSB) Opinion | Report of <i>Shariah</i> Supervisory Board Details regarding the qualifications of SSB members Details regarding the members of the SSB A statement on remuneration of the SSB members A statement certifying distribution of profits and losses are made according to <i>Shariah</i> law |
| 2) Unlawful transactions | A description of the nature of undertaking unlawful transactions Explanation on the reasons for undertaking such unlawful transactions The SSB's opinion about the necessity of these unlawful transactions The amount of revenue or expenses from the unlawful transactions How the bank disposed, or intends to dispose, of revenues from unlawful transactions Nature of unlawful transactions |

Table 6-3 (continued)

| | |
|---|--|
| <p>3) <i>Zakat</i></p> | <p>Statement of sources and uses of <i>Zakat</i> The balance of the <i>Zakat</i> fund not yet distributed, and reasons for non-distribution <i>Shariah</i> Supervisory Board attestation regarding the computation and distribution of the funds Statement showing the amount of <i>zakat</i> paid and its computation</p> |
| <p>4) <i>Qard Hassan</i></p> | <p>Sources of funds allocated to <i>Qard Hassan</i> The amounts given to beneficiaries The social purposes for which the funds were given The policy of the bank in providing such loans The policy of dealing with insolvent beneficiaries Statement on the policy for providing <i>Qard Hassan</i></p> |
| <p>5) Charity and Other Social Activities</p> | <p>The nature of charitable and social activities financed such as sadaqah and waqf (religious endowment) The amount spent on charitable and social activities The sources of funds used to finance charitable and social activities</p> |
| <p>6) Employees</p> | <p>The policy on wages and other remuneration (such as bonuses) The policy on education and training of employees The policy of equal opportunities towards women and minorities The policy on the employees' welfare such as religious provision, holidays and medical benefits The policy on working environment that are conducive to Islamic ethical values</p> |
| <p>7) Late Repayments and Insolvent Clients</p> | <p>The policy in dealing with insolvent clients The policy on late payments by clients The amount charged as late penalty, if any The SSB's opinion regarding the permissibility of imposing charges late payments</p> |
| <p>8) The Environment</p> | <p>The amount and nature of any donations or activities undertaken to protect the environment The projects financed by the bank that may lead to harming the environment The nature and amount spend on conservation of natural environment and wildlife A statement indicating that the company's operations are in compliance with environmental laws and regulation A statement describing employees training in relation to environmental issues</p> |
| <p>9) Other Community Involvement Aspects</p> | <p>The bank's role in economic development and participation in government social activities The bank's role in addressing social problems such as programs in helping to overcome poverty, illiteracy etc</p> |

Table 6-3 (Continued)

| | |
|---|--|
| 10) Products/Services | A statement stating all products/services are approved by SSB Description regarding the basis of <i>Shariah</i> concepts for each product/service A statement describing details of products/services produced by the company and their side effects/risks A statement indicating that the company's policy on marketing is in compliance with Islamic ethical values |
| 11) Disclosure of corporate mission statement | A statement stating that the company's operations are based on <i>Shariah</i> principle A statement stating that the main objective of the company is to achieve barakah (blessing) and al-falah (successful in the world and the hereafter) – emphasising on the importance of earning halal (permissible) profit |
| 12) Disclosure of information related to the top management | A detail of names and profile of BOD / management team Details regarding the qualifications of management team A statement on remuneration of management team A statement on policy in appointing, re-appointment and dismissal of BOD/management team |

Adopted from Maali et al. (2006) and Muwazir & Muhamad (2006)

The content analysis checklist which was constructed based on AAOIFI Standards on CSR (AAOIFI, 2010b) is depicted in Table 6-4. Based on the AAOIFI Standards, there are 11 CSRep categories.

Table 6-4 Content Analysis Instrument Categories Based on AAOIFI Standards on CSR

| Categories | Description |
|--|---|
| <i>Mandatory disclosure</i> | |
| 1) Disclosure of policy for screening clients | <ul style="list-style-type: none"> • The specific provisions of the screening policy including the benchmarks and/or criterion utilized to measure compliance with Islamic law • Whether these have been approved by the <i>Shariah</i> supervisory board |
| 2) Disclosure of policy for dealing with clients | <ul style="list-style-type: none"> • The defined procedure of the IFI on avoiding the imposition of onerous contractual terms on clients who are in a weaker bargaining position relative to the IFI • The provision ensuring that marketing campaigns and documents are ethically balanced • The obligation and rights of both parties • The due process and responsible terms and conditions under which credit is extended to clients, including the process by which the client's ability to repay and the effect on the client's financial and overall well-being is assessed • The remedies available in the event that one or both parties violate their contractual terms • The <i>Shariah</i> supervisory board's opinion on the permissibility of charging late payment charges • Late payment charges levied on clients • How the IFI allocates the late payment charges in its accounts (allocation to revenue or charity) • The conditions under which the IFI will defer collection of debt from insolvent clients |
| 3) Disclosure of earnings and expenditure prohibited by <i>Shariah</i> | <ul style="list-style-type: none"> • Aggregate descriptions, amounts, account classification (revenue, expense, liability or asset) and reasons for undertaking the types of transactions • The SSB's verdict on the necessity of these transactions • How the IFI intends to dispose of such amounts • The IFI's strategy to find viable permissible of halal alternatives, if any, for similar impermissible transactions in the future |
| 4) Disclosure of policy for employee welfare | <ul style="list-style-type: none"> • Provisions of the policy, including targeted disadvantaged groups • Quotas/targets and achievements for the year • Reasons for upward and downward revisions in quotas/target |

Table 6-4 (Continued)

| | |
|--|--|
| <p>5) Disclosure of policy for <i>Zakat</i></p> | <p>Refer Financial Accounting Standard No.9 on <i>Zakat</i></p> <ul style="list-style-type: none"> • Statements of the method used for determining the <i>Zakat</i> base and the items included in the base • Statements of the ruling of the <i>Shariah</i> Supervisory Board of the Islamic bank on the issues related to <i>Zakat</i> • Statements of whether or not the Islamic bank as a holding company pays its share of <i>Zakat</i> obligations in its subsidiaries • The amount of <i>Zakat</i> that is due from each share • The amount of <i>Zakat</i> that is due from equity of investment account holders • Statements of whether or not the Islamic bank collects and pays <i>Zakat</i> on behalf of holders of investment accounts and other accounts • Statements of the restriction imposed by the <i>Shariah</i> Supervisory Board of the Islamic bank in determining the <i>Zakat</i> base |
| <p style="text-align: center;">• <i>Voluntary disclosure</i></p> | |
| <p>6) Disclosure of policy for social, development and environment based investment quotas</p> | <ul style="list-style-type: none"> • The provisions of the policy • Classes of investments by ultimate purpose/beneficiary of investments (e.g. orphans, SME development, Islamic culture, reduction in tree logging, reduction in environmental greenhouse gases, increase in recycling, science and technology) • The profitability of such investments for the year • Quotas/targets and achievements for the year • Reasons for upward and downward revisions in quotas/target |
| <p>7) Disclosure of policy for par excellence customer service</p> | <ul style="list-style-type: none"> • Provision of the policy • Measures taken by management to develop customer service skills • Aggregate results of customer surveys demonstrating overall quality of customer service and areas of improvement |
| <p>8) Disclosure of policy for micro and small business and social savings and investments</p> | <ul style="list-style-type: none"> • Provisions of the policy • Features of the offer • Measures taken by management to implement the provisions of the policy • Quotas/targets and achievements for the year • Reasons for upward and downward revisions in quotas/target |

Table 6-4 (Continued)

| | |
|--|--|
| 9) Disclosure of policy for <i>Qard Hassan</i> | <ul style="list-style-type: none"> • Whether there is a formal scheme operated by the bank for depositors, shareholders and other parties to place their funds for the use of <i>Qard Hassan</i> borrowers • Provisions of the policy/scheme including conditions for those unable to repay the loans • Sources of funding for <i>Qard Hassan</i> loans • Aggregate purposes for which the <i>Qard Hassan</i> loans have been made • Quotas/targets to increase internal and external <i>Qard Hassan</i> funding and achievements for the year in this regard • Reasons for upward and downward revisions in quotas/target |
| 10) Disclosure of policy for charitable activities | <ul style="list-style-type: none"> • Provisions of the policy • Aggregate classes of charitable activities by ultimate beneficiary and amounts distributed to each aggregate class • Quotas/targets and achievements for the year • Reasons for upward and downward revisions in quotas/target |
| 11) Disclosure of policy for Waqf management | <ul style="list-style-type: none"> • Types of Waqf managed by the IFI • Financial and other services offered to the Awqaf³⁷ by the IFI |

Source: AAOIFI (2010b)

It can be seen in Table 6-4 that the AAOIFI Standard on CSR has both voluntary and mandatory components. These are indicated here for completeness and noted in the discussion of the results where appropriate, however, it is important to note that the standard is not compulsory in Malaysia therefore it could be argued that the entire standard is voluntary for Malaysian Islamic banks.

Both instruments are used to measure CSRep in terms of quantity and quality. The quantity of CSRep is measured by counting the number of words as discussed in Section 6.4.1, and the quality of CSRep is measured using a scoring system that is discussed in detail in the next section.

6.4.3 Measurement of CSRep Variables

In order to measure the quantity of disclosure, the number of words in each category is recorded and summed for each annual report analysed.

³⁷ *Awqaf* is plural form of *Waqf*

In order to determine the quality of the disclosure, CSR items were scored using an ordinal scale in accordance with the 0/1/2/3/4 system as defined by Guthrie and Farneti (2008). If the item is not disclosed, then it is scored as 0. If the item is disclosed in general declarative terms only, it scores 1. An item is assigned the score 2, if it is disclosed with specific information in monetary terms. If the item is in non-monetary terms, the score is 3. An item is scored 4, if it is disclosed in both monetary and non-monetary terms. For the purpose of analysis, the total scores within each Islamic CSRep category are considered. The CSRep measures are summarized in Table 6-5.

The scores for each disclosure item are then summed to obtain a total CSRep score for each category. The Appendix 2 shows the score range that is assigned for each disclosure item and the maximum score that can be obtained for each CSRep category.

Table 6-5: CSRep Quality Measures

| Score | Description |
|--------------|---|
| 0 | if the item is not disclosed |
| 1 | if the item is disclosed in general declarative terms only |
| 2 | if the item is disclosed with specific information in monetary terms |
| 3 | if the item is in non-monetary, but quantitative terms |
| 4 | if it is disclosed in both monetary and non-monetary quantitative terms |

A higher score for CSRep signifies high quality of disclosure. A disclosure is regarded being of high quality when the disclosure helps users to increase their understanding of the annual reports (Wallace et al., 1994). The information disclosed must be informative and useful to help users in decision making (Beattie et al., 2004). Al-Tuwaijri (2004) emphasises that compared to qualitative information, quantitative disclosures are more objective and informative to stakeholders.

Previous literature indicates that voluntary disclosure such as CSR shows less use of monetary values (Guthrie and Farneti, 2008). The lower use of monetary values may be due to administrative costs or it may be considered as sensitive information. Therefore quantitative terms especially monetary terms, are regarded as high quality and are recommended as a preferable type of disclosure (Wiseman, 1982). Hammond and Miles (2004) indicate that CSR disclosure that is "... quantitative and/or financial... and comprehensive with respect to coverage would be classified as of a higher quality than discursive, self-laudatory, selected disclosure" (p.75). The literature also confirms that corporations and quality assessors regard quantitative disclosure together with third party verification as the definition of quality CSR (Hammond and Miles, 2004).

6.4.4 Disclosure Media Analysed

As discussed earlier, this study analyses the CSRep of Islamic banks and utilizes two sources of reporting i.e. annual reports and stand-alone CSR reports.

Annual Reports

Annual reports are used in this study as the source of data for conducting the content analysis. A number of studies (Guthrie and Parker, 1990, Tilt, 1994, Hackston and Milne, 1996) consider that annual reports are appropriate sources for exploring CSR disclosures as they are a common medium used by companies to provide their social information to the public. Annual reports are also preferred in this study because they are easy to gain access to. In addition, annual reports are considered to be a medium with high credibility among stakeholders, especially pressure groups (Tilt, 1994).

Stand-alone CSR Reports

Stand-alone CSR reports are becoming more common and therefore are also included in this study, in particular, the case studies. Four banks in this study are identified as issuing stand-alone CSR reports, particularly the parent company of the Islamic banks. Malaysian listed companies have recently started to issue stand-alone CSR reports as encouraged by Bursa Malaysia, and this provides a

justification for these stand-alone CSR reports to be included in this study. However, caution is undertaken when examining the stand-alone CSR reports as they may contain repetitive social information as reported in annual reports.

6.5 Pre-testing

Each step in content analysis is subjected to pre-testing for inter-coder or inter-researcher agreement. In this study, two instruments are employed for analysis of the annual reports and stand-alone CSR reports. Through pre-testing, all instruments are tested for validity and reliability. Pre-testing is important because it can "... reveal ambiguities in the rules... (which) often leads to insights suggesting revisions of the classification scheme" (Weber, 1988, p.24). An independent coder was assigned for pre-testing the instruments and was required to do some simple data coding. The author and the independent coder discussed any uncertainty or grey areas in the coding. The independent coder also provided some suggestions or inputs on the classification made so that the instruments of this study could be improved. However, the independent coder was not engaged in the final conclusions of the instruments as all decisions were made by the author of this study.

The main objective of pre-testing is to examine the reliability of disclosure instruments and measurement to ensure its ability to represent various elements of Islamic social disclosure in the sample. The sample size for pre-testing can be 10% of the project sample size (Lackey et al., 1998). To achieve the objective of pre-testing, two Islamic banks were randomly selected which represent 12% of the sample. The annual reports for these Islamic banks in the years 2005 and 2006 (which are not in the final sample) were supplied to the author and another independent coder. In total, each coder was provided four annual reports for pre-testing. Only annual reports were used in the pre-testing as the purpose was the initial development of correct instrument categories, definitions and coding rules. The coding results were compared between coders and then the incongruities in the results were discussed to identify the reasons for these incongruities. From the

discussion, the instruments and the coding rules were revised accordingly, and a second round of coding then undertaken.

Each coder was given necessary instructions, keywords, instruments and coding rules. The coding rules for the present study are adapted from the original rules used by Hackston and Milne (1996, p.108) and Zeghal and Ahmed (1990). The general rules for coding are presented as following:

- All disclosures must be stated in specific, they cannot be implied.
- Repeated disclosure shall be counted every time it is appeared.
- Headings shall be counted.
- Any words from the whole sentences and logical parts of sentences shall be classified according to the disclosure categories (for example, the statement “RM10,000 was spent for project X”, is calculated as six words, monetary).
- A statement that is relevant to more than one disclosure category shall be classified to only one category.
- Only quantitative disclosure for the year under review shall be counted.
- Any caption to graphics, graphs and tables which provide information which is on the checklist instrument should be counted and classified accordingly.
- Any discussion of *zakat* in *Shariah* Supervisory Board report should be classified in the *zakat* category.
- Any discussion of non-performing loans, doubtful debts and bad debts should be classified as categories relating to clients, such as late repayment and insolvent clients, screening clients, and dealing with clients. However, discussions relating to accounting treatment for non-performing loans, doubtful debts and bad debts will not be counted as disclosure.

The coders code the presence of Islamic CSRep items in the reports, and then give a quality score to each item. The coders measure the quantity of CSR disclosure by calculating the number of words used. Each coder presents the number of words for each category of Islamic CSRep in a coding sheet.

6.5.1 Inter-coder reliability

By applying the previous general coding rules and instruments, the author noted some incongruities in the results with the independent coder. Each incongruity in the results between coders is highlighted in Appendix 3.

The incongruities in the coding of quality measurement were found to be due to; (i) lack of definition in the disclosure categories and sub-categories such as unlawful transactions, sources and uses of *zakat*, sources and beneficiaries of *Qard Hassan*, 'policy' term, charitable and social activities, wages and other remuneration, employees' welfare, and the basis of *Shariah* concepts for products/services; (ii) confusion and uncertainty regarding specific and implied statements, profit related to *zakat*, *zakat* provision, and other community involvement aspects; (iii) errors in the score provision for a few items in the instrument checklists; (iv) mistakes by either coder or either coder omits some items in the instrument checklist. The incongruities in the coding of quantity measurement were mainly caused by; (i) similar lack of definition in the disclosure categories and subcategories; (ii) differences in the keywords used by the coders; (iii) differences in coding quality disclosures; (iv) inclusion of year and currency; and (v) inclusion of pictures.

After identifying and discussing the reasons for the incongruities, the author undertook the following revisions to the coding rules and instructions:

- Defining unlawful transactions in the coding rules
- Training to differentiate specific statement and implied statement
- The disclosure of profit before *zakat* and profit after *zakat* will not be counted
- Defining the sources of *zakat* and uses of *zakat*
- *Zakat* provision is considered as part of amount *zakat* paid
- Defining sources of *Qard Hassan* fund and beneficiaries of *Qard Hassan*
- Defining the 'policy' term in the instrument checklists
- Defining charitable and social activities
- Defining wages and other remuneration

- Defining employees' welfare
- Defining the basis of *Shariah* concepts for products/services
- The subcategory of 'policy in dealing with insolvent clients' is combined with the subcategory of 'policy on late payments by clients'
- The category title of 'Other Community Involvement Aspects' is changed to 'Community Involvement Aspects that Generate Profit'
- The subcategory of 'a statement stating all products/services are approved by SSB' is changed to 'a statement stating all products/services are in accordance with *Shariah* principles'
- Correcting errors in the score provision for a few items in the instrument checklists
- Finalizing the keywords that should be used by both coders
- Pictures are excluded

Therefore, the coding rules were restructured as presented below:

- All disclosures must be stated in specific terms, they cannot be implied.
- Repeated disclosure shall be counted every time it appears.
- Headings shall be counted.
- Any words from the whole sentences and logical parts of sentences shall be classified according to the disclosure categories (for example, the statement "RM10,000 was spent for project X", is calculated as six words, monetary).
- Only quantitative disclosure for the year under review shall be counted.
- Any caption to graphics, graphs and tables which provide information which is on the checklist instrument should be counted and classified accordingly.
- A statement that is relevant to more than one disclosure category shall be classified to only one category.
- Any discussion of *zakat* in *Shariah* Supervisory Board information would be classified as *zakat* category.
- Unlawful transactions include disclosure of earnings or expenditures prohibited by *Shariah* such as interest revenues and expenses, investment in business relating to alcohol, weapon, gambling and etc.

- Any disclosure of profit before *zakat* and profit after *zakat* would not be counted as disclosure of *zakat* category.
- Any disclosure of *zakat* base is considered as the sources of *zakat* and any disclosure of distribution and beneficiaries of *zakat* is considered as the uses of *zakat*.
- Any disclosure of *zakat* provision is considered as part of amount *zakat* paid and would be classified in the *zakat* category.
- Any disclosure of deposits using *Qard Hassan* contracts would be considered as sources of *Qard Hassan* fund.
- Any disclosure of financing using *Qard Hassan* contracts would be considered as beneficiaries of *Qard Hassan*.
- The 'policy' term in the checklists refers to any disclosure categories under review, in terms of plan, process, procedure, statement, provision, the amounts and description of sources, the amounts and description of uses, and the balances amount.
- Charitable and social activities include disclosure such as *sadaqah* (donation), *waqf* (religious endowment), celebrating the orphan children, etc.
- Wages and other remuneration include any disclosure of short term employee benefits such as salaries, bonuses, allowances, and commissions.
- Employees' welfare includes any disclosure of long term employee benefits and fringe benefits such as provident and pension funds, religious provision, holidays, medical benefits, accident and health/life insurance, loans to employees and etc.
- Any discussion of non-performing loans, doubtful debts and bad debts would be classified as categories relating to clients, such as late repayment and insolvent clients, screening clients, and dealing with clients. However, discussions relating to accounting treatment for non-performing loans, doubtful debts and bad debts will not be counted as disclosure.
- The basis of *Shariah* concepts for products/services includes the description of the concepts such as *Wadiah*, *Mudharabah*, *Murabahah*, *Bai' Bithaman*

Ajil, Al-Ijarah, and *Musyarakah* for products and services offered by the banks.

The instrument checklist is also restructured accordingly.

As mentioned earlier, the main purpose of conducting a pre-test is to examine the reliability of the instrument and measurement. The basic characteristic of content analysis is that data should be tested to prove that they are objective, systematic and general (Holsti, 1969), and also reliable (Krippendorff, 2004). "Conclusions from such data can be trusted only after demonstrating their reliability" (Hayes and Krippendorff, 2007, p.77). Therefore, it is important to obtain inter-coder reliability in order to measure "the extent to which independent coders evaluate a characteristic of a message or artefact and reach the same conclusion" (Lombard et al., 2010, p.2). Inter-coder reliability can be recognised as the standard measure of research quality since high disagreement levels between coders signifies weaknesses in research methods or a poor set of definitions or categories or poor coder training (Kolbe and Burnett, 1991 as cited from, Lombard et al., 2010, p.2-3). Obtaining inter-coder reliability ensures more efficient coding, thus avoids criticism of data gathering and analysis in the study (Lombard et al., 2010).

The most commonly used measures of inter-coder reliability are; (i) percent agreement, (ii) Holsti's method, (iii) Scott's pi, (iv) Cohen's kappa, and (v) Krippendorff's alpha (Lombard et al., 2010, Hayes and Krippendorff, 2007).

Percent agreement is the most widely used and the simplest measure of reliability (Lombard et al., 2010). Percent agreement is "the ratio of the number of pairwise interjudge agreements to the total number of pairwise judgements" (Milne and Adler, 1999, p.240). Milne and Adler (1999) emphasise the weakness of percent agreement whereby "it ignores the possibility that some agreement may have occurred randomly" (p.240). When there is a fewer number of coding categories, it would lead random agreement to increase, thus percent agreement could be a

misleading measure as it may overestimate the coders' reliability (Milne and Adler, 1999).

Scott's pi includes expected agreement in the measure thus corrects percent agreement's reliability interpretation (Scott, 1955). However, Scott's pi still fails to address the problem of nominal data and two coders (Hayes and Krippendorff, 2007).

Among the five measures, Cohen's kappa is recommended and it is widely used to measure behaviour coding research (Dewey, 1983). Cohen's kappa was introduced to improve Scott's pi as it considers the expected agreement when the two coders are statistically independent (Hayes and Krippendorff, 2007). This reliability measure can be calculated using well known software i.e. Statistical Package for Social Sciences (SPSS) (Lombard et al., 2010). However, Krippendorff (1987) argues that some drawbacks of Cohen's kappa make the measure inapt to compute inter-coder agreement. Cohen's kappa also "retains the limitations of percent agreement to two observers and nominal data" (Hayes and Krippendorff, 2007, p. 81).

Thus, Krippendorff (2004) introduced Krippendorff's alpha. Krippendorff's alpha is regarded as a very flexible measure since it can be used with several coders, can include different sample sizes and missing data, and can be utilized for all level of variables, i.e. ordinal, interval and ratio (Lombard et al., 2010). To enable the computation of Krippendorff's alpha, a set of SPSS and SAS macros is required (Lombard et al., 2010, Hayes and Krippendorff, 2007). Macros are the "customized programming that can be used with existing software packages to automate the calculation of inter-coder reliability" (Lombard et al., 2010, p.8). For this study, a set of SPSS and SAS macros was downloaded from Dr. Andrew Hayes's website³⁸ and installed on the computer.

³⁸ <http://www.afhayes.com/spss-sas-and-mplus-macros-and-code.html>

According to Lombard et al. (2010), coefficients of 0.90 or greater are nearly always acceptable, 0.80 or greater is acceptable in most situations, and 0.70 may be appropriate for some measures. Higher criteria should be used for measures known to be liberal (i.e. percent agreement) and lower criteria can be used for indices known to be more conservative (Cohen's kappa, Scott's pi, and Krippendorff's alpha) (Lombard et al., 2010). However, the significance of Krippendorff's alpha can be interpreted as shown below as provided by Seppanen (2009, p.113):

| Krippendorff's alpha | Interpretation |
|-----------------------------|--------------------------|
| < 0 | Poor agreement |
| 0.0 – 0.2 | Fair agreement |
| 0.21 – 0.40 | Slight agreement |
| 0.41 – 0.60 | Moderate agreement |
| 0.61 – 0.80 | Substantial agreement |
| 0.81 – 1.00 | Almost perfect agreement |

Lombard et al. (2010, p.5) underline some advice for calculating inter-coder reliability:

- (i) Do not use only percent agreement,
- (ii) Do not use Cronbach's alpha, Pearson's r, or other correlation-based indices that standardize coder values and only measure covariation,
- (iii) Do not use chi-square to calculate reliability, and
- (iv) Do not use overall reliability across variables, rather than reliability levels for each variable.

Therefore in this study, the inter-coder reliability was calculated using percent agreement, and Krippendorff's alpha. Reliability levels were also calculated for each category.

To calculate the percent agreement, the following formula is used,

| |
|---|
| $\text{Per cent agreement} = \frac{\text{No. of agreements}}{\text{No. of judgements}}$ |
|---|

For example, in Table 6-6, there are 21 agreements and 3 disagreements between the two coders relating to the subcategories of *Shariah* Supervisory Board quality disclosure, which make the total judgement 24. Therefore the percent agreement for *Shariah* Supervisory Board category is $21/24 = 0.88$ or 88 percent of agreement.

Table 6-6: Quality Coding for *Shariah* Supervisory Board Category

| Category | 2005 | | | | 2006 | | | |
|---|----------|----------|----------|----------|----------|----------|----------|----------|
| | BMMB | | RHBIBB | | BMMB | | RHBIBB | |
| | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 |
| (C1) Disclosure of <i>Shariah</i> Supervisory Board (SSB) Opinion (max score is 9) | | | | | | | | |
| 1. Report of <i>Shariah</i> Supervisory Board (0-1) | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| 2. Details regarding the qualifications of SSB members (0-1) | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| 3. Details regarding the members of the SSB (0-1) | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| 4. A statement on remuneration of the SSB members (0-4) | 2 | 2 | 2 | 0 | 2 | 2 | 2 | 2 |
| 5. A statement certifying distribution of profits and losses are made according to <i>Shariah</i> law (0-1) | 1 | 0 | 0 | 0 | 1 | 0 | 0 | 0 |
| 6. Statement of recommendations to rectify defects in products/services (0-1) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total C1 | 6 | 5 | 5 | 3 | 6 | 5 | 5 | 5 |

To measure the reliability of quantity coding of *Shariah* Supervisory Board (SSB) as in Table 6-7, percentage of agreement was calculated for each case judgement. Then the total percentage of agreement was divided by four total judgements. For example, percentage of agreement for BMMB 2005 is $204/220=0.93$, RHBIBB 2005 is 0.61, BMMB 2006 is 0.82 and RHBIBB 2006 is 0.68. The total percentage of

agreement is $0.93+0.61+0.82+0.68=3.03$, then after dividing by four total judgements, the percent of agreement for quantity coding of SSB is 0.76 or 76% percent of agreement.

Table 6-7: Quantity Coding for *Shariah* Supervisory Board Category

| No. | Islamic Banks | C1 | |
|------------------|--------------------------------------|---------|---------|
| | | Coder 1 | Coder 2 |
| Year 2005 | | | |
| 1 | Bank Muamalat Malaysia Berhad (BMMB) | 220 | 204 |
| 2 | RHB Islamic Bank Berhad (RHBIBB) | 1790 | 2956 |
| Year 2006 | | | |
| 1 | Bank Muamalat Malaysia Berhad (BMMB) | 937 | 1143 |
| 2 | RHB Islamic Bank Berhad (RHBIBB) | 1502 | 2217 |

Krippendorff's alpha is calculated using SPSS and SAS Macros. However, as the sample for pre-testing in this study was small and the scoring system was not dichotomous, the current study was unable to compute reliability using Cohen's kappa. Even though Krippendorff's alpha can compute reliability for all types of data, the small sample size in this study also limits the calculation of Krippendorff's alpha, especially for data on CSRep quality. Therefore, the inter-coder reliability results for quality measurement of the pre-testing are presented in percent agreement only. However, the weakness of using percent agreement alone is noted. Table 6-8 presents the inter-coder reliability results for quality measurement of the pre-testing.

**Table 6-8: Results of Inter-coder Reliability Test of Quality Measurement
(Pre-test Round 1)**

| Categories | Percent Agreement |
|---|-------------------|
| (C1) Disclosure of <i>Shariah</i> Supervisory Board (SSB) Opinion | 0.88 |
| (C2) Unlawful transactions | 1.00 |
| (C3) <i>Zakat</i> | 0.75 |
| (C4) <i>Qard Hassan</i> (non-interest-bearing loans) | 0.90 |
| (C5) Charity and Other Social Activities | 0.92 |
| (C6) Employees | 0.75 |
| (C7) Late Repayments and Insolvent Clients | 0.56 |
| (C8) The Environment | 1.00 |
| (C9) Other Community Involvement Aspects | 0.75 |
| (C10) Products/Services | 0.56 |
| (C11) Disclosure of corporate mission statement | 0.75 |
| (C12) Disclosure of information related to the top management | 0.81 |

For CSRep quantity, reliability is measured by percent agreement and Krippendorff's alpha. Table 6-9 presents the inter-coder reliability results for quantity measurement for each disclosure category.

**Table 6-9 Results of Inter-coder Reliability Test of Quantity Measurement
(Pre-test Round 1)**

| Categories | Percent Agreement | Krippendorff's alpha |
|---|-------------------|----------------------|
| (C1) Disclosure of <i>Shariah</i> Supervisory Board (SSB) Opinion | 0.76 | 0.91 |
| (C2) Unlawful transactions | n/a | No variation |
| (C3) <i>Zakat</i> | 0.86 | 0.95 |
| (C4) <i>Qard Hassan</i> (non-interest-bearing loans) | 0.76 | 0.91 |
| (C5) Charity and Other Social Activities | 0.75 | 0.00 |
| (C6) Employees | 0.80 | 0.31 |
| (C7) Late Repayments and Insolvent Clients | 0.48 | 0.07 |
| (C8) The Environment | n/a | No variation |
| (C9) Other Community Involvement Aspects | 0.50 | -0.11 |
| (C10) Products/Services | 0.25 | -0.21 |
| (C11) Disclosure of corporate mission statement | 0.28 | -0.21 |
| (C12) Disclosure of information related to the top management | 0.81 | 0.53 |

The reliability results for the first round of pre-testing produced coefficients below an acceptable level for many disclosure categories. Some categories such as C9, C10 and C11 resulted in negative coefficients, which show there was poor agreement between the coders. Therefore, there was a need to conduct a second round of pre-testing.

6.5.2 Second Round Pre-testing

Second round pre-testing was conducted using the revised coding rules and the revised instrument checklists as detailed in Section 6.5.1. Table 6-10 and Table 6-11 depict the inter-coder reliability test results for the second round pre-testing.

Table 6-10: Results of Inter-coder Reliability Test of Quality Measurement (Pre-test Round 2)

| Categories | Percent Agreement |
|---|-------------------|
| (C1) Disclosure of <i>Shariah</i> Supervisory Board (SSB) Opinion | 0.96 |
| (C2) Unlawful transactions | 1.00 |
| (C3) <i>Zakat</i> | 1.00 |
| (C4) <i>Qard Hassan</i> (non-interest-bearing loans) | 1.00 |
| (C5) Charity and Other Social Activities | 0.92 |
| (C6) Employees | 0.95 |
| (C7) Late Repayments and Insolvent Clients | 0.83 |
| (C8) The Environment | 1.00 |
| (C9) Community Involvement Aspects that Generating Profit | 1.00 |
| (C10) Products/Services | 0.94 |
| (C11) Disclosure of corporate mission statement | 1.00 |
| (C12) Disclosure of information related to the top management | 0.88 |

Table 6-10 shows that the coefficient values for all categories were above 0.80, which is at an acceptable level. Therefore, the results confirmed the reliability of the instrument for the quality measurement, after revising the coding rules.

Table 6-11: Results of Inter-coder Reliability Test of Quantity Measurement (Pre-Test Round 2)

| Categories | Percent Agreement | Krippendorff's alpha |
|---|-------------------|----------------------|
| (C1) Disclosure of <i>Shariah</i> Supervisory Board (SSB) Opinion | 0.83 | 0.93 |
| (C2) Unlawful transactions | n/a | No variation |
| (C3) <i>Zakat</i> | 0.85 | 0.87 |
| (C4) <i>Qard Hassan</i> (non-interest-bearing loans) | 0.80 | 0.94 |
| (C5) Charity and Other Social Activities | 0.79 | 0.70 |
| (C6) Employees | 0.93 | 0.84 |
| (C7) Late Repayments and Insolvent Clients | 0.74 | 0.30 |
| (C8) The Environment | n/a | No variation |
| (C9) Community Involvement Aspects that Generating Profit | 0.82 | 0.87 |
| (C10) Products/Services | 0.89 | 0.80 |
| (C11) Disclosure of corporate mission statement | 0.97 | 0.97 |
| (C12) Disclosure of information related to the top management | 0.94 | 0.86 |

Table 6.11 shows that the coefficient values using the measure of percent agreement for quantity measurement, were above 0.70 which is at an appropriate level. Except for C2 and C8, where the coefficient was not applicable as there was no disclosure for the unlawful transactions category and the environment category.

Using the Krippendorff's alpha measure, the reliability results produced coefficients that were all above 0.70, except for C7 which is only 0.30. Rules for coding C7 were revised further after investigating the differences. For C2 and C8, Krippendorff's alpha could not be computed as there was no disclosure.

Hence, the second round of pre-testing confirms the reliability of the instrument checklist as the reliability coefficients are above 0.70, which shows substantial agreement between the coders.

6.6 Qualitative Analysis

To answer the first research question, that is, exploring the nature and the extent of CSRep of Islamic banks, a qualitative analysis is conducted to supplement the quantitative results obtained from the content analysis. This analysis takes two forms: First, to analyse the textual data that were gathered via the content analysis described above. This involves a thematic analysis of the annual report disclosures. Second, to undertake a case study of three banks' stand-alone CSR reports to investigate the disclosures in depth. A case study in business research comprises descriptive or exploratory research that refers to qualitative construction to describe a management situation (Ghauri and Grønhaug, 2005).

Qualitative analysis of text can include various processes depending on the four main categories of strategies; (i) understanding the characteristics of language, (ii) discovering regularities, (iii) comprehending the meaning of text or action, and (iv) reflection (Tesch, 1990, cited in, Saunders et al., 2011). Generally, qualitative analysis involves the process of grouping the mass of collected qualitative data into meaningful categories, so that researchers are able to comprehend the data, integrate related data drawn from different notes, pinpoint key patterns or themes from them for further exploration, and draw conclusions (Saunders et al., 2011, p. 380).

6.7 Regression Analysis

Once the extent of CSRep has been codified and counted using content analysis, regression techniques are used to determine the relationship between CSRep and financial performance in Islamic banks. Regression analysis is a statistical method that is concerned, "with the study of the dependence of one variable, the dependent variable, on one or more other variables, the explanatory variables (the independent variables), with a view to estimating and/or predicting the (population) mean or average value of the former in terms of the known or fixed (in repeated sampling) values of the latter" (Gujarati, 2003, p.18). In this study, the

dependent variables are quality and quantity of CSRep which were collected using content analysis, and the independent variables are a series of financial performance variables. This study uses panel regression which was run using Stata software. A further discussion of panel regression is explained in Chapter 8.

6.7.1 Financial Performance Variables

The financial performance variables include traditional and non-traditional financial performance measures plus control variables. These financial variables comprise the independent variables in this study.

6.7.1.1 Traditional Financial measures

Using accounting indicators, the traditional financial performance of Islamic banks is measured in terms of efficiency of cost, revenue and profit. The Cost to income ratio (CTIR) represents cost efficiency, and the variable of Other operating income to assets (OOIA) measures revenue efficiency. The bank's profit efficiency is measured by Return on equity (ROE). Using these financial measures corresponds to the study of economic efficiency of profit and revenue maximization and cost minimisation (Ariff et al., 2009). The traditional financial measures that are used to assess the core financial performance of Islamic banks in this study are depicted in Table 6-12. These financial measures are adopted from Ariff et al. (2009) who carry out a comparative study of financial performance between Islamic banks and conventional banks. Some other authors of studies on financial performance of Islamic banks also use accounting indicators (eg. Masruki et al., 2011, Masruki et al., 2010, Samad, 2004). Hence, this study chooses to use accounting indicators because they are related to balance sheet and income statement items over which the bank management has a control (Samad, 2004).

Table 6-12: The List of Traditional Financial Variables

| Financial Variable Name | Variable Description |
|---|---|
| Cost to income ratio (CTIR) | Operating expenses / Operating income |
| Other operating income to assets (OOIA) | Other operating income / Asset in the end |
| Return on equity (ROE) | Net income after tax and <i>zakat</i> / Equity in the end |

6.7.1.2 Socio-economic Accounting Measures

Non-traditional financial measures, which are called socio-economic accounting measures, are used as they are more aligned with the objectives of Islamic banks. According to Mangos and Lewis (1995), the socio-economic approach, which combines both social and economic factors, is a more encompassing theory. The measures of socio-economic accounting are shown in Table 6.13 and are adopted from Hameed, et al. (2004). The Profit sharing financing ratio (PSR) is included because Islamic banks operate on profit sharing. The *Zakat* performance ratio (ZPR) is measured to identify how far the Islamic banks have achieved the objective of paying *Zakat*, which is also a distinctive feature of Islamic banks as *Zakat* is an obligation in Islam. In *Zakat*, the bank's wealth performance is based on net worth (net assets), rather than net profit. The Equitable distribution ratio (EDRQHD) measures the extent that the Islamic banks' revenue has been distributed to a wide range of stakeholders. One of the objectives of Islamic banks is to ensure equitable distribution of wealth among their stakeholders, which can be distributed in terms of donation and *Qard Hassan*. The Director-employees welfare ratio (DEWR) is important to show the amount spent on directors' remuneration compared to the amount spent on employees' welfare which includes salaries, bonuses, education opportunities, etc. This DEWR will ensure that directors are not overpaid relative to the work carried out. The variable of Islamic investment vs Non-Islamic investment (IIVNII) ensures that Islamic banks properly distinguish and disclose any lawful (*halal*) investment and prohibited (*haram*) investment according to *Shariah*. In Islam, interest (*riba*), gambling, and uncertainty are prohibited but trade and profit sharing are permissible. As such Islamic banks must truly segregate their investments into *halal* and *haram* as failing to do so would deceive stakeholders about Islamic banks' business operations. Islamic banks also need to segregate their income into *halal* and *haram*, whereby they must clearly disclose income received from *halal* sources and income received from *haram* transactions. As such the variable of Islamic income vs Non-Islamic income (INVNIN) is appropriate to measure the segment of income received from *halal* sources in the Islamic banks' operations (Hameed et al., 2004).

Table 6-13: The List of Socio-economic Accounting Variables

| Socio-Economic Variable Name | Variable Description |
|---|--|
| Profit sharing ratio (PSR) | (Mudaraba+Musyaraka) / Total Financing |
| Zakat performance ratio (ZPR) | Zakat / Net assets |
| Equitable distribution ratio (EDRQHD) | Qard Hassan and donation / Revenue-(Zakat+Tax paid), |
| Directors-employees welfare ratio (DEWR) | Directors' remuneration / Employees' welfare |
| Islamic investment vs Non-Islamic investment (IIVNII) | Islamic investment / Islamic investment+Non-Islamic investment |
| Islamic income vs Non-Islamic income (INVNIN) | Islamic income / Islamic income+Non-Islamic income |

6.7.2 Control Variables

In a study of the link between corporate social performance and accounting measures, Waddock and Graves (1997) include size, risk, and industry as control variables. Roberts (1992) used age, industry and size as control variables for the study of the relationship between corporate social disclosure and economic performance. While Mills and Gardner (1984) used the control variables of size and firm growth rate in their study on the link between social expenditures disclosure and financial profiles. Clarkson (2008) used size, stock price volatility, leverage ratio, return on asset, fixed assets ratio, and capital intensity to study the relationship between environment disclosure and performance. Simpson and Kohers (2002) used size, risk and overhead expense to study the link between corporate social and financial performance in the banking industry.

In this study, the control variables used by Simpson and Kohers (2002) as shown in Table 6.14 are employed to take into account any effect of firm size, risk, and overhead expenses. However, any effect of industry is held constant because this study is using only firms from the same industry i.e. the Islamic banking industry.

Table 6-14: The List of Control Variables

| Control Variable Name | Variable Description |
|--|--|
| Total assets (TA) | Natural logarithm of total assets |
| Capital ratio (CR) | Equity capital/ Total assets |
| Liability ratio (LR) | Total liabilities/ Total assets |
| Overhead expenses (OE) | Total overhead expenses/ Total assets |
| Full Islamic bank (FUL) | Dummy variable, 1 if a full established Islamic bank from beginning, and 0 if a subsidiary of conventional bank |
| Bank ownership (BANKOWN) | Dummy variable, 1 if a local owned Islamic bank, 0 if a foreign owned Islamic bank |
| Year either before or after the Standards introduction (YEARSTAND) | Dummy variable, 1 if in years after the introduction of AAOIFI governance standards, 0 if in years before AAOIFI governance standards. |

Total assets (TA) and capital ratio (CR) were chosen as control variables to hold firm size, risk of asset portfolio, level of investment and cost of funds constant. Liability ratio (LR) was used as control variable to hold firm size, risk of liability portfolio, size of the liability portfolio and economic condition in local market constant. In previous studies, size and risk have been suggested to have effects on both CSRep and financial performance (Waddock and Graves, 1997, Clarkson et al., 2008). The evidence shows that larger firms and more risky firms are more socially responsible, because they draw more interest from the stakeholders and need to be responsive to stakeholder demands (Waddock and Graves, 1997).

Overhead expenses (OE) were used to hold overhead expenses constant, because any expenditure for R&D expenditures that might exist would probably be included in overhead expenses (Simpson and Kohers, 2002). Then, whether or not each firm in the sample is a full Islamic bank (FUL) was included to hold holding company affiliation constant, especially for the Islamic banks which are the subsidiaries of conventional banks. Bank ownership (BANKOWN) was used to hold the local owned and foreign owned bank constant. Finally, YEARSTAND was used to hold pre-Standards and post-Standards constant.

6.7.3 Hypotheses Development

In order to answer the second research question on the influence of AAOIFI Standards to the CSR disclosure, and to answer the third research question on the relationship between CSRep and financial performance, a set of hypotheses are developed in this study.

6.7.3.1 The influence of AAOIFI Governance Standards No.7: CSR conduct and disclosure for IFIs

Because the accounting standards (e. g. International Accounting Standards) developed for secular business organisations are of limited applicability to Islamic banks (see Karim, 1990, Karim, 2001), the banking authorities in many countries, for example Bahrain, Sudan, Qatar and Jordan have decided that all Islamic banks should prepare their annual reports based on AAOIFI Standards. In Malaysia, AAOIFI Standards are not mandatory but efforts are underway that may result in adherence to Standards based primarily on AAOIFI's Standards. Some Islamic banks in Malaysia (e.g., Bank Islam Berhad Malaysia) have also started to voluntarily use AAOIFI's accounting standards to prepare their financial statements (Karim, 2001).

AAOIFI also issued Governance Standard No. 7 which relates to Corporate Social Responsibility Conduct and Disclosure for IFIs and was introduced at the end of 2009. The AAOIFI accounting standards promote the disclosure of social information which is deemed important in Islamic perspective such as *Zakat*, screening clients, *Qard Hassan*, *Waqf*, etc.

Given that a number of AAOIFI accounting standards require the disclosure of information that helps stakeholders in their economic and social decisions, and on the assumption that the new governance standards issued by AAOIFI in 2010 will encourage Islamic banks to disclose the social information that they had disclosed on voluntary basis by providing proper guidelines, it can be hypothesized that these standards will result in a net increase in the quality and quantity of CSRep. The hypotheses are shown as follows:

Ha: After the introduction of AAOIFI Standards on CSR, there will be an increase in the quality of CSRep

Hb: After the introduction of AAOIFI Standards on CSR, there will be an increase in the quantity of CSRep

6.7.3.2 The relationship between CSRep and financial performance

According to the conceptual framework, the following two general hypotheses are formulated regarding the link between CSRep and financial performance:

General hypothesis 1: The level of CSRep of the Islamic bank is positively related to the banks' traditional financial performance

General hypothesis 2: The level of CSRep of the Islamic bank is positively related to the banks' social-economic accounting performance

Through these general hypotheses, the following sub-hypotheses are developed:

Traditional Financial Performance:

The general hypothesis 1 represents the relationship between CSRep and the traditional financial performance. The traditional financial performance variables such accounting indicators are commonly used to examine companies' financial performance in the accounting and finance literature. As mentioned in Section 6.6.1.1, the traditional financial performance being measured in this study is in terms of efficiency of cost, revenue and profit. The following section emphasises the sub-hypotheses that are developed for each type of efficiency:

- ***Cost efficiency***

Cost efficiency is cost minimisation. Cost efficiency includes minimisation in operating costs and financial costs (Maudos et al., 2002).

