



## **Weighted Corporate Social Responsibility Index for Measuring Islamic Banking's Social Performance: How to Develop It?**

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### **ABSTRACT**

It is posited that Islamic Banking is meant to be socially responsible. Relating to this social responsibility, this paper undertakes two objectives. One is to develop an illustration of a corporate social responsibility (CSR) measurement index by allocating differential weights to process-based and outcome-oriented CSR measures. The illustrative index contains nine (9) process-based measurement items, which fall under three (3) dimensions: investment, research and development, and human resources. Outcome-oriented measurement items are eight (8), which represent three (3) dimensions: Shariah Supervisory Board (SSB), social activities and sharing, and environment. The way of deciding different weights for these two categories of measures is explained, and a possible method for validation of assigned weights is proposed. Another objective is to explain why CSR measures relating to core business processes should be given more weight than outcome-oriented CSR measures for Islamic banks. In order to develop this explanation, the paper draws upon Quranic and Hadith texts, *maqasid* literature and published works on CSR of Islamic banks. The basic argument underlying this explanation is that purity of the process of earning is a precondition for the earning-based beneficial acts to be acceptable as good deeds.

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## INTRODUCTION

The Organization of Islamic Conference (OIC) defines an Islamic Bank as “a financial institution whose statutes, rules, and procedures expressly state its commitment to the principles of Islamic Shariah and to the banning of the receipt and payment of interest on any of its operations.” According to Islamic Banking Act 1983 of