Vitaliano and Stella (2006) employed a Data Envelopment Analysis (DEA) cost minimisation model to estimate the cost to a thrift institution of achieving a rating of 'outstanding' under the anti-redlining Community Reinvestment Act, which is viewed as an act of voluntary CSR. Cost efficiency is found to be the same between

'outstanding' and minimally compliant 'satisfactory' thrifts. Their finding also found that larger thrifts are less efficient. Thus, Vitaliano and Stella (2006) conclude that CSR does not impair financial performance and firms may recoup the costs of CSR. This study, hence, hypothesizes that cost efficiency is positively related to CSRep.

H1a: The quality of CSRep of Islamic banks is positively related to the banks' cost efficiency

H1b: The quantity of CSRep of Islamic banks is positively related to the banks' cost efficiency

- ***Revenue efficiency***

Revenue increases from higher sales and market share; often, researchers argue that CSR can lead to revenue increases. These can be achieved indirectly through an improved brand image or directly e.g., by CSR-driven product or market development (Weber, 2008). Therefore, this study hypothesizes that revenue efficiency is positively related to CSRep.

H2a: The quality of CSRep of Islamic banks is positively related to the banks' revenue efficiency

H2b: The quantity of CSRep of Islamic banks is positively related to the banks' revenue efficiency

- ***Profit efficiency***

Social responsibility is perceived as long-run profit maximization (Carroll, 1999), bearing in mind that profit efficiency in Islam should be an appropriate profit and not profit maximization (Willett and Sulaiman, 2001). Thus, the hypothesis for profit efficiency and CSRep is a positive relationship.

H3a: The quality of CSRep of Islamic banks is positively related to the banks' profit efficiency

H3b: The quantity of CSRep of Islamic banks is positively related to the banks' profit efficiency

Socio-economic Accounting Performance

The general hypothesis 2 represents the relationship between CSRep and the socio-economic accounting performance.

- ***Profit sharing ratio***

The main objective of Islamic Banking is profit sharing. Thus, it is important to identify how successfully the Islamic banks have achieved the objective of their existence (Hameed et al., 2004).

Islamic banks are supposed to adopt new financing policies and to explore new channels of investment which may encourage development and support to small scale traders to lift their economic level (Usmani, 2002). They should be advancing towards profit and loss sharing (*musyarakah*) in gradual phases and should increase the size of *musyarakah* financing (Masruki et al., 2010). Therefore, this study posits that there is positive relation between profit sharing ratio and CSRep.

H4a: The quality of CSRep of Islamic banks is positively related with banks' profit sharing ratio

H4b: The quantity of CSRep of Islamic banks is positively related with banks' profit sharing ratio

- ***Zakat performance ratio***

Zakat, as proposed by various authors (Shahul, 2000; Baydoun & Willet, 2000) should be one of the objectives of Islamic Accounting. Moreover, *Zakat* itself is one of the commandments in Islam. Therefore, Islamic bank performance should be based on the *Zakat* paid by the bank rather than the conventional performance indicator which is earnings per share (EPS). The wealth of the bank should be based on net worth (net assets) rather than net profit that has been emphasised by

conventional methods. Therefore, if the banks' net worth is higher, they should pay high *Zakat* (Hameed et al., 2004).

Zakat payments are certainly related to social welfare activities to the *asnaf* (beneficiary of *Zakat*). The Holy Quran (surah at-Taubah: verse 60) stipulates 8 groups of *asnaf*, which comprises of *fakir* (one who has neither material possessions nor means of livelihood), *miskin* (one with insufficient means of livelihood to meet basic needs), *amil* (workers associated with the collection and distribution of *Zakat*), *mualaf* (one who converts to Islam), *gharimin* (one who is indebt - money borrowed to meet basic, halal expenditure), *ibnu sabil* (one who is stranded in journey), *riqab* (one who wants to free himself from bondage or the shackles of slavery) and *fisabilillah* (activities in the way of God, e.g. preaching of Islam). Thus, this research posits that the *zakat* performance ratio is positively related to CSRep.

H5a: The quality of CSRep of Islamic banks is positively related with banks' *zakat* performance ratio

H5b: The quantity of CSRep of Islamic banks is positively related with banks' *zakat* performance ratio

- ***Equitable distribution ratio***

Apart from profit sharing activities, Islamic accounting also seeks equitable distribution among people. Therefore, this indicator is trying to find out how the revenue obtained by the Islamic banks has been distributed among various stakeholders which is represented by the amount spent for *Qard Hassan* and donations. (Hameed et al., 2004).

Hence, this study hypothesizes that the equitable distribution ratio is positively related to CSRep.

H6a: The quality of CSRep of Islamic banks is positively related with banks' equitable distribution ratio

H6b: The quantity of CSRep of Islamic banks is positively related with banks' equitable distribution ratio

- ***Directors-employees welfare ratio***

Directors' remuneration has been an important issue in the social responsibility literature, where there are claims that directors have been overpaid compared to the work they have done. Therefore, it is essential to identify how much money has been spent on directors' remuneration as compared to the money spent towards employees' welfare. Employees' welfare here includes salaries, training, benefits in kind, etc. (Hameed et al., 2004). Hence, this study posits that there is positive relationship between the directors-employees welfare ratio and CSRep.

H7a: The quality of CSRep of Islamic banks is positively related with banks' directors-employees welfare ratio

H7b: The quantity of CSRep of Islamic banks is positively related with banks' directors-employees welfare ratio

- ***Islamic investment vs Non-Islamic investment***

Islamic principles prohibit transactions involving *riba'*, *gharar* and gambling but at the same time encourage *halal* trade. Thus, it is required for the Islamic banks to disclose truthfully any investment which is considered halal, and which is prohibited. Failure to explicitly disclose such information might give a misleading and inaccurate picture of the business activities of Islamic banks (Hameed et al., 2004).

Muslims cannot invest their money in enterprises that engage in impermissible activities, for instance, gambling businesses, pig farms, alcohol producing factories, the tobacco industry, etc. Furthermore, they cannot invest in activities that are financed by debt or interest based activities, and these requirements are directly applicable to Islamic financial institutions (IFIs). Hence, in this context, it is imperative that IFIs screen their investments for compliance with Islamic laws and

principles. They should have a clear policy outlining their method of screening investments and the depth of their screening. They should also gain approval for this screening process from their *Shariah* Supervisory Board (Farook, 2008), to ensure that all investment is halal which is also part of Islamic CSR. Thus, this research posits that Islamic investment is positively related with CSRep.

H8a: The quality of CSRep of Islamic banks is positively related with banks' Islamic investment vs Non-Islamic investment

H8b: The quantity of CSRep of Islamic banks is positively related with banks' Islamic investment vs Non-Islamic investment

- ***Islamic income vs Non-Islamic income***

Apart from segregating the investments into Islamic and Non-Islamic, such segregation is also needed for income. Thus, Islamic banks should only receive income from *halal* (permissible) sources. In addition, if Islamic banks do have income from prohibited transactions, they should disclose information regarding such earnings, their sources, how they were disposed of and more importantly, any procedures available to prevent entering into transactions prohibited by the *Shariah* (Hameed et al., 2004).

Since Muslims cannot engage in *haram* (impermissible) activities, earnings from haram activities are also not permitted to be used for the operations of the firm and must be dealt with according to the *Shariah* Supervisory Board's opinion. To that extent, Islamic stakeholders need to be assured that the Islamic business organisation is acting in accordance with Islam by ensuring that no part of the stakeholder's wealth or income or activity is *haram*, and where it is *haram*, reports how it is dealt with (Farook, 2008). The concern of *halal* and *haram* incomes is part of Islamic CSR. Therefore, this study hypothesizes that Islamic income has positive relationship with CSRep.

H9a: The quality of CSRep of Islamic banks is positively related with banks' Islamic income vs Non-Islamic income

H9b: The quantity of CSRep of Islamic banks is positively related with banks' Islamic income vs Non-Islamic income

6.7.4 Multiple Regression Model

A multiple regression analysis is performed to examine the relationship between CSRep and traditional financial variables and socio-economic accounting variables. Multiple regression analysis depends on the formula $Y=f(x)$, which allows an explicit control for many explanatory variables that simultaneously affect the dependent variable (Wooldridge, 2009). The multiple regression underlying model is represented as follows:

$$Y_i = \beta_0 + \beta_1 X_{1i} + \beta_2 X_{2i} + \dots + \beta_k X_{ki} + \varepsilon_i$$

Where Y_i is dependent variable for firm i ; X_s are independent and control variables (from 1 to k); β_s are the estimated parameters of the model, and ε is the zero mean, homoscedastic and serially independent regression error.

In this study, a method of Ordinary Least Squares (OLS) is used to estimate the parameters in the multiple regression model. OLS is a linear regression model which is the common method used in the CSR disclosure literature. In order to prevent misleading results, this study needs to observe a number of assumptions underlying OLS regression. The underlying assumptions of OLS regression includes normality, collinearity and homoscedasticity (Garson, 2011).

Normality of residual errors

The assumption of normality refers to the distribution of the errors that are represented by the residuals. Residuals are "the difference between the observed values and those predicted by the regression equation" (Garson, 2011). Normally distributed residuals provide assurance that the P-values for the test are valid. This assumption can be examined using the histogram of standardized residuals of dependent variables and P-P plots in the SPSS program. A histogram will show a roughly normal curve like a bell shape to confirm the normality assumption. If using the P-P plot, a 45-degree line will appear to confirm the normality, with the

observed cumulative probabilities of occurrence of the standardized residuals on the Y axis and of expected normal probabilities of occurrence on the X axis. Tests of normality are important for studies with small sample size. That is because t-tests of regression coefficients are not accurate when errors are not normally distributed for small samples. Unlike large samples, violations of the normality of errors assumption have little or no impact on the conclusions. That is because for large samples, the sampling distribution of the b coefficient will still be normal even though error is not normally distributed (Garson, 2011).

Homoscedasticity

Homoscedasticity (also spelled as Homoskedasticity) is an assumption that the residual error variance should be constant for all independent values, as OLS regression assumes the homogeneity of residuals variance. There are two meanings if homoscedasticity is lacking: (i) there is an interaction effect between a measured independent variable and an unmeasured independent variable not in the model; or (ii) that some independent variables are skewed while others are not (Garson, 2011).

Absence of Multicollinearity

Multicollinearity means that the independent variables are correlated, which can create difficulties in estimating the regression coefficients. This assumption refers to both the absence of perfect multicollinearity and high partial multicollinearity. Perfect multicollinearity arises when independent variables are linear functions of each other, it can cause no unique regression solution. High partial multicollinearity means when the independent variables increase in correlation with each other, it can inflate the standard errors of the regression coefficients. High multicollinearity biases the reliability estimates, therefore it will be difficult to assess the relative importance of the independent variables (Garson, 2011).

After noting some assumptions of OLS regression, the next section shows the regression models which are estimated for the quality and quantity of CSRep in this study.

6.7.4.1 Quality of CSRep

The regression model to estimate the relationship between CSR quality disclosure with traditional financial and socio-economic accounting performance is expressed as follows:

$$\text{CSRepQly}_{jt} = \text{CTIR}_{jt} + \text{OOIA}_{jt} + \text{ROE}_{jt} + \text{PSR}_{jt} + \text{ZPR}_{jt} + \text{EDRQHD}_{jt} + \text{DEWR}_{jt} + \text{IIVNII}_{jt} + \text{INVNIN}_{jt} + \text{TA}_{jt} + \text{CR}_{jt} + \text{LR}_{jt} + \text{OE}_{jt} + \text{BANKOWN}_{jt} + \text{YEARSTAND}_{jt} + \text{FUL}_{jt} + \varepsilon_{jt}$$

where:

| | |
|-------------------------|--|
| CSRepQly _{jt} | = A CSRep quality total score, for firm j in year t |
| CTIR _{jt} | = Operating expenses / Operating income for firm j in year t |
| OOIA _{jt} | = Other operating income / Asset in the end for firm j in year t |
| ROE _{jt} | = Net income after tax and <i>zakat</i> / Equity in the end for firm j in year t |
| PSR _{jt} | = (<i>Mudharabah+Musyarakah</i>) / Total financing for firm j in year t |
| ZPR _{jt} | = <i>Zakat</i> / Net assets for firm j in year t |
| EDR _{jt} | = [<i>Qard Hassan</i> and donation / Revenue-(<i>Zakat</i> +Tax paid)] for firm j in year t |
| DEWR _{jt} | = Directors' remuneration / Employees' welfare for firm j in year t |
| IIVNII _{jt} | = Islamic investment / (Islamic investment+Non-Islamic investment) for firm j in year t |
| INVNIN _{jt} | = Islamic income / (Islamic income+Non-Islamic income) for firm j in year t |
| TA _{jt} | = Measured by the natural log of average total assets for firm j in year t |
| CR _{jt} | = Equity capital/ Total assets for firm j in year t |
| LR _{jt} | = Total loans/Total assets for firm j in year t |
| OE _{jt} | = Total overhead expenses/ Total assets for firm j in year t |
| BANKOWN _{jt} | = A dummy variable, 1 if a local owned Islamic bank, 0 if a foreign owned Islamic bank |
| YEARSTAND _{jt} | = A dummy variable, 1 if in years after the introduction of AAOIFI governance standards, 0 if in years before AAOIFI governance standards. |
| FUL _{jt} | = A dummy variable, 1 if a full established Islamic bank from beginning, 0 if a subsidiary of conventional bank |
| ε _{jt} | = Error term for firm j in year t |

6.7.4.2 Quantity of CSRep

The regression model to estimate the relationship between CSR quantity disclosure with traditional financial and socio-economic accounting performance is expressed as follows:

$$\text{CSRepQtt}_{jt} = \text{CTIR}_{jt} + \text{OOIA}_{jt} + \text{ROE}_{jt} + \text{PSR}_{jt} + \text{ZPR}_{jt} + \text{EDRQHD}_{jt} + \text{DEWR}_{jt} + \text{IIVNII}_{jt} + \text{INVNIN}_{jt} + \text{TA}_{jt} + \text{CR}_{jt} + \text{LR}_{jt} + \text{OE}_{jt} + \text{BANKOWN}_{jt} + \text{YEARSTAND}_{jt} + \text{FUL}_{jt} + \varepsilon_{jt}$$

where:

| | |
|-------------------------|--|
| CSRepQtt _{jt} | = A CSRep quantity total, for firm j in year t |
| CTIR _{jt} | = Operating expenses / Operating income for firm j in year t |
| OOIA _{jt} | = Other operating income / Asset in the end for firm j in year t |
| ROE _{jt} | = Net income after tax and <i>zakat</i> / Equity in the end for firm j in year t |
| PSR _{jt} | = (<i>Mudharabah</i> + <i>Musyarakah</i>) / Total financing for firm j in year t |
| ZPR _{jt} | = <i>Zakat</i> / Net assets for firm j in year t |
| EDR _{jt} | = [<i>Qard Hassan</i> and donation / Revenue-(<i>Zakat</i> +Tax paid) for firm j in year t |
| DEWR _{jt} | = Directors' remuneration / Employees' welfare for firm j in year t |
| IIVNII _{jt} | = Islamic investment / (Islamic investment+Non-Islamic investment) for firm j in year t |
| INVNIN _{jt} | = Islamic income / (Islamic income+Non-Islamic income) for firm j in year t |
| TA _{jt} | = Measured by the natural log of average total assets for firm j in year t |
| CR _{jt} | = Equity capital/Total assets for firm j in year t |
| LR _{jt} | = Total loans/Total assets for firm j in year t |
| OE _{jt} | = Total overhead expenses/ Total assets for firm j in year t |
| BANKOWN _{jt} | = A dummy variable, 1 if a local owned Islamic bank, 0 if a foreign owned Islamic bank |
| YEARSTAND _{jt} | = A dummy variable, 1 if in years after the introduction of AAOIFI governance standards, 0 if in years before AAOIFI governance standards. |
| FUL _{jt} | = A dummy variable, 1 if a full established Islamic bank from beginning, 0 if a subsidiary of conventional bank |
| ε _{jt} | = Error term for firm j in year t |

6.7.4.3 Issues of Multiple Regression Modelling

There are two common issues in estimating the multiple regression models, i.e. omitted variable bias and endogeneity.

Firstly, there is a potential for omitted variable bias due to unidentified, inestimable or unavailable data. A relevant variable that actually belongs in the population model may be omitted and this can cause the OLS estimators to be biased (Wooldridge, 2009).

Secondly, endogeneity can arise when there is measurement error, simultaneity, omitted variables and sample selection errors. A parameter or variable is considered endogenous when the parameter or variable and the error term are correlated to each other. Endogeneity can be also caused by a causality loop between the independent and dependent variables of a model (Wooldridge, 2009).

To the extent that there may be omitted variables and endogeneity, it is important to observe the assumptions noted in Section 6.7.4 and interpret the estimates with caution.

6.8 Chapter Summary

This chapter outlined the methodological approach taken in this thesis, the methods applied, and how variables are measured. It described the qualitative analysis techniques employed and presented the regression modelling. The next two chapters present the findings.

Chapter 7: Corporate Social Reporting of Islamic Banks & the Influence of AAOIFI Standards on the CSR Disclosure: Empirical Findings & Discussion

7.1 Introduction

This chapter presents the results of the analysis of corporate social reporting (CSRep) by Islamic banks based on the results of the content analysis. The purpose of this chapter is to address the first research question regarding the extent and nature of CSRep by Islamic banks, and also to address the second research question relating to AAOIFI Standards' influence on the CSRep of Islamic banks in Malaysia. Section 7.2 presents the descriptive statistics for the quantity and quality of CSRep based on the Islamic CSRep Framework and AAOIFI Standards, and also descriptive statistics for pre AAOIFI Standards and post AAOIFI Standards. In Section 7.3, the statistical analysis is explained. Section 7.4 discusses the qualitative analysis of corporate social reporting in Islamic banks' annual reports. Section 7.5 presents a case study of CSRep in stand-alone reports. Lastly, the empirical analysis of the CSRep of Islamic banks is summarized in Section 7.6. This chapter presents the results of the analysis with some discussion, but the main implications of the findings are presented in Chapter 9.

7.2 Descriptive Statistics of Corporate Social Reporting

In this study, the total cases in the sample is $N = 85$. There are 83 cases valid for the study, while the remaining two cases contain missing values. The missing values are due to unavailability of annual reports that was caused by the change in financial year end³⁹, business transfer⁴⁰ and cost control efforts⁴¹.

³⁹ Bank Muamalat Malaysia Berhad (BMMB) changed its financial year end from 31 December 2009 to 31 March 2010, in order to coincide with the financial year end of its holding company, DRB-HICOM Berhad. Hence, BMMB's annual report for 2009 is unavailable because its annual report for 2010 presented the report for financial period from 1 Jan 2009 to 31 March 2010.

The descriptive statistics of corporate social reporting over a period of five years (2007-2011) are presented in the following section. The first part presents the descriptive statistics of CSRep using the content analysis themes based on the Framework developed in Chapter 5 and the second part presents the content analysis based on themes developed from the CSR Standards described in Chapter 3 and developed in Chapter 6.

7.2.1 Descriptive Statistics of CSRep based on the Framework

As discussed in the methodology in Chapter 6, CSRep is analysed for both quality, using an ordinal scale and index, and quantity, using number of words. Table 7-1 exhibits the descriptive statistics of the CSRep quality based on the Framework.

⁴⁰ Annual reports of EONCAP Islamic Bank Berhad (EONCAPIBB) for 2011 onwards is unavailable because the assets, liabilities, activity, business and the undertaking of the Islamic banking business of EONCAPIBB were transferred and vested to Hong Leong Islamic Bank Berhad (HLIBB).

⁴¹ CIMB Islamic Bank Berhad (CIMBIBB)'s annual report is no longer published from 2010 onwards because its holding company, CIMB Group decided to control cost. As an alternative for this study, all information related to CIMBIBB is referred to the annual reports of CIMB group.

Table 7-1⁴²: Statistics for CSRep based on the Framework (QUALITY) (N=83, N Missing=2)

| CSRep Categories | Mean | Std. Dev | Median | Range | Min | Max |
|--|--------------|-----------------|---------------|--------------|------------|------------|
| <i>Shariah</i> Supervisory Board opinion | 4.98 | 1.31 | 5.00 | 7 | 2 | 9 |
| Unlawful transactions | 0.83 | 1.57 | 0.00 | 5 | 0 | 5 |
| <i>Zakat</i> (religious levy) | 3.96 | 2.03 | 5.00 | 7 | 0 | 7 |
| <i>Qard Hassan</i> (benevolent loan) | 1.31 | 1.72 | 0.00 | 5 | 0 | 5 |
| Charity | 1.84 | 1.39 | 2.00 | 5 | 0 | 5 |
| Employee | 5.29 | 1.16 | 5.00 | 7 | 4 | 11 |
| Late Payment and Insolvent clients | 3.76 | 1.18 | 4.00 | 6 | 1 | 7 |
| Conservation of environment | 1.24 | 1.99 | 0.00 | 9 | 0 | 9 |
| Community involvement | 2.35 | 1.08 | 2.00 | 5 | 0 | 5 |
| Products/services | 2.20 | 0.89 | 2.00 | 6 | 0 | 6 |
| Corporate mission statement | 1.04 | 0.40 | 1.00 | 2 | 0 | 2 |
| Top management | 6.37 | 0.82 | 7.00 | 3 | 4 | 7 |
| Average Framework Quality | 35.18 | 6.45 | 34.00 | | | |

It can be seen from Table 7-1 that the data set from the sample of 83 annual reports has an average quality score of 35.18, with a median of 34.00 and small variability as measured by the standard deviation of 6.45.

For the individual categories of CSRep based on the Framework, the Top Management category reported the highest mean of 6.37 (highlighted in the Table). The high quality score for the Top management category might be motivated by the regulation required by Bank Negara Malaysia (BNM) – the Central

⁴² The maximum potential score is referred to in Appendix 2: Score Range and Maximum Score for Each Category of CSRep Instruments (Instrument Categories Based on the Islamic CSRep Framework).

Bank of Malaysia and the Securities Commission Malaysia which emphasises the disclosure of corporate governance especially on the details and roles of the bank's management and its board.

The Employee category reported the second highest mean of 5.29. This Employee category is probably of the next highest concern for Islamic banks because it is also part of their corporate governance, especially regarding relationships with employees as one of their stakeholders. Islamic banking offer services, and as such, their employees are important.

The third category with a high mean score is the *Shariah* Supervisory Board Opinion category with a mean of 4.98. Most Islamic banks disclose their *Shariah* Supervisory report because it is regulated by BNM. The *Shariah* Supervisory board is also one of the features that differentiate Islamic banks from conventional banks. The *Shariah* Supervisory board provides an oversight function to ensure that Islamic banks' operations are in accordance with *Shariah* (Islamic law). Therefore, most Islamic banks report the details of the *Shariah* Supervisory board members and their remuneration.

The lowest mean of 0.83 is reported in the Unlawful Transactions category. Islamic law prohibits business transactions that are considered unlawful, and being involved in unlawful transactions would expose *Shariah* risk to Islamic banks. The lack of disclosure in this category might be because it does not occur in the operation of the banks, or because they choose not to disclose practices that reflect poorly on the banks.

Table 7-2 shows the descriptive statistics based on the Framework for the quantity of CSRep.

Table 7-2: Statistics for CSRep based on Framework (QUANTITY) (N=83, N Missing=2)

| CSRep Categories | Mean | Std. Dev | Median | Range | Min | Max |
|--|----------------|----------------|-------------|-------|-----|------|
| <i>Shariah</i> Supervisory Board opinion | 1036.78 | 703.82 | 895.00 | 3783 | 56 | 3839 |
| Unlawful transactions | 8.86 | 14.78 | 0.00 | 64 | 0 | 64 |
| <i>Zakat</i> (religious levy) | 81.20 | 66.68 | 67.00 | 335 | 0 | 335 |
| <i>Qard Hassan</i> (benevolent loan) | 5.98 | 8.72 | 0.00 | 37 | 0 | 37 |
| Charity | 202.90 | 308.98 | 40.00 | 1218 | 0 | 1218 |
| Employee | 684.70 | 630.59 | 478.00 | 3740 | 64 | 3804 |
| Late Payment and Insolvent clients | 767.86 | 473.68 | 610.00 | 2301 | 119 | 2420 |
| Conservation of environment | 80.70 | 135.69 | 0.00 | 570 | 0 | 570 |
| Community involvement | 131.53 | 258.96 | 37.00 | 1415 | 0 | 1415 |
| Products/services | 137.17 | 124.34 | 95.00 | 875 | 0 | 875 |
| Corporate mission statement | 40.66 | 45.49 | 28.00 | 264 | 0 | 264 |
| Top management | 1365.57 | 908.08 | 1246.00 | 3702 | 130 | 3832 |
| Average Framework Quantity | 4543.90 | 2169.26 | 4026 | | | |

When analysed by quantity as shown in Table 7-2, it is clear that the majority of the disclosures appear under the themes of Top Management, *Shariah* Supervisory Board Opinion, and Late Payment and Insolvent Clients (as highlighted in the Table).

The Top Management category reported the highest mean of 1365.57 words. This means the Top Management category scores the highest for both quality and quantity disclosure based on the Framework. This category might be the highest because there is a regulation that requires banks to report the details of the top management of the bank, and there is also a guideline on how to report in this

category. The details of what is disclosed in this category will be examined further in the qualitative analysis later in this chapter.

The second highest mean of 1036.78 words is for the *Shariah* Supervisory Board Opinion category. This category is among the top three for both quality and quantity of disclosure based on the Framework, which indicates that Islamic banks emphasise *Shariah* Supervisory requirements in their reporting. The disclosure of *Shariah* Supervisory Board Opinion could be driven by the regulation and most importantly, this category reflects that Islamic banks strive to conduct their operations according to *Shariah*, which would be expected of Islamic organisations.

The third highest category is Late Payment and Insolvent Clients with a mean of 767.86 words. This category is not among the top categories for quality, which emphasises monetary and non-monetary quantitative aspects. In the Late Payment and Insolvent Clients category, most Islamic banks report narrative details on their dealings with insolvent and default clients, which may explain why this category, is among the top for the quantity. However, it indicates that details of the number of clients, amount of insolvency, late payment charges etc., are minimal.

The least disclosure appears under the theme of *Qard Hassan*. As discussed in Chapter 3, *Qard Hassan* literally means “loan benevolent” or “benevolent loan”. It is observed that many local Islamic banks in Malaysia do not report *Qard Hassan*, except Bank Muamalat Malaysia Berhad (BMMB). In the 2005 resolution meeting of the *Shariah* Advisory Council of BNM, the council contemplated that inappropriate use of *Qard Hassan* would potentially create problems that may tarnish the image of Islamic banking because there is vagueness in *Qard Hassan* of the need for the loans to be repaid or otherwise, and it is inappropriate to use *Qard Hassan* as a financing mode by utilizing customers’ deposits who expect returns. Therefore, the council resolved that the word “*Hassan*” should be taken out after the word *Qard* implying that *Qard* is an obligation for borrowers to pay back their loan to lenders. However, the true meaning of *Qard Hassan* is implicit so this may discourage Islamic banks from offering *Qard Hassan* as a mode of financing, and thus there would be a lack of reporting of this category.

Meanwhile, the standard deviations for Unlawful Transactions, *Qard Hassan*, Charity, Conservation of Environment, Community Involvement and Corporate Mission Statement were all larger than the mean for that category, which suggests wide dispersion of the data. Therefore, care must be taken when using the means to draw conclusions. Detailed discussion will be undertaken in subsequent chapters of this thesis.

7.2.2 Descriptive Statistics of CSRep based on AAOIFI Standards

As the AAOIFI Standards were introduced in 2010, the data were also analysed using themes developed from these Standards for both quality and quantity. Table 7-3 presents the statistics for CSRep based on the Standards for quality.

Table 7-3⁴³: Statistics for CSRep based on Standards (QUALITY) (N=83, N Missing=2)

| CSRep Categories | Mean | Std. Dev | Median | Range | Min | Max |
|--|--------------|-------------|--------------|-------|-----|-----|
| Mandatory disclosure | | | | | | |
| Policy for screening clients | 0.96 | 0.19 | 1 | 1 | 0 | 1 |
| Policy for dealing with clients | 6.08 | 2.03 | 7 | 10 | 2 | 12 |
| Earnings and expenditure prohibited by <i>Shariah</i> | 0.69 | 1.24 | 0 | 4 | 0 | 4 |
| Policy for employee welfare | 3.76 | 0.80 | 4 | 5 | 3 | 8 |
| Policy for <i>Zakat</i> | 4.69 | 2.27 | 5 | 10 | 0 | 10 |
| Voluntary disclosure | | | | | | |
| Policy for social, development and environment based investment quotas | 2.6 | 2.46 | 3 | 10 | 0 | 10 |
| Policy for par excellence customer service | 1.42 | 1.28 | 2 | 5 | 0 | 5 |
| Policy for micro and small business and social savings | 3.16 | 0.93 | 3 | 5 | 0 | 5 |
| Policy for <i>Qard Hassan</i> | 1.31 | 1.71 | 0 | 5 | 0 | 5 |
| Policy for charitable activities | 1.96 | 1.62 | 2 | 6 | 0 | 6 |
| Policy for <i>Waqf</i> (trust) management | 0.22 | 0.70 | 0 | 4 | 0 | 4 |
| Average Standards Quality | 26.86 | 6.73 | 26.00 | | | |

In the data on CSRep quality based on the Standards, the top three categories with a high quality score are the Policy for Dealing with Clients, the Policy for *Zakat*, and the Policy for Employee Welfare (as highlighted in Table 7-3).

⁴³ The maximum potential score is referred to in Appendix 2: Score Range and Maximum Score for Each Category of CSRep Instruments (Instrument Categories Based on AAOIFI Standards on CSR).

The category of Policy for Dealing with Clients gained the highest quality mean score of 6.08. As discussed in the results based on the Framework, the quantitative disclosure for this category is minimal, but comprises more narrative disclosures. The Standards emphasise more on policy disclosure and most of the subcategories in the Policy for Dealing with Clients category were disclosed, which explains why this category scores the highest mean. The finding also reflects the emphasis of the Standards on provisions relating to the avoidance of onerous terms on clients, marketing ethics, responsible financing practices in all types of transactions with clients and dealing with late repayments and insolvent clients.

The second highest mean of 4.69 is in the Policy for *Zakat* category. Compared to the Framework, the Standards require greater disclosure in this category, such as whether Islamic banks pay *Zakat* for its subsidiaries, whether they pay *Zakat* on behalf of investment account holders, and the *Zakat* amount due from each share and from equity of investment account holders. In the analysis of CSRep quality based on the Framework, the *Zakat* category is ranked fourth. This indicates the category relating to *Zakat* is important to Islamic banks because it is compulsory to pay *Zakat* according to Islamic law.

The third highest mean is the Policy for Employee Welfare category which is 3.76. Employees were also highly ranked for quality in the analysis based on the Framework (ranked second), indicating employees are seen to be an important element of CSRep by banks.

The Policy for *Waqf* (Trust/Endowment) Management reports the lowest mean of 0.22. *Waqf* is considered new for the Islamic banking industry in Malaysia, compared to Islamic banking in the Middle East. There is very small number of Islamic banks in Malaysia which offer *Waqf*, thus less reporting occurred for this category.

Table 7-4 exhibits the statistics of CSRep based on the Standards for quantity.

Table 7-4: Statistics for CSRep based on Standards (QUANTITY) (N=83, N Missing=2)

| CSRep Categories | Mean | Std. Dev | Median | Range | Min | Max |
|--|----------------|----------------|-------------|-------|-----|------|
| Mandatory disclosure | | | | | | |
| Policy for screening clients | 323.9 | 234.58 | 261 | 1160 | 0 | 1160 |
| Policy for dealing with clients | 739.19 | 469.17 | 579 | 2125 | 125 | 2250 |
| Earnings and expenditure prohibited by <i>Shariah</i> | 7.8 | 13.72 | 0 | 64 | 0 | 64 |
| Policy for employee welfare | 674.24 | 593.77 | 454 | 2985 | 99 | 3084 |
| Policy for <i>Zakat</i> | 80.29 | 63.77 | 67 | 335 | 0 | 335 |
| Voluntary disclosure | | | | | | |
| Policy for social, development and environment based investment quotas | 132.12 | 239.00 | 16 | 1240 | 0 | 1240 |
| Policy for par excellence customer service | 161.11 | 308.45 | 68 | 2139 | 0 | 2139 |
| Policy for micro and small business and social savings | 29.66 | 42.73 | 19 | 286 | 0 | 286 |
| Policy for <i>Qard Hassan</i> | 9 | 30.55 | 0 | 273 | 0 | 273 |
| Policy for charitable activities | 211.94 | 320.34 | 44 | 1213 | 0 | 1213 |
| Policy for <i>Waqf</i> (trust) management | 19.35 | 125.86 | 0 | 1131 | 0 | 1131 |
| Average Standards Quantity | 2388.60 | 1460.47 | 1933 | | | |

For the CSRep quantity score based on the Standards, the top three categories are the Policy for Dealing with Clients, the Policy for Employee Welfare, and the Policy for Screening Clients (as highlighted in Table 7-4). It is important to note that these

three categories comprise part of the mandatory section of the AAOIFI standards. In the voluntary section, charitable activities and customers rank highest.

The least disclosure however, is in the Earnings and Expenditure Prohibited by *Shariah*, which is also part of the mandatory requirements of the standard. This category is quite similar to the Unlawful Transactions category in the Framework, which also reports the least quality.

It is apparent that a theme is appearing for the categories which have the highest level and quality of disclosures. The top categories under both the Framework and the Standards cover *Shariah* Supervisory Opinion, Management, Employees, Clients and *Zakat*. These are discussed further in the Section 7.4 and Chapter 9.

As the AAOIFI Standards were introduced in 2010, it is necessary to consider the data separately in two periods. The following sections therefore provide descriptive statistics for quality and quantity pre- and post- the introduction of the Standards.

7.2.3 Descriptive Statistics of Pre AAOIFI Standards (2007-2009)

Table 7-5 and Table 7-6 show the descriptive statistics for CSRep prior to the introduction of the Standards (i.e. 2007-2009), for quality and quantity respectively. Based on the mean value, the top three categories are shaded in grey.

Table 7-5: Statistic for CSRep Quality in Pre AAOIFI Standards (N=50, N Missing=1)

| CSRep Categories | Mean | Std. Dev | Variance | Range | Min | Max |
|--|--------------|-----------------|-----------------|--------------|------------|------------|
| Mandatory disclosure | | | | | | |
| Policy for screening clients | .94 | .240 | .058 | 1 | 0 | 1 |
| Policy for dealing with clients | 5.64 | 1.735 | 3.011 | 6 | 2 | 8 |
| Earnings and expenditure prohibited by <i>Shariah</i> | .48 | 1.111 | 1.234 | 4 | 0 | 4 |
| Policy for employee welfare | 3.72 | .784 | .614 | 5 | 3 | 8 |
| Policy for <i>Zakat</i> | 4.72 | 2.286 | 5.226 | 10 | 0 | 10 |
| Voluntary disclosure | | | | | | |
| Policy for social, development and environment based investment quotas | 2.46 | 2.323 | 5.396 | 10 | 0 | 10 |
| Policy for par excellence customer service | 1.34 | 1.222 | 1.494 | 5 | 0 | 5 |
| Policy for micro and small business and social savings | 3.02 | 1.078 | 1.163 | 5 | 0 | 5 |
| Policy for <i>Qard Hassan</i> | 1.32 | 1.696 | 2.875 | 5 | 0 | 5 |
| Policy for charitable activities | 1.82 | 1.674 | 2.804 | 5 | 0 | 5 |
| Policy for <i>Waqf</i> (trust) management | .02 | .141 | .020 | 1 | 0 | 1 |
| Average Pre-Standards Quality | 25.48 | 6.208 | 38.540 | | | |

Table 7-6: Statistics for CSRep Quantity in Pre AAOIFI Standards (N=50, N Missing=1)

| CSRep Categories | Mean | Std. Dev | Variance | Range | Min | Max |
|--|----------------|-----------------|--------------------|--------------|------------|------------|
| Mandatory disclosure | | | | | | |
| Policy for screening clients | 242.04 | 172.804 | 29861.207 | 870 | 0 | 870 |
| Policy for dealing with clients | 535.38 | 189.874 | 36052.077 | 834 | 125 | 959 |
| Earnings and expenditure prohibited by <i>Shariah</i> | 4.60 | 9.370 | 87.796 | 30 | 0 | 30 |
| Policy for employee welfare | 549.96 | 478.138 | 228615.876 | 2225 | 99 | 2324 |
| Policy for <i>Zakat</i> | 77.24 | 62.022 | 3846.717 | 267 | 0 | 267 |
| Voluntary disclosure | | | | | | |
| Policy for social, development and environment based investment quotas | 103.10 | 194.165 | 37700.173 | 1176 | 0 | 1176 |
| Policy for par excellence customer service | 142.66 | 328.917 | 108186.596 | 2139 | 0 | 2139 |
| Policy for micro and small business and social savings | 28.80 | 39.547 | 1563.959 | 240 | 0 | 240 |
| Policy for <i>Qard Hassan</i> | 11.10 | 38.689 | 1496.867 | 273 | 0 | 273 |
| Policy for charitable activities | 199.60 | 310.928 | 96676.408 | 1087 | 0 | 1087 |
| Policy for <i>Waqf</i> (trust) management | 3.72 | 26.304 | 691.920 | 186 | 0 | 186 |
| Average Pre-Standards Quantity | 1897.60 | 1244.520 | 1548828.980 | | | |

As can be seen in Table 7-5, for CSRep quality before the introduction of the Standards, the top three categories are the Policy for Dealing with Clients, the Policy for *Zakat* and the Policy for Employee Welfare. The least quality for pre Standards is the category of Policy for *Waqf* (trust) Management.

For CSRep quantity, the top three categories are the Policy for Employee Welfare, the Policy for Dealing with Clients, and the Policy for Screening Clients, even though their mean score is still well below the maximum score. The category with the least number of words is also the Policy for *Waqf* (trust) Management category (Table 7-6).

The following section provides a further discussion of these disclosed categories, in order to explain any changes between pre and post AAOIFI Standards. The top categories are also discussed in Section 7.4.3 for the qualitative analysis.

7.2.4 Descriptive Statistics of Post AAOIFI Standards (2010-2011)

Table 7-7 and Table 7-8 exhibit the descriptive statistics for the post-introduction period of the Standards (i.e. 2010-2011), for quality and quantity respectively. In the tables, the top three categories are shaded in grey based on their mean values.

Table 7-7: Statistics for CSRep Quality in Post AAOIFI Standards (N=33, N Missing=33)

| CSRep Categories | Mean | Std. Dev | Variance | Range | Min | Max |
|--|--------------|--------------|---------------|-------|-----|-----|
| Mandatory disclosure | | | | | | |
| Policy for screening clients | 1.00 | .000 | .000 | 0 | 1 | 1 |
| Policy for dealing with clients | 6.76 | 2.292 | 5.252 | 9 | 3 | 12 |
| Earnings and expenditure prohibited by <i>Shariah</i> | 1.00 | 1.369 | 1.875 | 4 | 0 | 4 |
| Policy for employee welfare | 3.82 | .846 | .716 | 3 | 3 | 6 |
| Policy for <i>Zakat</i> | 4.64 | 2.289 | 5.239 | 8 | 2 | 10 |
| Voluntary disclosure | | | | | | |
| Policy for social, development and environment based investment quotas | 2.82 | 2.675 | 7.153 | 10 | 0 | 10 |
| Policy for par excellence customer service | 1.55 | 1.371 | 1.881 | 5 | 0 | 5 |
| Policy for micro and small business and social savings | 3.36 | .603 | .364 | 2 | 3 | 5 |
| Policy for <i>Qard Hassan</i> | 1.30 | 1.776 | 3.155 | 5 | 0 | 5 |
| Policy for charitable activities | 2.18 | 1.530 | 2.341 | 6 | 0 | 6 |
| Policy for <i>Waqf</i> (trust) management | .52 | 1.034 | 1.070 | 4 | 0 | 4 |
| Average Post-Standards Quality | 28.94 | 7.053 | 49.746 | | | |

Table 7-8: Statistics for CSRep Quantity in Post AAOIFI Standards (N=33, N Missing=1)

| CSRep Categories | Mean | Std. Dev | Variance | Range | Min | Max |
|--|----------------|-----------------|--------------------|--------------|------------|------------|
| Mandatory disclosure | | | | | | |
| Policy for screening clients | 448.85 | 263.567 | 69467.445 | 1049 | 111 | 1160 |
| Policy for dealing with clients | 1048.00 | 587.880 | 245602.562 | 1883 | 367 | 2250 |
| Earnings and expenditure prohibited by <i>Shariah</i> | 12.64 | 17.550 | 307.989 | 64 | 0 | 64 |
| Policy for employee welfare | 862.55 | 701.909 | 492676.131 | 2938 | 146 | 3084 |
| Policy for <i>Zakat</i> | 84.91 | 67.038 | 4494.085 | 326 | 9 | 335 |
| Voluntary disclosure | | | | | | |
| Policy for social, development and environment based investment quotas | 176.09 | 292.116 | 85331.710 | 1240 | 0 | 1240 |
| Policy for par excellence customer service | 189.06 | 277.141 | 76807.184 | 1063 | 0 | 1063 |
| Policy for micro and small business and social savings | 30.97 | 47.764 | 2281.405 | 272 | 14 | 286 |
| Policy for <i>Qard Hassan</i> | 5.82 | 9.064 | 82.153 | 37 | 0 | 37 |
| Policy for charitable activities | 230.64 | 338.128 | 114330.239 | 1213 | 0 | 1213 |
| Policy for <i>Waqf</i> (trust) management | 43.03 | 196.397 | 38571.780 | 1131 | 0 | 1131 |
| Average Post-Standards Quantity | 3132.55 | 1465.143 | 2146643.631 | | | |

For CSRep quality after the introduction of the Standards, the top three categories are the Policy for Dealing with Clients, the Policy for *Zakat* and the Policy for Employee Welfare, which are similar to the top categories of CSRep quality before the introduction of the Standards. The least quality for post-Standards is still the category of Policy for *Waqf* (trust) Management.

For quantity after the introduction of the Standards, the top three categories are also the same as the CSRep quantity before the Standards were introduced but

with an increased number of words and a slight change for the categories that are first ranked and second ranked. The first ranked was the Policy for Dealing with Clients, followed by the Policy for Employee Welfare, and the Policy for Screening Clients. The category with the least number of words changed between pre and post AAOIFI Standards, from the Policy for *Waqf* (trust) Management category to the Policy for *Qard Hassan* category. Notwithstanding some minor differences, this indicates that there were no real changes in what CSR areas were emphasised before and after the introduction of the AAOIFI Standards.

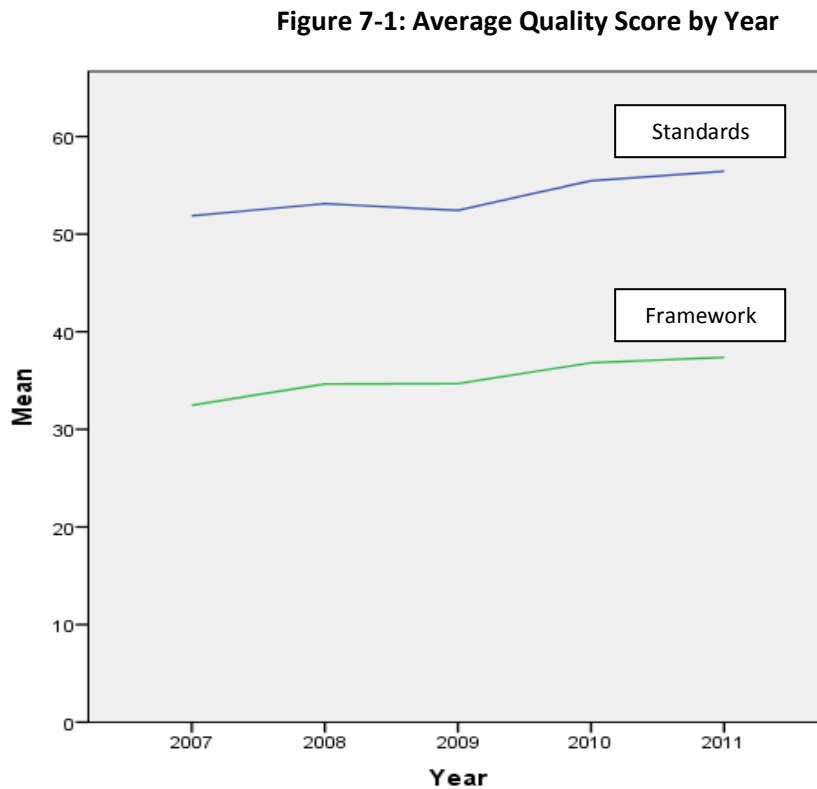
However, it can be seen from the tables above, that both the quality score and the quantity of disclosure increased on average after the introduction of the Standards. Overall quality increased from 25.48 to 28.94 and total quantity disclosed increased by approximately 65%. Interestingly, the increase in quality seems to be generally across all categories, not just in one area. The mean scores for quality have increased most notably in the categories of Waqf Management (2500%), Earnings and Expenditures Prohibited by *Shariah* (108%) and Employee Welfare (28%). For quantity, the notably increased categories are Dealing with Clients (96%), Earnings and Expenditures Prohibited by *Shariah* (175%) and Waqf Management (1075%). Even though Waqf Management is reported as the least category for both quality and quantity of disclosure, this category has shown a large increase in percentage for both quality and quantity over pre and post AAOIFI Standards. This indicates the Standards helped to improve the disclosure in these categories.

However, there is a decrease in quantity for *Qard Hassan* (benevolent loan) by 48%. This may have occurred because, as mentioned earlier, *Qard Hassan* is an unpopular category among Islamic banks in Malaysia because of the implicit repayment of *Qard Hassan*.

Further discussion of these disclosed categories between pre- and post- AAOIFI Standards is provided in the qualitative analysis in Section 7.4.3.

7.2.5 The Trend of CSRep

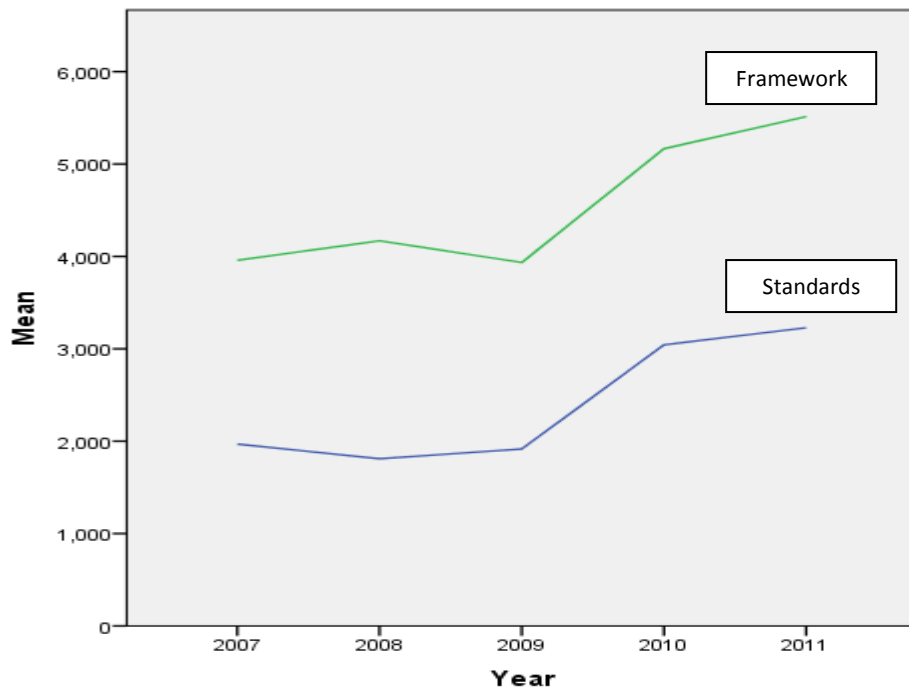
Figure 7-1 shows the trends of CSRep quality based on the Framework and the standards over the period of analysis.



From the graph in Figure 7-1, it is clear that there is an increasing trend of CSRep quality both based on the Framework and on the Standards. CSRep quality scores based on the Standards are consistently higher than the Framework. Higher quality scores based on the Standards is likely to be because there is more emphasis on quantitative disclosure in the Standards.

Figure 7-2 shows the trends of CSRep quantity based on the Framework and the Standards over the period of analysis.

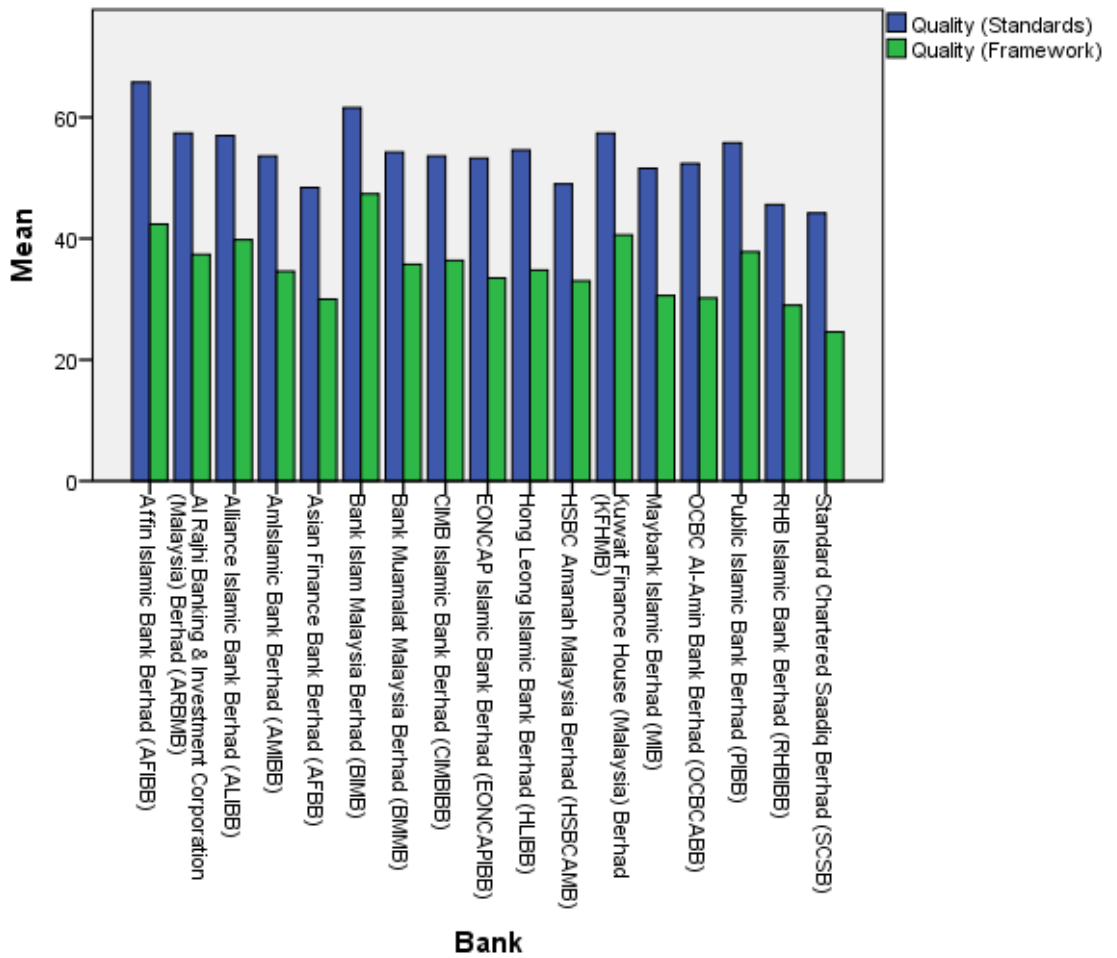
Figure 7-2: Average Quantity Score by Year



The graph in Figure 7-2 exhibits an increasing trend of CSRep quantity both based on the Framework and the Standards. Despite the increasing trend, there is a decrease in the average quantity of disclosure in 2009, but an increase again in 2010. This coincides with the introduction of the Standards, so is indicative that they have had an effect on CSRep in Malaysia, even though they are not mandatory in Malaysia.

When considering individual banks, rather than just averages, it can be seen that CSRep quality scores based on the Standards are higher for every bank in the sample (Figure 7-3), indicating that the core elements of the Standards have been seen as important to Islamic banks, even prior to the introduction of the Standards.

Figure 7-3: Average Quality Score by Banks

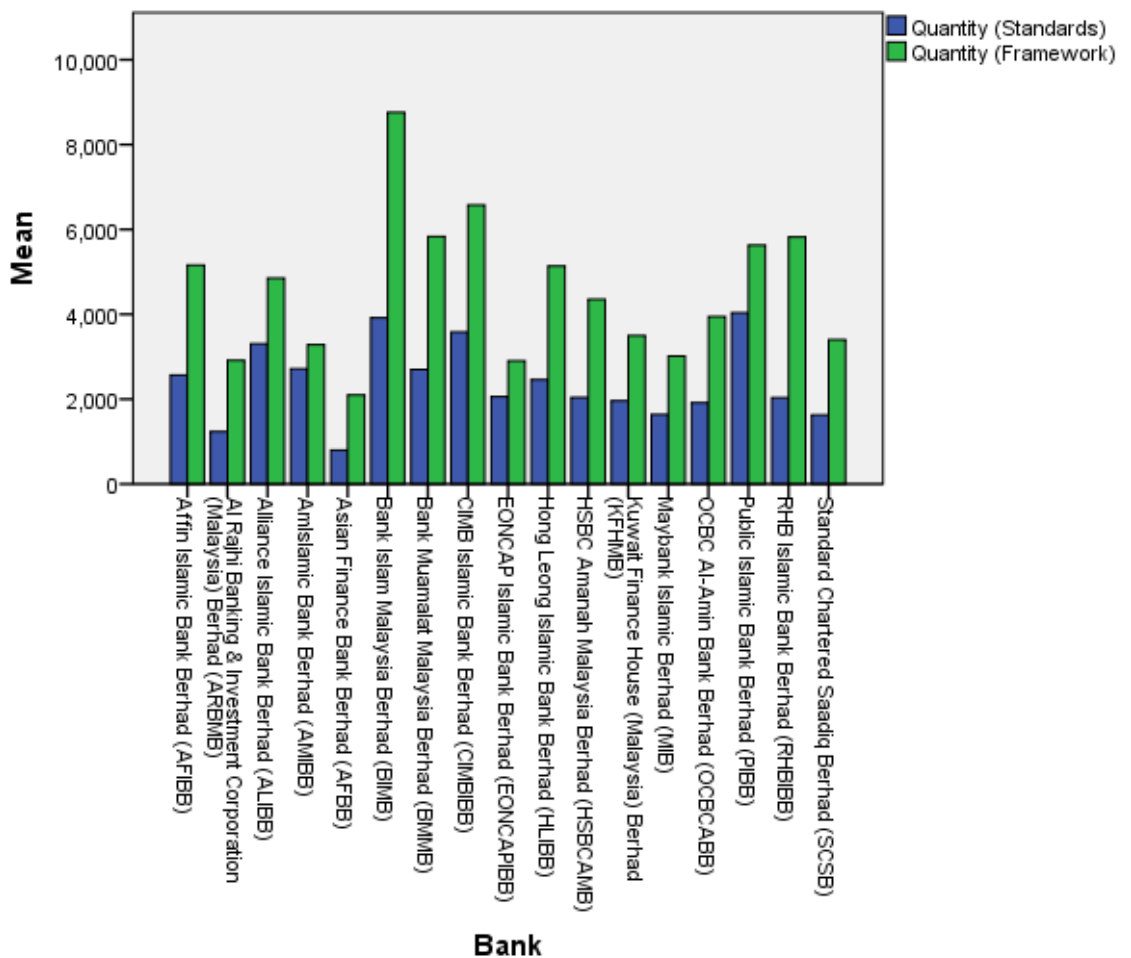


As shown in Figure 7-3, the highest CSRep quality based on the Framework is by Bank Islam Malaysia Berhad (BIMB). This is not surprising because BIMB is a premier Islamic bank and a fully-fledged Islamic bank from its inception. For the CSRep quality based on the Standards, Affin Islamic Bank Berhad (AFIBB) is the highest which is quite surprising because AFIBB is a subsidiary Islamic bank of a conventional bank. In addition AFIBB is a locally owned Islamic bank and this result is unexpected knowing that the AAOIFI Standards are not mandatory in Malaysia. The lowest CSRep quality scores based on the Framework and the Standards are by OCBC Al-Amin Bank Berhad (OCBCABB) and Standard Chartered Saadiq Berhad (SCSB), respectively. It seems both Islamic banks that show the lowest CSRep

quality are the subsidiaries of conventional banks and are the foreign owned Islamic banks of which the headquarters are not in the Gulf region. OCBCABB's headquarters is based in Singapore and SCSB's headquarters is based in London.

Based on Figure 7-4, the CSRep quantity scores however, show that the quantity of disclosure is higher for categories based on the Framework as opposed to the Standards. The reason the number of words may be higher based on the Framework is likely because the Framework sub-categories are too general compared to the Standards which have more specific requirements and place more emphasis on amounts, quotas and targets, and thus limit the descriptive nature of the disclosures.

Figure 7-4: Average Quantity Score by Banks



As shown in Figure 7-4, BIMB is the highest in terms of quantity based on the Framework. For the same reason given earlier, BIMB shows the highest for both quality and quantity possibly due to its position as a premier Islamic bank which has been established for three decades, compared to other Islamic banks which were mostly established about decades later. Thus BIMB may practice and embrace the core elements of the CSRep Framework in their operations as they have been in the Islamic banking system for a long period. However, for the CSRep quantity based on the Standards, Public Islamic Bank Berhad (PIBB) is the highest, which again is quite surprising because PIBB is a subsidiary of conventional bank and also a locally owned Islamic bank and in Malaysia, the AAOIFI Standards are not compulsory. BIMB closely follows PIBB, which indicates that BIMB also attempts to provide more disclosure according to the Standards. It is surprising that Asian Finance Bank Berhad (AFBB) has the lowest CSRep quantity for both based on the Framework and based on the Standards, as AFBB is a foreign owned Islamic bank which is backed by the Middle Eastern financial institutions where the interpretation of Sharia is considered to be less liberal than in Malaysia and where AAOIFI is mandatory.

7.2.6 Summary of Descriptive CSRep in Annual Reports

The descriptive analysis indicates that there is an increasing trend for both CSR reporting quality and quantity by banks in Malaysia. The introduction of the AAOIFI Standards, notwithstanding that they are not mandatory in Malaysia does appear to have had some influence on reporting, and this will be discussed further below. Some specific categories of disclosure appear to dominate the reporting, such as employees, clients, SSB and top management.

It is noted that Unlawful Transactions and *Qard Hassan* are the categories based on the Framework that are disclosed the least. The category of Mission Statements is also among the bottom three, and it is disappointing that many Islamic banks do not incorporate *Shariah* in their mission statements, considering the core of Islamic banks operations is based on *Shariah* law.

For the categories based on the Standards, *Waqf* and *Qard Hassan* are the least disclosed. The Earning and Expenditures Prohibited by *Shariah* is also in the bottom three categories based on the Standards, but this is not unexpected given the nature of these categories.

7.3 Normality and Univariate Tests

In addition to the overall information presented above, the data were examined to ensure they meet the assumptions required for statistical testing. This is presented in the following sections.

7.3.1 Normality Testing of Pre and Post AAOIFI Standards Data

Assessing normality is a prerequisite for many inferential statistical techniques (Coakes and Steed, 2007). In normality testing, the data are checked for central tendency and dispersion. According to Sekaran and Bougie (2010), examination of the measure of central tendency and how dispersed the variables are, gives a good idea of how well the instruments were framed. There are several ways to explore normality by visual displays, such as through histograms, stem-and-leaf plots, boxplots, normal probability plots and detrended normal plots. Normality can also be tested statistically by testing skewness, kurtosis, Kolmogorov-Smirnov statistic with Lilliefors significance level and Shapiro-Wilk statistic.

The data were tested for normality for both quality and quantity, separated into the periods before and after the introduction of the Standards. Figure 7-5 and Table 7-9 below show the histograms and statistics of the distribution analysis for the period before the introduction of the Standards (pre-Standards: 2007-2009).

Figure 7-5: Histograms of Pre-Standards Data (2007-2009)

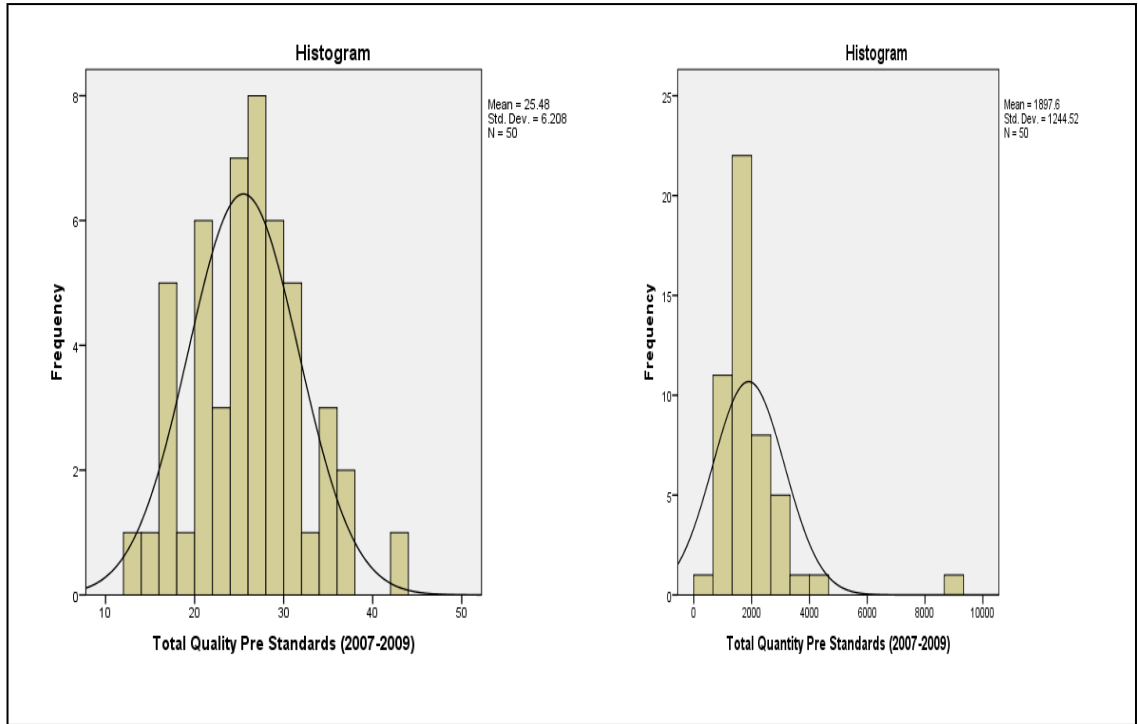


Table 7-9: Normality Tests of Pre-Standards Data (2007-2009)

| Dependent Variables | Test of Normality using Skewness Statistic | | | |
|------------------------|--|----------------|----------------|------------|
| | Statistic | Standard Error | Remark | |
| Pre-Standards QUALITY | 0.163 | 0.337 | Normal | |
| Pre-Standards QUANTITY | 3.713 | 0.337 | Not normal | |
| | Test of Normality using Kurtosis Statistic | | | |
| | Statistic | Standard Error | Remark | |
| Pre-Standards QUALITY | -0.14 | 0.662 | Normal | |
| Pre-Standards QUANTITY | 19.321 | 0.662 | Not normal | |
| | Test of Normality using Kolmogorov-Smirnov Statistic | | | |
| | W Statistic | df | Sig. (p-value) | Remark |
| Pre-Standards QUALITY | 0.073 | 50 | 0.200 | Normal |
| Pre-Standards QUANTITY | 0.206 | 50 | 0.000 | Not normal |
| | Test of Normality using Shapiro-Wilk Statistic | | | |
| | W Statistic | df | Sig. (p-value) | Remark |
| Pre-Standards QUALITY | 0.982 | 50 | 0.658 | Normal |
| Pre-Standards QUANTITY | 0.670 | 50 | 0.000 | Not normal |

A histogram with normally distributed data should have a symmetrical and bell shaped curve (Gravetter and Wallnau, 2008). The histograms provided in Figure 7-5, indicate that the data are relatively normal, although slightly skewed in some places.

However, normality can also be tested statistically. The statistical test for skewness measures the symmetry of the sample distribution and the kurtosis measures the spread of data (Coakes and Steed, 2007). For normally distributed data, the skewness value and the kurtosis value is close to 0 and within the range of twice its standard error (Palaniappan, 2009). For Kolmogorov-Smirnov and Shapiro-Wilk statistic, the significance level should be at $p > .05$ to assume normality. Based on Table 7-9, the results of the statistical tests for skewness= .163 and Kurtosis= -.014

indicates the normality for the quality of pre-Standards data. The P values of Kolmogorov-Smirnov and Shapiro-Wilk tests are more than .05, which also suggests the normality of distribution for the quality of pre-Standards data.

However, for the quantity of pre-Standards data, the statistical values indicate that data are not normally distributed (skewness = 3.713; Kurtosis = 19.321), and both the Kolmogorov-Smirnov and Shapiro-Wilk statistics is at $p < .05$, therefore the data are assumed not normal.

Figure 7-6 and Table 7-10 exhibit the histograms and statistics of the distribution analysis for the period after the introduction of the Standards (post-Standards: 2010-2011).

Figure 7-6: Histograms of Post-Standards Data (2010-2011)

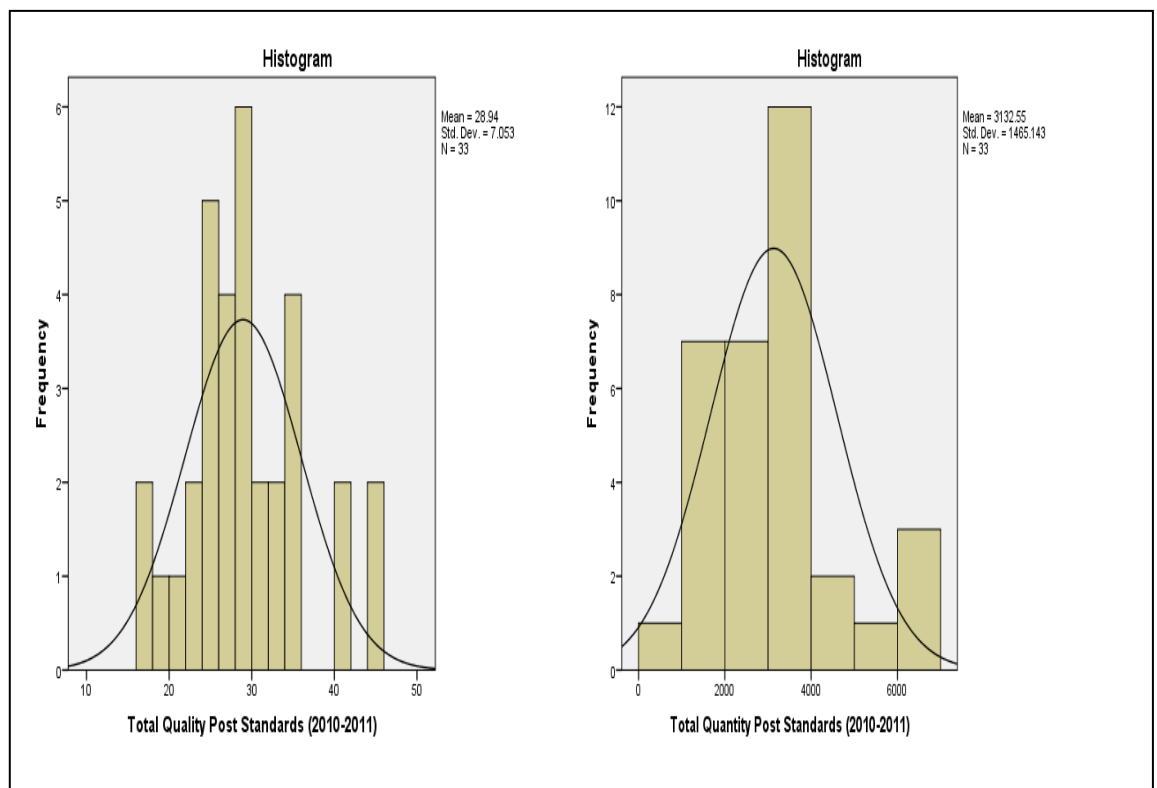


Table 7-10: Normality Tests of Post-Standards Data (2010-2011)

| Dependent Variables | Test of Normality using Skewness Statistic | | | |
|-------------------------|--|----------------|----------------|--------|
| | Statistic | Standard Error | Remark | |
| Post-Standards QUALITY | .466 | .409 | Normal | |
| Post-Standards QUANTITY | .847 | .409 | Normal | |
| | Test of Normality using Kurtosis Statistic | | | |
| | Statistic | Standard Error | Remark | |
| Post-Standards QUALITY | .050 | .798 | Normal | |
| Post-Standards QUANTITY | .538 | .798 | Normal | |
| | Test of Normality using Kolmogorov-Smirnov Statistic | | | |
| | W Statistic | df | Sig. (p-value) | Remark |
| Post-Standards QUALITY | .137 | 33 | .118 | Normal |
| Post-Standards QUANTITY | .115 | 33 | .200 | Normal |
| | Test of Normality using Shapiro-Wilk Statistic | | | |
| | W Statistic | df | Sig. (p-value) | Remark |
| Post-Standards QUALITY | .961 | 33 | .279 | Normal |
| Post-Standards QUANTITY | .938 | 33 | .060 | Normal |

The histograms provided in Figure 7-5, indicate that the data are relatively normal. According to the statistics in Table 7-10, the post-Standards data are normally distributed for both quality (skewness= .466; Kurtosis= .050) and quantity (skewness= .847; Kurtosis= .538), as all skewness and kurtosis values are close to 0 and within the range of twice their standard errors. The *P* values of Kolmogorov-Smirnov and Shapiro-Wilk tests for both quality and quantity of post-Standards data are also more than .05, which indicate the normality of data distribution.

7.3.2 Univariate Non-parametric Test: Wilcoxon Signed-Rank Test

As mentioned above, this study attempts to explore the differences in CSRep before and after the introduction of the Standards, to see any influence of AAOIFI

Standards on CSR conduct and disclosure. Two hypotheses were developed to test for differences:

Ha: After the introduction of AAOIFI Standards on CSR, there will be an increase in the quality of CSRep.

Hb: After the introduction of AAOIFI Standards on CSR, there will be an increase in the quantity of CSRep.

Since some of the data sets' distributions are not normal, the Wilcoxon signed-rank test was used in this study. The Wilcoxon signed-rank test is used when subjects are measured on two occasions, or under two different conditions (Pallant, 2010).

Tables 7-11 and 7-12 provide the results of the Wilcoxon Signed Ranks test for the quality score pre- and post- the introduction of the Standards.

Table 7-11: Wilcoxon Signed Ranks

| | | N | Mean Rank | Sum of Ranks |
|----------------------------------|----------------|------------------|-----------|--------------|
| Total of Post Standards | Negative Ranks | 11 ^a | 11.05 | 121.50 |
| QUALITY - Total of Pre Standards | Positive Ranks | 21 ^b | 19.36 | 406.50 |
| QUALITY | Ties | 1 ^c | | |
| | Total | 33 ⁴⁴ | | |

a. Total of Post Standards QUALITY < Total of Pre Standards QUALITY

b. Total of Post Standards QUALITY > Total of Pre Standards QUALITY

c. Total of Post Standards QUALITY = Total of Pre Standards QUALITY

⁴⁴ Since the pre-standards period consists of 3 years (2007-2009) and the post-standards period consists of only 2 years (2010-2011), 2007 is not accounted for so that the paired observation could be made. There are two missing data, one for 2009 and another one for 2011, therefore pre-standards is N=33 and post-standards is also N=33. Both pre-standards and post-standards data are paired for the test, making the total pairs of observation 33.

Table 7-12: Test Statistics^b

| | Total of Post Standards QUALITY - Total of Pre Standards QUALITY |
|------------------------|---|
| Z | -2.671 ^a |
| Asymp. Sig. (2-tailed) | .008 |

a. Based on negative ranks.

b. Wilcoxon Signed Ranks Test

It is also important to know and report the effect size, so that people can know a standardized measure of the size of the effect that was observed in the study and then can compare this to other studies (Field, 2005). The effect size estimate, r , can be calculated as follows (Field, 2005, p.532):

$$r = \frac{Z}{\sqrt{N}}$$

In which Z is the Z-score that SPSS produces, and N is the size of the study on which Z is based. In this case, the effect size of the Wilcoxon Signed Ranks test for the quality score pre- and post- the introduction of the Standards is, therefore:

$$\begin{aligned} r_{Quality} &= \frac{-2.671}{\sqrt{33}} \\ &= -.46 \end{aligned}$$

As shown in Table 7-12, the P value is .008 ($p < .05$), therefore this indicates the difference between pre-Standards and post-Standards of CSRep quality is statistically significant, supporting the descriptive finding that there is a difference in quality before and after the Standards were introduced. Tables 7-11 and 7-12 report that quality of CSRep was significantly higher for post-Standards reports than in pre-Standards reports, $T = 121.50$, $p < .05$, $r = -.46$. T is the test statistic of the smallest of the two sum of ranks.

The results of the Wilcoxon Signed Ranks test for Quantity are presented in Tables 7-13 and 7-14.

Table 7-13: Wilcoxon Signed Ranks

| | | N | Mean Rank | Sum of Ranks |
|-----------------------------------|----------------|-----------------|-----------|--------------|
| Total of Post Standards | Negative Ranks | 4 ^a | 15.75 | 63.00 |
| QUANTITY - Total of Pre Standards | Positive Ranks | 29 ^b | 17.17 | 498.00 |
| QUANTITY | Ties | 0 ^c | | |
| | Total | 33 | | |

- a. Total of Post Standards QUANTITY < Total of Pre Standards QUANTITY
- b. Total of Post Standards QUANTITY > Total of Pre Standards QUANTITY
- c. Total of Post Standards QUANTITY = Total of Pre Standards QUANTITY

Table 7-14: Test Statistics^b

| | |
|------------------------|---|
| | Total of Post Standards QUANTITY - Total of Pre Standards QUANTITY |
| Z | -3.886 ^a |
| Asymp. Sig. (2-tailed) | .000 |

- a. Based on negative ranks.
- b. Wilcoxon Signed Ranks Test

The effect size of the Wilcoxon Signed Ranks test for the quantity score pre- and post- the introduction of the Standards is calculated as follows:

$$r_{Quantity} = \frac{-3.886}{\sqrt{33}} = -.68$$

As for quantity, the results indicate a *P* value of .000 (*p*<.05), showing that the difference between pre-Standards and post-Standards CSRep quantity is statistically significant. Tables 7-13 and 7-14 report that quantity of CSRep is significantly higher in post-Standards reports than in pre-Standards reports, *T*= 63, *p*< .05, *r* = -.68. These results support the hypothesis that the introduction of AAOIFI has had an impact on CSRep in Malaysia, notwithstanding their non-mandatory status.

7.3.3 Univariate Parametric Test on Paired Samples T-test

Parametric tests have greater power to detect effects, especially for normally distributed data. The parametric t-test for paired samples was used in this study to confirm the findings of the Wilcoxon signed-rank tests. A paired sample t-test is used when data are collected from one group of subjects on two different occasions, or under two different conditions (Pallant, 2010). In this study, data were collected from Malaysian Islamic banks' annual reports both pre-introduction of Standards and post-Standards. The results are presented in Table 7-15 below, and again indicate that there is a significant difference between pre- and post-Standards CSR reporting for both quality and quantity, based on the significance value (2-tailed) $p < .05$.

Table 7-15: Paired Samples T-Tests

| | | Mean | N | Std. Deviation | Std. Error Mean | | | | |
|---------------|-------------------------|---------|----|----------------|-----------------|--|--|--|--|
| Pair 1 | Pre-Standards QUALITY | 25.48 | 33 | 6.76 | 1.18 | | | | |
| | Post-Standards QUALITY | 28.94 | 33 | 7.05 | 1.23 | | | | |
| Pair 2 | Pre-Standards QUANTITY | 1890.79 | 33 | 1409.86 | 245.43 | | | | |
| | Post-Standards QUANTITY | 3132.55 | 33 | 1465.14 | 255.05 | | | | |

| | | Paired Differences | | | | | | | |
|---------------|--|--------------------|----------|-----------------|---|---------|-------|----|-----------------|
| | | | | | 95% Confidence Interval of the Difference | | | | |
| | | Mean | Std. Dev | Std. Error Mean | Lower | Upper | t | df | Sig. (2-tailed) |
| Pair 1 | Pre-Standards QUALITY – Post-Standards QUALITY | -3.46 | 7.08 | 1.23 | -5.96 | -.95 | -2.81 | 32 | .008* |
| Pair 2 | Pre-Standards QUANTITY – Post-Standards QUANTITY | -1241.76 | 1770.96 | 308.29 | -1869.71 | -613.80 | -4.03 | 32 | .000* |

*The significance level is .05

There is a statistically significant increase in CSRep quality from pre-Standards ($M=25.48, SD=6.76$) to post-Standards ($M=28.94, SD=7.05, t(32), p<.05$). Also for CSRep quantity, there is a statistical increase from pre-Standards ($M=1890.79, SD=1409.86$) to post-Standards ($M=3132.55, SD=1465.14, t(32), p<.05$).

7.3.4 Summary of Univariate Tests Results of CSRep in Pre- and Post- Standards

Table 7-16 summarizes the hypotheses test results. Both tests of a nonparametric and parametric nature suggest same results of the strength of the differences. The tests yield significant results at a 5% level of significance, which means that the null hypotheses of no difference are rejected. In fact, the differences are highly significant and Wilcoxon signed rank results show that there were increases in the CSRep quality and quantity after the introduction of AAOIFI Standards on CSR, similar to what the author hypothesized.

Table 7-16: Hypotheses Test Summary

| Null Hypothesis | Test | Sig. | Decision |
|--|--|------|--|
| There is no difference between Total Pre-Standards QUALITY and Total Post-Standards QUALITY. | Related-Samples Wilcoxon Signed Rank Test & Paired Samples T-test | .008 | Reject the null hypothesis Accept Ha: After the introduction of AAOIFI Standards on CSR, there will be an increase in the quality of CSRep. |
| There is no difference between Total Pre-Standards QUANTITY and Total Post-Standards QUANTITY. | Related-samples Wilcoxon Signed Rank Test & Paired Samples T-test | .000 | Reject the null hypothesis Accept Hb: After the introduction of AAOIFI Standards on CSR, there will be an increase in the quantity of CSRep. |

Asymptotic significances are displayed. The significance level is .05.

It is surprising that AAOIFI has had such an influence on CSRep in Malaysia, given the Standards' non-mandatory status. However, the results raise questions about whether the AAOIFI Standards on CSR can improve the CSRep in Malaysia. This is because the Standards may encourage the Islamic banks to simply follow and disclose only the information required by the Standards. Thus, Islamic banks may be discouraged from disclosing additional information, particularly in a narrative format as the Standards focus on quantitative information. This matter will be discussed further in the discussion section in Chapter 9.

7.4 Qualitative Analysis

As indicated earlier, this thesis comprises both a quantitative and a qualitative element. This chapter is related to research questions one and two, on the extent and nature of CSRep by Islamic Banks before and after the introduction of the Standards. Therefore, the qualitative analysis is presented next, before considering additional quantitative modelling in Chapter 8, which addresses the third research question.

Mayring (2000) defines qualitative content analysis as "an approach of empirical, methodological controlled analysis of texts within their context of communication, following content analytical rules and step by step models, without rash quantification" (p.2).

In this study, a qualitative analysis is conducted by examining the disclosures in each sub-category included in both the Framework and the Standards. These categories are examined for common themes and trends across the banks and over time.

7.4.1 CSRep based on the Framework

As outlined in the descriptive statistics, the analysis based on the Framework (Quality) indicated the highest quality disclosure is in the categories of Top management, Employees, and *Shariah* Supervisory Board opinion. Similarly, for the Framework (Quantity); the Top Management, *Shariah* Supervisory Board Opinion,

and Late Payment and Insolvent Clients categories showed the highest level of disclosures. These categories are discussed further below.

The Top management category is included as the top category for both quality and quantity, and this confirms the Islamic principle of Responsibility in practice. Specifically, management decisions based on Shariah, and fulfilling the responsibility of the organisation towards society should show that Islamic banks attempt to put the Islamic relations system principle of Accountability into their disclosure. Managers need to fulfill the responsibility entrusted to them by managing business operations effectively and efficiently. To do this, they must have certain qualities to carry out their duties. Thus, this is why the Framework requires the disclosure of directors' and managers' details, their qualifications, remuneration and the policy for appointing, reappointing and dismissing them, to ensure that they have a good background and fit qualities to carry out their duties according to Shariah.

From the qualitative content analysis, the majority of the disclosures in this category provide a profile of directors and managers, their responsibilities and remuneration. For example,

YBHG. DATO' SRI ABDUL AZIZ BIN ABDUL RAHMAN

Independent Non-Executive Director

Dato' Sri Abdul Aziz bin Abdul Rahman, aged 66, was appointed to the Board of Directors of AFFIN ISLAMIC on 1 November 2011. Dato' Sri Abdul Aziz graduated with a Bachelor of Commerce from University of New South Wales, Sydney, Australia. He is member of the Malaysian Institute of Certified Public Accountants (MICPA) and the Malaysian Institute of Accountants (MIA). He has served as Chairman and board member of several government institutions, agencies and public listed companies, both in Australia and Malaysia. At the corporate level he was with Price Waterhouse & Co. Sydney, Malaysia Airlines and Managing Director of Bank Rakyat Bhd before venturing into politics and public service as the Pahang State Assemblyman, State Executive Councillor and Deputy Chief Minister of Pahang. He was a Senator of Malaysian Parliament for a maximum period of two (2) terms. Presently he is a Board member of AFFINBANK, the International Islamic University Malaysia, University Malaysia Pahang and their associated holding companies. Dato' Sri Abdul Aziz's expertise and knowledge carries across a broad spectrum relating to finance and accounting. His standing in the community contributes effectively to his role as an Independent Director particularly in meeting various stakeholders expectation. Dato' Sri Abdul Aziz bin Abdul Rahman during his tenure attended the Board Meeting held for the period November to December 2011.

ASSOCIATE PROFESSOR DR. ASYRAF WAJDI BIN DATO' DUSUKI

Independent Non-Executive Director

Associate Professor Dr. Asyraf Wajdi Bin Dato' Dusuki, a Malaysian aged 36, was appointed as a Director of AFFIN ISLAMIC on 9 May 2011. He is currently the Head of Research Affairs, International Shariah Research Academy for Islamic Finance (ISRA). Prior to joining ISRA he was an Assistant Professor of Islamic Banking at the Kulliyah of Economics and Management Sciences, International Islamic University Malaysia (IIUM). Apart from serving ISRA, he also serves as a Chairman of AFFIN Group Shariah Committee and Shariah consultant and advisor to several financial institutions and advisory firms including London based Mortgage Company Chain Mender Limited, US-based Islamic Financial Institution United Chartered Bank (UCB), Singapore-based IFIS Business Advisory Pte Ltd and AFTAAS Shariah Advisory Sdn Bhd. He holds Master of Science degree in Islamic Economics, Banking and Finance and PhD in Islamic Banking and Finance from Loughborough University, United Kingdom. He has been published in numerous international and local referred academic journals. One of his articles entitled 'Banking for the Poor: Role of Islamic Banking in Microfinance Initiatives' has been awarded at the 2009 Outstanding Paper Award by the well-known International Referred Journal Article Publisher Emerald Literati Network. Apart from that he has presented papers at both local and international conferences including London, Bahrain, Berlin, Dubai, Tehran, Jakarta, Singapore and Brunei. He also conducts training in Islamic banking and finance related areas to officers of Central Bank of Malaysia, banking practitioners, government officials and public. Dr. Asyraf Wajdi during his tenure attended all 7 Board Meetings held for the period May to December 2011.

(Affin Bank, 2011)

From the above example, the directors' profile shows that both directors have suitable qualifications and professional experience to manage bank operations and have also knowledge of Shariah and Islamic banking. These qualities should make them fit to carry their responsibilities in decision making for Islamic banks and to be accountable for following Shariah.

In terms of remuneration, the directors' and top management's remuneration is also disclosed in detail, including the amount for each individual director, and each benefit that they get. The policy to appoint, reappoint and dismiss a director is also disclosed in a great detail. However, as mentioned earlier, the majority of the disclosures in this category provide a profile of directors and managers, their responsibilities and remuneration, which is also the same requirement for corporate governance that is made compulsory by the legal authority. They do not directly relate to specific Islamic principles, except the mentioned Responsibility principle.

However, this disclosure does not confirm whether the directors have the full power to carry out their responsibilities. In Malaysia, most Islamic banks are

subsidiaries of conventional banks, where conventional banks have full control over the Islamic banks' operations including control of their directors and managers. Therefore, the actions of directors and managers could be constrained by the conventional banks (Ibrahim, 2010), and thus it would be hard for them to carry out the true spirit of Islamic CSR as the motive of conventional banks is profit maximization, whereas Islamic banks should aim for reasonable profit and also carry out a social role. It would not be a problem if the Islamic bank was not under the control of another organisation, but because Islamic banks are still new and developing, many of them are controlled by conventional banks which are larger and longer established. In order to examine this idea further, a comparison was undertaken of CSRep between Islamic banks which are controlled by conventional banks and those non-controlled Islamic banks using Mann-Whitney U tests. Based on the mean rank, the results show that in terms of CSRep quality, the non-controlled Islamic banks disclose higher quality information than Islamic banks which are controlled by conventional banks. For CSRep quantity, there is no difference between Islamic banks which are controlled by the conventional banks and non-controlled Islamic banks. The results indicate that the non-controlled Islamic banks performed better CSRep than Islamic subsidiaries of conventional banks. See Appendix 4 for details of the statistical tests. However, the results were confined to the disclosure of CSR. They only provide a brief picture of which type of Islamic banks, those controlled by conventional banks or non-controlled Islamic banks, disclose better CSR. Therefore, the results do not provide evidence about the limited power of directors and managers of Islamic banks that are subsidiaries of conventional banks. An interesting area for further study would be a comparison between controlled Islamic banks and non-controlled Islamic banks by interviewing the managers and directors to know whether they really have full power over their responsibilities and whether or not they are constrained by their parent companies which are conventional banks.

The SSB category is also among the top three categories for both quality and quantity in annual reports. This category is related to the Islamic principle of Unity and the Islamic social relations system of Trustworthiness, as the SSB report

provides information on the Islamic banks' compliance with Shariah law. All Islamic banks in the study provide disclosure in this category and most produce an SSB report and give details of their SSB members, their remuneration, requirements and responsibilities. Again, however, the disclosure is mainly compliance-focused in nature even though the quantity of disclosure is high. An example of SSB report extract is provided below:

We have reviewed the principles and the contracts relating to the transactions and applications introduced by Asian Finance Bank Berhad during the financial year ended 31 December 2011. We have also conducted our review to form an opinion as to whether Asian Finance Bank Berhad have complied with the Shariah principles and with the Shariah rulings issued by the Shariah Advisory Council of Bank Negara Malaysia, as well as Shariah decisions made by us. The Management of Asian Finance Bank Berhad is responsible for ensuring that the Bank conducts its business in accordance with Shariah principles. It is our responsibility to form our independent opinion, based on our review of the operations for Asian Finance Bank Berhad, and to report to you.

We have assessed the work carried out by Shariah review and Shariah audit which included examining, on a test basis, each type of transaction, the relevant documents and procedures adopted by Asian Finance Bank Berhad.

We planned and performed our view so as to obtain all the information and explanations which we consider necessary in order to provide us with sufficient evidence to give reasonable assurance that Asian Finance Bank Berhad has not violated the Shariah principles. In our opinion:

- the contracts, transactions and dealings entered into by Asian Finance Bank Berhad during the financial year ended 31 December 2011 that we have reviewed are in compliance with Shariah principles;
- the allocation of profits and losses relating to investment accounts conform to the basis that had been approved by us in accordance with Shariah principles; and
- all earnings that have been realised from sources or by means prohibited by Shariah principles, have been disposed to charitable causes.

(AFBB, 2011)

In the above SSB report, it provides a very detailed opinion on the Islamic bank's operations. For instance, this SSB report provides a certification that distribution of profits and losses are made according to Shariah law, the existence of earnings prohibited by Shariah, and the way the bank disposes of prohibited earnings, which are all checklist items in the content analysis. Most SSB reports issued by other Islamic banks in the sample are brief, and only disclose a general certification on Shariah compliance.

The Employee category is among the top categories in terms of quality. This category relates to the Islamic principle of Unity in Man-Human beings relationships, thus needs social justice and fairness when dealing with employees. Therefore, Islam requires firms to avoid discrimination of its employees. Themes within this category include Policies for wages and bonus payments, education and training for employees, equal opportunities, and the working environment. For example, Affin Islamic Bank Berhad (AFIBB) reported “everyone as equally important” (AFIBB, 2008), which is intended to show there is no discrimination of employees regardless of gender, handicap ability, race and so on. Thus, they are asserting that every employee has equal opportunities in career training and development based on their own personal capability and competency as reported in annual report of Alliance Islamic Bank Berhad (ALIBB):

We have also invested in an online Human Resource Management System which empowers employees to take ownership of their personal development and career progression.

(ALIBB, 2011)

Islamic banks also claim to ensure that employees have adequate Islamic banking knowledge to prepare them for working in the Islamic banking industry, through initiatives such as:

Induction training to educate new employees on the fundamentals of working for the Islamic banking industry

(BIMB, 2009)

To promote staff excellence and encourage teamwork, induction programmes as well as team building exercises are continuously organised with the help of our own Shariah Department.

(BMMB, 2010)

They also inculcate Islamic knowledge into their employees to ensure that they work within the spirit of Islam.

...religious lectures delivered by notable in-house and invited speakers

(BIMB, 2009)

Lastly, the Late Payment and Insolvent Clients category is among the top categories in terms of quantity. This is related to the Free Will principle, where mankind is a trustee who is given freedom from Allah to manage resources. Free will should be filled with goodness and be conscious of the rest of mankind, and care for the less fortunate. The relationship between man and other human beings must be taken

care of, and in the case of Islamic banks, must be conscious when dealing with their insolvent clients who may have a valid excuse for being in default. A penalty charge could be applied, but the penalty charge that is earned by Islamic banks must be disposed of. The Islamic banks should disclose their policy on dealing with insolvent clients and on late payment by clients, the permissibility of imposing penalty charges by the SSB and the penalty charge amount. For example:

Agree that all earnings realised are from permissible sources, except the component of late payment penalty which has already been accrued but yet to be channeled to charity. This amount shall be readjusted in the following financial year.

(AFIBB, 2010)

...the amount channeled to charity fund as at 31 December 2011 was RM290,417.77 as purification of late payment charges and fee income earned from impermissible usage of debit card

(AFIBB, 2011)

It is observed that in the annual reports, Malaysian Islamic banks did disclose the amount of the penalty charges and those penalty charges were disposed of as charity, as shown in the annual report of Affin Islamic Bank Berhad (AFIBB). These penalty charge details are reported particularly in the SSB report, which shows that the SSB permitted the penalty charges and confirmed the disposal of the penalty charges.

However, it is disheartening that Mission Statements category is among the bottom three, which shows that many Islamic banks do not incorporate their commitment to operate within Shariah into their mission statements. According to Campbell et al. (2001) mission statements “deal with the overarching rationale for an organization, a common thread or unifying theme, detailing the reason for the existence of the entity” (p.66). In Islam, the mission statement is considered as a contract (*Uqud*) statement in which the management members are expected to fulfil their contract. If the commitment to *Shariah* is disclosed in the vision and mission statements, it can assure the Muslim stakeholders that the business operations are as required by Islamic principles. Even though there is no presence of *Shariah* in the mission statements, the analysis observes that many Islamic banks include Islamic terms and values in their annual reports such as greetings in Islam,

mentions of the grace of Allah, thanks to Allah, and quotes from the Quran and Hadith. Thus, the presence of Islamic terms and values is somehow attempting to show that the banks are committed to fulfilling the needs of the Muslim stakeholders.

It can be seen from the qualitative analysis, that the banks in the study do report on the items expected according to the Islamic CSR Framework developed, however, the disclosures appear to be somewhat 'compliance' focused (that is, compliance with regulations rather than Islamic expectations) and the disclosures provide limited details.

The next section discusses the qualitative analysis of CSRep themes developed based on the AAOIFI Standards to determine whether these categories better reflect the disclosures. As noted earlier, the categories developed from the Framework and the categories determined from the Standards do overlap, but the two analyses are conducted to form an overall picture of whether disclosures appear to be based on a set of expected Islamic values, or are more related to compliance with an extant guideline.

7.4.2 CSRep based on AAOIFI Standards

Descriptive statistics of CSRep based on AAOIFI Standards show that for Quality, the highest scores are in the categories of Policy for Dealing with Clients, the Policy for *Zakat*, and the Policy for Employee Welfare. For Quantity, the Policy for Dealing with Clients, the Policy for Employee Welfare, and the Policy for Screening Clients categories showed the highest level of disclosures. These categories are discussed further below.

The Policy for Dealing with Clients category is included as the top category for both quality and quantity. The Standards require Islamic banks to report their policy and procedures for client contracts, conditions to extend credit and to defer debt collection, the amount of penalty charges, and disposal of penalty charges. An indicative disclosure is:

Customers' accounts are classified as non-performing where repayments are in arrears for more than 90 days from the day of default.

(ARBMB, 2010)

...purification by Shariah of RM2,189,430 (2009: RM2,189,430) which has been excluded from the Bank's income. Subsequent to the financial year, the amount under the purification by Shariah shall be distributed.

(ARBMB, 2010)

The above disclosure shows the policy of Al Rajhi Banking & Investment Corporation (Malaysia) Berhad (ARBMB) for treating clients' accounts when they are in default and the amount of penalty charge that would be disposed of. This category also requires the statement that marketing campaigns and documents are ethically balanced, and this is shown, for example, by:

the Shariah Committee must endorse the following:

- i. the terms and conditions contained in the proposal form, contract, agreement or other legal documentation used in executing the transactions; and
- ii. the product manual, marketing advertisements, sales illustrations and brochures used to describe the product.

(AFBB, 2009)

From the above disclosure, it shows that the SSB is responsible for endorsing the marketing campaigns and documents such as contracts, agreements and so on. This disclosure means that Islamic banks try to convince the readers of the annual report that the SSB ensures that marketing campaigns and documents are prepared according to Shariah and are also ethical.

The Policy for Employee Welfare category is also among the top categories for both quality and quantity. This category is similar to the Employee category based on the Framework, but the AAOIFI Standards require the disclosure of a policy for employee welfare that includes disadvantaged groups, its quotas and targets. The Employee Welfare disclosures can be demonstrated by the following from Hong Leong Islamic Bank Berhad (HLIBB):

...develops talent regardless of race, gender or religious belief. Employee advancement is based on merit and we believe that it is this variety of persuasions and cultures that fuel creativity, entrepreneurship and openness.

(HLIBB,2011)

From the disclosure by HLIBB, it shows that the employees are given equal opportunities to develop their talents and career, including the disadvantaged groups such as women and minorities who are working in the Islamic banks.

Similarly, disclosure is provided about how assistance is provided to employees:

Staff Welfare Fund

The Group's Staff Welfare Fund, with its tagline "CIMBians helping CIMBians", provides financial assistance to employees and their family members to cope with high medical expenses as a result of accident or serious illness, and to assist in the event of loss or damage to property resulting from natural disasters.

(CIMB,2011)

The above disclosure made by CIMB Group, indicates that welfare in term of financial assistance is available to all employees within the company group including CIMB Islamic Bank Berhad (CIMBIBB), and that the welfare is extended to their family members.

As mentioned above, the Policy for *Zakat* category is among the top categories in terms of quality. This generally includes statements about the method of determining *Zakat* and other issues related to *Zakat*. For example, the method used for determining the *Zakat* base and the items included in the base is disclosed by Affin Islamic Bank Berhad (AFIBB):

The Bank pays zakat based on 2.5% of prior year's net asset method, to comply with the principles of Shariah. The Bank does not pay zakat on behalf of the shareholders or depositors. The Bank made provision for zakat amounting to RM4.38 million for the financial year ended 31 December 2009.

(AFIBB,2009)

The disclosure shown above not only provides information about the *Zakat* base, but also provides the calculation method of *Zakat*, the *Zakat* amount, and the statement of whether or not the Islamic bank pays *Zakat* on behalf of the shareholders and depositors as required by the AAOIFI Standards. Another requirement of the Standards for this category is, a statements about the ruling of the Shariah Supervisory Board (SSB) of the Islamic bank on the issues related to *Zakat*:

Confirm that the calculation of Zakat is in compliance with Shariah rules and principles.
(AFIBB,2009)

AFIBB provided the above disclosure in the SSB report, stating that the SSB gave a ruling on the *Zakat* calculation and also attests that the calculation is in accordance with Shariah. Generally, Islamic banks disclose sufficient information that would assist the stakeholders to pay *Zakat*.

Finally, the Policy for Screening Clients category is among the top categories for disclosure quantity. AAOIFI Standards require information on the provisions of the screening policy utilized to measure compliance with Shariah. As most Islamic banks invest in Shariah-approved companies in Bursa Malaysia, it could be assumed that most clients of Islamic banks comply with Shariah. Therefore, Islamic banks screen their clients by using credit quality. For example:-

The Bank assess credit quality of financing and advances using internal rating models which have been developed internally and combine statistical analysis with credit officers' judgement.

(AFBB, 2011)

The disclosures based on the AAOIFI Standards also reflect Shariah compliance. In general, the disclosures based on both the Framework and the Standards indicate that CSR aspects, according to both an Islamic viewpoint and the AAOIFI Standards, dominate the annual report disclosures of Malaysian Islamic banks.

Consistent with the descriptive and statistical analysis, the qualitative analysis so far indicates that the content of annual reports reflects the expected CSR disclosures based on a general Islamic Framework and also indicates that the elements of the AAOIFI Standards appear to have an influence on disclosure. Again, however, it is important to consider whether there is evidence of greater or better disclosures after the Standards were introduced.

7.4.3 CSRep: Pre AAOIFI Standards and Post AAOIFI Standards

Section 7.2 above provided the descriptive analysis of CSRep in annual reports in terms of both quality and quantity. This section returns to the categories identified

as providing the most disclosure, or that shows the greatest change over time, and discusses the content of those disclosures in more detail.

In summary, for CSRep quality before the introduction of the Standards, the top three categories indicated by the descriptive statistics are Dealing with Clients, *Zakat* and Employee Welfare. For CSRep quantity, the top three categories are Employee Welfare, Dealing with Clients, and Screening Clients. Hence, quality and quantity measures show similarities in the main items disclosed before the Standards were introduced. Similarly for CSRep quality after the introduction of the Standards, the top three categories remain as Dealing with Clients, *Zakat* and Employee Welfare. For quantity after the introduction of the Standards, the top three categories are also the same as the CSRep quantity before the Standards were introduced. As mentioned, while this indicates that there were no changes in what CSR areas were emphasised before and after the introduction of the AAOIFI Standards, for each particular category, there were increases in quality and quantity after their introduction.

The notable increase in the quantity score for Dealing with Clients suggests that the Standards have influenced the banks to improve their dealings with customers, because the Standards emphasise the disclosure of bank procedures for contracts, marketing campaigns, credit processes, remedies, late payment charges, and conditions to defer debt collection. This is an important aspect because clients are stakeholders, and the core of the conceptual framework is Unity, where the main part of the Unity principle is Muslim brotherhoods. Muslims must be united and bound by brotherhood, so they must observe the relationships of Man and Human beings, and thus must take care of their stakeholders.

The increase in the category of Earnings and Expenditures Prohibited by Shariah suggests that the Standards help to improve Islamic banks' adherence to Shariah compliance requirements, especially dealing with *haram* (unlawful) income and expenses.

Disclosure in the category of Waqf Management has also increased because the Standards promote more awareness by the Islamic banks about the importance of

Waqf. Waqf (endowment) is part of charity, but the Standards have provided an individual category for Waqf Management to be disclosed which means that Islamic banks have to pay more attention to Waqf as part of their CSR.

However, a decrease was noted in quantity for *Qard Hassan* (benevolent loan). This category is unpopular among Islamic banks in Malaysia because of the implicit repayment of *Qard Hassan* as mentioned earlier, and they may be afraid of default clients risk, and thus *Qard Hassan* has decreased over the years. It can be seen that actually the decreasing trend occurs both prior to, and after, the introduction of the Standards because the Standards put emphasis on *Qard Hassan*, especially its funds scheme, policy, sources of funds, purposes of loans, quotas and targets. This emphasis on *Qard Hassan* is because it is a common practice in the Middle East and the Standards were developed mainly based on Islamic banking in the Gulf region. The observation also notes that the foreign Islamic banks operating in Malaysia which have their headquarters in the Middle East, such as Al Rajhi Banking & Investment Corporation (Malaysia) Berhad (ARBMB) and Kuwait Finance House (Malaysia) Berhad (KFHMB), have shown consistent disclosure of *Qard Hassan*. However, for local Islamic banks, some of them have not disclosed *Qard Hassan* at all, as it may not be practiced.

7.4.4 Summary of Qualitative Analysis of CSRep in Annual Reports

In summary, Malaysian Islamic banks provide quite substantial CSRep in their annual reports, particularly the categories that relate to corporate governance such as top management, and SSB. The Employee and Client categories are also extensively reported in the annual reports. It is noted that the disclosure does include some Islamic values in the annual reports which give the sense of Islamic CSR. However, this sense of Islamic CSR varies in different annual reports depending on the type of Islamic bank.

It is also noted that the AAOIFI Standards on CSR have some influence on the reporting. Some of the Islamic banks disclose not only the categories that are required by the Standards, but also attempt to disclose the specific information

items that the Standards require. However, the AAOIFI Standards on CSR raise concerns about whether Islamic banks would only follow the specific requirements in the Standards and decline to do more reporting.

The observation of the annual reports also raises the question of whether the Islamic banks are doing well in their reporting, that is, as are they being minimalist in their reporting or are they overstating. This issue will be discussed further in the discussion section in Chapter 9.

7.5 Case Studies of CSRep in Stand-alone CSR Reports

While annual reports are still the main form of disclosure for CSR information by Malaysian Banks, there is a growing trend towards using separate CSR reports. Therefore, this study also analyses the nature of Islamic banks' CSRep in stand-alone CSR reports. This study uses the term 'CSR Report' for any report produced by the sample banks in addition to the annual report, which is used to address social and environmental issues. Some banks use the term CSR, others call them 'Sustainability Reports'.

In Malaysia, most Islamic banks are subsidiaries of conventional banks. The stand-alone CSR reports of Malaysian Islamic banks are usually issued by the company group. The reason for this is because many CSR activities by Islamic banks are performed in partnership with the parent company and other subsidiaries within the company group. Some other Islamic banks perform CSR activities in partnership with the foundation that is setup by the company group. Table 7-17 shows the list of stand-alone CSR reports produced by respective Islamic banks in Malaysia.

Table 7-17: List of Stand-alone CSR Reports for Islamic Banks in Malaysia

| No. | Islamic Banks | 2007 | 2008 | 2009 | 2010 | 2011 |
|-----|---|------|------|------|------|------|
| 1 | Affin Islamic Bank Berhad | | | | | |
| 2 | Al Rajhi Banking & Investment Corporation (Malaysia) Berhad | | | | | |
| 3 | Alliance Islamic Bank Berhad | | | | | |

| | | | | | | |
|----|--|---|---|---|---|---|
| 4 | Amlslamic Bank Berhad | | | | | |
| 5 | Asian Finance Bank Berhad | | | | | |
| 6 | Bank Islam Malaysia Berhad | | | | | |
| 7 | Bank Muamalat Malaysia Berhad | | | | | |
| 8 | CIMB Islamic Bank Berhad | | ✓ | ✓ | ✓ | ✓ |
| 9 | EONCAP Islamic Bank Berhad | | | | | |
| 10 | Hong Leong Islamic Bank Berhad | | | | | |
| 11 | HSBC Amanah Malaysia Berhad | ✓ | ✓ | ✓ | | |
| 12 | Kuwait Finance House (Malaysia) Berhad | | | | ✓ | ✓ |
| 13 | Maybank Islamic Berhad | | | | ✓ | ✓ |
| 14 | OCBC Al-Amin Bank Berhad | | | | | |
| 15 | Public Islamic Bank Berhad | | | | | |
| 16 | RHB Islamic Bank Berhad | | | | ✓ | ✓ |
| 17 | Standard Chartered Saadiq Berhad | | | | | |

One of the difficulties in analysing stand-alone CSR reports is that none of the Malaysian Islamic banks produce a CSR report directly. Reports are either produced by a parent company, or by the bank's charitable Foundation, although some do refer directly to their Malaysian subsidiaries. It is interesting however, to examine these CSR reports and compare them to the annual report disclosures. This identifies another source of reporting and may add to the understanding of why the banks do, or do not, disclose in their annual reports.

From Table 7-17, it can be seen that five Islamic banks are identified to have stand-alone CSR reports. Two Islamic banks i.e. HSBC Amanah Malaysia Berhad (HSBCAMB) and RHB Islamic Bank Berhad (RHBIBB), have stand-alone CSR reports that are issued by the parent company. The stand-alone CSR reports of two other Islamic banks, CIMB Islamic Bank Berhad (CIMBIBB) and Maybank Islamic Berhad (MIB) are issued by the foundation of the company group, as most of CSR activities are committed in partnership with the foundation. While for Kuwait Finance House (Malaysia) Berhad (KFHMB), the stand-alone CSR reports are released by the head office in Kuwait, but are also targeted for Malaysian readers.

For the purpose of current study, case studies are conducted on the stand-alone CSR reports. Three banks are selected for the case studies:

- i) CIMB Islamic Bank Berhad (CIMBIBB)
- ii) Kuwait Finance House (Malaysia) Berhad (KFHMB)
- iii) RHB Islamic Bank Berhad (RHBIBB)

The case studies of these three banks are conducted on their stand-alone CSR reports issued for the years 2010 and 2011 using content analysis. Before presenting the results of the content analysis, however, it is necessary to justify the reasons for selecting the three banks and to also provide some descriptions of the CSR Reports used for the case studies.

CIMB Islamic Bank Berhad (CIMBIBB)

CIMBIBB is selected because it is the bank that consecutively had stand-alone CSR reports since 2008, compared to the other banks which generally started to produce stand-alone CSR reports only in 2010. CIMBIBB also represents Islamic banks that have CSR in partnership with a foundation.

In 2010, the CSR report of CIMBIBB is named "*CIMB Group Corporate Social Responsibility Report 2010*". This CSR report was prepared by the CIMB Foundation with a motto statement of "*Bringing our vision closer to stakeholders*". The length of the CSR report is about 90 pages with pictures covering around 35 percent of the report. The contents of the report include a CSR overview, project highlights, testimonials, community, workplace, marketplace, and environment. The CSR report also provides information on the CIMB foundation such as its charter, the board of trustees, the top 20 grants, and also the financial statements.

For 2011, the name of the CSR report was changed to "*CIMB Group Sustainability Report 2011*". This CSR report was also prepared by the CIMB Foundation. The number of pages is around 108 pages with about 32 percent of the report being pictures. The contents include a statement by the group chief executive, project highlights, stakeholder inclusivity and engagement, corporate governance, community, workplace, marketplace, environment, and global reporting initiative

index summary. Information on the CIMB foundation is also included such as their foundation charter, the boards of trustees, and the financial statement.

Kuwait Finance House (Malaysia) Berhad (KFHMB)

KFHMB is selected because it was the first foreign Islamic bank in Malaysia. The stand-alone CSR reports of KFHMB are produced by the head office which is also an Islamic bank.

The 2010 CSR report of KFHMB is called "*Corporate Sustainability Report 2010*". This CSR report is a global report because it was prepared by the head office in Kuwait and it covers Kuwait Finance House in other countries as well as those that are under the same company group. Therefore, any money amount in this report is expressed in US dollars. Since the CSR report provides a country focus, this study focuses on CSR in Malaysia only. There are about 31 pages in total, with around 8 pages scattered throughout that talk about KFHMB and Malaysia. The contents include a CEO message, sustainability vision and pillars, talking business, communication channels, the workplace, community, global stewardship, the sustainability strategy, stakeholder management plan, GRI index, and the approach used in preparing the CSR report. Kuwait Finance House claimed this report is the first CSR report that it has published.

For 2011, the CSR report is called "*Corporate Sustainability Report 2011*". This CSR report is the same as 2010, and is also a global CSR report. The length is about 74 pages. The contents include a CEO message, sustainability vision and pillars, sustainability in the context of Shariah, the sustainability strategy progress, stakeholder management, corporate governance including SSB, business principles, customers, people, deeds, environment, and the GRI index.

RHB Islamic Bank Berhad (RHBIBB)

RHBIBB is selected in order to represent Islamic banks whose CSR reports are produced by the holding company which is a conventional bank.

For 2010, the CSR report for RHBIBB is called "*RHB Banking Group Corporate Social Responsibility Report 2010*". This report is prepared for RHB Banking Group. The

length is about 24 pages. The contents comprise a message from the chairman, corporate responsibility philosophy, commitment to communities, commitment to workforce, commitment to marketplace, and environment conservation efforts.

The CSR report in 2011 is named "*RHB Banking Group Corporate Social Responsibility Report 2011*". This report is also prepared for RHB Banking Group. The total number of pages is around 28. The contents include a message from the chairman, core values, approach to corporate responsibility, awards and accolades 2011, commitment to communities, commitment to workforce, commitment to marketplace, commitment to environment, and the way forward.

The following section discusses the content analysis of the CSR reports mentioned above.

7.5.1 Form- and Meaning-oriented Content Analysis in Case Studies

For the case studies, content analysis similar to that used for the annual reports is conducted. Kohlbacher (2006) highlights the strength of using quantitative and qualitative content analysis in case study research as a comprehensive approach and theory-guided analysis.

Form-oriented content analysis focuses both on quantitative and qualitative data that explain the disclosure behaviour (Merkl-Davies et al., 2011). Meaning-oriented content analysis is used to understand meaning construction in corporate narrative (Merkl-Davies et al., 2011). The stand-alone CSR reports are analysed quantitatively and qualitatively to determine themes, trends and meanings and this is related to the conceptual framework developed in Chapter 5 and to the AAOIFI Standards.

Quantitative data collected for the stand-alone CSR reports is provided in Table 7-18 (based on the Framework) and Table 7-19 (based on the Standards). The tables provide the mean score in each category for quality and the mean number of words in each category for quantity. The top three categories are shaded.

Table 7-18: Comparing Statistics for CSRep based on the Framework in Stand-alone CSR Reports and Annual Reports

| CSRep Categories | Quality | | | | Quantity | | | |
|---|-------------------------|-------------|----------------|-------------|-------------------------|----------------|----------------|----------------|
| | Stand-alone CSR Reports | | Annual Reports | | Stand-alone CSR Reports | | Annual Reports | |
| | Mean | Std. Dev | Mean | Std. Dev | Mean | Std. Dev | Mean | Std. Dev |
| | N=6 | | N=83 | | N=6 | | N=83 | |
| Shariah Supervisory Board opinion | .00 | .00 | 4.98* | 1.31 | .00 | .00 | 1036.78* | 703.82 |
| Unlawful transactions | .00 | .00 | .83 | 1.57 | .00 | .00 | 8.86 | 14.78 |
| Zakat (religious levy) | .5 | .84 | 3.96 | 2.03 | 26.17 | 57.06 | 81.20 | 66.68 |
| Qard Hassan (benevolent loan) | .00 | .00 | 1.31 | 1.72 | .00 | .00 | 5.98 | 8.72 |
| Charity | 3.00* | 1.67 | 1.84 | 1.39 | 565.33* | 724.36 | 202.90 | 308.98 |
| Employee | 6.33* | 3.27 | 5.29* | 1.16 | 503.83* | 339.78 | 684.70 | 630.59 |
| Late Payment and Insolvent clients | .00 | .00 | 3.76 | 1.18 | 19.00 | 46.54 | 767.86* | 473.68 |
| Conservation of environment | 5.50* | 2.35 | 1.24 | 1.99 | 330.83 | 91.43 | 80.70 | 135.69 |
| Community involvement | .33 | .52 | 2.35 | 1.08 | 34.33 | 54.67 | 131.53 | 258.96 |
| Products/services | 1.50 | 1.38 | 2.20 | .89 | 307.83* | 492.50 | 137.17 | 124.34 |
| Corporate mission statement | .33 | .52 | 1.04 | .40 | 45.00 | 83.58 | 40.66 | 45.49 |
| Top management | .00 | .00 | 6.37* | .82 | .00 | .00 | 1365.57* | 908.08 |
| Aggregate Framework Quality/Quantity | 17.50 | 8.24 | 35.18 | 6.45 | 1832.33 | 1118.54 | 4543.90 | 2169.26 |

*The top three categories

Table 7-19: Comparing Statistics for CSRep based on the Standards in Stand-alone CSR Reports and Annual Reports

| CSRep Categories | Quality | | | | Quantity | | | |
|--|-------------------------|-------------|----------------|-------------|-------------------------|---------------|----------------|----------------|
| | Stand-alone CSR Reports | | Annual Reports | | Stand-alone CSR Reports | | Annual Reports | |
| | Mean | Std. Dev | Mean | Std. Dev | Mean | Std. Dev | Mean | Std. Dev |
| | N=6 | | N=83 | | N=6 | | N=83 | |
| Mandatory disclosure | | | | | | | | |
| Policy for screening clients | .50 | .84 | .96 | .19 | 61.33 | 114.49 | 323.9* | 234.58 |
| Policy for dealing with clients | .00 | .00 | 6.08* | 2.03 | .00 | .00 | 739.19* | 469.17 |
| Earnings and expenditure prohibited by <i>Shariah</i> | .00 | .00 | .69 | 1.24 | .00 | .00 | 7.8 | 13.72 |
| Policy for employee welfare | 6.00* | 2.757 | 3.76* | .80 | 522.83* | 307.63 | 674.24* | 593.77 |
| Policy for <i>Zakat</i> | .50 | .84 | 4.69* | 2.27 | 26.17 | 57.06 | 80.29 | 63.77 |
| Voluntary disclosure | | | | | | | | |
| Policy for social, development and environment based investment quotas | 5.67* | 2.07 | 2.6 | 2.46 | 351.33* | 110.53 | 132.12 | 239.00 |
| Policy for par excellence customer service | 1.33 | 1.37 | 1.42 | 1.28 | 268.33 | 247.01 | 161.11 | 308.45 |
| Policy for micro and small business and social savings | .33 | .82 | 3.16 | .93 | 13.83 | 33.89 | 29.66 | 42.73 |
| Policy for <i>Qard Hassan</i> | .00 | .00 | 1.31 | 1.71 | .00 | .00 | 9 | 30.55 |
| Policy for charitable activities | 4.33* | 1.51 | 1.96 | 1.62 | 565.33* | 724.36 | 211.94 | 320.34 |
| Policy for <i>Waqf</i> (trust) management | .00 | .00 | .22 | .70 | .00 | .00 | 19.35 | 125.86 |
| Aggregate Standards Quality/Quantity | 18.67 | 5.39 | 26.86 | 6.73 | 1809.17 | 913.95 | 2388.60 | 1460.47 |

*The top three categories

Based on Table 7-18, it can be seen that the CSRep themes based on the Framework in terms of quality reported in the stand-alone CSR reports are dominated by the Employee, Conservation of Environment, and Charity categories. However, the CSRep themes in the annual reports are more focused on Top management, Employee, *Shariah* Supervisory Board opinion categories. The results also show that both CSR reports and annual reports give high quality disclosures for the employee category. The CSR reports disclose higher quality CSRep on social issues that directly relate to the community such as environment and charity. While annual reports focus on disclosure that relates to corporate governance issues like top management and the *Shariah* supervisory board.

In terms of quantity, the stand-alone CSR reports are dominated by Charity, Employee, and Products/services. While in the annual reports, the CSRep themes are dominated by the Top management, *Shariah* Supervisory Board opinion, and Insolvent Clients categories. This result again shows that the CSR reports provide more disclosures on CSR issues that are related to the community, their employees and their products and services to customers. Whereas annual reports offer more disclosures related to the business operations and management, as most disclosures are on corporate governance and managing insolvent and late payment clients.

In Table 7-19, it can be seen that the CSRep themes based on the AAOIFI Standards in terms of quality that are dominant in the CSR reports include the Policy for employee welfare, Policy for social, development and environment based investment quotas, and Policy for charitable activities categories, all scoring means above 4. However in the annual reports, the CSRep quality is higher for Policy for dealing with clients, Policy for *Zakat*, and Policy for employee welfare categories. In terms of quantity, the results are similar - CSR reports are also dominated by Policy for charitable activities, Policy for employee welfare, and Policy for social, development and environment based investment quotas. In the annual reports, however, there is more about the Policy for dealing with clients, Policy for employee welfare, and Policy for screening clients categories. Thus, while there is

still a difference in emphasis between annual reports and CSR reports, when analysed based on the Standards, the difference is less apparent.

In general, Islamic banks do appear to give a different focus to CSRep themes in the CSR reports compared to the annual reports and each type of report is targeted at different readers. CSR reports seem to be targeted towards their employees and the wider community shown by the disclosures about employee issues, charity, social development, product/services and the environment. These are all societal issues and activities. On the other hand, the annual reports report more CSRep themes that are focused on regulation compliance, such as top management, *Shariah* supervisory board, and *Zakat*. The annual reports also disclose information about employees and but have more disclosures about clients. The targeted readers of annual reports may be mainly investors, regulators and also employees. Both CSR reports and annual reports provide ample information about employees which may be because their employees are particularly valuable to Islamic banking operations. An interesting area for further study would be a comparison on employee disclosures between Islamic and conventional banks.

Having gained a general overview of the CSR reports, the following section provides case studies of the CSR reports of the three selected Islamic banks.

7.5.2 Case Studies of CSR Reports

The stand-alone CSR reports of each Islamic bank selected for the case studies are explored to understand in depth the meaning construction in their corporate narrative.

7.5.2.1 CIMB Islamic Bank Berhad (CIMBIBB)

The CSR Reports of CIMB and CIMBIBB have a strong focus on their employees. The sections on Employees include the amount spent on training and incorporate quantitative information (percentages), for example:

In 2010, we invested approximately RM39 million in training. The Group also meets the requirements of Bank Negara Malaysia where the amount should be at least 2.5%

(for CIMB Bank & CIMB Islamic Bank) and 3% (for CIMB Investment Bank) of total gross salary of the preceding year.(2010)

There is also some emphasis on Islamic banking knowledge for their employees:

The Green Competition is an annual event which started in 2009. It is a creative learning competition that encourages knowledge acquisition in Islamic banking and teamwork.(2010)

Finally, the reports discuss ways in which employees are supported, such as encouraging work life balance, facilities and a prayer room for Muslim staff:

It is a place that offers a work-life balance, for example, spacious pantry areas for better interaction among staff, state-of-the-art gymnasium facilities, breastfeeding rooms for mothers, a surau on every floor, library facilities, a food court and many others. (2010)

This paragraph is repeated in both the 2010 and 2011 reports, indicating that it is seen as an important element of CSR.

Community involvement is also a focus in the CSR reports. The link between community activities and employees is also apparent. Community activities are initiated by the corporate foundation with the involvement of CIMB Group staff including CIMB Islamic staff who represent the foundation:

The Community Link Challenge 2010 for Malaysia was launched on 5th July and was extended to all CIMB Bank and CIMB Islamic's branches, business centres and all units of the Consumer Sales and Distribution (CSD) division. A Community Link Task Force was set up comprising staff representing CIMB Foundation and CSD to develop guidelines for the projects and drive participation. Posters, flyers, bags, notebooks, mouse pads were distributed to staff and the public to get them involved. (2010)

The Group's partnership with the National Kidney Foundation (NKF) entered its 3rd year in 2010. Leveraging on the mobile clinic donated by CIMB Foundation to NKF in 2008, NKF received a further grant of RM137,000 from CIMB Foundation to conduct 116 events throughout Malaysia in partnership with CIMB Bank and CIMB Islamic branches. (2010)

Approximately 3,060 staff volunteered for Community Link in 2011. In 2011, a total of 178 Community Link initiatives were approved with total grants of RM5.8 million. (2011)

From the above paragraphs, it can be seen that the community involvement activities are performed in partnerships between the parent company (CIMB Bank), CIMB Islamic and CIMB Foundation, where it is hard to identify which CSR is strictly practiced by CIMB Islamic alone.

For the CSR disclosure that relates to products and services, both 2010 and 2011 reports highlight that the customers can comfortably have different space areas for Islamic banking and conventional banking:

Private meeting rooms are available for confidential meetings while separate conventional and Islamic banking areas make it convenient for customers. (2010)
(2011)

The same CIMB bank branch outlets offer conventional banking and Islamic banking but with different space areas which may be important for some customers. For example, Muslim customers may not want to be seen using conventional banking, while the non-Muslims may prefer not to be seen using Islamic banking services.

The final theme of the CSR report that appears is the Environment. Disclosures cover their 'ecosave' financial product which is described in both 2010 and 2011, and also showing their support for a 'green project', community support for environmental protection and an environmental campaign:

In 2008, CIMB Islamic launched its EcoSave Savings Account-I, an account that is environmentally friendly with 'on-line' and paperless mode of operations (no passbook and no physical statement which promotes 'green cause activities'. A quarterly contribution of 0.2% of the total EcoSave portfolio balance is also rewarded to environmental activities such as CIMB Islamic's Tanamera Green Project. (2010)
(2011)

In 2010, CIMB Islamic initiated the Tanamera Green Project in partnership with the Global Environment Centre (GEC) and Subang Jaya Municipal Council (MPSJ). This was the local community's first step towards adopting a sustainable lifestyle by reducing their household organic waste and converting it into compost to feed their herb gardens. (2010)

CIMB-MVFRA Environment Care Programme

CIMB Bank and CIMB Islamic partnered together with the Malaysian Volunteer Fire and Rescue Association (MVFRA) to develop a community that cares for the environment by recycling to prevent water pollution and forest fire. (2010)

"Say No to Plastic Bags"

This was a campaign which was implemented in 2011 in shopping malls in the northern region. The campaign involved eight CIMB Islamic and CIMB Bank branches in partnership with two NGOs. Campaigns were run in eight malls and supermarkets to encourage shoppers to switch to reusable shopping bags instead of using plastic bags. This was supplemented by a kitchen waste composting programme which won the "Best Community Link Project" for the year. (2011)

In summary, the CSR reports of CIMBIBB have a strong focus on employees and community, including environmental issues. Due to the fact that the CSR reports

are prepared by the bank's foundation, the main narrative appears to be more appeal to their employees, customers, community and environment by highlighting work-life balance, customers comfort, community activities and environment supports. Thus, these disclosures may attract more interest from the related stakeholders.

7.5.2.2 Kuwait Finance House (Malaysia) Berhad (KFHMB)

The Kuwait Finance House (Malaysia) Berhad case provides evidence from a fully-fledged Islamic bank. Therefore, this case is longer than the other two and provides a greater volume of information as its CSR report is a global report and contains more Islamic terminology, and related social issues that are viewed important by the headquarters company in Kuwait.

The KFHMB global CSR report with the country focus of Malaysia has its major emphasis community, employees and customers. It emphasises the CSR theme of Charity and other social activities which include contributions in terms of money and in kind, and support activities with the youth from poor families as follows:

Ramadhan, the month of giving at KFH Malaysia

- Contributed ihram garments to Malaysian male pilgrims who are performing Hajj was given by KFH Malaysia in 2010. Representing KFH Malaysia at the event was Chief Executive Officer, Puan Jamelah Jamaluddin, who presented the Bank's contribution of 15,000 pairs of ihram garments worth over \$130,000.
- Contributed to the Ziarah Ramadan Programme with over US\$ 36,000 in conjunction with His Royal Highness Tengku Muhammad Faris Petra, the Regent of Kelantan. Handover ceremonies were held at 10 selected mosques in 10 districts in Kelantan, where His Royal Highness Tengku Muhammad Faris presented a cash donation of approximately \$65 to each of the 500 eligible recipients. Identified as severely disadvantaged, these include wheelchairbound and chronically-ill patients.
- Hosted 'Breaking of Fast' for 220 youths from poor families of Baitul Hasanah Klang, Kuala Selangor and Hulu Selangor. Puan Jamelah Jamaluddin, the Chief Executive Officer, was present to hand over gifts and packets of money for Hari Raya. Seventy employees from KFH Malaysia were also present to attend to the young guests. Selected by Lembaga Zakat Selangor, the children reside at a hostel under the administration of the body, where they receive proper care and support.

(2010)

The CSR report in 2010 also provides a breakdown of the amounts of money that were spent on community involvement activities, which accords with a high quality score:

| Charitable Activities | Funds US \$ |
|-------------------------------|------------------|
| Underprivileged community | 386,720 |
| Education | 733,454 |
| Islamic-related activities | 862,800 |
| Environment | 12,635 |
| Medical support | 729,324 |
| Employees community programme | 44,571 |
| Total | 2,769,504 |

(2010)

This breakdown of charitable and community involvement activities with their amounts is very useful for users to know what type of charitable activities that KFHMB is involved in and which activity is channeled the most and least amounts of money. However, it is disappointing to find that the CSR report for 2011 does not provide a similar breakdown of expenditure on charitable activities.

In the 2011 CSR report, KFHMB discloses their charitable activities and community involvement only through statements of several contributions to a disaster fund, orphanage and humanitarian society and also the support provided for education.

Contribution to the NSTP-Media Prima Disaster Fund in aid of the Hidayah Madrasah Al-Taqwa orphanage landslide victims which killed sixteen people and injured nine on 21 May 2011.

Donations made to orphanage houses in Malaysia in the spirit of the holy month of Ramadan.

Donation of three ambulances to the Malaysian Red Crescent Society, supporting the humanitarian missions that society is involved in.

Encouraging Education. Engaging the youth, Malaysia

Becoming the main financier of MysysNet Development, which will see the construction of 97 schools in Johor through a Murabahah Tawarruq facility. Apart from financing, KFH will supply relevant facilities and equipment for the resource centers.

(2011)

KFHMB does highlight its commitment to CSR as a concept in its 2011 report. The following excerpt indicates their work on the development of a CSR logo.

KFH Malaysia has launched the new Corporate Social Responsibility (CSR) flagship in August 2011. The bank unveiled a new CSR logo, 'Creating Footsteps' which aligns the bank's best experiences in CSR. The move signifies KFH's commitment for the betterment of society and hopes to pave the way and inspire others to reconcile the economic, social and environmental ambitions of the country. The emblem of 'Creating Footsteps' signifies the Kuwait Finance House brand.

(2011)

Even though KFHM is a foreign Islamic bank and its CSR Report is a global report, the above described CSR logo represents the four quadrant of the bank's CSR programme as prescribed by the Bursa Malaysia (Malaysian Stock Exchange) CSR Framework which covers community, marketplace, workplace and environment. Thus, some form of external benchmarking is used.

In the 2011 CSR Report, they also provide their mission statement that contains their commitment towards Shariah or Islamic principles and also towards CSR.

In our mission to become the leading Islamic financial institution providing Shariah compliant banking, we have holistically framed our objectives together with our long-standing corporate values, which are the following:

1. Uphold Shariah principles and values among all activities of KFH
2. Support ongoing initiatives of the global financing industry
3. Participate in and assist the socio-economic endeavors of local communities as a responsible corporate citizen

(2011)

The above excerpt shows that KFHM incorporates Shariah in the mission statement to ensure Islamic principles are applied in the operations. The mission statement also includes socio-economic responsibility as part of the bank's commitment, and as discussed earlier, the mission and vision is considered to be a contract in Islam.

Also in the 2011 CSR Report, KFHM explains the importance of their Shariah Supervisory Board (SSB) and its functions. As would be expected of an Islamic organisation, they emphasise that the SSB is very significant for the bank to uphold Islamic principles in their operations.

Being a pioneer in Shariah-compliant financial services, we need the continuous guidance and support from our Shariah Board, who oversee key strategic decision-making and give us their views and rulings on certain matters. Our respectful and humbling relationship with our Shariah Board keeps our business in perspective with the ultimate goals we wish to achieve towards our legacy. (2011)

The Fatwa and Shariah Board are an independent body overseeing all Shariah matters providing expert opinion and rulings in relation to all financial activities of KFH, strictly based on the rules and principles of Shariah. The Board also periodically inspects and ensures full compliance and are an integral part of the KFH governance structure. (2011)

Identified sustainability concerns - Shariah-compliance in all subsidiaries of KFH Group of Companies (2011)

Zakat is of also a focus in the CSR report of KFHMB. Even though *Zakat* is mainly reported in the annual report, especially the amount of *zakat* paid as required by the statutory authority, *Zakat* in the CSR report focuses more on the uses of *Zakat*:

Zakat House also hosts numerous activities in the Holy Month of Ramadan, and has projects such as sponsoring scholars, orphans and building mosques, schools, water wells and development centers. (2010)

The Shariah-compliance department calculates KFH's annual Zakat in order to follow the basic Islamic principle (2011)

The CSR theme of Employees in the CSR report of KFHMB emphasises opportunities towards women. In fact, in their reports, it is mentioned that gender equality is part of their top agenda in addressing equal opportunity. In the 2010 CSR report, they disclose that the CEO management is led by a woman indicating that there is no discrimination against women in the bank and ultimately in Islam:

Our first female Chief Executive was appointed in 2010 by KFH Malaysia. Puan Jamelah Jamaluddin is responsible for the bank's operations in Malaysia and the Asia Pacific. This marks her second tenure at KFH, where she served as the bank's deputy chief executive officer since 2005, steering the corporate investment banking division. An experienced Islamic banker, having been in the financial industry for 25 years, Puan Jamelah will play a pivotal role as the new CEO of the Bank, in delivering the strategy for the Bank's operations in Malaysia and in the Asia- Pacific region. (2010)

In order to show the fair opportunities and fair treatment given to the employees regardless of their gender, the 2010 CSR report provides the salary grade ratio according to gender for each position in management and also the gender breakdown in the bank's workforce.

Salary Grade Ratio

| | |
|-----------------------------------|---------|
| Assistant Director- Chief Officer | 3.4 : 1 |
| Assistant/Senior Manager | 1.5 : 1 |
| Associate/Senior Executive | 0.6 : 1 |
| Non-Executive | 0.9 : 1 |
| Average | 1.5 : 1 |

Male : Female salary ratio for KFH Malaysia

Gender breakdown in workforce (KFH Malaysia)

Male 276
Female 282

However, in the 2011 CSR Report, KFHMB does not emphasise gender equality as much as in the 2010 CSR Report but discloses in the Employee category by focusing

more on employees training policy, welfare and benefits, and their employee engagement survey. KFHMB acknowledges that their success is shaped by their employees and therefore it is their responsibility to make a good working environment for their employees to fully utilize their skills. Hence, KFHMB identifies the sustainability concerns related to their employees and their engagement mechanisms:

Identified sustainability concerns

- Fair performance assessments leading to career progression
- Regular training on modern topics, tools and concepts
- Positive and motivating office culture
- Payments and benefits

Engagement mechanisms

- Annual performance appraisals and fair 7 Tier Grading System with training needs analysis
- Comprehensive training programmes provided to employees on an array of skills such as Shariah compliant finance and soft skills
- Employee satisfaction & engagement surveys conducted by KFH and all of our reporting subsidiaries
- Employee sports, leisure and charity activities organized by social committees
- Competitive payment and benefit scheme action
- Integrate sustainability aspect in employee engagement

(2011)

KFHMB provides training to their employees regularly which covers soft skills, banking knowledge as well as Shariah knowledge. The bank also welcomes any questions from their employees regarding Shariah.

Staff training on Shariah and awareness

Our KFH e-magazine 'Fatwa' is issued on a monthly basis and distributed to all our employees via email. The magazine introduces key concepts of Shariah-compliant banking by using examples and providing solutions of incorporating Shariah to new financial instruments. This demonstrates real-life future scenarios and provides valuable knowledge to employees.

Our training has been ongoing, where we have trained 398 customer service staff in 2011.

Open communicate with employees to pose questions to Shariah-compliance department for queries on any future deals and transactions

(2011)

The welfare and benefits offered by KFHMB to their employees include benefits both in terms of money and in kind. These benefits are to ensure that the bank can retain their employees and can attract potential good talent.

Our benefits package

We acknowledge the link between employee satisfaction and the health, well-being, motivation and productivity of its people. In order to provide a modern working

environment for employees we offer a range of benefits to our full-timers:
Competitive salary and bonuses, End of services, Medical and dental insurance,
Maternity leave, Over-time compensation, Teller allowance, Grade allowance,
Transportation allowance, Shift allowance, Branch allowance, Food allowance, and
Special bonuses

(2011)

KFHMB also emphasises the survey they undertake of their employee engagement in order to better understand their employees. Among the results of their survey are organisational pride, leadership and effectiveness, work environment, teamwork and collaboration, and job satisfaction. Their employees also provide main reasons they keep working at KFHMB are because it is a Shariah-compliant company, salary and benefits, and the reputation of the company.

It is also noted that in the 2010 CSR Report, KFHMB discloses in the Employee category by providing the criteria required by the AAOIFI Standards on CSR disclosure such as the policy, targets and achievements for the year. This can be seen in the following excerpt that indicates the commitment towards their employees, their ambition and goals for the next year:

Employees

Regular career appraisals leading to training schedules, Regular team meetings, Job satisfaction, Career longevity, lifelong learning, Fair compensations and promotions, Pleasant working environment

- 1) Conduct employee engagement and satisfaction survey
- 2) Introduce an employee-initiated feedback mechanism scheme

Ambition

Be an employer of choice

2011 Goals

Increase number of women in workforce, with focus on senior positions
Establish a CSR Committee for the group to promote sustainability

(2010)

Hence, it appears that employees are a major category of disclosure during both periods, but the emphasis changes slightly between 2010 and 2011.

KFHMB also discloses the category of Other community involvement that generates profit, where it provides information on microfinancing:

Changing lives through Microfinance

Microfinance is an effective means of helping people in developing countries to help themselves – and is an important sector for KFH to support. Such a scheme was conducted by KFH Malaysia through microfinance provided to widows to start-up their own business. In 2011, microfinancing was given out to eighteen recipients in areas of Kota Bharu, Kuching and Batu Pahat. It is becoming increasingly popular to incorporate micro-entrepreneurship within corporate sustainability strategies, described as The Bottom of the Pyramid movement. (2011)

The above excerpt also fulfils some of the requirements of the AAOIFI Standards that relate to the category of micro and small business and social savings and investments

KFHMB also discloses CSR as required by the AAOIFI Standards in the category of social, development and environment based investment quotas. They provide the policy regarding social, development and environment based investment, their investment, and their goals and targets for the next year:

Supporting our national economies

It is important to us that countries of our operations benefit and prosper from our activities. We maintain a healthy and mutually beneficial relationship between us and the countries we work in.

Ambition

Uphold reputation in our positive impact to society

2011 Goals

Develop diverse products and services that can create indirect economic impacts
(2010)

For the Environment category, KFHMB reports on their environmental project that can help conserve the environment:

Annual tree planting in Kuala Lumpur, has been kicked started by KFH Malaysia to celebrate 53 years of Malaysian Independence. Trees can act as carbon sinks, absorbing and locking away carbon dioxide, the main greenhouse gas responsible for climate change. Trees also help cleanse the air by intercepting airborne particles and can reduce urban-city heat by absorbing pollutants such as carbon monoxide, sulfur dioxide and nitrogen dioxide. (2010)

They also disclose that they include environmental protection in the bank's operations and offices such as using ozone-friendly chillers and recycling. In these disclosures the information is quite technical and provides background to the science:

Staying Ozone-Friendly.

Approximately 20-30 km above the earth, our ozone layer protects us by absorbing the sun's high frequency ultraviolet (UV) light. The depletion of the ozone, caused primarily by chlorofluorocarbons (CFCs) and hydrochlorofluorocarbons (HCFCs) has long been of major global concern. We are happy to report that we have maintained progress of our ozone-friendly chillers installed in our offices in 2010, which led to our offices emitting zero ozone depleting substances. (2010)

The International Year of Forests.

The year 2011 marked the United Nations International Year of Forests which aimed to raise awareness and strengthen the sustainable management and conservation of all types of forests for the benefit of current and future generations. The conservation of forests, being a major carbon source, is vital in global efforts to fight climate change. With numbers reaching as high as 24 trees needing to be felled to produce one tonne of office paper, we would like the concept of reduce, reuse and recycle to ring throughout our corridors, thereby embedding it in our office culture. (2011)

This more technical disclosure also includes some estimates of the usage of electricity, carbon, water and paper:

1,85 Kwh per FTE (Full time employee) - Our Electricity Consumption
1.2 tonnes CO2 per FTE - Our Carbon Footprint
18,659 liters per FTE - Our Water Consumption
49 kg per FTE - Our Paper Consumption

(2011)

For the category of Products/Services, KFHM discloses the products/services that are offered by the bank by describing some details and the basis of the Shariah concept for the product/service. For example:

Innovation in Shariah-compliant products and services Going for Gold. KFHM Malaysia introduced the KFHM Gold Account-*i* which is the first Shariah-based gold account in Malaysia that allows customers to invest in gold in a convenient, secure and affordable way without keeping the gold physically. The Shariah concepts used for this product are B'ai As Sarf, which refers to the exchange of one monetary form for another in the same or different form on a spot basis, as well as Qardh Hasan which refers to benevolent loans whereby the bank as the borrower is only required to repay the principal borrowed. (2011)

The above excerpt also provides some disclosure for the category of *Qard Hassan*.

In the 2011 CSR Report, KFHM discloses the category of par excellence customer service also as required by the AAOIFI Standards. The Standards require the policy for par excellence customer service, measures taken to develop customer service skills and the results of customer survey to be disclosed. They disclose their customer service policy, identified sustainability concern that relates to the customer service, customer engagement mechanisms, and also their customer survey.

In pursuit of top-service quality

We value our customer feedback and want to ensure that we receive it on a timely basis. Our KFH dedicated department, Service Quality, has streamlined and simplified our customer-related business processes in an effort to increase efficiency in transaction time and eliminate unnecessary paper work and signatures. This clears the way for our KFH service representatives to build and maintain a more direct relationship with our customers.

We have created a reward system to incentivize our customer service staff, where last year a total of 12 members were inaugurated into the 'Service Quality Golden Club'. KFH has also honored a total of 63 employees from 11 of our service centers who have provided distinguished service to our customers throughout the year. The KFH Service Quality Department has embraced new initiatives to improve our services. In 2011 we have established a monthly customer satisfaction index, by measuring and surveying customer satisfaction at the end of their visit to any of our KFH Service Centers. We are beginning to tailor our services more according to our customer type through a variety of focus groups. The primary aim of these group meetings is to meet and exceed their expectations through closer engagement.

Surveying Customer Satisfaction:

When looking towards our customers, each of our subsidiaries has a tailored approach suiting their relative region and company culture. Here we look at the varying methods of engagement with highlights of results...

(2011)

In the 2010 CSR Report, KFHMB discloses the plan for the customer survey and the plan of the customer service.

Customers

- 1) Conduct and report results on customer satisfaction surveys, including customers of key initiatives such as affordable housing
- 2) Include feedback from the survey when developing annual sustainability initiatives related to customer services
- 3) Establish a dedicated customer care unit

(2010)

They also disclose that they provide Shariah advice to their customers. As KFHMB claims that they are more than just a bank, they disclose that customers can seek Islamically-sound advice from the bank's Shariah compliance department, which can go beyond the banking scope. Their reports also reveal that their employees are trained with sign language in order to serve the less fortunate customers or customers with disabilities.

Finally, another category that is required by the AAOIFI Standards that is disclosed by KFHMB is the category of Screening clients. In the 2010 CSR Report, KFHMB reports their policy of how they screen their clients with regard to the compliance

of Shariah by providing all the screening criteria in detail. They also disclose that the screening is overseen by the Shariah Supervisory Board (SSB).

The Shariah Way: Our Policy on Investments. Any investment activities in KFH is guided by the “Fatwa” (ruling) and advice is issued by the Shariah Board when evaluating investment decisions. The Shariah Board is an independent body overseeing all Shariah matters and provides views and ruling in relation to the fund’s investment activities based on the rules and principles of Shariah. This division also periodically inspects the investment activities of KFH to ensure that the actual implementation of the investments is in compliance with Shariah rules and principles.

As a rule of thumb, the following activities are classified as non Shariah compliant and thus

we are not involved in companies that are linked to the following:

- Financial services based on “riba” (interest)
- Conventional insurance
- Stock broking or share trading in Shariah non-approved securities
- Gambling
- Manufacture or sale of non-halal products
- Entertainment activities non-permissible by Shariah
- Other products or services deemed non-permissible and/or ambiguous

All equity investments, with this in mind, must thus adhere to the following criterion:

1. If the intention is to control and to convert the invested company, the companies must clean up all interest bearing debt or borrowing within a three year grace period.
2. Companies we are invested in, must not deal in interest, neither earned interest, nor expense interest.
3. Common stock and Islamic finance tools must be the only source of fund or finance to the invested companies.

(2010)

Surprisingly, the disclosure of Screening clients in the 2011 CSR Report is not as detailed as in the 2010 CSR Report. KFHMB discloses the policy of screening clients very briefly without specific screening criteria.

Our investments thus constitute managed diversification, which have all been screened and are Shariah-compliant. This enables us to offer attractive products and results to our clients and stakeholders, and maintain a satisfactory risk profile at the same time. The major sectors which we invest in include Health Care, Food, Insurance, IT, Leasing, Real Estate, Sukuk, Training, Research and Industry.

Negative screening mechanisms in place for all KFH investments and transactions. An internal audit is performed using random sampling to test compliance to Shariah.

(2011)

In summary, there are several CSR themes that are emphasised in the CSR reports of KFHMB which include charity and other social activities, community, *zakat*, vision and mission statement, employees, product and services and Shariah Supervisory Board. The CSR reports also disclose the themes which are specifically

required by the AAOIFI Standards, for example par excellence customer service and screening clients. The Employee category appears to include quite a lot more about gender and women in the company. As the CSR reports are a global report and are prepared by the parent company in Kuwait, the employee issue is focussed particularly towards women's position in the workforce which is considered as an issue of concern in Kuwait. The CSR reports of KFHMB also appear to report more according to the requirements of AAOIFI Standards in many CSR categories.

7.5.2.3 RHB Islamic Bank Berhad (RHBIBB)

The CSR report of RHB Bank Berhad as a parent company of RHBIBB reports some information that relates to charity and other social activities, which also involve the staff of RHBIBB. The social activity that RHB and RHBIBB are specifically involved in is searching for missing children. Mainly RHBIBB staff are involved in the search efforts using the company's facilities. The following is the excerpt from the 2010 CSR Report that mentions the search efforts for missing children by RHB and RHBIBB:

Casting the Net Further Out

Being the fourth largest fully integrated financial services group in the country, we are able to tap into our extensive delivery channel network to communicate the details of the missing children. To date, our search efforts have seen us mobilising our 11,000-strong employee network throughout 339 branches (including RHB Islamic and Easy outlets) as well as leveraging our 1,058 ATMs and extensive media support. In some instances, financial assistance is provided to families to ensure search efforts are not hindered. (2010)

The above excerpt is also repeated in the 2011 CSR Report but with more information of how many RHB Islamic branches are involved in this social activity. Compared to the previous year, the information on search efforts for the missing children in the 2011 CSR Report is more detailed as the bank reports the reason for involving in the search for missing children as their CSR program, the structures of the program and operating procedures.

RHB's first strategic CR initiative programme began in early 2007, when the Management of the Group, moved by the plight of the families of missing children, determined to lend a helping hand to look for such children. The Missing Children – Reuniting Families programme was launched in late 2007 in response to public outcry for a solution to address the issue of missing children. From a simple working

arrangement between RHB and PDRM, the programme has become a more structured and comprehensive one and today involves concerted efforts between, RHB, PDRM, NGOs, the media and members of the public. (2011)

Standard Operating Procedures in the Search for a Missing Child

1. RHB obtains the information of the missing child either from the media or PDRM
2. If the source comes from the media, RHB then verifies this with PDRM
3. RHB seeks permission from the parents/ guardians of the missing child to publicise his/her latest photograph
4. RHB immediately produces posters in-house and mobilises staff in the vicinity to distribute posters on the same day (or a day after) at the location where the child was last seen
5. RHB distributes posters nationwide from the third day onwards
6. RHB puts up advertisements in major dailies within three days
7. RHB works with NGOs and holds a press conference to get the profile of the missing child out to the public
8. We ensure constant contact with PDRM and the parents/guardians of the missing child
9. Posters and photos of the missing child remain posted at our branches and on AT Ms respectively for 100 days

(2011)

Employee issues are also a focus in the CSR Reports. In the 2010 CSR Report, the bank reports how they appreciate their employees by providing training and development programs. The bank also discloses the amount spent for the training:

Grooming Our Talent

The Group is fully committed to giving its employees every opportunity to realise their full potential. To this end, training and development programmes play an important role in motivating our people, building their skills set and enabling career progression. This commitment to employee development is helping us not only retain our high-achievers but is also helping us attract top talent from around the country. In 2010, we invested some RM18.6 million in our people representing 4% of the total employee gross salary – well above the 2.5% requirement stipulated by the regulatory authorities. (2010)

However, the bank does not specify how much is spent specifically for training the staff of RHB Islamic because the amount stated is the general amount of training cost for the RHB group. In the 2010 CSR Report, the bank states that their training programs are structured for every level of employees starting from young graduate trainees, through management associate programmes, buddy systems and also both local and overseas training for senior management. All this information that relates to training and development for the employees is repeated in the 2011 CSR Report, except that the bank updates the amount spent for the training.

Other than training, the bank also highlights employee welfare in their CSR Reports. The bank mentions that their employees are ‘the heart of the operations’, and thus appreciates their employees by offering competitive remuneration, benefits or welfare. The employee welfare includes medical benefits, staff welfare fund, support to obtain diplomas or degrees, and recognition to the educational achievements of their staff’s children:

Employee Care and Recognition

Our people are at the heart of our operations and this is reflected in the competitive remuneration and various benefits that are available to our staff, be they medical benefits or a host of other incentives. The RHB Staff Welfare Fund provides assistance to employees above and beyond the benefits already provided by the Group. The Fund helps alleviate the financial distress of employees and their immediate families arising from serious accidents, illnesses, injuries or loss of property and/or life due to natural disasters, among other incidences. We also provide staff the opportunity to work towards obtaining their diplomas or degrees by way of special incentives for industry-related courses conducted by Institut Bank-Bank Malaysia or IBBM. A robust performance management system is in place to reward high achievers and this has helped to motivate staff to strive for greater levels of excellence. (2010)

On top of this, we have extended the concept of the RHB Family to our staff’s families by giving due recognition to the educational achievements of the children of our staff. As employee safety and health is a priority, we continue to observe strict compliance with occupational safety and health measures and improve upon these. (2011)

In the 2010 and 2011 CSR Report, the employee work-life balance is also emphasised. Among the activities that are organised by the bank to ensure the work-life balance for their employees are sports and recreational activities, karaoke competitions, staff dinners, health talks and etc., as in the following excerpt:

Ensuring Work-Life Balance

In line with our commitment to creating a conducive work environment that promotes creativity and encourages high productivity, we continue to roll out activities that provide employees with a good work-life balance and a sense of fulfilment. Activities such as our Sport Fiesta organised across states and regions, the RHB Idol karaoke competition, staff dinners, health talks, team building exercises, soccer clinics for staff’s children, summer camps during school holidays, as well as the annual teh tarik chat sessions with the Group Managing Director, continue to be extremely popular among employees. In addition, the Group gives due recognition to the educational achievements of the children of our staff as well as to national sportsmen and sportswomen who excel in their fields. Staff are also kept abreast of developments within the Group through the quarterly Talk and Bond newsletter distributed to all employees. Our MyOnePortal also serves as a platform to post policies, guidelines and the Group Managing Director’s (“GMD”) monthly communiqués that in turn highlight the Group’s aspirations and achievements to employees. (2011)

The next CSR theme that is emphasised in the CSR Report of RHBIBB is the environment. As for employees, the environmental issues that are reported are generally for the RHB Group without any specific environment information of RHB Islamic. Among the environmental activities that the bank is involved in are financing the greenfield projects by small medium enterprises, recycling paper and water, energy conservation and providing a non-smoking zone:

As part of our environmental conservation efforts, the Group continues to foster an awareness of the environment among our employees and customers. From our continued collaboration with the Japan Bank for International Cooperation (“JBIC”) to promote and finance small and medium sized enterprises (“SMEs”) engaged in greenfield projects, to paper and water recycling activities carried out nationwide, we are slowly but surely making good progress in this area. To date, our environmental efforts also extend to recycling water from the sewerage treatment plant and channelling the treated water to the RHB Complex at Bangi to reduce water consumption. On top of this, we have begun to promote energy conservation through our involvement in the annual Earth Hour initiatives as well as ensure energy savings measures are in place at the workplace over the holidays and festive seasons. Paper recycling activities are also carried out throughout our operations on a daily basis, with our janitors taking the lead in these activities. To ensure we create a pollution-free working environment, the RHB Centre has been designated a non-smoking zone with only one room made available to smokers. (2010)

In the 2011 CSR Report, the bank emphasises the plan of environmental efforts for the following year:

Going forward, plans are in the offing to take our environmental efforts up several notches. 2012 will see the launch of a formal “Greening RHB” programme which will see environmental policies being embedded into the Group’s processes and a deeper appreciation for the environment being inculcated among employees and customers. The initiative will involve the implementation of educational and training materials as well as focused recycling programmes, among other things. (2011)

Included in the plan of the bank is formal environmental policies and investment in the educational and training materials that relate to the environment. The plan for the next year is as required by the AAOIFI Standards. The AAOIFI Standards require the bank to state the quota or target for environmental investment for the year.

The bank also emphasises their investment in companies that undertake environmental projects which includes reduction in environmental greenhouse

gases and renewable energy. The bank reports their credit or lending policy includes the environmental conservation as one of the criteria.

In Support of Green Companies

Our collaboration with the Japan Bank for International Cooperation (JBIC) to promote and finance small and medium-sized enterprises (SMEs) engaged in greenfield projects continues to gain momentum. Today, the Group is involved in lending financial assistance to companies undertaking clean development mechanism (CDM) projects to produce renewable energy, reduce greenhouse gas emissions in Malaysia, or trade their carbon emission rights (for carbon credits). The Group's credit policy advocates a cautious approach towards conservation by setting lending targets based on a sectoral outlook. (2011)

In summary, the category of charity and other social activities, employees, and environment are strongly emphasised in the CSR Report of RHB Group. As the CSR Report is prepared for the company group however, it is difficult to distinguish between RHB Bank and RHB Islamic, especially in relation to employees and environment, because both are shared within the company group. For the employee category, the CSR reports of RHB Group focus on employee welfare and work-life balance as these are the employee issues that are of most concern in Malaysia.

7.5.3 Summary of Case Studies in CSR Reports

In summary, Malaysian Islamic banks report mainly the themes of employees, customers, product and services, community and environment in their CSR reports. The results from this study are similar to the previous studies as, according to Megeid (2013), CSR reports usually include the company's responsibilities to a wide range of stakeholders such as employees, customers, community and the environment (Megeid, 2013).

The major theme that comes across in the CSR reports analysed is a particular focus on employees. In Malaysia, employees are very important especially in the banking sector, as Islamic banking faces fierce competition thus has to ensure efficiency (Mokhtar et al., 2008). Efficiency is when more outputs are produced from the inputs, and for the banking industry their employees are inputs (Sufian, 2007), which means the Islamic banks must take a good care of their employees to ensure they can deliver more outputs for the banks.

Other major themes that are identified in the CSR reports in the case studies are customers and products/services. Prior studies have found that a major quality of the Malaysian banking industry is based on a trusting relationship between customers and employees (Ndubisi, 2006). Services and employees of the banks are used to build trust and to get customer satisfaction, and thus create a quality relationship with customers (Ndubisi, 2006). This may explain the reasons that the analysis from the case studies found the CSR reports particularly KFHMB, provide substantial information on services quality, dealing with clients, customer satisfaction surveys, and plans to increase customer satisfactions. This information should provide confidence to their customers that the banks' operations are of quality and most importantly as Muslim stakeholders, they would know that products/services are Shariah-compliant and the dealings with customers are as taught in Shariah.

Substantial information on community and environment are also found in the analysed CSR reports. The efforts towards the community and environment that were reported by each Islamic bank seem to vary. However, generally the themes of employees, customers, products/services, community, and environment in the CSR reports are more heavily emphasised and they seem more detailed compared to the annual reports. Some are repetitive of the annual reports but with more detailed information. From the analysis, the annual reports of Islamic banks focus more on Shariah Supervisory Board and top management, and also the themes of employees and customers which matches with CSR reports are not as highly emphasised as in the CSR reports.

Two of the banks in the case studies also include reasonable emphasis on AAOIFI compliance, especially KFHMB, which has its parent company in Kuwait. The results from the case studies also found that only KFHMB incorporates Shariah and CSR into their vision and mission statements. As referred to in the Islamic Framework proposed in this thesis, the Islamic principles (values) are put in the CSR reports of KFHMB, but are ignored in the CSR reports of CIMBIBB and RHBIBB. The Islamic banks do mention the Islamic principles and values, but somehow not as wholly as proposed in the Islamic Framework, and their intention is also unclear. However,

their efforts to report CSR information of Islamic subsidiaries are still worthy because the CSR disclosure that relates to the Islamic items and what is promoted in Islam are a reflection that the Islamic principles exist in their operations. Mohd Nor and Asutay (2011) suggest that the failure to prioritise Islamic value ethics and commitment for CSR might be the factors resulting in low level of Islamic CSR, as the inner force or the cause of god-consciousness (*Tawhid/Unity of God*) is still utopian. As discussed in the Chapter 5, Unity of God is an Islamic principle and the core of the Islamic CSR Framework that would drive Islamic banks to engage in CSR with the objective of wealth redistribution and poverty eradication. However, Kamla and Rammal (2013) have found that Islamic banks are in reality diverting from what they claim regarding helping to redistribute wealth and to eradicate poverty. In fact, Islamic banks are still commercially driven, rather than operating for the sake of seeking God's pleasure (Mohd Nor and Asutay, 2011).

The discussion in the previous literature is aligned with the analysis of this study that observes, CSR reports that are issued by non-Islamic parent company and foundation (i.e. CIMBIBB and RHBIBB), are lacking Islamic philosophy of CSR and also Islamic terminology even though the reports disseminate the CSR activities of their Islamic subsidiaries. As most of the CSR activities were performed in a joint venture, the Islamic subsidiaries might share similar values with the parent companies which are driven by the commercial motive. The Islamic banks and their parent companies are supposed to have a different underlying philosophy of doing CSR; however as subsidiaries, they might have no choice except to follow their parent companies. This can be seen in the case of RHBIBB where, it is unclear whether the motive for CSR is commercial or for god-consciousness. In addition, there is no Islamic terminology in their CSR reports. As the CSR reports were prepared by the non-Islamic parent company, the CSR reports tend to be reported using general terminology because they are intended for all stakeholders of the company group. The reason for no separate CSR report for Islamic subsidiaries may be simply due to cost savings. The CSR information that was reported, was mostly on employees, customers, community, and environment, which are the social issues that are common for both banks regardless whether they are conventional

or Islamic. The exception is that for the Islamic subsidiaries, they also mention the facilities provided for Muslim employees and Muslim customers. But other CSR issues are also important from an Islamic perspective, such as, *Zakat* distribution, Shariah compliance, prohibited transactions, screening clients for ensuring they abide by Shariah and so on, and these are absent from the CSR reports. Therefore, the absence of these type of Islamic CSR information in the CSR reports make them insufficient to help Muslim stakeholders to make sound economic and religious decisions. A similar problem of a lack of Islamic CSR information is also found in the CSR reports of CIMBIBB which are prepared by the foundation that follows the conventional CSR Framework. However, it is important to be aware that the foundation is a separate entity from the bank which only receives the funding to manage CSR.

Interestingly, however, for an Islamic bank like KFHMB which has an Islamic parent company, although their CSR reports have many Islamic terminologies, it is also unclear whether they are using the Islamic terminology for strategy or truly for god-consciousness (*Tawhid/Unity of God*). Compared to Islamic subsidiaries under non-Islamic parent companies, KFHMB's CSR reports do provide more information on Islamic CSR issues such as *Zakat*, screening criteria to ensure clients are Shariah compliant, and Shariah Supervisory Board, which are helpful in decision making of Muslim stakeholders.

Some Islamic banks might be still orientated by the commercial motive which could be possible factor that explains why Islamic CSRep is still low in Islamic banks. However, the increasing trend of CSRep and more awareness of CSRep by Islamic banks does provide some hope that eventually they may undertake CSRep with the intention of seeking God's pleasure and reward for the managers in the Hereafter, and helping Muslim stakeholders to make economic-religious decision.

7.6 Chapter Summary

This chapter outlined the results of the content analysis of annual reports and CSR reports of Islamic banks in Malaysia to address the first research question on the extent and nature of CSRep. CSRep is apparent in the reports and appears to be increasing. The influence of AAOIFI Standards was also evaluated in response to the second research question. Results indicate an increase of CSRep between pre- and post-introduction of the Standards, and also a different emphasis between annual reports and CSR reports, particularly in relation to reporting against the Islamic Framework developed for the study.

Now that an overall picture of CSRep has been established, the next phase is to consider whether this has any impact on Islamic banks in terms of their performance. Therefore, the next chapter considers the relationship between CSRep and financial performance.

Chapter 8: The Relationships between Corporate Social Reporting and Financial Performance in Islamic Banking Industry: Empirical Findings & Discussion

8.1 Introduction

This chapter addresses third research question of the study, i.e. exploring the relationships between CSRep and the financial performance of Islamic banks. The previous chapter described the CSRep undertaken by Islamic banks in Malaysia in their annual reports, and compared this with their CSR reports. This chapter considers only the annual report disclosures and investigates whether there is a link to financial performance. The Framework developed in Chapter 5 sets out the expectations for reporting by Islamic banks, but this thesis also provides the Malaysian context in Chapter 2, where it is noted that Malaysia is an unusual case, being a multi-cultural country. Malaysian Islamic organisations therefore face traditional pressures from investors, customers, etc., to perform financially, and also pressures to act according to Islamic principles. The reporting is therefore analysed for its link to performance using both traditional measures of performance and a set of socio-economic indicators.

8.2 Descriptive Statistics

In order to provide a general overview of the sample firm characteristics, Table 8-1 presents the descriptive statistics for the independent variables used in the study as outlined in Chapter 6.

Table 8-1: Statistics for the Independent Variables (N valid=83, N missing=2)

| Financial Performance | Mean | Std. Dev | Median | Range | Min | Max |
|--|--------|----------|--------|-------|--------|--------|
| Traditional Financial Variables | | | | | | |
| Cost to income ratio (CTIR) | .489 | .456 | .429 | 3.800 | .042 | 3.842 |
| Other operating income to asset (OOIA) | .003 | .003 | .003 | .015 | .000 | .015 |
| Return on Equity (ROE) | .083 | .103 | .091 | .820 | -.405 | .414 |
| Socio-Economic Variables | | | | | | |
| Profit sharing ratio (PSR) | .576 | .227 | .607 | .960 | .034 | .993 |
| Zakat performance ratio (ZPR) | .001 | .003 | .000 | .016 | -.005 | .011 |
| Equitable distribution ratio – <i>Qard Hassan</i> (EDRQHD) | .007 | .020 | .001 | .135 | .000 | .135 |
| Directors-employees welfare ratio (DEWR) | .109 | .234 | .052 | 1.840 | .000 | 1.840 |
| Islamic investment vs Non-Islamic investment (IIVNII) | .957 | .114 | 1.000 | .784 | .216 | 1.000 |
| Islamic income vs Non-Islamic income (INVNIN) | .982 | .055 | 1.000 | .319 | .682 | 1.000 |
| Total Control Variables | | | | | | |
| Total assets (TA) | 16.032 | .825 | 16.012 | 3.963 | 14.041 | 18.004 |
| Capital ratio (CR) | .107 | .114 | .078 | .968 | .032 | 1.000 |
| Loan ratio (LR) | .904 | .056 | .923 | .289 | .680 | .968 |
| Overhead expenses (OE) | .014 | .007 | .013 | .035 | 0.001 | .036 |

Table 8-1 provides an overview of the three types of independent variables used in the models presented in this chapter – traditional financial variables, socio-economic variables and control variables.

Traditional financial variables are the variables that are commonly used to measure bank performance, which consist of cost to income ratio (CTIR), other operating income to asset (OOIA) and Return on Equity (ROE). Based on Table 8-1, a mean and median of .489 and .429 were reported for CTIR as measured by the standard

deviation of .456, these mean, median and standard deviation are the highest compared to OOIA and ROE, showing high operating expense against operating income. The means of OOIA and ROE showed that income are about 0.3% and 8.3% to asset and equity, respectively.

Socio-economic accounting variables are non-traditional financial measures which are used in this study because they are more aligned with the objectives of Islamic banks. Socio-economic accounting variables consist of the Profit sharing ratio (PSR), *Zakat* performance ratio (ZPR), Equitable distribution ratio–*Qard Hassan* (EDRQHD), Directors-employees welfare ratio (DEWR), Islamic investment vs Non-Islamic investment (IIVNII) and Islamic income vs Non-Islamic income (INVNIN). The mean of PSR shows that financing based on profit sharing agreement was 57.6% of the total financing. *Zakat* to net assets was only 0.1% among the Malaysian Islamic banks based on the ZPR mean score. Based on the EDRQHD mean score, *Qard Hassan* is only 0.7% of revenue after tax and *zakat*. The mean of DEWR showed that Directors' remuneration to employees' welfare is .109. The IIVNII mean score shows that Islamic investment was 95.7% of the total investment made by Malaysian Islamic banks and 98.2% of the total income were Islamic income is based on the mean of INVNIN.

Control variables that were employed to take into account any effect of firm size, risk, and overhead expenses include Total assets (TA), Capital ratio (CR), Loan ratio (LR), and Overhead expenses (OE). TA and CR were used to hold the firm size and investment risk constant, and showed that the means were 16.032 and 10.7% respectively. LR which was used to control for firm size and liability risk, had a mean of 90.4%, showing high liability among Malaysian Islamic banks. Lastly, for OE which was employed to control overhead expenses, the mean is 1.4%.

8.3 Normality Testing

In addition to the descriptive statistics presented above, statistical tests are performed to determine whether there are any relationships between variables *i* and whether they are statistically significant. Before undertaking the testing

however, the data were examined for normality to ensure they meet the assumptions required for such testing. This is presented in the next section.

8.3.1 Test for Normality - Dependent Variables

Based on the curve in the histogram shown in Figure 8-1, the Framework Quality data look symmetrical and close to a bell shaped curve which is defined as normal (Gravetter and Wallnau, 2008). However, normality can also be tested statistically. The statistical test for skewness measures the symmetry of the sample distribution and the kurtosis measures the spread of data (Coakes and Steed, 2007). For normally distributed data, the skewness value and the kurtosis value is close to 0 and within the range of twice its standard error (Palaniappan, 2009). Analysis of the distribution in Figure 8-1 and Table 8-2 shows that the Framework Quality data are almost normally distributed (skewness = .551; Kurtosis = .297). For Kolmogorov-Smirnov and Shapiro-Wilk statistic, the significance level should be at $p > .05$ to assume normality. The P value of Kolmogorov-Smirnov and Shapiro-Wilk statistic for Framework Quality showed mixed results.

In Figure 8-1 and Table 8-2, analysis of the distribution shows that Framework Quantity data are slightly positively skewed and relatively peaked in their distribution (skewness = 1.206; Kurtosis = 1.581). The P values of Kolmogorov-Smirnov and Shapiro-Wilk tests are less than .05. This suggests the non-normality of the data distribution.

The Normality Tests for CSRep based on AAOIFI Standards are also shown in Figure 8-1 and Table 8-2. The figure indicates that Standards Quality data are normally distributed (skewness = .371; Kurtosis = .201) and the Shapiro-Wilk statistic is at $p > .05$, therefore the data are assumed normal.

In Figure 8-1 and Table 8-2, the distribution analysis shows that Standard Quantity data are slightly positively skewed and relatively peaked distributed (skewness = 1.869; Kurtosis = 4.875). P value of Kolmogorov-Smirnov and Shapiro-Wilk are less than .05. This suggests the non-normality of the data distribution and hence some transformations are conducted (see section 8.3.3).

Figure 8-1: Histograms of Untransformed CSRep Data

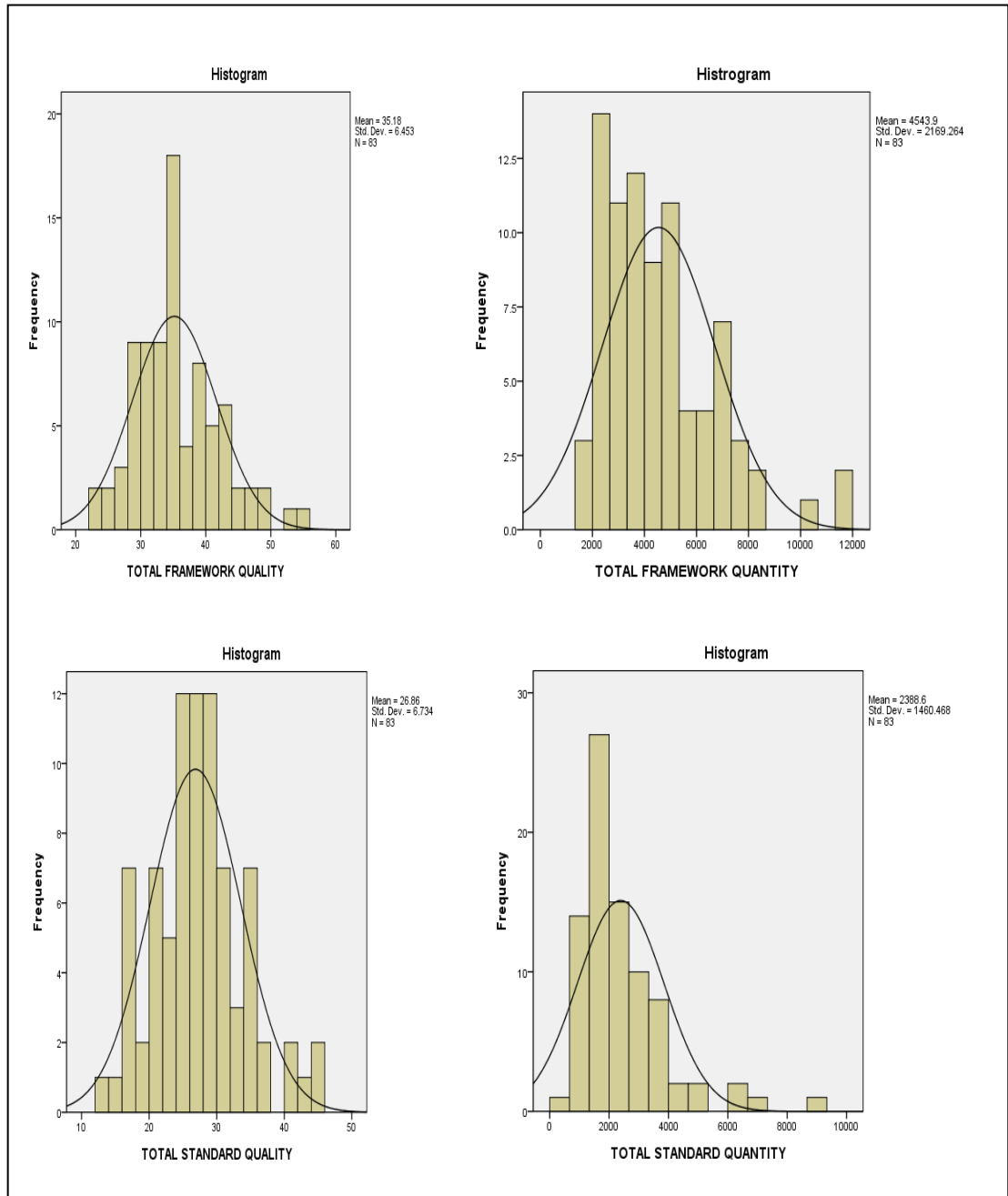


Table 8-2: Tests of Normality of Untransformed CSRep Data

| Dependent Variables | Test of Normality using Skewness Statistic | | | |
|---------------------|--|----------------|----------------|------------|
| | Statistic | Standard Error | Remark | |
| FRAMEWORK QUALITY | .551 | .264 | Not normal | |
| FRAMEWORK QUANTITY | 1.206 | .264 | Not normal | |
| STANDARDS QUALITY | .371 | .264 | Normal | |
| STANDARDS QUANTITY | 1.869 | .264 | Not normal | |
| | Test of Normality using Kurtosis Statistic | | | |
| | Statistic | Standard Error | Remark | |
| FRAMEWORK QUALITY | .297 | .523 | Normal | |
| FRAMEWORK QUANTITY | 1.581 | .523 | Not normal | |
| STANDARDS QUALITY | .201 | .523 | Normal | |
| STANDARDS QUANTITY | 4.785 | .523 | Not normal | |
| | Test of Normality using Kolmogorov-Smirnov Statistic | | | |
| | W Statistic | df | Sig. (p-value) | Remark |
| FRAMEWORK QUALITY | .138 | 83 | .001 | Not normal |
| FRAMEWORK QUANTITY | .120 | 83 | .005 | Not normal |
| STANDARDS QUALITY | .103 | 83 | .029 | Not normal |
| STANDARDS QUANTITY | .149 | 83 | .000 | Not normal |
| | Test of Normality using Shapiro-Wilk Statistic | | | |
| | W Statistic | df | Sig. (p-value) | Remark |
| FRAMEWORK QUALITY | .937 | 83 | .079 | Normal |
| FRAMEWORK QUANTITY | .901 | 83 | .000 | Not normal |
| STANDARDS QUALITY | .977 | 83 | .138 | Normal |
| STANDARDS QUANTITY | .844 | 83 | .000 | Not normal |

8.3.2 Test for Normality – Independent Variables

Table 8-3 below provides the results of the normality tests for independent variables.

Table 8-3: Normality tests statistics for Independent Variables

| Financial Performance | Skewness | | Kurtosis | | Kolmogorov-Smirnov | | Shapiro-Wilk | |
|---|----------|------------|----------|------------|--------------------|-------|--------------|-------|
| | Stat. | Std. Error | Stat. | Std. Error | Stat. | Sig. | Stat. | Sig |
| Cost to income ratio (CTIR) | 5.597 | 0.264 | 37.835 | 0.523 | 0.282 | 0.000 | 0.473 | 0.000 |
| Other operating income to asset (OOIA) | 1.77 | 0.264 | 3.626 | 0.523 | 0.164 | 0.000 | 0.829 | 0.000 |
| Return on Equity (ROE) | -1.224 | 0.264 | 7.263 | 0.523 | 0.154 | 0.000 | 0.861 | 0.000 |
| Total Traditional Financial Variables | 6.151 | 0.264 | 45.625 | 0.523 | 0.281 | 0.000 | 0.446 | 0.000 |
| Profit sharing ratio (PSR) | -0.54 | 0.264 | -0.058 | 0.523 | 0.093 | 0.072 | 0.963 | 0.018 |
| Zakat performance ratio (ZPR) | 2.029 | 0.264 | 3.772 | 0.523 | 0.324 | 0.000 | 0.618 | 0.000 |
| Equitable distribution ratio – Qard Hassan & Donation (EDR-QHD) | 5.103 | 0.264 | 27.609 | 0.523 | 0.37 | 0.000 | 0.343 | 0.000 |
| Directors-employees welfare ratio (DEWR) | 5.912 | 0.264 | 39.754 | 0.523 | 0.321 | 0.000 | 0.374 | 0.000 |
| Islamic investment vs Non-Islamic investment (IIVNII) | -4.387 | 0.264 | 23.835 | 0.523 | 0.363 | 0.000 | 0.433 | 0.000 |
| Islamic income vs Non-Islamic income (INVNIN) | -4.223 | 0.264 | 19.049 | 0.523 | 0.397 | 0.000 | 0.374 | 0.000 |
| Total Socio-Economic Variables | 1.329 | 0.264 | 4.829 | 0.523 | 0.088 | 0.169 | 0.919 | 0.000 |
| Total assets (TA) | 0.096 | 0.264 | -0.389 | 0.523 | 0.072 | 0.200 | 0.990 | 0.761 |
| Capital ratio (CR) | 6.18 | 0.264 | 46.764 | 0.523 | 0.259 | 0.000 | 0.444 | 0.000 |
| Loan ratio (LR) | -1.991 | 0.264 | 4.558 | 0.523 | 0.22 | 0.000 | 0.795 | 0.000 |
| Overhead expenses (OE) | 0.384 | 0.264 | 0.487 | 0.523 | 0.068 | 0.200 | 0.979 | 0.191 |
| Total Control Variables | 0.059 | 0.264 | -0.416 | 0.523 | 0.076 | 0.200 | 0.991 | 0.847 |

As the normality testing shows the independent variables are all non-normal except for TA and OE, some transformations of the financial and control variables is conducted, and presented in section 8.3.4.

8.3.3 Transforming CSRep Data (Dependent Variables)

When the data show non-normality, steps are taken to transform the data. To enable the transformation, the CSRep quality data have to be rescaled from the 0/1/2/3/4 system to 1/2/3/4/5 system. As there are zeros for some observations, the data were scaled by adding 1 to each value. The reason for rescaling and modifying the data is because the transformations, especially log transformations cannot produce a log value for zero or negative numbers.

Figure 8-2 shows the distribution of transformed data using log transformations and Table 8-4 shows the results of normality tests. Transformed data are approximately normal, and are therefore used in the modeling presented in section 8.5.

Figure 8-2: Histograms of Transformed CSRep Data

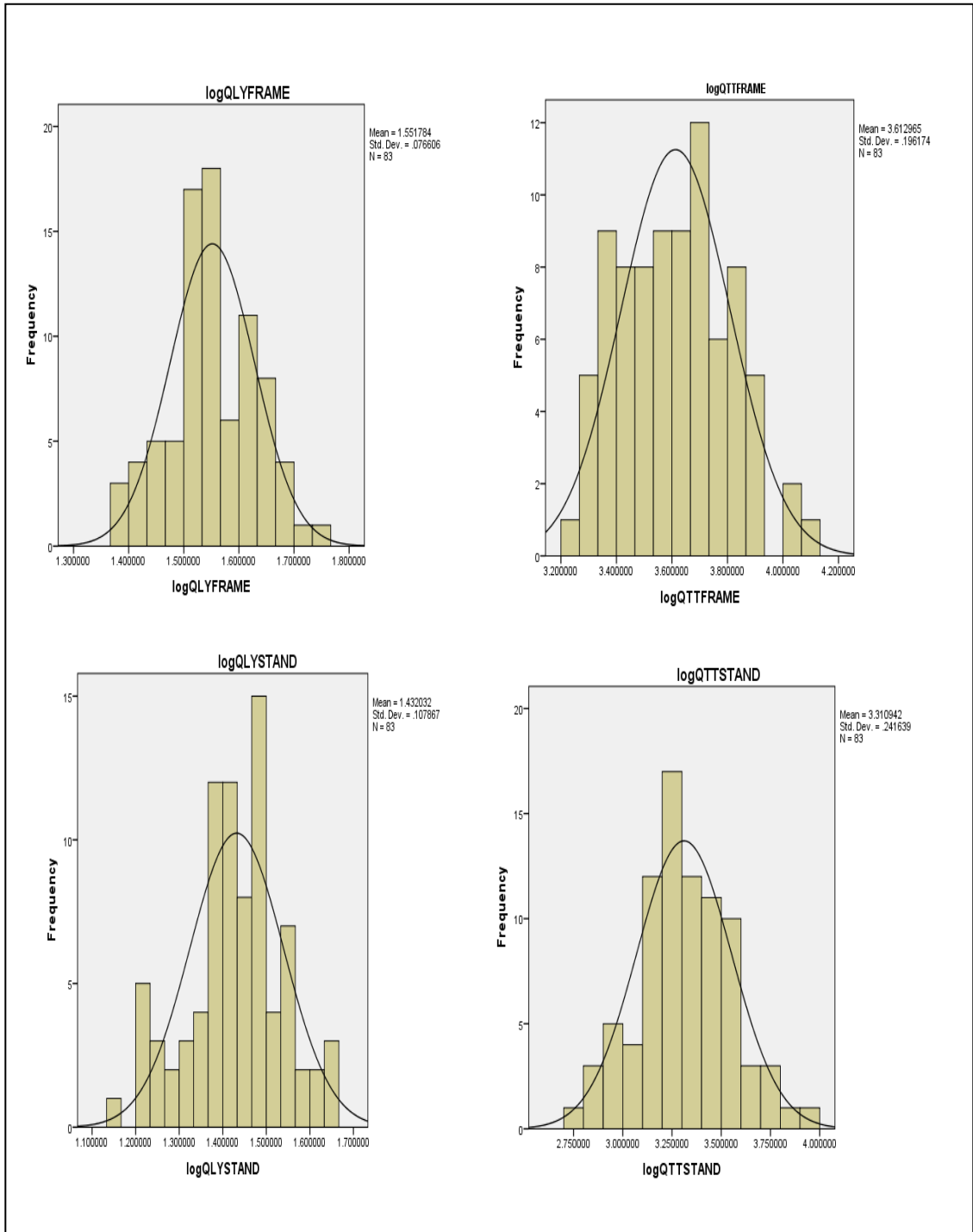


Table 8-4: Test of Normality of Transformed CSRep Data

| Dependent Variables | Test of Normality using Skewness Statistic | | | |
|-------------------------------------|--|----------------|----------------|------------|
| | Statistic | Standard Error | Remark | |
| FRAMEWORK QUALITY (logQLYFRAME) | .056 | .264 | Normal | |
| FRAMEWORK QUANTITY (logQTTFRAME) | .203 | .264 | Normal | |
| STANDARDS QUALITY (logQLYSTAND) | -.334 | .264 | Normal | |
| STANDARDS QUANTITY (logQTTSTAND) | .091 | .264 | Normal | |
| | Test of Normality using Kurtosis Statistic | | | |
| | Statistic | Standard Error | Remark | |
| logQLYFRAME | -.088 | .523 | Normal | |
| logQTTFRAME | -.645 | .523 | Normal | |
| logQLYSTAND | .027 | .523 | Normal | |
| logQTTSTAND | .020 | .523 | Normal | |
| | Test of Normality using Kolmogorov-Smirnov Statistic | | | |
| | W Statistic | df | Sig. (p-value) | Remark |
| logQLYFRAME | .103 | 83 | .030 | Not normal |
| logQTTFRAME | .068 | 83 | .200 | Normal |
| logQLYSTAND | .099 | 83 | .044 | Not normal |
| logQTTSTAND | .056 | 83 | .200 | Normal |
| | Test of Normality using Shapiro-Wilk Statistic | | | |
| | W Statistic | df | Sig. (p-value) | Remark |
| logQLYFRAME | .989 | 83 | .718 | Normal |
| logQTTFRAME | .981 | 83 | .255 | Normal |
| logQLYSTAND | .977 | 83 | .147 | Normal |
| logQTTSTAND | .993 | 83 | .934 | Normal |

8.3.4 Transforming Financial Data (Independent Variables)

Different types of transformation techniques are utilized, namely log transformation, square root transformation, and inverse transformation. In order to enable the transformation, the data were rescaled using the 'rule-of-thumb' $+0.5*(\text{minimum excluding zero})$. After that, the independent variables were transformed. The transformed independent variables were renamed, as shown in Table 8-5.

Table 8-5: Independent Variables Transformation

| Transformation method | Description | Independent variables | New independent variables |
|---|--|--|---|
| Log transformation ($\log(X_i)$) | Taking the logarithm of a set numbers squashes the right tail of the distribution. It is a good way to reduce positive skew. Any zero or negative numbers are added to $0.5*(\text{minimum value excluding zero})$ | Cost to income ratio (CTIR) Other operating income to asset (OOIA) <i>Zakat</i> performance ratio (ZPR) Equitable distribution ratio <i>Qard Hassan & Donation</i> (EDR-QHD) Directors-employees welfare ratio (DEWR) Islamic investment vs Non-Islamic investment (IIVNII) Islamic income vs Non-Islamic income (INVNIN) Loan ratio (LR) Overhead expenses (OE) | logCTIR logOOIA logZPR logEDR-QHD logDEWR logIIVNII logINVNIN logLR logOE |
| Square root transformation ($\sqrt{X_i}$) | Taking the square root of large values has more of an effect than taking the square root of small values. Taking the square root of each score will consequently bring any large scores closer to the center. | Return on Equity (ROE) Profit sharing ratio (PSR) | srROE srPSR |
| Inverse transformation ($1/X_i$) | Dividing the scores into 1 to reduce the impact of large scores. | Capital ratio (CR) | invCR |

The independent variables used in the final mode are chosen based on the normality test results of the transformed data. Table 8-6 provides the normality tests of the independent variables that were transformed.

Table 8-6: Transformed Financial Data

| Financial Performance | Skewness | | Kurtosis | | Kolmogorov-Smirnov | | Shapiro-Wilk | |
|--|----------|------------|----------|------------|--------------------|------|--------------|------|
| | Stat. | Std. Error | Stat. | Std. Error | Stat. | Sig. | Stat. | Sig |
| Cost to income ratio (logCTIR) | .173 | .264 | 5.109 | .523 | .125 | .003 | .910 | .000 |
| Other operating income to asset (logOOIA) | -.638 | .264 | .764 | .523 | .098 | .046 | .968 | .039 |
| Return on Equity (srROE) | -1.828 | .264 | 9.664 | .523 | .168 | .000 | .826 | .000 |
| Total Traditional Financial Variables | .979 | .264 | 7.857 | .523 | .134 | .001 | .863 | .000 |
| Profit sharing ratio (srPSR) | -1.282 | .264 | 1.576 | .523 | .125 | .003 | .891 | .000 |
| Zakat performance ratio (logZPR) | 2.023 | .264 | 3.756 | .523 | .324 | .000 | .618 | .000 |
| Equitable distribution ratio – Qard Hassan (logEDRQHD) | .036 | .264 | -1.526 | .523 | .226 | .000 | .856 | .000 |
| Directors-employees welfare ratio (logDEWR) | .099 | .264 | .967 | .523 | .075 | .200 | .974 | .089 |
| Islamic investment vs Non-Islamic investment (logIIVNII) | -5.955 | .264 | 41.885 | .523 | .377 | .000 | .338 | .000 |
| Islamic income vs Non-Islamic income (logINVNIN) | -4.488 | .264 | 21.513 | .523 | .391 | .000 | .353 | .000 |
| Total Socio-Economic Variables | -.506 | .264 | 1.191 | .523 | .091 | .088 | .966 | .026 |
| Total assets (TA) | .096 | .264 | -.389 | .523 | .072 | .200 | .990 | .761 |
| Capital ratio (invCR) | .550 | .264 | .379 | .523 | .093 | .073 | .976 | .114 |
| Loan ratio (logLR) | -2.248 | .264 | 5.945 | .523 | .230 | .000 | .760 | .000 |
| Overhead expenses (logOE) | -1.625 | .264 | 3.143 | .523 | .139 | .000 | .855 | .000 |
| Total Control Variables | .173 | .264 | -.287 | .523 | .062 | .200 | .990 | .773 |

Some financial data were still not normally distributed after the transformation; however, the number of individual financial measures which are normally distributed had increased. Parametric analysis is used in the study although the independent variables are not all normally distributed, because the data collected comprise the entire population of Malaysian Islamic banks.

8.4 Correlation Results among Variables

One of the aims in this study is to run a reasonable regression model of CSRep with the normally distributed independent variables. In regression analysis, there is a restriction which is to have no multicollinearity among the independent variables. To test for multicollinearity, it is necessary to conduct correlation analyses on all the independent variables. The rule of thumb for checking for the problem of multicollinearity is when the correlation is >0.780 (Gujarati, 2003).

Details of the correlations undertaken for the transformed data can be found in Appendix 5. All correlation results that is >0.780 are bolded in Appendix 5. Appendix 5 shows some correlations in the independent variables that may result in multicollinearity. In order to deal with the multicollinearity, the highly correlated independent variables are either combined or dropped from the model.

Most of the bi-variate results for dependent variables show that they highly correlated. The results show high correlation between the two dependent variables, i.e. quality disclosure and quantity disclosure (Framework: $r=.992, p<.01$)(Standards: $r=.986, p<.01$), which is in consistent with previous studies (e.g. Hooks and van Staden, 2011) and studies that find companies with a greater amount of CSRep are also disclosing higher quality of CSRep (Buniamin, 2012).

There is also high correlation between the variable for Quality score based on the Framework (QLYFRAME) and for Quality score based on the Standards (QLYSTAND) ($r=.995, p<.01$), and also between the Quantity of words based on the Framework (QTTFRAME) and Quantity based on the Standards (QTTSTAND)($r=.994, p<.01$). This is expected as both the measure of quality and of quantity is taken from the same

annual reports, just based on different CSRep categories as set out in the Framework (normative/expected CSRep) and the Standards (CSRep guidelines). Thus, when measuring the total results will be the same - differences will appear when considering each category.

8.5 Regression Analysis

Once the data were transformed and diagnostic tests for data suitability were conducted, modeling was undertaken to investigate the relationship between CSR reporting and financial performance in order to test the two general hypotheses developed in Chapter 6:

General hypothesis 1: The level of CSRep of the Islamic bank is positively related to the banks' traditional financial performance

General hypothesis 2: The level of CSRep of the Islamic bank is positively related to the banks' social-economic accounting performance

These are specifically investigated through the testing of nine specific hypotheses which, for ease of reference, are reproduced at the end of section 8.5 (refer Table 8-17). In this study, regression analysis was used, considering OLS versus Panel Modelling, and this is discussed next.

8.5.1 Cross-sectional Regression Analysis

Cross-sectional analysis using Ordinary Least Squares (OLS) regression can be represented as follows:

$$Y_i = \beta_0 + \beta_1 X_{1i} + \beta_2 X_{2i} + \dots + \beta_n X_{ni} + \varepsilon_i$$

where Y denotes the dependent variable, X_s are the set of n independent variables, β_s are parameters to be estimated (β_0 is the intercept) and ε_i are the idiosyncratic error which are normally distribute, zero mean, finite variance, and not correlated across time, individual units or with explanatory variables. Under these assumptions the OLS estimates are consistent best linear unbiased (BLUE).

Cross-sectional analysis has two major potential limitations: first, it does not take account of unobserved heterogeneity (an omitted variable problem) and second repeated observations on the same units (e.g. banks) may not be independent. In either case, the errors will no longer fulfil the required assumptions for OLS to be used—estimates will not be BLUE (Baltagi, 2008, Cameron and Trivedi, 2005). While individual heterogeneity can be modelled by the inclusion of a set of dummy variables, this can be impractical (e.g., use of this method reduced the degrees of freedom from 32 to 19 when individual dummy variables are included—all other things equal, the fewer the degrees of freedom the less likely statistical significance will be found⁴⁵). Nonetheless, cross-sectional analysis is the starting point as it provides consistent unbiased efficient estimates, if it is the appropriate specification and if it is not it provides a useful base-case against which to compare more sophisticated models.

8.5.2 Panel Regression Analysis

Panel models are a workhorse for econometric analysis (Greene, 2008, Frees, 2004, Wooldridge, 2002). Notwithstanding some drawbacks (see below), generally, they increase the degrees of freedom, reduce collinearity among explanatory variables, improve efficiency, reliability and stability of econometric estimates, and identify and measure effects not detectable in cross-sectional or time-series data. Moreover, failure to use panel models when appropriate is a model misspecification error resulting in biased estimated coefficients and unreliable diagnostic statistics (Baltagi, 2008, Greene, 2008, Frees, 2004, Wooldridge, 2002).

The basic framework of the panel model used is as follows (Greene, 2008):

$$Y_{it} = \beta_0 + \beta_1 X_{1it} + \beta_2 X_{2it} + \dots + \beta_j X_{jit} + \varepsilon_{it}$$

In the panel model the error term (ε_{it}) has two components, individual time-invariant effects (α_i) and the usual individual time-variant error term (u_{it}) giving the composite error:

⁴⁵ E.g., for a t-test on regression coefficients the critical value (5% - 2 tail) is 2.086 for df=20, but 1.98 for df=120.

$$\varepsilon_{it} = \alpha_i + \mu_{it}.$$

Thus, the panel model can be represented as:

$$Y_{it} = \beta_0 + \beta_1 X_{1it} + \beta_2 X_{2it} + \dots + \beta_j X_{jit} + \alpha_i + \mu_{it}$$

where, in this study, i represents individual banks, t represents time (years 2006 to 2011), Y denotes dependent variables (e.g. YYY), β_0 is the common intercept, X is a set of independent variables (e.g. XXX)—including any control variables; β represents parameters to be estimated, α_i corresponds to the unobserved heterogeneity in banks, and μ_{it} are idiosyncratic errors.

The one-way error component panel model described above is the simplest panel model approach; the two-way error component model includes time effects as shift dummies; more complex models are available, but given the limited sample size more complex models are avoided.

The question of whether a Random Effects Model (REM) or Fixed Effects Model (FEM) is appropriate is the subject of much discussion. Following Wooldridge (2002) and Hsiao (2003), it may be summarised as follows:

The Fixed Effects Model (FEM)

In the FEM the individual effects, α_i , are allowed to be correlated with the observed independent variables. In the FEM procedure the individual effects are estimated. The major drawback of the FEM is that time-invariant explanatory variables are differenced out of the model. Another limiting factor is that FEM estimates are sample specific and cannot be generalized outside the sample (Wooldridge, 2002), but in this case this is not an issue as the 'sample' represents the population of relevant banks during the period under investigation.

The Random Effects Model (REM)

An important assumption of the REM is the assumption that the individual effects (α_i) are uncorrelated with all independent variables, X_{it} . Since the time-invariant unobserved effects in the error term may cause the composite errors to be serially correlated. To deal with this problem, the REM uses the Generalised Least Squares

(GLS) regression method. The main problem with the REM approach is that when the individual specific effects are correlated with any of the independent variables, the estimates are not consistent.

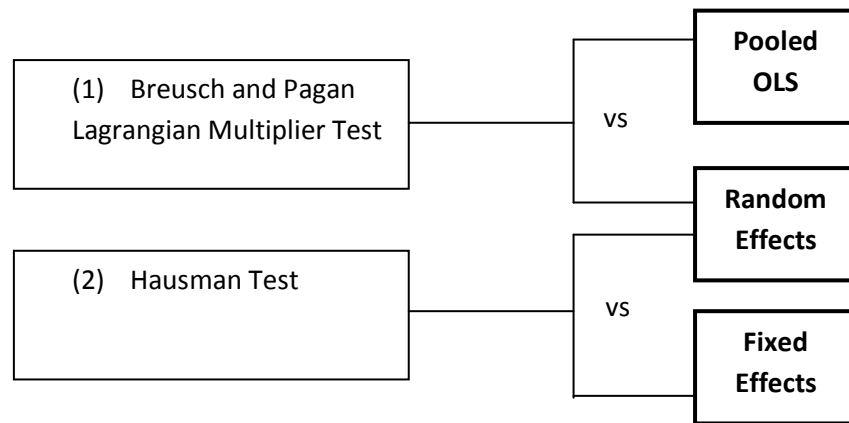
Benefits of the REM are that estimates are based on “within” and “between” differences (i.e. difference in data for each bank across years and differences between banks for each year) while the FEM (and OLS) estimates are based only on “within” differences; it allows the inclusion of time-invariant explanatory variables that may be interest (the FEM, however, lodges all time-invariant effects in the individual-effects dummy variable which does not allow assessment of their impact (Cameron and Trivedi, 2005); while FEM first-difference coefficients pick-up short-run effects, REM coefficients can be viewed as long-run effects; the REM estimator is equivalent to a weighted average of the FEM and the OLS “between estimator” (Baltagi, 2008, Cameron and Trivedi, 2005, Greene, 2008) —and can be considered the optimal combination of within and between estimators.

8.5.2.1 Model Selection: Pooled OLS or Panel Model; REM or FEM

To test the pooled OLS versus the REM, the Breusch and Pagan Lagrangian multiplier test for random effects is used; the null hypothesis is that the cross-sectional variance (i.e. unobserved heterogeneity) is zero hence rejection of the null hypothesis indicates the REM is preferred to the OLS (Breusch and Pagan, 1980).

Testing the FEM versus the REM is done using the Hausman specification test: the null hypothesis is that the individual effects are uncorrelated with the explanatory variables; rejection of the null indicates the preferred model is the fixed effects model (Hausman, 1978). Figure 8-3 summarizes the regression model selection method.

Figure 8-3: Regression Model Selection



8.5.2.2 Endogeneity

Before considering model results one further matter must be considered. The model results to be discussed are based on a strong assumption: causality is from explanatory variables to the dependent variable(s). That is, a caveat when considering the model outcomes is that causality is uni-directional not bi-directional; it is assumed that the dependent variable in the model does not influence one or more explanatory variables i.e. endogeneity is not an issue. If causality was bi-directional parameter estimates from the regression analyses could be biased and inconsistent. Empirical studies have addressed this potential endogeneity issue by employing a two-stage regression procedure that utilizes instrumental variables to produce predicted values of endogenous independent variables. This approach is only appropriate if the instrumental variables are correlated with the endogenous independent variable, but unrelated to the error term of the second-stage regression (Cameron and Trivedi, 2005). Unfortunately, it is hard to identify instrumental variables that satisfy these conditions for these data and models. More generally it is difficult to find instrumental variables that satisfy these conditions in accounting and finance research settings (Chenhall and Moers, 2007). There is, however, an informal form of instrumental variables that can be used—lagged values of explanatory variables are used as instrument. That is, models include as explanatory variables the one-period lagged value of the desired explanatory variables on the basis that these are correlated with the

'current' period value, but as they precede the dependent variable by one period there cannot be direct causality from the dependent to the lagged explanatory variables.

8.6 Regression Results

As outlined in Chapter 6, four models (i.e. models for CSRep quality-Framework, CSRep quantity-Framework, CSRep quality-Standards and CSRep quantity-Standards) are tested in this thesis, to investigate the relationship between CSR (quality and quantity) and financial performance (traditional and socio-economic). The model equations are repeated here for ease of reference, and transformed data labels included:

$$\log\text{CSRepQly}_{jt} = \log\text{CTIR}_{jt} + \log\text{OOIA}_{jt} + \text{sqrtROE}_{jt} + \text{sqrtPSR}_{jt} + \log\text{ZPR}_{jt} + \log\text{EDRQHD}_{jt} + \log\text{DEWR}_{jt} + \log\text{IIVNII}_{jt} + \log\text{INVNIN}_{jt} + \text{TA}_{jt} + \text{invCR}_{jt} + \log\text{LR}_{jt} + \log\text{OE}_{jt} + \text{FUL}_{jt} + \varepsilon_{jt}$$

$$\log\text{CSRepQtt}_{jt} = \log\text{CTIR}_{jt} + \log\text{OOIA}_{jt} + \text{sqrtROE}_{jt} + \text{sqrtPSR}_{jt} + \log\text{ZPR}_{jt} + \log\text{EDRQHD}_{jt} + \log\text{DEWR}_{jt} + \log\text{IIVNII}_{jt} + \log\text{INVNIN}_{jt} + \text{TA}_{jt} + \text{invCR}_{jt} + \log\text{LR}_{jt} + \log\text{OE}_{jt} + \text{FUL}_{jt} + \varepsilon_{jt}$$

where:

$\log\text{CSRepQly}_{jt}$ = log[A CSRep quality total score, for firm j in year t]

$\log\text{CSRepQtt}_{jt}$ = log[A CSRep quantity total, for firm j in year t]

$\log\text{CTIR}_{jt}$ = log[Operating expenses / Operating income for firm j in year t]

$\log\text{OOIA}_{jt}$ = log[Other operating income / Assets for firm j in year t]

sqrtROE_{jt} = square root [Net income after tax and *zakat* / Equity for firm j in year t]

sqrtPSR_{jt} = square root [(*Mudharabah+Musyarakah*) / Total financing for firm j in year t]

$\log\text{ZPR}_{jt}$ = log[*Zakat* / Net assets for firm j in year t]

$\log\text{EDRQHD}_{jt}$ = log[*Qard Hassan* and donation / Revenue-(*Zakat*+Tax paid) for firm j in year t]

$\log\text{DEWR}_{jt}$ = log[Directors' remuneration / Employees' welfare for firm j in year t]

$\log\text{IIVNII}_{jt}$ = log[Islamic investment / (Islamic investment+Non-Islamic investment) for firm j in year t]

$\log\text{INVNIN}_{jt}$ = log[Islamic income / (Islamic income+Non-Islamic income) for firm j in year t]

- TA_{jt} = Measured by the natural log of average total assets for firm j in year t
 $invCR_{jt}$ = inverse[Equity capital/Total assets for firm j in year t]
 $logLR_{jt}$ = log[Average total loans/Total assets for firm j in year t]
 $logOE_{jt}$ = log[Total overhead expenses/ Total assets for firm j in year t]
 $BANKOWN_{jt}$ = A dummy variable, 1 if a local owned Islamic bank, 0 if a foreign owned Islamic bank
 $YEARSTAND_{jt}$ = A dummy variable, 1 if in years after the introduction of AAOIFI governance standards, 0 if in years before AAOIFI governance standards.
 FUL_{jt} = A dummy variable, 1 if a full established Islamic bank from beginning, 0 if a subsidiary of conventional bank
 ϵ_{jt} = Error term for firm j in year t

These model equations are used for CSep based on the Framework and CSRep based on the Standards. To avoid the endogeneity issue, a lagged model is used, where explanatory/independent variables that are lagged by one year are included.

As outlined above, for each model, tests are performed to determine whether to use OLS versus Panel, and a Fixed Effect or Random Effect model. Table 8-7 provides the decision matrix applied for each model.

Table 8-7: Summary of tests

| Test | Results |
|--|---------------------------------------|
| Breuch Pagan for OLS vs. REM | Null Hypothesis: OLS preferred to REM |
| Hausman Fixed-Effects vs. Random-Effects | Null Hypothesis: REM preferred to FEM |

8.6.1 CSRep Quality based on Framework

For the dependent variable, QLYFRAME, the testing process described above give the results summarised in Table 8-8 below:

Table 8-8: Summary of test results: logQLYFRAME

| Test | Test Statistic | Prob > Test Statistic | Results |
|---|-------------------------------|-----------------------|-----------------------------------|
| Breuch Pagan for OLS vs. REM Chi ² (df) | Chi ² (1) 28.76 | 0.0000 | Reject null: REM preferred to OLS |
| Fixed-Effects vs. Random-Effects Chi ² (df) | 36.66 | 0.0005 | Reject Ho: FEM preferred to REM |

Notes: Preferred model FEM.

Based on Table 8-8, $p < .05$ therefore the null hypothesis was rejected and FEM was preferred in the modelling as shown in Table 8-9.

Table 8-9: Model for logQLYFRAME

| VARIABLES | REM logQLYFRAME | FEM logQLYFRAME | OLS logQLYFRAME |
|-------------------------------|----------------------------|----------------------------|----------------------------|
| L.logTA | 0.003 (1.030) | 0.003 (0.861) | 0.00172 (0.00372) |
| L.invCR | 0.001 (1.033) | 0.001 (0.581) | 0.00266 (0.00200) |
| L.logLR | -0.477 (-1.387) | -0.372 (-1.061) | -0.818* (0.403) |
| L.logOE | 0.059** (2.481) | 0.052* (1.925) | 0.0989** (0.0351) |
| L.logCTIR | -0.028 (-0.746) | -0.023 (-0.592) | -0.0338 (0.0513) |
| L.logOOIA | 0.003 (0.163) | 0.006 (0.318) | -0.00674 (0.0209) |
| L.srROE | 0.085 (1.355) | 0.013 (0.215) | 0.193** (0.0789) |
| L.srPSR | -0.002 (-0.0342) | 0.114 (1.652) | -0.133** (0.0468) |
| L.logZPR | 1.050 (1.410) | 1.032 (1.359) | 1.293* (0.725) |
| L.logEDRQHD | 0.014*** (3.732) | 0.008 (1.582) | 0.0230*** (0.00624) |
| L.logDEWR | -0.010 (-0.687) | -0.007 (-0.605) | -0.0106 (0.0206) |
| L.logIIVNII | -0.016 (-0.450) | -0.023 (-0.453) | -0.0166 (0.0379) |
| L.logINVNIN | -0.010 (-0.0643) | 0.028 (0.162) | -0.127 (0.214) |
| BANKOWN | 0.047 (1.205) | | 0.0556 (0.0321) |
| YEARSTAND | 0.020 (1.220) | 0.021 (1.408) | 0.0219 (0.0200) |
| Constant | 0.848* (1.827) | 0.866* (1.862) | 0.748 (0.451) |
| Observations | 82 | 82 | 82 |
| R-squared | | 0.445 | 0.522 |
| R ² -Overall | 0.442 | 0.127 | |
| R ² -Within | 0.383 | 0.445 | |
| R ² -Between | 0.502 | 0.0251 | |
| Var explained ui | 0.445 | 0.766 | |
| <i>Log likelihood</i> | | | 124.6 |
| <i>F-test</i> | | | 36.55 |
| <i>Adjusted R²</i> | | | 0.414 |

Robust z-statistics in parentheses *** p<0.01, ** p<0.05, * p<0.10

Table 8-9 shows that the total observations are 82⁴⁶. The model reports the results on the transformed variables in log, square root and inverse; therefore for the purpose of discussion, the exponential of the transformed results were converted to the original and interpreted accordingly for each significant coefficient variable. This applies for all regression models in this chapter.

For the preferred model (FEM), the value of R^2 is 0.445, which indicates the explanatory power of the independent variables is 44.5%, to explain the variation in QLYFRAME. The variance of the regression error term U_i is 0.766. Only (the one-period lag of) OE (10%) is statistically significant. For (lag) logOE the coefficient = 0.052 (t-statistic = 1.925), which means the elasticity in that a 1% increase in OE will result a 0.052% increase in QLYFRAME.

The results indicate that the banks which have increased their overhead expenses in the previous year would have higher quality of CSRep based on the Framework. However, the previous studies found the companies which are committed to CSR program, their overhead expenses would be reduced (Mendoza, 2007, Jones et al., 2012). As CSR programs and reporting of CSR are commonly related (Besmer, 2006), the result of the current study is somehow contradictory to the previous studies. However, overhead expense (OE) is the only variable that is significant and is also a control variable in this study, so there does not seem to be a relationship between quality of CSRep based on the Framework and performance.

8.6.2 CSRep Quantity based on the Framework

Table 8-10 shows the test results summary for CSRep Quantity based on the Framework.

⁴⁶ The total observation is 82 because a lagged model was used in the study. There are two annual reports that were missing in this study i.e. BMMB 2009 and EONCAPIBB 2011, as explained in Chapter 7. Because the model is lagged, BMMB 2010 is unaccounted for in the model due to the missing data of BMMB 2009. The missing report of EONCAPIBB 2011 does not affect the model because 2011 is the last period of the sample. Therefore the total missing is 3 cases, making the total observation 82 for the panel regression model, instead of 85.

Table 8-10: Summary of test results: logQTTFRAME

| Test | Test Statistic | Prob > Test Statistic | Results |
|---|--------------------------------|-----------------------|-----------------------------------|
| Breuch Pagan for OLS vs. REM Chi ² (df) | Chi ² (1) 10.31 | 0.0007 | Reject null: REM preferred to OLS |
| Fixed-Effects vs. Random-Effects Chi ² (df) | Chi ² (12) 11.03 | 0.5268 | Cannot Reject Ho: REM Consistent |

Notes: Preferred model REM.

Based on Table 8-10, $p > .05$ therefore the null hypothesis is accepted and the REM is preferred in the modelling as shown in Table 8-11. Because the model in Table 8-11 reports the results on the transformed variables, the exponential of the transformed results were converted to the original and interpreted accordingly for each significant coefficient variable.

Based on Table 8-11, the value of R^2 for the preferred model (REM) is 0.379. The R^2 indicates that 37.9% of the variation in QTTFRAME is explained by the independent variables. The result of the R^2 is quite low because it means that 62% of the variation in the dependent variable is unexplained by the model. The variance explains the regression error term U_i of 0.5.

Table 8-11: Model for logQTTFRAME

| VARIABLES | REM logQTTFRAME | FEM logQTTFRAME | OLS logQTTFRAME |
|-------------------------------|---------------------|--------------------|-----------------------|
| L.logTA | 0.010* (1.671) | 0.003 (0.369) | 0.0153* (0.00761) |
| L.invCR | -0.003 (-0.921) | -0.004 (-1.162) | 0.000258 (0.00426) |
| L.logLR | 0.043 (0.0357) | -0.651 (-0.489) | 0.857 (1.287) |
| L.logOE | -0.011 (-0.131) | 0.037 (0.407) | -0.0238 (0.106) |
| L.logCTIR | 0.067 (0.465) | 0.120 (0.780) | -0.0703 (0.168) |
| L.logOOIA | 0.156*** (3.458) | 0.140** (2.819) | 0.164*** (0.0509) |
| L.srROE | 0.393*** (2.717) | 0.321* (2.008) | 0.409* (0.205) |
| L.srPSR | 0.088 (0.667) | 0.279* (1.757) | -0.0287 (0.153) |
| L.logZPR | 1.311 (0.612) | 1.935 (0.987) | 0.445 (2.152) |
| L.logEDRQHD | 0.027 (1.426) | 0.026 (1.398) | 0.0338 (0.0223) |
| L.logDEWR | -0.067 (-1.269) | -0.053 (-0.991) | -0.0781 (0.0596) |
| L.logIIVNII | -0.052 (-0.683) | -0.105 (-1.360) | -0.00194 (0.0859) |
| L.logINVNIN | 1.107* (1.756) | 0.961 (1.517) | 1.188* (0.634) |
| BANKOWN | 0.178*** (3.119) | | 0.132** (0.0578) |
| YEARSTAND | 0.021 (0.517) | 0.034 (0.769) | 0.0166 (0.0422) |
| Constant | 2.542* (1.893) | 2.375* (1.946) | 3.045** (1.355) |
| Observations | 82 | 82 | 82 |
| R-squared | | 0.341 | 0.445 |
| R ² -Overall | 0.379 | 0.0202 | |
| R ² -Within | 0.311 | 0.341 | |
| R ² -Between | 0.414 | 0.0583 | |
| Var explained ui | 0.500 | 0.671 | |
| <i>Log likelihood</i> | | | 41.94 |
| <i>F-test</i> | | | 31.41 |
| <i>Adjusted R²</i> | | | 0.319 |

Robust z-statistics in parentheses *** p<0.01, ** p<0.05, * p<0.10

Based on the results of REM model in Table 8-11, (the one-period lag of) TA (10%), OOIA (1%), ROE (1%) and INVNIN (10%) are statistically significant. The (lag) TA

coefficient = 0.010 (t-statistic = 1.671), where TA is a log so that the coefficient can be interpreted as the elasticity, which means that a 1% increase in TA will cause a 0.010 % increase in QTTFRAME. For the (lag) logOOIA coefficient = 0.156 (t-statistic = 3.458), this means that a 1% increase in OOIA causes a 0.156 % increase in QTTFRAME. For (lag) srROE, the coefficient = 0.393 (t-statistic = 2.717). As ROE is in a square root, the output for ROE means that regardless of the coefficient, when ROE is small (i.e. close to zero) a 1% increase in ROE causes a 0.1% increase in QTTFRAME, but when ROE is large (i.e. close to its maximum) a 1% increase in ROE causes an increase between 1% and 2%. Finally, for (lag) logINVNIN, the coefficient = 1.107 (t-statistic = 1.756), which also means the elasticity, then a 1% increase in INVNIN will cause a 1.107% increase in QTTFRAME. Mainly the control variables (TA), traditional variables (OOIA & ROE) and socio-economic variable (INVNIN) are significant, which shows that the quantity of disclosures has some relationship with financial variables.

Total assets (TA) represent the firm size and this study found that an increase in total assets significantly lead to more quantity of CSRep. The result of this study is consistent with previous studies which found larger companies publish more CSR information (for example, Buniamin, 2012). According to Cormier and Gordon (2001), larger companies are more visible to the public, therefore they are expected to be more accountable for CSR issues. In order to reduce public pressure, larger companies disclose more CSR information (Cormier and Gordon, 2001). However, in this study, TA is only used as a control variable.

Other operating income to assets (OOIA) is a variable that represents the revenue efficiency of a firm. The current study finds that an increase in other operating income to assets, or more efficient revenue, leads to an increase in the quantity of CSRep. The result contradicts some previous studies that found operating income growth has a negative correlation with CSR, especially for established corporations which have more stable earnings (McGuire et al., 1988). This study's result also contrast with Cochran and Wood (1984) who found that the operating earnings to assets measure has no significant relationship with CSR, and found that firms with a higher CSR rating have lower operating earnings to assets, which might be

explained by the assets usage or assets age. According to Cochran and Wood (1984), firms with older assets have lower CSR ratings, however, this is not the case for the current study. The different result found in this study indicates a need for further investigation into this issue.

Return on equity (ROE) also has a significant relationship with CSRep quantity based on the Framework. The results show that an increase ROE, which is a measure of profitability, leads to an increase in CSRep. In addition, the result also indicates that how large the increase in CSRep is depends on the size of ROE. This finding is in line with previous studies that found a positive linkage between ROE and CSR (Iqbal et al., 2013, Preston and O'Bannon, 1997, Uadiale and Fagbemi, 2012). This means better profitability in the previous year means Islamic banks will provide more disclosure of CSR as there is positive change in CSRep quantity based on the Framework. Preston and O'Bannon (1997) describe the positive linkage between ROE and CSRep as due to "the available funding".

The significant results of TA, OOIAA and ROE indicate that disclosure by Islamic banks is influenced by traditional pressures, such as economic pressures, which is similar to findings in developed countries such as the study by Simpson and Kohers (2002).

This study adds to the literature on what characteristics influence CSRep by adding socio-economic variables to the model. The model results show that one socio-economic variable is likewise significant with CSRep. INVNIN which represents Islamic income or segmented income received from halal sources has a significant positive relationship with CSRep quantity based on the Framework. The result of the current study is consistent with a previous study that found Islamic banks with less non-halal income, leads to an increased level of CSRep (Fitrijanti and Alamanda, 2013). Hameed et al. (2004) found that the major income of Islamic banks comes from halal sources, but Malaysian Islamic banks have a lower percentage of Islamic income compared to Bahrain Islamic banks. Hameed et al. (2004) also argue that there is other income which is not clearly justified as non-Islamic income. It is important for users to know that the major income of Islamic

banks comes from halal sources, hence any income from haram sources which should not be earned by Islamic banks, must be declared, then must be disposed of. Islamic banks are accountable to report any segment of non-Islamic income and the means of disposal of that non-Islamic income, which is part of CSRep in an Islamic context. It would thus appear that firms with higher levels of income from Halal sources, and therefore adhering to the CSR requirements of Islam, are more likely to report on their CSR activities.

BANKOWN is also significant at 1%, which means that if the bank is locally owned Islamic bank, logQTTFRAME would be higher by 0.178%. Previous studies have found that locally owned Islamic banks are more efficient than foreign Islamic banks (Ariff and Rosly, 2011). The efficiency of local Islamic banks may be explained by the fact that, in Malaysia, local Islamic banks have to compete with conventional banks. In order to be competitive, there is 'liberal' interpretation of *Shariah* by the local Islamic banks, for example forming the Islamic product called *Inah* (buy-back) sales in credit card (Ariff and Rosly, 2011). The majority of *Shariah* scholars in the Middle East have criticised and disapproved of *Inah* sales because it is seen as a device to legitimize *riba* (usury). However, for Malaysian *Shariah* scholars, they adopt a more lenient approach and have a local *Shariah* justification for permitting *Inah* sales (Shaharuddin, 2012). This example of *Inah* sales, may explain why local Islamic banks would disclose larger amount of CSRep, as they need to disclose more information to explain the Islamic product that they offer and to legitimize their Islamic products according to *Shariah*.

8.6.3 CSRep Quality based on AAOIFI Standards

Tables 8-12 shows that FEM is the preferred model, for the results of panel regression between Quality of reporting based on the AAOIFI Standards with financial performance.

Table 8-12: Summary of test results: logQLYSTAND

| Test | Test Statistic | Prob > Test Statistic | Results |
|---|--------------------------------|-----------------------|--|
| Breuch Pagan for OLS vs. REM Chi ² (df) | Chi ² (1) 0.0001 | 0.9899 | Cannot reject null: OLS preferred to REM |
| Fixed-Effects vs. Random-Effects Chi ² (df) | Chi ² (12) 35.89 | 0.0006 | Reject Ho: FEM preferred to REM |

Notes: Preferred model FEM.

Table 8-13 presents the results for the panel modeling of the Quality of reporting based on the AAOIFI Standards.

Table 8-13: Model for logQLYSTAND

| VARIABLES | REM logQLYSTAND | FEM logQLYSTAND | OLS logQLYSTAND |
|-------------------------------|----------------------|----------------------|------------------------|
| L.logTA | 0.005 (0.780) | 0.009 (1.423) | 0.00476 (0.00611) |
| L.invCR | 0.001 (0.316) | -0.002 (-0.818) | 0.00107 (0.00337) |
| L.logLR | -0.097 (-0.169) | -0.003 (-0.00813) | -0.0972 (0.575) |
| L.logOE | 0.083* (1.772) | 0.042 (0.825) | 0.0832* (0.0469) |
| L.logCTIR | -0.027 (-0.566) | -0.028 (-0.513) | -0.0269 (0.0476) |
| L.logOOIA | -0.006 (-0.235) | 0.029 (0.772) | -0.00624 (0.0265) |
| L.srROE | 0.224** (2.319) | 0.014 (0.145) | 0.224** (0.0966) |
| L.srPSR | -0.139** (-2.353) | 0.223* (1.966) | -0.139** (0.0591) |
| L.logZPR | 2.912*** (2.892) | 2.447*** (3.722) | 2.912** (1.007) |
| L.logEDRQHD | 0.040*** (5.082) | 0.015 (1.322) | 0.0402*** (0.00791) |
| L.logDEWR | 0.006 (0.226) | -0.009 (-0.513) | 0.00638 (0.0283) |
| L.logIIVNII | -0.077* (-1.645) | -0.070 (-1.085) | -0.0772 (0.0470) |
| L.logINVNIN | -0.325 (-1.356) | 0.013 (0.0402) | -0.325 (0.240) |
| BANKOWN | 0.047 (1.395) | | 0.0466 (0.0334) |
| YEARSTAND | 0.026 (0.964) | 0.021 (1.210) | 0.0257 (0.0266) |
| Constant | -0.328 (-0.521) | -0.179 (-0.432) | -0.328 (0.630) |
| Observations | 82 | 82 | 82 |
| R-squared | | 0.372 | 0.509 |
| R ² -Overall | 0.509 | 0.164 | |
| R ² -Within | 0.195 | 0.372 | |
| R ² -Between | 0.813 | 0.0551 | |
| Var explained ui | 0 | 0.625 | |
| <i>Log likelihood</i> | | | 95.47 |
| <i>F-test</i> | | | 41.92 |
| <i>Adjusted R²</i> | | | 0.397 |

Robust z-statistics in parentheses *** p<0.01, ** p<0.05, * p<0.10

For the preferred model (FEM), the R² value which indicates the explanatory power of the independent variables is 0.372. The R² result means that only 37.2% of the

variation in QLYSTAND is explained by the independent variables, which is quite low as about 63% of the variation in QLYSTAND is not explained by the model. This signifies that the relationship between the independent variables and QLYSTAND is weak. The variance of the regression error term U_i is 0.625.

According to the FEM model, only (the one-period lag of) srPSR and logZPR are statistically significant, at 10% and 1% respectively. For (lag) srPSR, the coefficient = 0.223 (t-statistic = 1.966). As PSR was transformed using a square root, the output for PSR means that regardless of the coefficient, when PSR is small (i.e. close to zero) a 1% increase in PSR causes a 0.1% increase in QLYSTAND, and when PSR is large (i.e. close to its maximum) a 1% increase in PSR would cause a 0.3% increase in QLYSTAND. For (lag) logZPR, the coefficient = 2.447 (t-statistic = 3.722), which means that 1% increase in ZPR results a 2.447% increase in QLYSTAND.

In the model for Quality, two socio economic variables are significant. This shows that the introduction of the Standards seems to have changed the emphasis of the reporting to being more socio-economic values-based.

PSR refers to profit-sharing financing products that consist of *mudharabah* and *musyarakah* contracts. Profit-sharing financing requires high capital for equity products. The profit-sharing financing by Islamic banks offers capital to small and medium enterprises and large corporate clientele, and then the business profits are shared between the Islamic banks and the enterprises. Profit sharing is a way to develop the economic conditions in the community. A higher PSR means more involvement in community economic development. In this study, the regression results show that Islamic banks with higher PSR produce higher quality CSRep when measured according to the Standards. The current result is consistent with a previous study that found higher profit sharing investment results in more widespread of CSRep (Fitrijanti and Alamanda, 2013). However a study by Hameed et al. (2004) found that profit sharing financings of Islamic banks is smaller compared to other modes of financing, such as cost-plus mark-up financing. Cost-plus mark-up financing (*murabahah*) does not have direct consequences for economic development or for improvement in the community, because cost-plus

mark-up financing is offered just to satisfy the needs of consumerism (Hameed et al., 2004). Hameed et al. 's (2004) study shows that Islamic banks had focused more on cost-plus mark-up financing, instead of providing more financing involving profit-sharing which is more useful for community economic development.

The *Zakat* Performance Ratio (ZPR) is another socio-economic variable that has a significant relationship with CSRep based on the Standards. *Zakat* is a tool of income redistribution especially to the poor and needy. *Zakat* is compulsory in Islam, hence *Zakat* is also a distinctive feature of Islamic banking. Therefore, it is reasonable to evaluate the performance of Islamic banks based on *Zakat* performance. According to the AAOIFI Standards, the *Zakat* category is a form of mandatory reporting. The results of this study show that an increase in the *Zakat* performance ratio results in an increase in CSRep quality based on the Standards. However, the result is in contrast with a previous study, that *Zakat* performance has no significant effect on Islamic CSRep (Fitrijanti and Alamanda, 2013). Hameed et al. (2004) propose that Islamic banks with higher net assets would pay more *Zakat*, hence have better *Zakat* performance, and found that this contention is supported for Bahrain Islamic banks which has better CSR, but not for Malaysian Islamic banks (Hameed et al., 2004). As it is known, the AAOIFI Standards are mandatory in Bahrain. However, from the results it can be concluded that Malaysian Islamic banks do not necessarily pay more *Zakat* when their wealth increases, but when they have better *Zakat* performance, their CSRep based on Standards will increase. This may indicate a legitimacy motive for the disclosures. Compared to Bahrain, where Islamic banks pay more *Zakat* when they have higher net assets, but their *Zakat* performance's relationship with CSRep is unknown. Therefore, it would be interesting for future research to explore the relationship of *Zakat* performance and CSRep in countries where the AAOIFI Standards are mandatory.

8.6.4 CSRep Quantity based on AAOIFI Standards

For the quantity of CSR based on the Standards (QTTSTAND), the testing results are summarised in Table 8-14 below:

Table 8-14: Summary of test results: logQTTSTAND

| Test | Test Statistic | Prob > Test Statistic | Results |
|---|--------------------------------|-----------------------|--|
| Breuch Pagan for OLS vs. REM Chi ² (df) | Chi ² (1) 0.66 | 0.2080 | Cannot reject null: OLS preferred to REM |
| Fixed-Effects vs. Random-Effects Chi ² (df) | Chi ² (12) 27.01 | 0.0124 | Reject Ho: REM not consistent |

Notes: Preferred model FEM.

Table 8-15 shows the panel regression model for logQTTSTAND:

Table 8-15: Model for logQTTSTAND

| VARIABLES | REM logQTTSTAND | FEM logQTTSTAND | OLS logQTTSTAND |
|-------------------------------|---------------------|---------------------|------------------------|
| L.logTA | 0.023*** (3.054) | 0.004 (0.387) | 0.0244*** (0.00835) |
| L.invCR | -0.004 (-1.128) | -0.007* (-1.772) | -0.00267 (0.00425) |
| L.logLR | 1.382 (1.030) | -0.324 (-0.175) | 1.472 (1.273) |
| L.logOE | 0.051 (0.458) | 0.140 (1.115) | 0.0506 (0.116) |
| L.logCTIR | -0.156 (-1.083) | 0.023 (0.132) | -0.203 (0.156) |
| L.logOOIA | 0.099 (1.526) | 0.119* (1.772) | 0.0900 (0.0661) |
| L.srROE | 0.521*** (2.988) | 0.325 (1.443) | 0.517** (0.182) |
| L.srPSR | -0.175 (-1.053) | 0.487* (1.763) | -0.250 (0.159) |
| L.logZPR | 0.615 (0.498) | 2.098 (1.351) | 0.389 (1.148) |
| L.logEDRQHD | 0.033 (1.588) | 0.025 (0.898) | 0.0355 (0.0211) |
| L.logDEWR | -0.012 (-0.244) | -0.029 (-0.577) | -0.00571 (0.0521) |
| L.logIIVNII | -0.156 (-1.506) | -0.160 (-1.034) | -0.149 (0.108) |
| L.logINVNIN | -0.296 (-0.421) | 0.879 (0.837) | -0.519 (0.703) |
| BANKOWN | 0.161*** (2.740) | | 0.146** (0.0576) |
| YEARSTAND | 0.143*** (2.732) | 0.147** (2.676) | 0.146** (0.0529) |
| Constant | 2.489*** (3.263) | 1.910* (2.057) | 2.638*** (0.711) |
| Observations | 82 | 82 | 82 |
| R-squared | | 0.425 | 0.495 |
| R ² -Overall | 0.491 | 0.0212 | |
| R ² -Within | 0.307 | 0.425 | |
| R ² -Between | 0.680 | 0.362 | |
| Var explained ui | 0.0972 | 0.652 | |
| <i>Log likelihood</i> | | | 28.46 |
| <i>F-test</i> | | | 67.46 |
| <i>Adjusted R²</i> | | | 0.381 |

Robust z-statistics in parentheses *** p<0.01, ** p<0.05, * p<0.10

Based on the preferred model (FEM), the value of R^2 is 0.425 which means that 42.5% of the variation in logQTTSTAND is explained by the independent variables. The variance explained the regression error term U_i is 0.652. Based on the results of FEM model, (the one-period lag of) invCR (10%), logOOIA (10%), and srPSR (10%) are statistically significant.

For (lag) invCR, the coefficient = -0.007 (t-statistic = -1.772). This means one unit increase in CR results increase in QTTSTAND but at a diminishing rate or has a very small impact. In other words, any small increase in CR causes approximately a one unit increase in QTTSTAND (or less than a 0.1% change). Although Capital Ratio (CR) is statistically significant in the model, it is 'not practically significant' but it must be included in the model to ensure there is no "specification effort" resulting in "specification bias" (Heckman, 1979, Frost, 1979). In this study, CR is used as a control variable. Capital Ratio (CR) is commonly used to measure firm size and is consistent with previous studies that find larger companies disclose more information than is required by Standards (Buniamin, 2012).

For (lag) logOOIA, the coefficient = 0.119 (t-statistic = 1.772), which means that 1% a increase in OOIA causes a 0.119% increase in QTTSTAND. OOIA represents the measure of revenue efficiency. The significant result of a positive linkage between OOIA and CSRep quantity based on the Standards is in line with previous studies that found CSR can lead to higher sales through CSR-driven products, brand image and reputation (Weber, 2008, Knox et al., 2005, Chapple and Moon, 2005), and thus more CSR reporting.

For (lag) srPSR, the coefficient = 0.487 (t-statistic = 1.763). As PSR is in a square root, the output for PSR means that regardless of the coefficient, when PSR is small (i.e. close to zero) a 1% increase in PSR causes a 0.2% increase in QTTSTAND, and when PSR is large (i.e. close to its maximum) a 1% increase in PSR would cause a 0.6% increase in QTTSTAND. The regression results show a similar positive significant relationship between PSR and CSRep based on the Standards, for both quality and quantity.

Generally, the results show a mix of control, financial and socio economic variables that have a significant relationship with the quantity of CSRep when it is measured by the AAOIFI Standards.

YEARSTAND is also significant at 5%, where in the years after the introduction of the Standards, QTTSTAND increases by 0.147%. YEARSTAND represents the year that AAOIFI Standards on CSR were introduced. The YEARSTAND variable being statistically significant, may indicate that introducing the Standards has had an effect which is consistent with the evidence from descriptive statistics that there was an increase in CSRep after they were introduced.

The results for all dependent variables in this study are presented in Table 8-16.

Table 8-16: Summary of Panel Regression Results

| CSRep Measures | Variables | Relationship | Sig.⁴⁷ |
|---|--|---------------------|--------------------------|
| Quality based on the Framework (QLYFRAME) | Financial variables: | | |
| | -Cost to income ratio (CTIR) | - | No |
| | -Other operating income to asset (OOIA) | + | No |
| | -Return on equity (ROE) | + | No |
| | Socio-economic variables: | | |
| | -Profit sharing ratio (PSR) | + | No |
| | - <i>Zakat</i> performance ratio (ZPR) | + | No |
| | -Equitable distribution ratio <i>Qard Hassan</i> and donation (EDRQHD) | + | No |
| | -Directors-employees welfare ratio (DEWR) | - | No |
| | -Islamic investment vs Non-Islamic investment (IIVNII) | - | No |
| | -Islamic income vs Non-Islamic income (INVNIN) | + | No |
| | Control variables: | | |
| | -Total assets (TA) | + | No |
| | -Capital ratio (CR) | + | No |
| -Liability ratio (LR) | - | No | |
| - Overhead expenses (OE) | + | Yes | |
| Quantity based on the Framework (QTTFRAME) | Financial variables: | | |
| | - CTIR | + | No |
| | - OOIA | + | Yes |
| | - ROE | + | Yes |
| | Socio-economic variables: | | |
| | - PSR | + | No |
| | - ZPR | + | No |
| | - EDRQHD | + | No |
| | - DEWR | - | No |
| | - IIVNII | - | No |
| | - INVNIN | + | Yes |
| | Control variables: | | |
| | - TA | + | Yes |
| | - CR | - | No |
| - LR | + | No | |
| - OE | - | No | |

⁴⁷ The study shows there are few significant variables. To ensure that the problem of few significant variables was not caused by the lagged variables, the models were also run without lagged variables, and no difference was found.

Table 8-16 (continued)

| CSRep Measures | Variables | Relationship | Sig. |
|--|---------------------------|--------------|------------|
| Quality based on the Standards (QLYSTAND) | Financial variables: | | |
| | - CTIR | - | No |
| | - OOIA | + | No |
| | - ROE | + | No |
| | Socio-economic variables: | | |
| | - PSR | + | Yes |
| | - ZPR | + | Yes |
| | - EDRQHD | + | No |
| | - DEWR | - | No |
| | - IIVNII | - | No |
| | - INVNIN | + | No |
| | Control variables: | | |
| | - TA | + | No |
| | - CR | - | No |
| - LR | - | No | |
| - OE | + | No | |
| Quantity based on the Standards (QTTSTAND) | Financial variables: | | |
| | - CTIR | + | No |
| | - OOIA | + | No |
| | - ROE | + | No |
| | Socio-economic variables: | | |
| | - PSR | + | Yes |
| | - ZPR | + | No |
| | - EDRQHD | + | No |
| | - DEWR | - | No |
| | - IIVNII | - | No |
| | - INVNIN | + | No |
| | Control variables: | | |
| | - TA | + | No |
| | - CR | - | Yes |
| - LR | - | No | |
| - OE | + | No | |

8.6.5 Hypotheses

The regression models above are used to test the nine related hypotheses developed in Chapter 6. Table 8-17 provides a summary of the results and these are discussed further in section 8.7.

Table 8-17: Summary of Hypotheses Testing Results

| Hypothesis | Accept/Reject | Discussion |
|--|---|--|
| <p>H1a: The <u>quality</u> of CSRep of Islamic banks is positively related to the banks' <u>cost efficiency</u></p> <p>H1b: The <u>quantity</u> of CSRep of Islamic banks is positively related to the banks' <u>cost efficiency</u></p> | <p>Framework: Reject H1a Reject H1b</p> <p>Standards: Reject H1a Reject H1b</p> | <p>The results indicate no relationship between CSR quality and financial performance when measured by traditional means.</p> |
| <p>H2a: The <u>quality</u> of CSRep of Islamic banks is positively related to the banks' <u>revenue efficiency</u></p> <p>H2b: The quantity of CSRep of Islamic banks is positively related to the banks' <u>revenue efficiency</u></p> | <p>Framework: Reject H2a Accept H2b</p> <p>Standards: Reject H2a Reject H2b</p> | <p>There is limited support for the notion that CSR quantity, when assessed according to the Islamic Framework, is related to financial performance.</p> |
| <p>H3a: The <u>quality</u> of CSRep of Islamic banks is positively related to the banks' <u>profit efficiency</u></p> <p>H3b: The <u>quantity</u> of CSRep of Islamic banks is positively related to the banks' <u>profit efficiency</u></p> | <p>Framework: Reject H3a Accept H3b</p> <p>Standards: Reject H3a Reject H3b</p> | <p>There is no support that CSR which is assessed according to the AAOIFI Standards has a relationship with traditional financial performance.</p> |

Table 8-17 (continued)

| | | |
|--|---|---|
| <p>H4a: The <u>quality</u> of CSRep of Islamic banks is positively related with banks' <u>profit sharing ratio</u> H4b: The <u>quantity</u> of CSRep of Islamic banks is positively related with banks' <u>profit sharing ratio</u></p> | <p>Framework: Reject H4a Reject H4b</p> <p>Standards: Accept H4a Accept H4b</p> | |
| <p>H5a: The <u>quality</u> of CSRep of Islamic banks is positively related with banks' <u>zakat performance ratio</u> H5b: The <u>quantity</u> of CSRep of Islamic banks is positively related with banks' <u>zakat performance ratio</u></p> | <p>Framework: Reject H5a Reject H5b</p> <p>Standards: Accept H5a Reject H5b</p> | <p>There is limited evidence that there is a relationship between CSR quantity and socio-economic indicators.</p> |
| <p>H6a: The <u>quality</u> of CSRep of Islamic banks is positively related with banks' <u>equitable distribution ratio</u> H6b: The <u>quantity</u> of CSRep of Islamic banks is positively related with banks' <u>equitable distribution ratio</u></p> | <p>Framework: Reject H6a Reject H6b</p> <p>Standards: Reject H6a Reject H6b</p> | <p>CSR quantity which is measured by the Framework is related only with the Islamic income indicator.</p> |
| <p>H7a: The <u>quality</u> of CSRep of Islamic banks is positively related with banks' <u>directors-employees welfare ratio</u> H7b: The <u>quantity</u> of CSRep of Islamic banks is positively related with banks' <u>directors-employees welfare ratio</u></p> | <p>Framework: Reject H7a Reject H7b</p> <p>Standards: Reject H7a Reject H7b</p> | <p>CSR quality and quantity when measured by the Standards is only related to the profit sharing ratio, while CSR quantity with <i>zakat</i> performance.</p> |
| <p>H8a: The <u>quality</u> of CSRep of Islamic banks is positively related with banks' <u>Islamic investment vs Non-Islamic investment</u> H8b: The <u>quantity</u> of CSRep of Islamic banks is positively related with banks' <u>Islamic investment vs Non-Islamic investment</u></p> | <p>Framework: Reject H8a Reject H8b</p> <p>Standards: Reject H8a Reject H8b</p> | |
| <p>H9a: The <u>quality</u> of CSRep of Islamic banks is positively related with banks' <u>Islamic income vs Non-Islamic income</u> H9b: The <u>quantity</u> of CSRep of Islamic banks is positively related with banks' <u>Islamic income vs Non-Islamic income</u></p> | <p>Framework: Reject H9a Accept H9b</p> <p>Standards: Reject H9a Reject H9b</p> | |

8.7 Results Discussion

More significant results for traditional variables and control variables, and for socioeconomic variables that relate to the profit sharing ratio (PSR), show the tendency of Islamic banks to focus on sharing of profit and risks, which means there is more focus on the wealthy and on business people, possibly neglecting the poor and needy. Despite the fact that profit sharing financing is beneficial for economic development, the spirit of Islamic banking requires the benefit to reach the mass community in a caring manner, which includes it benefiting the poor and less fortunate. Islamic banking should not merely be about profit sharing.

Even though the results show the profit sharing ratio is significant, indicating that Islamic banks may emphasise profit sharing, previous studies have found that profit sharing financing is very small, only about 0.5% compared to cost-plus mark-up financing (Hameed et al., 2004, Chong and Liu, 2009). Cost-plus mark-up financing is not only to fulfill the needs of consumerism, but this mode of financing is also lacking in the spirit of usury (*riba*) prohibition although it is permitted under *Shariah* law (Chong and Liu, 2009). The larger focuses of Islamic banks towards cost-plus mark-up financing make them no different to conventional banks, ignoring their purported aims to help in economic development of the community.

A 'liberal' *Shariah* interpretation, as seems to appear in the reports of the banks in the sample in this study, allows Islamic banks to be in competition with conventional banking and also allows a more multicultural aspect of their operations. Islamic banking products are offered to both Muslims and non-Muslims, and the directors and top management in Islamic banks include both Muslims and non-Muslims. According to Ariff and Rosly (2011), there is growing participation of non-Muslims in Islamic banking (as clients and directors). However, *Shariah* scholars are all Muslim. Non-Muslims are interested in Islamic banking because of the ethical element of Islamic products such as being free from interest (*riba*), uncertainty, exploitation and gambling, and the fact that all mankind of any religiosity appreciates good ethics and values (Ariff and Rosly, 2011). Ariff and Rosly (2011) also add that participation of non-Muslims in Islamic banking is because of

their desire to diversify their assets and liabilities, and also they are attracted to the fiscal incentives in Islamic product agreements. Malaysian Islamic banks try to meet the demands of Muslim and non-Muslim clients and for the purpose of the public interest, Malaysian *Shariah* scholars adopt a more lenient approach in their *Shariah* interpretation to sustain the growth of Islamic banks, in contrast to the views of *Shariah* scholars in the Middle East who have a different Islamic school of thought (*mazhab*)⁴⁸ (Hasan, 2006). In Malaysia, this is not unexpected given its multicultural nature, but an interesting area for further study is to consider whether they are manipulating the notion of religion for the banks' economic profit, or whether they are responding to the need to accommodate the local multicultural environment.

Surprisingly, EDRQHD that represents the equitable distribution ratio of *Qard Hassan* and donation is not significant in this study. This is inconsistent with a previous study that found Islamic bank with more *Qard Hassan* is significantly related to more CSRep (Fitrijanti and Alamanda, 2013).

Finally, it is possible that the banks are using Islam as a label for marketing of their products, and this could be seen as diverting their operations from the original sacred aims of Islam. The elements of the framework that are most prominent are those relating to employees and clients, which do not conflict with conventional banking notions.

8.8 Chapter Summary

This chapter presented the findings of the statistical modelling used to answer research question three. Malaysian banks do appear to be different to Islamic banks in other countries and there is some evidence that disclosure in annual reports is related to financial and socio-economic variables. There is again evidence that the AAOIFI standards influence the disclosures. A comparison between the findings from the annual reports and from the CSR reports is discussed in the final

⁴⁸ Malaysia is following Shafi'i school of thought. Most countries in the Middle East are following Hanbali school of thought.

chapter of this thesis, along with discussion of the contributions of this research. In addition, implications, limitations and further research are outlined.

Chapter 9: Discussions, Implications and Conclusions

9.1 Introduction

The final chapter of this thesis is divided into five main parts. The first part presents an overview of the research findings and also provides some discussion. The second part discusses the implications and contributions of the research findings for knowledge, practice and policy. The third part identifies the limitations of the research, and the subsequent part suggests some areas for future research. Lastly, the thesis is concluded.

9.2 Summary of Research Findings

This thesis investigated Corporate Social Reporting by Islamic banks in Malaysia. Specifically, it asked four research questions as follows:

- i. What is the nature and extent of CSRep by Malaysian Islamic banks?
- ii. To what extent does the AAOIFI standard on CSR disclosure influence the corporate social reporting practices of Islamic banks in Malaysia?
- iii. What is the relationship between Islamic corporate social reporting and financial performance in the Islamic banking industry?
- iv. Do Islamic banks balance their social responsibility and their pursuit of profits?

The questions were addressed through the examination of CSR disclosures using two instruments, one based on a more general conceptual framework of Islamic values and concepts based on prior literature, and one based on the CSR standard introduced by AAOIFI in 2009. In addition, both traditional economic performance variables, and a set of socio-economic variables were considered for their potential link to CSRep. Each research question is addressed in turn in the following sections but, first, the major findings can be summarized as:

- CSR reporting is evident in Malaysia and is increasing in quantity and improving in quality.

- Annual reports are a major medium for CSRep, but stand-alone CSR reports are on the increase.
- Employees are a major focus of the disclosures made by Islamic banks in Malaysia.
- There were increases in the CSRep quality and quantity after the introduction of AAOIFI Standards on CSR.
- For CSRep based on the Framework, there is no relationship between performance and CSRep quality, but there are a mix of traditional financial variables and socio-economic variables that appear to influence CSRep quantity.
- For CSRep based on the Standards, there are more relationships with socio-economic variables, but none with traditional financial variables.
 - Revenue efficiency and profit efficiency have a relationship only with CSRep quantity that is based on the Framework.
 - The profit sharing ratio is statistically significant in relation to both CSRep quantity and quality that are based on the Standards.

9.2.1 The Nature and Extent of CSRep in Malaysian Islamic Banks

The first research question investigates the nature and extent of CSRep by Islamic banks in Malaysia. Both the descriptive and inferential statistics indicate that the trend in both quantity and quality is increasing overall. This is apparent in both annual reports and CSR reports.

There are some repetitive disclosures in the annual reports and the CSR reports. The CSR reports repeat some annual report disclosures but with more elaboration, especially for the themes of employees, community and environment. Generally, the annual reports focus on disclosure that relates to corporate governance issues like top management and the *Shariah* supervisory board. The CSR reports disclose higher quality of CSRep on social issues that directly relate to the community in which they operate, such as the environment and charity. The CSRep quantity result shows, similarly, that annual reports offer more disclosures related to the business operations and management, as most disclosures are on corporate

governance and managing insolvent and late payment clients. Whereas the CSR reports provide more disclosures on CSR issues that are related to the community, their employees and their products and services to customers. From these results, it seems that Malaysian Islamic banks produce annual reports that have less of a sense of CSR but more are more related to governance. Currently there are not many Malaysian Islamic banks that produce stand-alone CSR reports, but the available CSR reports show that their reports have a greater sense of CSR compared to the annual reports. However, there is an increasing number of Islamic banks that have begun issuing stand-alone CSR reports so this is an aspect that will require further investigation over time. Interestingly, the theme of employees is emphasised in both the annual reports and the CSR reports.

As mentioned above, this study uses two sets of CSRep categories, one is based on the Framework developed in the thesis and another set is based on the AAOIFI Standards. The disclosure of the various categories in the Framework or the Standards is a reflection that Islamic principles are being applied in the operations of Islamic banks. In general, in terms of quality, CSRep based on the Framework is lower than CSRep based on the Standards due to more requirements for quantitative disclosure in the Standards. However, in terms of quantity, CSRep based on the Framework is higher than CSRep based on the Standards, which is likely because the Framework emphasises not only CSR but also Islamic governance. The influence of the Standards is considered further in the next section.

The study also found that the annual reports of the Asian Finance Bank Berhad (AFBB) have the lowest CSRep quantity, whether based on the Framework or the Standards. This result is surprising as AFBB is a foreign owned Islamic bank which is backed by Middle Eastern financial institutions where the interpretation of Sharia is considered to be less liberal than in Malaysia and where AAOIFI is mandatory. The contrary, and more expected result is found in the case studies of the CSR reports, where Kuwait Finance House (Malaysia) Berhad (KFHMB) which is also a foreign Islamic bank owned by an Islamic bank based in Kuwait, showed the highest

disclosure of CSR compared to other banks. A more in-depth investigation of AFBB may shed light on this anomaly, so is an area for further research.

When analysing for each CSRep theme or category, the employee category appears to be among the major foci in both annual reports and CSR reports. Annual reports emphasise more on the salary, training and benefits for their employees. This result for employees in the annual reports is similar to the study by Aribi and Gao (2010) who found Islamic banks give more attention to training and development and employee benefits, but provide less disclosure on equal opportunities and the work environment in their annual reports. However, this study found that in the CSR reports, the emphasis is more on the employees' welfare, facilities for employees, health and safety, and work-life balance. The focus of employees in annual reports and CSR reports of Malaysian Islamic banks reflects that they are applying Islamic principles, especially Unity (*Tawhid*) that teaches brotherhood and avoids discrimination. The disclosures on fair pay, development opportunities for employees, good work environment and work-life balance are reflections in line with advice in the Holy Quran and Hadith (Aribi and Gao, 2010). The result that employees are a major focus is also consistent with the Aribi and Gao (2010) result that the employee category is among the largest disclosure measured by number of words and that the category is reported by all Islamic financial institutions. Another reason for the focus on the employee category, as discussed in Chapter 7, is likely due to the competition in the banking industry in Malaysia. Islamic banks realise that their employees are crucial inputs and therefore must be taken care of so that they will deliver more outputs for the banks.

This study also found that the *Shariah* Supervisory Board (SSB) category is among the top categories, which contrasts with a previous study that found the disclosure on the SSB is still low (Wan Abdullah, 2013). However, the analysis by the type of Islamic banks in Wan Abdullah's (2013) study found that local Islamic banks report the most disclosure on the SSB compared to foreign Islamic banks. The results of the current study may suggest that Islamic banks are aware that their operations are based on the foundation of *Shariah* adherence, thus the disclosure of information on SSB would raise the confidence level of the stakeholders about their

Islamic banking operations. The management of Islamic banks may also apply the Unity principle that teaches trustworthiness; as trustees of Allah's resources they must ensure their operations are according to *Shariah* for accountability towards God, society and nature. Thus, the SSB is significant for ensuring the operations are within *Shariah*.

In the annual reports, the category of mission statements is among the bottom three. Many Islamic banks do not include their commitment to *Shariah* in their vision and mission statements. For the CSR reports, only KFHMB incorporates *Shariah* and CSR to the vision and mission statements. Prior studies have found that companies which have a vision or mission that is related to CSR tend to disclose more (Amran and Haniffa, 2011, Eljido-Ten, 2004) and this study supports that contention because the case studies show that CSR disclosures of KFHMB are more than CIMBIBB and RHBIBB. The CSR reports for CIMBIBB and RHBIBB do not include any commitment to *Shariah* in their mission statements and there are no Islamic terms and values in their reports. The CSR reports merely disclose CSR activities of the Islamic subsidiaries. However, because the CSR reports are prepared by the foundation and by the parent company that is a conventional bank, the CSR reports are not set up to publish information that meet the needs of the Muslim stakeholders only. As Malaysia is a multicultural country, the foundation and the parent company tend to make CSR reports that state their commitment to CSR for the benefits of Malaysians as a whole.

The current study notes a decrease in quantity for the *Qard Hassan* category and this category is also among those with the least disclosure. Previous studies in Iran have also found that the *Qard Hassan* component of total financing has decreased even though the state requires the banks to allocate a specific amount of *Qard Hassan* (Pourian, 1995, p.92, as cited in Aggarwal and Yousef, 2000, p.103). Aggarwal and Yousef (2000) also found that *Qard Hassan* is the least component of financing among Islamic banks in Egypt, Jordan, Malaysia and Iran. *Qard Hassan* is a benevolent loan that has no charge, no interest due, and no mark-up, which makes it a negative NPV investment for Islamic banks (Aggarwal and Yousef, 2000). Zaher and Hassan (2001) argue that Islamic banks are permitted to charge a service fee to

the *Qard Hassan* borrowers, so that the Islamic banks can cover the costs of administrative and handling the loans. Zaher and Hassan (2001) describe *Qard Hassan* as non-interest loans which are urged by the Holy Quran to Muslims to provide the loans to 'those who need'. According to Haron (1998), there are some differences in the use of *Qard Hassan* loans among Islamic banks in different countries. In countries like Jordan, Bahrain and United Arab Emirates, *Qard Hassan* is provided to the beneficiaries for productive purposes such as to start independent lives, to raise their living standards or incomes, to assist people who need money such as for education or medical treatment, and it could also be used by the shareholders or the depositors on a short term basis and with small amounts for productive purposes (Haron, 1998). Thus, *Qard Hassan* is arguably an important CSR issue and in Malaysia as *Qard Hassan* loans could be extended to other social organisations which have the objective of increasing the income of the poor (Haron, 1998). However, from the results of this study, the disclosure of *Qard Hassan* being among the least shows that *Qard Hassan* is still not the choice of Islamic banks in Malaysia. This may not be surprising because, according to Zaher and Hassan (2001), the current use of *Qard Hassan* loans is usually on a small scale compared to other Islamic financing types. The Islamic banks may view *Qard Hassan* loans as unattractive or not as profitable as other types of Islamic financing. But as the Holy Quran has described *Qard Hassan* as beautiful loan which is helping people in need, Islamic banks are supposed to intensify their *Qard Hassan* financing facilities and not to make them limited, especially in terms of scale.

For the CSRep categories that are based on the AAOIFI Standards, the annual reports show some similarities and some differences to previous studies but, in general, indicate that the Standards are being adhered to and that disclosure is increasing in AAOIFI categories. Of note, are disclosures on *Zakat*, Waqf Management and the Policy for Screening Clients.

Zakat is among the top categories disclosed even though previous studies have found *Zakat* disclosure to be much lower than the AAOIFI requirements (Ahmad Nadzri, 2009, Wan Abdullah, 2013). The finding that *Zakat* is among the top categories in terms of disclosure quality is probably due to the quality measures

used in the study that recognise quantitative items as being of high quality. The *Zakat* disclosure is mostly in quantitative terms such as *Zakat* amount, calculation, and the uses of *Zakat* in proportion, thus this might be an explanation for the contradictory result of this study and suggests more consideration needs to be given to the definition of disclosure quality.

In Bangladesh (Ullah, 2013) and Indonesia (Harahap, 2003) no banks disclose the Earnings and Expenditures Prohibited by *Shariah* which contrasts the result in the current study, which shows that although some Islamic banks do disclose in this category it is still among the bottom categories in terms of both the quality and quantity. However, over the years the disclosure of Earnings and Expenditures Prohibited by *Shariah* category has increased in Malaysia which indicates that Islamic banks are trying to improve their adherence to *Shariah* compliance requirements, especially in dealing with *haram* (unlawful) income and expenses. Most Malaysian Islamic banks report that the method used to dispose of *haram* income is by channelling it to the charities.

Disclosure in the category of Waqf Management has also increased and this is consistent with a prior study of Malaysian listed companies (Othman and Thani, 2010). The increase in the Waqf Management category indicates that the Standards promote more awareness by Islamic banks about the importance of Waqf, which is part of charity, but may be explained by the fact that the Standards have provided an individual category for Waqf Management meaning that Islamic banks have to pay more attention to Waqf as part of their CSR.

Finally, the Policy for Screening Clients is among the top categories in terms of quantity. However, most Malaysian Islamic banks screen their clients only by their creditworthiness as they depend on the *Shariah*-approved companies in Bursa Malaysia. Except in the case study of CSR report of KFHMB where the bank provides a detailed policy of screening clients that is related to *Shariah* compliance, it is disappointing that Malaysian Islamic banks did not provide their clients screening policy that relates to *Shariah* compliance in the annual reports, especially for the clients which are small and medium enterprises and are not listed as

Shariah-approved companies. A prior study shows that there is no universal *Shariah* screening policies in the banking industry, which causes the use of different policies and results in different classifications of clients into halal and haram (Derigs and Marzban, 2008). Therefore, this study suggests the Malaysian Islamic banks should not only depend on creditworthiness and should develop a generally accepted *Shariah* screening policy.

The observations made of the disclosure within each CSRep category raises the question of whether the Islamic banks are doing well in their reporting, that is, as are they being minimalist in their reporting, are they exaggerating, over-emphasising some areas at the expense of others, and etc. In general, the Islamic banks seem to over-emphasise the reporting of CSR practice and performance for some categories such as employees and community, and this may be because both categories are directly related to social issues. Thus, the Islamic banks may tend to over-emphasise their activities for employees and community for the purpose of reputation management, which then could attract potential employees and customers. For example, the banks report the “Eid Fitr” event with employees and an orphanage, or a family day and lucky draw as part of CSR activities, but these activities are not productive CSR which can create equal opportunities and help to eradicate poverty as claimed by Islamic banks. Moreover, for a category such as unlawful transactions, the Islamic banks are often being minimalist which may be due to the potential exposure of *Shariah* non-compliance risk.

This study of Islamic banking in Malaysia is particularly interesting because some of the Islamic banks are subsidiaries of conventional banks. As such, it is questionable as to whether they look Islamic in appearance only but maintain the elements that are similar to conventional banking. It raises the question of whether the Islamic bank subsidiaries of the conventional banks carry an Islamic philosophy as they claim. This study has found that CSR reports of Islamic banks that are subsidiaries of conventional banks, and also those that are prepared by a foundation, disclose less Islamic CSRep specifically Islamic value information. This result is similar to previous studies that have found the least disclosure of Islamic CSR is in Islamic subsidiaries of conventional banks and conventional banks with an Islamic window

(Wan Abdullah, 2013). The reason for the lack of disclosure might be the incongruence of the underlying philosophy between parent company and Islamic subsidiaries, or might be because the Islamic subsidiaries themselves lack an Islamic philosophy in their management as they are set up by the parent conventional banks with capitalist intentions. As such the parent conventional banks probably do not understand the Islamic banking objective, especially in relation to socio-economic justice. Thus, they disclose less Islamic value information which is deemed significant for Muslim stakeholders. This has significant implications for Islamic banking in Malaysia and also for CSRep that may stem from Islamic principles and philosophy.

9.2.2 The Influence of AAOIFI Governance Standards on CSR Disclosure in Malaysian Islamic Banks

When considering the influence of AAOIFI Standards on CSRep, in order to answer research question two, this study compared the quality and quantity of reporting before and after the introduction of the Standards. The null hypothesis of no difference was rejected and the results were significant at the 5% level, indicating that there was a significant increase in disclosure after AAOIFI was introduced. As noted in Chapter 7, it is somewhat surprising that the result was significant given that AAOIFI is non-mandatory. The results suggest that Malaysian Islamic banks may refer to the AAOIFI Standards, meaning that they have created a high level of awareness of CSR and therefore influenced quality and quantity of disclosure.

When considering individual categories of disclosure, the results showed that the choice of what categories to disclose did not change after the Standards were introduced, but rather, the increase was across all categories. This result appears somewhat contradictory to the research cited in Sarea (2012, p.28), that indicated that the acceptability level and compliance level of AAOIFI is 'moderate' among the managers in Malaysian Islamic banks when compared to Islamic banks in other countries (Che Pa, 2006, Zaini, 2007). However, as this study only looked at Malaysia, comparisons to other countries cannot be drawn and thus is an important area for further research.

In the previous section (Section 9.2.1), which provides a summary of findings about the nature and extent of CSRep in Malaysian Islamic Banks using the AAOIFI Standards as instrument, also shows some influence of AAOIFI Standards on CSR. The results reveal that the Standards are being adhered to and that disclosure is increasing in AAOIFI categories, particularly disclosures on *Zakat*, Waqf Management and the Policy for Screening Clients.

Given the significant result however, an argument can be made that making AAOIFI Standards mandatory would continue to improve CSRep in Malaysia. There is evidence that some aspects of the Standards are perhaps less relevant to Malaysia than to Middle Eastern countries, so some modification that suits the local needs and regulations may be necessary.

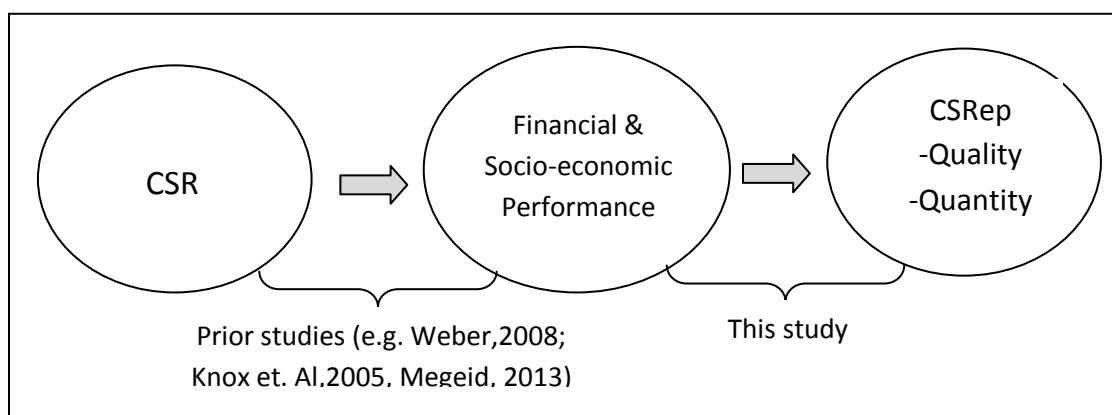
However, the results raise questions about whether the AAOIFI Standards on CSR would make those that were good performers before the Standards continue their good practice or whether they may become worse. This is because the Standards may encourage the Islamic banks to simply follow AAOIFI and disclose only the information required by the Standards. Thus, Islamic banks may be discouraged from disclosing additional information. For example, this study has found that the *Zakat* category is among the top categories in the pre-Standards reports, but not in the post-Standards reports. The analysis discovered that most Islamic banks report the *Zakat* calculation method, its amount, rulings from SSB regarding *Zakat* and the statement of whether or not the Islamic bank pays *Zakat* on behalf of the shareholders and depositors as required by the AAOIFI Standards. However, no Islamic bank provided reasons behind decision by the management not to pay *Zakat* on behalf of the shareholders and depositors as it is not required by the Standards. In addition, Islamic banks may be discouraged from disclosing CSR information in a narrative format as the Standards focus on quantitative information, meaning that some CSR information may be lost.

9.2.3 The Relationship between CSRep and Financial Performance in the Islamic Banking Industry

The third research question in this thesis investigates the relationship between CSRep and financial performance. The results show mixed results depending on whether the CSRep is measured based on the Framework or based on the Standards.

As shown in Figure 9-1, prior studies in the West (e.g. Weber, 2008, Knox et al., 2005) have found a relationship between CSR programs and financial performance. For example, CSR activities and programs have led to higher sales and higher profits due to increased reputation (Weber, 2008). In another prior study on CSR programs and performance in Islamic banking, Megeid (2013) finds that service quality improves profitability. Referring to the diagram in Figure 9-1, this study extends the research about the effect of financial and socio-economic performance on CSRep, particularly reporting.

Figure 9-1: Summary of Relationships between CSR, Performance and CSRep



To capture this relationship better, this study uses the prior year's financial and socio-economic performance to determine the relationships with CSRep quality and quantity, whereas most of the studies of Islamic CSRep and performance use current year performance. The current study found that some prior year's performance variables do have relationships with Islamic CSRep and that may be due to more funding being available. This study also found that socio-economic

performance and CSRep are likely being used to attract customers, especially Muslim stakeholders.

For CSRep based on the Framework, all hypotheses that related to performance and CSRep quality were rejected indicating there is no relationship between performance and CSRep quality. The results are in line with prior studies that have found that CSR disclosure in Islamic banks has no relation to return on assets (ROA) and return on equity (ROE) (El Mosaid and Boutti, 2012). In terms of CSRep quantity, there are mixed results when considering traditional financial variables and socio-economic variables. The tests show that the hypotheses about the relationships between CSRep quantity and prior year's revenue efficiency and profit efficiency cannot be rejected. The result is consistent with a previous study that found CSRep in Malaysian Islamic banks is significantly related to profitability (Arshad et al., 2012). The hypothesis about the relationship between CSRep quantity and prior year's Islamic income vs Non-Islamic income is also accepted, which is consistent with the notion that Islamic banks with less non-halal income, results in an increase level of CSRep (Fitrijanti and Alamanda, 2013).

For CSRep based on the Standards, all hypotheses with traditional financial variables are rejected indicating no relationship. In the Standards, the policy for par excellence customer service is considered as one CSRep category but this study finds it has no relationship with traditional financial variables. This contradicts a prior study that found service quality and customer satisfaction, which are part of CSR in Islamic banks, is positively related to financial performance, particularly profitability and liquidity (Megeid, 2013).

The findings for CSRep based on the Standards show more relationships with socio-economic variables, particularly the profit sharing ratio, for both CSRep quality and quantity, and finds *Zakat* performance significantly related to CSRep quantity. Profit sharing ratio appears to be the focus of Islamic banks as their socio-economic objective which results in better CSRep as profit sharing is helping with the economic development of the community. However, Islamic banking is not merely profit sharing, as profit sharing cannot reach the poor and those in need of money.

Qard Hassan is more capable of helping the poor and who need money, yet the socio-economic variable of equitable distribution ratio of *Qard Hassan* and donation is not significant in this study. However, the relationship between *zakat* performance and CSRep quantity is significant. *Zakat* is a compulsory religious levy and one of Islamic banking's main features. This study concludes that Malaysian Islamic banks do not necessarily pay more *Zakat* when their wealth increases, but when they have better *Zakat* performance, their CSRep based on Standards will increase.

Overall, it is concluded that there is some relationship between CSRep and performance in Malaysian Islamic banks. However, good performance appears mostly related to high disclosures of traditional banking notion of customer service, and the better known Islamic values of profit sharing and *Zakat*. This suggests that in a liberal Muslim country like Malaysia the more fundamental Islamic CSR notions of poverty alleviation, through things like benevolent loans, may be considered too much of a threat to financial outcomes. This balance is addressed further in the next section.

The study also found that bank ownership, which is a control variable, has a significant relationship with CSRep quantity, especially local Islamic banks. Local Islamic banks in particular tend to be liberal in their *Shariah* interpretation in order to be competitive, thus they need to disclose more information to explain the Islamic products that they offer and to legitimize their Islamic products according to *Shariah*. In addition, the liberal approach is likely used in Malaysian Islamic banking in order to satisfy the multicultural needs of the country.

9.2.4 Balancing Social Responsibility and Pursuit of Profits of Islamic Banks

The final research question considers whether Islamic banks in Malaysia attempt to balance their social responsibility obligations with their financial performance obligations. The results from this study show that Malaysian Islamic banks have tried to be competitive financially and also socially. However, their efforts are still not wholly aimed towards socio-economic justice as required by Islamic teachings.

Islamic banks in Malaysia are relatively new and smaller than the conventional banks, and they are still shadowed by the capitalism motive as some of them are controlled by conventional banks. However, the results of the analysis of their CSRep also show that Islamic banks are improving their social responsibility.

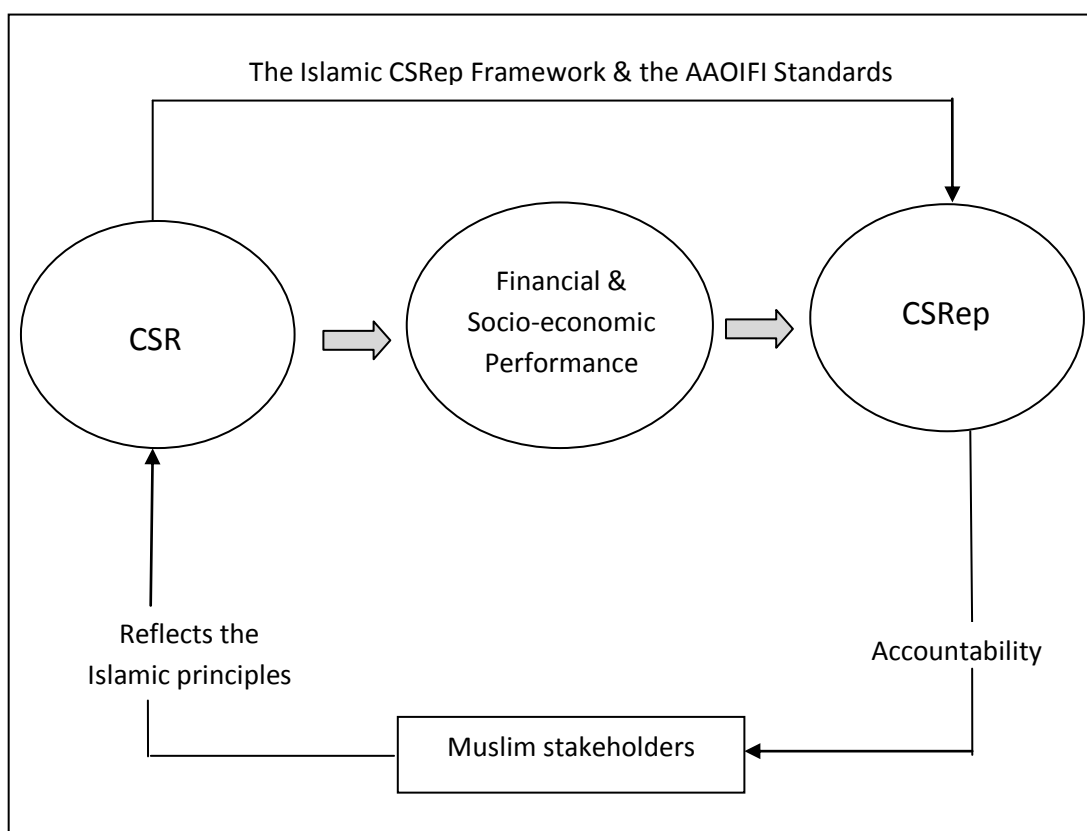
The bigger picture considered in this study is summarized in Figure 9-2. Islamic banks operate based on *Shariah* elements and Islamic principles. In the Islamic CSRep Framework developed in this study, Islamic principles especially Tawhid, are the core element, that should give spiritual motivation to commit to CSR. *Shariah* has an effect on the behaviour of management as they need to reflect Islamic principles. This management behaviour should be evident in the operations of Islamic banks including when preparing and disseminating financial and non-financial information. Islamic banks that have comprehensive Islamic CSRep in their annual reports and/or CSR reports and complete financial statements, could assist their stakeholders in making economic-religious decisions. For Islamic business organisations, disclosing the Islamic CSR items is part of the *Uqud* (contracts) in Islam. The concept of *Uqud* is similar to Social contract theory, however, Islam stresses a comprehensive understanding of the various contractual relationships in human life and the fulfilment of obligations and includes both explicit contracts and tacit contracts. In Islam, the faithful execution of all obligations of contracts, especially tacit contracts, is recognised as *ibadah* (worship Allah) (Haniffa and Hudaib, 2004).

According to Baydoun and Willett (2000), the manifestation of Islamic values in business organisations affects the interpretation of certain accounting measures and the disclosure of accounting information, including the information that disseminates their accountability to God (Allah), the community and the environment. The stakeholders have the right to adequate information as required by *Shariah*, which could assist them in decision making and could enable them to fulfil the three interrelated duties and obligations to God, to society and to nature, and which are part of the Islamic CSRep Framework used in this study. According to Figure 9-2, Muslim stakeholders can demand Islamic banks to reflect Islamic principles in their operations, and likewise can make demands for their information

needs. Therefore Islamic banks should be responsible to Muslim stakeholders by analysing their information needs and managing their demands. Using stakeholder theory, any conflicting demands of stakeholders are able to be dealt with and balanced by the Islamic ethical principles because each key ethical issue faced by multiple stakeholders can be prioritised using the Islamic approaches of justice, trust and benevolence (Beekun and Badawi, 2005).

In this study, Islamic CSRep is measured using the Islamic CSRep Framework and the AAOIFI Standards. The Islamic CSRep Framework presents the core of CSR as the Islamic ethical principles, which derive the fulfilment of obligations to God, society and nature, within a social relations system based on accountability, social justice and trust. Here is where the Islamic CSRep Framework becomes important and relevant to guide the general reporting of CSR for Islamic business organisation. AAOIFI Standards also can also provide guidance, especially for Islamic financial institutions, as they are more specific.

Figure 9-2: Summary of Balancing CSR and Performance



As shown in Figure 9-2, there is an arrow flows from CSRep to Muslim stakeholders, which indicates that a sufficient and comprehensive set of information provided by Islamic CSRep could enhance stakeholders' ability to make sound economic-religious decisions and could help the stakeholders to assess whether the business activities are operating according to Islamic principles. Thus, balancing CSR and profit pursuit in Islamic banks could portray a good image to their stakeholders and could attract more potential stakeholders, which is in line with the study by Dusuki and Abdullah (2007) that pointed out that stakeholders preferred banks with impressive Islamic CSR and financial reputations.

As discussed in the previous section (Section 9.2.3), CSR activities and programs could improve financial performance. Then, with better financial performance and better socio-economic performance, Islamic banks afford to disclose better quality and more reporting of CSR.

It is important therefore, that management is aware that financial performance is not the sole factor for the survival of an Islamic bank, but social responsibility to their various stakeholders is also part of the competition they face. Social responsibility and the pursuit of profit need not be conflicting goals for Islamic banks as they have dual roles. The commitment to CSR could be a strategic tool that attracts Muslim stakeholders, and thus bring profitable and sustainable business in the long run. Good financial performance provides available funds to Islamic banks for disseminating CSR via reporting and also for investing in CSR programs in the following year. Therefore, CSR, financial performance, and reporting of CSR should not be viewed as conflicting, but as complementary to each other.

9.3 Research Implications & Contributions

The following sections explain the research implications and contributions of the study particularly to knowledge, practitioners, regulators and policy makers. The contributions include a major contribution to theory and methodology; it uses additional empirical elements that have not yet used in previous studies; and

provides a contextual understanding of a unique setting through the use of a multicultural country setting.

9.3.1 Summary of Major Research Contributions

This thesis provides a number of important contributions to the literature and research on CSR reporting by Islamic business organisations.

The conceptual framework of Islamic CSRep that is developed in this study contributes to the theoretical literature on Islamic social reporting. The Framework is more holistic and comprehensive because it shows how Islamic principles derive the obligations expected of Islamic organisations, the social relations system within which those obligations sit, and finally the expectations of Islamic social reporting. The use of this Framework to measure CSRep and its comparison to a measure based on an existing Framework is a unique contribution to the literature and indicates that incorporating a cultural or spiritual element may impact attitudes to reporting, and this is important for developing countries efforts to introduce and encourage CSR.

This study contributes to the research on Malaysian Islamic banks by including a qualitative component in the examination and analysis of annual reports and CSR reports. Such an examination allows more detailed consideration of the actual reporting content, rather than simple word or sentence counts. Evidence that arises from this examination includes the finding that employee disclosure is significant for this industry in Malaysia and thus provides a rich area for future investigation.

This study also contributes to knowledge of corporate social reporting in general as it provides an overview of CSRep in Malaysia, both before and after the AAOIFI Standards were introduced. This use of the AAOIFI Standards on CSR as instrument to collect data on CSRep, also add to the literature on social reporting as there is no other study that has used the new CSR standard to date. The instruments developed in this thesis can be used in future studies.

The study also uses socio-economic variables to consider performance which is more aligned with the objective of Islamic banks thus it also contributes to enriching the literature on social reporting as it provides a more context-specific analysis. Most of the previous studies of Islamic banks' performance use conventional financial variables such as profitability and liquidity. The significant findings for some of these variables indicate that this addition to the literature is important.

Finally, this study offers additional evidence of the link between economic performance and reporting by Islamic banks, particularly the economic performance of the prior year on CSRep, which has not been used in other studies of Islamic CSR. Hence, this thesis adds significantly to the literature and knowledge of Corporate Social Reporting by Islamic banks in Malaysia.

9.3.2 Practical Implications

The results of the study indicate that adherence to AAOIFI Standards seems to improve the level of reporting as the results show an increase in quality as measured by AAOIFI. However, a more nuanced consideration suggests there could be some drawbacks to this approach as there is some evidence that AAOIFI may lead to minimalist reporting since AAOIFI puts more emphasis on quantitative information.

The results in this study also show that the increase in the Waqf category is significant. AAOIFI provides individual category for Waqf Management, which can encourage Islamic banks to focus on Waqf as part of their main CSR, rather than as just one type of charity. As such, Islamic banks are likely to improve their management and reporting on Waqf facilities due to the emphasis by AAOIFI.

Individual Islamic banks could self-benchmark their CSRep practices against the AAOIFI Standards. The results from this study provide averages of aggregated data on CSRep based on the Framework and the Standards. The study provides insights into which CSRep categories those Islamic banks should give more attention to and should improve, especially the reporting of the three lowest categories, if they wish

to differentiate their banks and to compete with others. Previous studies have suggested that the stakeholders prefer banks with impressive Islamic CSR and financial reputations (Dusuki and Abdullah, 2007, Dusuki and Dar, 2007).

9.3.3 Social/Policy Implications

A number of implications for policy are also evident from the findings of this thesis. The results provide justifications for policy makers and regulators, especially the Malaysian Accounting Standards Board (MASB), to initiate actions to provide Islamic CSR standards for Islamic business organisations. MASB could consider adopting AAOIFI Standards and making the standards mandatory with some modifications that suit local requirements. For example, standards requiring explicit reporting on environmental issues.

As an alternative to the AAOIFI Standards, MASB could also consider providing Islamic CSRep standards or guidelines which have as a minimum the Islamic CSRep Framework developed in the study. The Islamic CSRep Framework would provide guidelines for disclosure practices that accommodate Islamic issues.

Some Malaysian Islamic banks are also listed on Bursa Malaysia as *Shariah*-compliant companies. From 2006, Bursa Malaysia requires the disclosure of CSR information as part of its Listing Requirements. The current guideline for CSR disclosure practices by the Securities Commission (SC) is a conventional CSR Framework that is based on Western experiences. The results from this study give justifications that policy makers and regulators like the SC and *Shariah* Advisory Council in the SC, should issue a guideline on best disclosure practices from an Islamic perspective to encourage Islamic business organisations to enhance their reporting on Islamic CSR.

With a comprehensive guideline on CSRep in the Islamic context from MASB, SC and the *Shariah* Advisory Council in the SC, Islamic banks in Malaysia could provide information on Islamic CSRep which is complete, relevant and important to their stakeholders to help them in making their religious and economic decisions. As a result, stakeholders would have better understanding of the elements of CSR in

Islamic banks and the disclosure would help them to assess whether the Islamic banks have actually complied with Islamic principles.

9.4 Research Limitations

As with all research, this thesis has some limitations. First, as the data are gathered solely from secondary sources using annual reports and stand-alone CSR reports, this study can only provide limited insights into CSRep practices of Islamic banks. Using secondary sources as the sole medium means the existing information may not fully meet the specific needs of this study (Cooper and Schindler, 2003). Moreover, the financial performance measures identified in this study are confined to items that have been disclosed and items that should be disclosed in the annual reports, which is also a limitation that has been acknowledged by the authors who developed the measures (Ariff et al., 2009, Hameed et al., 2004). Despite this, the current study is still valuable since it provides a quantitative evaluation of Islamic principles and concepts in CSR through the examination of CSRep.

Second, there are some limitations in the content analysis which is used as the method in this study. The major issue is the subjectivity in the process of content analysis and among the coders. According to Weber (1988), as content analysis involves classification of many words of text into a smaller number of content categories, a rigorous instrument is important in order to draw valid inferences from the text. The instrument must ensure that the classification procedure is reliable and consistent among different coders, and must use valid variables that represent what it is intended to measure (Weber, 1988). In this study, the instrument is developed primarily from established studies such as Maali, et al. (2006), Muwazir and Muhamad (2006), and CSR standards from AAOIFI (2010b). Since the instruments in previous studies were developed with a series of techniques to improve their reliability and validity, the instrument in this study is likely to be less subjective.

Third, this study faces the problem of potential endogeneity between CSR reporting and performance variables. In order to check for endogeneity issues, lagged

variables were used in the model. However, using the lagged variables might affect the significance of the results. Therefore, to ensure that the lagged variables were not the cause, the study also ran the models without lagged variables, and found no difference. In addition, there is some potential for multicollinearity. As (non-perfect) multicollinearity causes standard errors to be high (coefficients may be imprecise) one limitation of this study is that model estimates are conservative (statistical significance is less likely to be found).

Fourth, AAOIFI Standards are not mandatory in Malaysia, unlike in Bahrain and some other Islamic countries, thus measuring their influence is difficult. As AAOIFI Standards are voluntary, the Islamic banks in Malaysia do not fully adopt AAOIFI as their main accounting standard, including standards on CSR. Malaysian Islamic banks' financial statements are prepared in accordance with MASB Approved Accounting Standards in Malaysia for Entities Other Than Private Entities that includes the Technical Release (TR) and Statement of Principle (SOP), specifically TR *i-3 Presentation of Financial Statements of Islamic Financial Institutions* and SOP *i-1 Financial Reporting from an Islamic Perspective*. However, in the process of formulating TR *i-3* and SOP *i-1* standards, the MASB has given careful cognizance to the AAOIFI Standards. In addition, MASB and some Islamic financial institutions in Malaysia have become members of AAOIFI, therefore Malaysian Islamic banks are expected to refer to AAOIFI Standards on CSR as a guideline to report social information.

Fifth, the generalisability of the research findings is limited to the Malaysian context and to the banking industry so the findings cannot be generalised to other Islamic countries or industries. However, the limited scope is specifically related to investigation in the context of the liberal approach used by local *Shariah* scholars and the multicultural needs of the country. Research in other countries and industries is warranted in the future.

Sixth, the use of CSR reporting as a proxy for CSR activity is a contested idea.

Finally, the CSR information analysed also referred to the annual reports of the parent companies of the Islamic banks. Similarly for the CSR reports, the study uses CSR reports issued by parent companies and foundations which may lack an Islamic philosophy. Thus, the results must be interpreted with caution, particularly when making comparisons between banks.

9.5 Suggestions for Future Research

This study focuses on the CSRep in the context of social contract and stakeholder theories from an Islamic perspective. However, legitimacy theory is also applicable in the context of Muslim society, as society gives the mandate to Islamic banks to operate according to Islamic principles and *Shariah*. Therefore, the study of CSRep from an Islamic perspective using legitimacy theory is recommended for future research.

As the current study examined only the annual reports and CSR reports, it is suggested for future research to consider additional disclosure media such as corporate websites, press releases, and additional reports. The analysis of additional disclosure media could provide a more complete and comprehensive understanding of disclosure practices of Islamic banks. Little research to date has considered the websites of Islamic organisations.

The findings of this study could also be built upon if the managerial views could be explored to understand the influences on, and intention of, their reporting practices. Interviews with Islamic bank's corporate managers would be a fruitful area for future study. Relatedly, an interesting area for future investigation would be a comparison between controlled Islamic banks and non-controlled Islamic banks by interviewing the managers and directors to know whether they really have full power over their responsibilities and whether or not they are constrained by their parent companies which are conventional banks. Similarly, interviews and fieldwork could also look specifically at the Islamic subsidiaries, to determine whether they have an Islamic philosophy as claimed or if they maintain a similar philosophy to their parents.

The issues of employee disclosures could also be explored further by doing a comparison between Islamic and conventional banks, and organisations in other industries.

It would also be interesting for future study to benchmark the CSRep of Malaysian Islamic banks and Islamic banks in other countries with the AAOIFI Standards on CSR.

Similarly, an interesting area for further study is to determine whether the banks are manipulating the notion of religion for economic profit, or whether they are responding to the need to accommodate the local multicultural environment. An in-depth case study of the industry would shed light on these issues.

Finally, consideration of whether Western and Islamic contexts face any similar or different challenges in a comparative study would indicate whether the two should be separate or related.

9.6 Conclusions

CSR Reporting is an important issue globally; however, there is only an emerging body of research on non-western countries. Studies that have been conducted generally apply a western approach to CSR and examine it using theories particularly appropriate to Western contexts.

Malaysia has been given limited attention in the research literature to date. This thesis provides an investigation into Banks, one of the major industries in Malaysia. Specifically, Islamic banking has particular relevance for CSR given the social aspect of Islamic teachings. The study presented here uses a framework developed specifically for an Islamic context and applies this to the Islamic banking sector. It provides an important contribution to our understandings of the links between CSR, Islam, reporting and firm performance.

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Appendices

Appendix 1

CSR Definitions

| CSR Definitions | Sources |
|--|--|
| CSR means something, but not always the same thing to everybody. To some it conveys the idea of legal responsibility or liability; to others, it means socially responsible behaviour in the ethical sense; to still others, the meaning transmitted is that of 'responsible for' in a causal mode; many simply equate it with a charitable contribution; some take it to mean socially conscious; many of those who embrace it most fervently see it as a mere synonym for legitimacy in the context of belonging or being proper or valid; a few see a sort of fiduciary duty imposing higher standards of behavior on businessmen than on citizens at large | (Votaw, 1972, p.25) |
| The firm's consideration of, and response to, issues beyond the narrow economic, technical, and legal requirements of the firm... (to) accomplish social benefits along with the traditional economic gains which the firm seeks | (Davis, 1973, p.312) |
| 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 | (Davis & Blomstrom, 1975, p.6) |
| Encompassing the economic, legal, ethical and discretionary expectations that society has of organizations at a given point in time | (Carroll, 1979, p.500) |
| The fundamental idea of 'corporate social responsibility' is that business corporations have an obligation to work for social betterment | (Frederick, 1986, p.4) |
| ...responsibilities of actions which do not have purely financial implications and which are demanded of an organization under some (implicit and explicit) identifiable contract | (Gray, Owen, & Maunders, 1987, p.4) |
| Actions that appear to further some social good beyond the interests of the firm and that which is required by law | (McWilliams & Siegel, 2001, p.117) |
| CSR is at heart a process of managing the costs and benefits of business activity to both internal (workers, shareholders, investors) and external (institutions of public governance, community members, civil society groups, other enterprises) stakeholders. Setting boundaries for how those costs and benefits are managed is partly a question of business policy and strategy and partly a question of public governance | (Fox, Ward, Howard, & Practice, 2002, p.1) |

CSR Definitions (continued)

| CSR Definitions | Sources |
|--|----------------------------------|
| CSR refers to company activities – voluntary by definition – demonstrating the inclusion of social and environmental concerns in business operations and in interactions with stakeholders | (Marrewijk, 2003, p.102) |
| The obligation of decision makers to pursue actions which protect and improve the welfare of society as a whole, rather than only their own interest | (Abdallah & Murtuza, 2005, p.5) |
| A concept whereby companies integrate social and environmental concerns on a voluntary basis in their business operations as well as in their interactions with their stakeholders | (European Commission, 2007, p.3) |
| Those activities that companies undertake to directly benefit society | (Waddock, 2008 p.88) |

Appendix 2

Score Range and Maximum Score for Each Category of CSRep Instruments

Instrument Categories Based on the Islamic CSRep Framework

| Categories | Description |
|--|---|
| 1) Disclosure of <i>Shariah</i> Supervisory Board (SSB) Opinion (max score is 9) | Report of <i>Shariah</i> Supervisory Board (0-1) Details regarding the qualifications of SSB members (0-1) Details regarding the members of the SSB (0-1) A statement on remuneration of the SSB members (0-4) A statement certifying distribution of profits and losses are made according to <i>Shariah</i> law (0-1) Statement of recommendations to rectify defects in products/services (0-1) |
| 2) Unlawful transactions (max score is 8) | A description of the nature of undertaking unlawful transactions (0-1) Explanation on the reasons for undertaking such unlawful transactions (0-1) The SSB's opinion about the necessity of these unlawful transactions (0-1) The amount of revenue or expenses from the unlawful transactions (0-4) How the bank disposed, or intends to dispose, of revenues from unlawful transactions (0-1) |
| 3) <i>Zakat</i> (max score is 13) | Statement of sources and uses of <i>Zakat</i> (0-4) The balance of the <i>Zakat</i> fund not yet distributed, and reasons for non-distribution (0-4) <i>Shariah</i> Supervisory Board attestation regarding the computation and distribution of the funds (0-1) Statement showing the amount of <i>zakat</i> paid and its computation (0-4) |
| 4) Qard Hassan (max score is 11) | Sources of funds allocated to Qard Hassan (0-4) The amounts given to beneficiaries (0-4) The social purposes for which the funds were given (0-1) The policy of the bank in providing such loans (0-1) The policy of dealing with insolvent beneficiaries (0-1) |
| 5) Charity and Other Social Activities (max score is 9) | The nature of charitable and social activities financed such as <i>sadaqah</i> and <i>waqf</i> (religious endowment) (0-1) The amount spent on charitable and social activities (0-4) The sources of funds used to finance charitable and social activities (0-4) |
| 6) Employees (max score is 14) | The policy on wages and other remuneration (such as bonuses) (0-4) The policy on education and training of employees (0-4) The policy of equal opportunities towards women and minorities (0-1) The policy on the employees' welfare such as religious provision, holidays and medical benefits (0-4) The policy on working environment that are conducive to Islamic ethical values (0-1) |
| 7) Late Repayments and | The policy in dealing with insolvent and late payment clients |

| | |
|--|---|
| Insolvent Clients (max score is 9) | (0-4) The amount charged as late penalty, if any (0-4) The SSB's opinion regarding the permissibility of imposing charges late payments (0-1) |
| 8) The Environment (max score is 14) | The amount and nature of any donations or activities undertaken to protect the environment (0-4) The projects financed by the bank that may lead to harming the environment (0-4) The nature and amount spend on conservation of natural environment and wildlife (0-4) A statement indicating that the company's operations are in compliance with environmental laws and regulation (0-1) A statement describing employees training in relation to environmental issues (0-1) |
| 9) Other Community Involvement Aspects (max score is 8) | The bank's role in economic development and participation in government social activities (0-4) The bank's role in addressing social problems such as programs in helping to overcome poverty, illiteracy etc. (0-4) |
| 10) Products/Services (max score is 7) | A statement stating all products/services are approved by SSB (0-1) Description regarding the basis of <i>Shariah</i> concepts for each product/service (0-1) A statement describing details of products/services produced by the company and their side effects/risks (0-4) A statement indicating that the company's policy on marketing is in compliance with Islamic ethical values (0-1) |
| 11) Disclosure of corporate mission statement (max score is 2) | A statement stating that the company's operations are based on <i>Shariah</i> principle (0-1) A statement stating that the main objective of the company is to achieve barakah (blessing) and al-falah (successful in the world and the hereafter) – emphasising on the importance of earning halal (permissible) profit (0-1) |
| 12) Disclosure of information related to the top management (max score is 7) | A detail of names and profile of BOD / management team (0-1) Details regarding the qualifications of management team (0-1) A statement on remuneration of management team (0-4) A statement on policy in appointing, re-appointment and dismissal of BOD/management team (0-1) |

Instrument Categories Based on AAOIFI standards on CSR

| Categories | Items of information |
|--|--|
| Mandatory disclosure | |
| 1) Disclosure of policy for screening clients (max score is 2) | <ul style="list-style-type: none"> • The specific provisions of the screening policy including the benchmarks and/or criterion utilized to measure compliance with Islamic law (0-1) • Whether these have been approved by the Shariah supervisory board (0-1) |
| 2) Disclosure of policy for dealing with clients (max score is 17) | <ul style="list-style-type: none"> • The defined procedure of the IFI on avoiding the imposition of onerous contractual terms on clients who are in a weaker bargaining position relative to the IFI (0-1) • The provision ensuring that marketing campaigns and documents are ethically balanced (0-1) • The obligation and rights of both parties (0-1) • The due process and responsible terms and conditions under which credit is extended to clients, including the process by which the client's ability to repay and the effect on the client's financial and overall well-being is assessed (0-4) • The remedies available in the event that one or both parties violate their contractual terms (0-4) • The Shariah supervisory board's opinion on the permissibility of charging late payment charges • Late payment charges levied on clients (0-1) • How the IFI allocates the late payment charges in its accounts (allocation to revenue or charity) (0-4) • The conditions under which the IFI will defer collection of debt from insolvent clients (0-1) |
| 3) Disclosure of earnings and expenditure prohibited by Shariah (max score is 7) | <ul style="list-style-type: none"> • Aggregate descriptions, amounts, account classification (revenue, expense, liability or asset) and reasons for undertaking the types of transactions (0-4) • The SSB's verdict on the necessity of these transactions (0-1) • How the IFI intends to dispose of such amounts (0-1) • The IFI's strategy to find viable permissible of halal alternatives, if any, for similar impermissible transactions in the future (0-1) |
| 4) Disclosure of policy for employee welfare (max score | <ul style="list-style-type: none"> • Provisions of the policy, including targeted disadvantaged groups (0-4) |

| | |
|---|---|
| is 9) | <ul style="list-style-type: none"> • Quotas/targets and achievements for the year (0-4) • Reasons for upward and downward revisions in quotas/target (0-1) |
| 5) Disclosure of policy for Zakat (max score is 16) | <p>Refer Financial Accounting Standard No.9 on Zakat:</p> <ul style="list-style-type: none"> • Statements of the method used for determining the Zakat base and the items included in the base (0-4) • Statements of the ruling of the Shariah Supervisory Board of the Islamic bank on the issues related to Zakat (0-1) • Statements of whether or not the Islamic bank as a holding company pays its share of Zakah obligations in its subsidiaries (0-1) • The amount of Zakat that is due from each share (0-4) • The amount of Zakat that is due from equity of investment account holders (0-4) • Statements of whether or not the Islamic bank collects and pays Zakat on behalf of holders of investment accounts and other accounts (0-1) • Statements of the restriction imposed by the Shariah Supervisory Board of the Islamic bank in determining the Zakat base (0-1) |
| <i>Voluntary disclosure</i> | |
| 6) Disclosure of policy for social, development and environment based investment quotas (max score is 17) | <ul style="list-style-type: none"> • The provisions of the policy for social, development and environment based investment quotas (0-4) • Classes of investments by ultimate purpose/beneficiary of investments (e.g. orphans, SME development, Islamic culture, reduction in tree logging, reduction in environmental greenhouse gases, increase in recycling, science and technology) (0-4) • The profitability of such investments for the year (0-4) • Quotas/targets and achievement s for the year (0-4) • Reasons for upward and downward revisions in quotas/target (0-1) |
| 7) Disclosure of policy for par excellence customer service (max score is 3) | <ul style="list-style-type: none"> • Provision of the policy for par excellence customer service (0-1) • Measures taken by management to develop customer service skills (0-1) • Aggregate results of customer surveys demonstrating overall quality of customer service and areas of improvement (0-1) |
| 8) Disclosure of policy for micro and small business and social savings and investments | <ul style="list-style-type: none"> • Provisions of the policy for micro and small business and social savings and investments (0-4) |

| | |
|--|--|
| (max score is 11) | <ul style="list-style-type: none"> • Features of the offer for micro and small business and social savings and investments (0-1) • Measures taken by management to implement the provisions of the policy (0-1) • Quotas/targets and achievements for the year (0-4) • Reasons for upward and downward revisions in quotas/target (0-1) |
| 9) Disclosure of policy for Qard Hassan (max score is 15) | <ul style="list-style-type: none"> • Whether there is a formal scheme operated by the bank for depositors, shareholders and other parties to place their funds for the use of Qard Hassan borrowers (0-1) • Provisions of the policy/scheme including conditions for those unable to repay the loans (0-1) • Sources of funding for Qard Hassan loans (0-4) • Aggregate purposes for which the Qard Hassan loans have been made (0-4) • Quotas/targets to increase internal and external Qard Hassan funding and achievements for the year in this regard (0-4) • Reasons for upward and downward revisions in quotas/target (0-1) |
| 10) Disclosure of policy for charitable activities (max score is 10) | <ul style="list-style-type: none"> • Provisions of the policy for charitable activities (0-1) • Aggregate classes of charitable activities by ultimate beneficiary and amounts distributed to each aggregate class (0-4) • Quotas/targets and achievements for the year (0-4) • Reasons for upward and downward revisions in quotas/target (0-1) |
| 11) Disclosure of policy for Waqf management (max score is 8) | <ul style="list-style-type: none"> • Types of Waqf managed by the IFI (0-4) • Financial and other services offered to the Awqaf¹ by the IFI (0-4) |

¹ *Awqaf* is plural form of *Waqf*

Appendix 3

Inter-coder pretesting result for quality measurement

| Categories | 2005 | | | | 2006 | | | |
|--|----------|----------|----------|----------|----------|----------|----------|----------|
| | BMMB | | RHBIBB | | BMMB | | RHBIBB | |
| | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 |
| (C1) Disclosure of Shariah Supervisory Board (SSB) Opinion (max score is 9) | | | | | | | | |
| 1. Report of Shariah Supervisory Board (0-1) | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| 2. Details regarding the qualifications of SSB members (0-1) | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| 3. Details regarding the members of the SSB (0-1) | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| 4. A statement on remuneration of the SSB members (0-4) | 2 | 2 | 2 | 0 | 2 | 2 | 2 | 2 |
| 5. A statement certifying distribution of profits and losses are made according to shariah law (0-1) | 1 | 0 | 0 | 0 | 1 | 0 | 0 | 0 |
| 6. Statement of recommendations to rectify defects in products/services (0-1) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total C1 | 6 | 5 | 5 | 3 | 6 | 5 | 5 | 5 |
| (C2) Unlawful transactions (max score is 8) | | | | | | | | |
| 1. A description of the nature of undertaking unlawful transactions (0-1) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 2. Explanation on the reasons for undertaking such unlawful transactions (0-1) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 3. The SSB's opinion about the necessity of these unlawful transactions (0-1) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 4. The amount of revenue or expenses from the unlawful transactions (0-4) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

| | | | | | | | | |
|--|---|---|---|---|---|---|---|---|
| 5. How the bank disposed, or intends to dispose, of revenues from unlawful transactions (0-1) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total C2 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| (C3) Zakat (max score is 16) | | | | | | | | |
| 1. Statement of sources and uses of Zakat (0-4) | 1 | 1 | 0 | 0 | 1 | 2 | 0 | 1 |
| 2. The balance of the Zakat fund not yet distributed, and reasons for non-distribution (0-4) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 3. Shariah Supervisory Board attestation regarding the computation and distribution of the funds (0-4) | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 |
| 4. Statement showing the amount of zakat paid and its computation (0-4) | 4 | 2 | 2 | 2 | 4 | 4 | 2 | 2 |
| Total C3 | 5 | 3 | 2 | 2 | 5 | 7 | 2 | 3 |
| (C4) Qard Hassan (non-interest bearing loans) (max score is 8) | | | | | | | | |
| 1. Sources of funds allocated to Qard Hassan (0-4) | 0 | 2 | 0 | 0 | 0 | 0 | 0 | 0 |
| 2. The amounts given to beneficiaries (0-4) | 2 | 0 | 0 | 0 | 2 | 2 | 0 | 0 |
| 3. The social purposes for which the funds were given (0-1) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 4. The policy of the bank in providing such loans (0-1) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 5. The policy of dealing with insolvent beneficiaries (0-1) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total C4 | 2 | 2 | 0 | 0 | 2 | 2 | 0 | 0 |
| (C5) Charity and Other Social Activities (max score is 9) | | | | | | | | |
| 1. The nature of charitable and social activities financed such as sadaqah (donation) and waqf (religious endowment) (0-1) | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 |
| 2. The amount spent on charitable and social activities (0-4) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 3. The sources of funds used to finance charitable and social activities (0-4) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total C5 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 |

| | | | | | | | | |
|--|---|---|---|---|---|---|---|---|
| (C6) Employees (max score is 11) | | | | | | | | |
| 1. The policy on wages and other remuneration (such as bonuses)(0-4) | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 |
| 2. The policy on education and training of employees (0-4) | 0 | 0 | 1 | 1 | 1 | 1 | 1 | 1 |
| 3. The policy of equal opportunities towards women and minorities (0-1) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 4. The policy on the employees' welfare such as religious provision, holidays and medical benefits (0-1) | 2 | 0 | 2 | 0 | 2 | 0 | 2 | 0 |
| 5. The policy on working environment that are conducive to Islamic ethical values (0-1) | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total C6 | 5 | 2 | 5 | 3 | 5 | 3 | 5 | 3 |
| (C7) Late Repayments and Insolvent Clients (max score 10) | | | | | | | | |
| 1. The policy in dealing with insolvent clients (0-4) | 4 | 0 | 4 | 1 | 4 | 0 | 4 | 2 |
| 2. The policy on late payments by clients (0-1) | 0 | 0 | 0 | 1 | 0 | 2 | 0 | 1 |
| 3. The amount charged as late penalty, if any (0-4) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 4. The SSB's opinion regarding the permissibility of imposing charges late payment (0-1) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total C7 | 4 | 0 | 4 | 2 | 4 | 2 | 4 | 3 |
| (C8) The Environment (max score is 11) | | | | | | | | |
| 1. The amount and nature of any donations or activities undertaken to protect the environment (0-4) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 2. The projects financed by the bank that may lead to harming the environment (0-1) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 3. The nature and amount spend on conservation of natural environment and wildlife (0-4) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

| | | | | | | | | |
|--|---|---|---|---|---|---|---|---|
| 4. A statement indicating that the company's operations are in compliance with environmental laws and regulation (0-1) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 5. A statement describing employees training in relation to environmental issues (0-1) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total C8 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| (C9) Other Community Involvement Aspects (max score is 8) | | | | | | | | |
| 1. The bank's role in economic development and participation in government social activities (0-4) | 0 | 1 | 1 | 0 | 0 | 0 | 0 | 0 |
| 2. The bank's role in addressing social problems such as programs in helping to overcome housing, literacy etc (0-4) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total C9 | 0 | 1 | 1 | 0 | 0 | 0 | 0 | 0 |
| (C10) Products/Services (max score is 7) | | | | | | | | |
| 1. A statement stating all products/services are approved by SSB (0-1) | 0 | 0 | 1 | 1 | 0 | 0 | 1 | 0 |
| 2. Description regarding the basis of <i>Shariah</i> concepts for each product/service (0-1) | 0 | 1 | 1 | 0 | 1 | 0 | 1 | 1 |
| 3. A statement describing details of products/services produced by the company and their side effects/risks (0-4) | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 |
| 4. A statement indicating that the company's policy on marketing is in compliance with Islamic ethical values (0-1) | 0 | 0 | 1 | 0 | 0 | 0 | 1 | 0 |
| Total C10 | 0 | 1 | 3 | 1 | 2 | 0 | 3 | 1 |
| (C11) Disclosure of corporate mission statement (max score is 2) | | | | | | | | |
| 1. A statement stating that the company's operations are based on shariah principle (0-1) | 1 | 0 | 1 | 1 | 1 | 0 | 1 | 1 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 2. A statement stating that the main objective of the company is to achieve barakah (blessing) and al-falah (successful in the world and the hereafter) – emphasizing on the importance of earning halal (permissible) profit (0-1) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total C11 | 1 | 0 | 1 | 1 | 1 | 0 | 1 | 1 |
| (C12) Disclosure of information related to the top management (max score is 7) | | | | | | | | |
| 1. A detail of names and profile of BOD/management team (0-1) | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| 2. Details regarding the qualifications of BOD/management team (0-1) | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| 3. A statement on remuneration of BOD/management team (0-4) | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 2 |
| 4. A statement on policy in appointing, re-appointment and dismissal of BOD/management team (0-1) | 1 | 0 | 1 | 1 | 1 | 0 | 1 | 1 |
| TOTAL C12 | 7 | 6 | 7 | 7 | 7 | 6 | 7 | 5 |

Inter-coder pretesting result for quantity measurement

| Year 2005 | | No. of words | | | | | | | | | | | | | | | | | | | | | | | |
|-----------|--------------------------------------|--------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| No. | Islamic Banks | C1 | | C2 | | C3 | | C4 | | C5 | | C6 | | C7 | | C8 | | C9 | | C10 | | C11 | | C12 | |
| | | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 |
| 1 | Bank Muamalat Malaysia Berhad (BMMB) | 220 | 204 | 0 | 0 | 89 | 137 | 12 | 5 | 0 | 0 | 326 | 168 | 177 | 0 | 0 | 0 | 128 | 0 | 53 | 21 | 0 | 1159 | 1359 | |
| 2 | RHB Islamic Bank Berhad (RHBIBB) | 1790 | 2956 | 0 | 0 | 32 | 36 | 0 | 0 | 331 | 0 | 272 | 360 | 171 | 191 | 0 | 0 | 15 | 0 | 161 | 96 | 22 | 186 | 1750 | 2662 |

| Year 2006 | | No. of words | | | | | | | | | | | | | | | | | | | | | | | |
|-----------|--------------------------------------|--------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| No. | Islamic Banks | C1 | | C2 | | C3 | | C4 | | C5 | | C6 | | C7 | | C8 | | C9 | | C10 | | C11 | | C12 | |
| | | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 | Coder 1 | Coder 2 |
| 1 | Bank Muamalat Malaysia Berhad (BMMB) | 937 | 1143 | 0 | 0 | 93 | 97 | 8 | 5 | 0 | 0 | 392 | 419 | 308 | 459 | 0 | 0 | 0 | 0 | 244 | 34 | 28 | 0 | 1630 | 1554 |
| 2 | RHB Islamic Bank Berhad (RHBIBB) | 1502 | 2217 | 0 | 0 | 17 | 16 | 0 | 0 | 0 | 0 | 235 | 239 | 268 | 786 | 0 | 0 | 0 | 0 | 174 | 45 | 22 | 22 | 1808 | 2333 |

Appendix 4

A Comparison between Controlled Islamic Banks and Non-controlled Islamic Banks:

CSRep Quality

Mann-Whitney U-Ranks: CSRep Quality

| | A dummy variable of full established of Islamic bank or subsidiary | N | Mean Rank | Sum of Ranks |
|--|--|----|-----------|--------------|
| Total Disclosure of Shariah Supervisory Board (SSB) Opinion (C1) | if a subsidiary of conventional bank | 59 | 34.49 | 2035.00 |
| | if a full established Islamic bank from beginning | 24 | 60.46 | 1451.00 |
| | Total | 83 | | |
| Total Unlawful transactions (C2) | if a subsidiary of conventional bank | 59 | 36.15 | 2133.00 |
| | if a full established Islamic bank from beginning | 24 | 56.38 | 1353.00 |
| | Total | 83 | | |
| Total Zakat (C3) | if a subsidiary of conventional bank | 59 | 42.62 | 2514.50 |
| | if a full established Islamic bank from beginning | 24 | 40.48 | 971.50 |
| | Total | 83 | | |
| Total Qard Hassan (non interest-bearing loans) (C4) | if a subsidiary of conventional bank | 59 | 34.53 | 2037.00 |
| | if a full established Islamic bank from beginning | 24 | 60.38 | 1449.00 |
| | Total | 83 | | |
| Total Charity and Other Social Activities (C5) | if a subsidiary of conventional bank | 59 | 39.68 | 2341.00 |
| | if a full established Islamic bank from beginning | 24 | 47.71 | 1145.00 |
| | Total | 83 | | |
| Total Employees (C6) | if a subsidiary of conventional bank | 59 | 41.42 | 2443.50 |
| | if a full established Islamic bank from beginning | 24 | 43.44 | 1042.50 |
| | Total | 83 | | |
| Total Late Repayments and Insolvent Clients (C7) | if a subsidiary of conventional bank | 59 | 42.87 | 2529.50 |
| | if a full established Islamic | 24 | 39.85 | 956.50 |

| | | | | |
|---|---|----|-------|---------|
| | bank from beginning | | | |
| | Total | 83 | | |
| Total The Environment (C8) | if a subsidiary of conventional bank | 59 | 46.16 | 2723.50 |
| | if a full established Islamic bank from beginning | 24 | 31.77 | 762.50 |
| | Total | 83 | | |
| Total Community Involvement Aspects that Generating Profit (C9) | if a subsidiary of conventional bank | 59 | 42.54 | 2510.00 |
| | if a full established Islamic bank from beginning | 24 | 40.67 | 976.00 |
| | Total | 83 | | |
| Total Products/Services (C10) | if a subsidiary of conventional bank | 59 | 41.01 | 2419.50 |
| | if a full established Islamic bank from beginning | 24 | 44.44 | 1066.50 |
| | Total | 83 | | |
| Total Disclosure of corporate mission statement (C11) | if a subsidiary of conventional bank | 59 | 39.31 | 2319.00 |
| | if a full established Islamic bank from beginning | 24 | 48.63 | 1167.00 |
| | Total | 83 | | |
| Total Disclosure of information related to the top management (C12) | if a subsidiary of conventional bank | 59 | 38.42 | 2266.50 |
| | if a full established Islamic bank from beginning | 24 | 50.81 | 1219.50 |
| | Total | 83 | | |
| Average Framework Quality | if a subsidiary of conventional bank | 59 | 37.79 | 2229.50 |
| | if a full established Islamic bank from beginning | 24 | 52.35 | 1256.50 |
| | Total | 83 | | |

Test Statistics^a : CSRep Quality

| | C1 | C2 | C3 | C4 | C5 | C6 | C7 | C8 | C9 | C10 | C11 | C12 | Average Framework Quality |
|------------------------|----------|----------|---------|----------|----------|----------|---------|---------|---------|----------|----------|----------|---------------------------|
| Mann-Whitney U | 265.000 | 363.000 | 671.500 | 267.000 | 571.000 | 673.500 | 656.500 | 462.500 | 676.000 | 649.500 | 549.000 | 496.500 | 459.500 |
| Wilcoxon W | 2035.000 | 2133.000 | 971.500 | 2037.000 | 2341.000 | 2443.500 | 956.500 | 762.500 | 976.000 | 2419.500 | 2319.000 | 2266.500 | 2229.500 |
| Z | -4.661 | -4.229 | -.375 | -5.113 | -1.416 | -.417 | -.795 | -2.774 | -.408 | -.633 | -2.528 | -2.380 | -2.502 |
| Asymp. Sig. (2-tailed) | .000 | .000 | .708 | .000 | .157 | .676 | .427 | .006 | .683 | .527 | .011 | .017 | .012 |

a. Grouping Variable: A dummy variable of full established of Islamic bank or subsidiary

CSRep Quantity

Mann-Whitney U-Ranks: CSRep Quantity

| | A dummy variable of full established of Islamic bank or subsidiary | N | Mean Rank | Sum of Ranks |
|--|--|----|-----------|--------------|
| Disclosure of Shariah Supervisory Board (SSB) Opinion (C1) | if a subsidiary of conventional bank | 59 | 39.18 | 2311.50 |
| | if a full established Islamic bank from beginning | 24 | 48.94 | 1174.50 |
| | Total | 83 | | |
| Unlawful transactions (C2) | if a subsidiary of conventional bank | 59 | 35.87 | 2116.50 |
| | if a full established Islamic bank from beginning | 24 | 57.06 | 1369.50 |
| | Total | 83 | | |
| Zakat (C3) | if a subsidiary of conventional bank | 59 | 41.42 | 2443.50 |
| | if a full established Islamic bank from beginning | 24 | 43.44 | 1042.50 |
| | Total | 83 | | |
| Qard Hassan (non interest-bearing loans) (C4) | if a subsidiary of conventional bank | 59 | 34.74 | 2049.50 |
| | if a full established Islamic bank from beginning | 24 | 59.85 | 1436.50 |
| | Total | 83 | | |
| Charity and Other Social Activities (C5) | if a subsidiary of conventional bank | 59 | 43.81 | 2584.50 |
| | if a full established Islamic bank from beginning | 24 | 37.56 | 901.50 |
| | Total | 83 | | |
| Employees (C6) | if a subsidiary of conventional bank | 59 | 46.27 | 2730.00 |
| | if a full established Islamic bank from beginning | 24 | 31.50 | 756.00 |
| | Total | 83 | | |
| Late Repayments and Insolvent Clients (C7) | if a subsidiary of conventional bank | 59 | 45.73 | 2698.00 |
| | if a full established Islamic bank from beginning | 24 | 32.83 | 788.00 |
| | Total | 83 | | |
| The Environment (C8) | if a subsidiary of | 59 | 45.93 | 2710.00 |

| | | | | |
|---|---|----|-------|---------|
| | conventional bank | | | |
| | if a full established Islamic bank from beginning | 24 | 32.33 | 776.00 |
| | Total | 83 | | |
| Community Involvement Aspects that Generating Profit (C9) | if a subsidiary of conventional bank | 59 | 43.56 | 2570.00 |
| | if a full established Islamic bank from beginning | 24 | 38.17 | 916.00 |
| | Total | 83 | | |
| Products/Services (C10) | if a subsidiary of conventional bank | 59 | 38.54 | 2274.00 |
| | if a full established Islamic bank from beginning | 24 | 50.50 | 1212.00 |
| | Total | 83 | | |
| Disclosure of corporate mission statement (C11) | if a subsidiary of conventional bank | 59 | 34.91 | 2059.50 |
| | if a full established Islamic bank from beginning | 24 | 59.44 | 1426.50 |
| | Total | 83 | | |
| Disclosure of information related to the top management (C12) | if a subsidiary of conventional bank | 59 | 41.42 | 2444.00 |
| | if a full established Islamic bank from beginning | 24 | 43.42 | 1042.00 |
| | Total | 83 | | |
| Average Framework Quantity | if a subsidiary of conventional bank | 59 | 43.66 | 2576.00 |
| | if a full established Islamic bank from beginning | 24 | 37.92 | 910.00 |
| | Total | 83 | | |

Test Statistics^a : CSRep Quantity

| | C1 | C2 | C3 | C4 | C5 | C6 | C7 | C8 | C9 | C10 | C11 | C12 | Average Framework Quantity |
|------------------------|----------|----------|----------|----------|---------|---------|---------|---------|---------|----------|----------|----------|----------------------------|
| Mann-Whitney U | 541.500 | 346.500 | 673.500 | 279.500 | 601.500 | 456.000 | 488.000 | 476.000 | 616.000 | 504.000 | 289.500 | 674.000 | 610.000 |
| Wilcoxon W | 2311.500 | 2116.500 | 2443.500 | 2049.500 | 901.500 | 756.000 | 788.000 | 776.000 | 916.000 | 2274.000 | 2059.500 | 2444.000 | 910.000 |
| Z | -1.672 | -4.419 | -.347 | -4.872 | -1.080 | -2.531 | -2.210 | -2.636 | -.924 | -2.049 | -4.209 | -.342 | -.984 |
| Asymp. Sig. (2-tailed) | .094 | .000 | .729 | .000 | .280 | .011 | .027 | .008 | .355 | .040 | .000 | .733 | .325 |

a. Grouping Variable: A dummy variable of full established of Islamic bank or subsidiary

Appendix 5: Correlation Results among Variables

| | log ctir | log ooia | sr roe | sr psr | log zpr | log edrqhd | log dewr | log iivnii | log invnin | ta | inv cr | log lr | log oe | log Qlyframe | log Qttframe | log Qlystand | log Qttstand |
|-------------|----------|----------------|----------------|----------------|---------|------------|----------|------------|------------|--------|---------|---------|----------------|---------------|---------------|---------------|--------------|
| logctir | 1 | | | | | | | | | | | | | | | | |
| logooia | .542** | 1 | | | | | | | | | | | | | | | |
| srroe | -.611** | -.926** | 1 | | | | | | | | | | | | | | |
| srpsr | -.530** | -.851** | .863** | 1 | | | | | | | | | | | | | |
| logzpr | -0.07 | -0.07 | 0.07 | 0.07 | 1 | | | | | | | | | | | | |
| logedrqhd | 0.12 | -0.15 | 0.07 | 0.09 | -0.1 | 1 | | | | | | | | | | | |
| logdewr | -0.07 | 0.19 | -.221* | -0.1 | 0.14 | .199* | 1 | | | | | | | | | | |
| logiivnii | -.201* | -.323** | .385** | .305** | 0.04 | .221* | .226* | 1 | | | | | | | | | |
| loginvnin | 0.12 | 0.08 | -0.14 | -0.2 | -0 | 0.093 | -0.07 | -0.07 | 1 | | | | | | | | |
| ta | -.294** | -0.17 | .261** | 0.09 | 0.08 | -.214* | -0.12 | 0.196 | -0.016 | 1 | | | | | | | |
| invcr | -.521** | -.680** | .700** | .629** | .215* | -0.15 | -.348** | 0.153 | -0.035 | .360** | 1 | | | | | | |
| loglr | .234* | .476** | -.497** | -.427** | 0.15 | -.358** | -0.18 | -.275** | 0.088 | 0.16 | 0.11 | 1 | | | | | |
| logoe | .701** | .940** | -.938** | -.823** | -0 | -0.074 | 0.15 | -.327** | 0.1 | -.225* | -.696** | .523** | 1 | | | | |
| logQlyframe | -.552** | -.920** | .988** | .839** | 0.09 | 0.146 | -.214* | .394** | -0.13 | .237* | .662** | -.536** | -.923** | 1 | | | |
| logQttframe | -.569** | -.919** | .991** | .844** | 0.08 | 0.098 | -.250* | .386** | -0.116 | .242* | .695** | -.492** | -.927** | .992** | 1 | | |
| logQlystand | -.553** | -.918** | .980** | .825** | 0.12 | 0.177 | -.199* | .388** | -0.132 | .250* | .666** | -.523** | -.919** | .995** | .984** | 1 | |
| logQttstand | -.586** | -.914** | .988** | .826** | 0.08 | 0.103 | -.234* | .390** | -0.143 | .269** | .688** | -.484** | -.925** | .991** | .994** | .986** | 1 |

** Correlation is significant at the 0.01 level (2-tailed). * Correlation is significant at the 0.05 level (2-tailed).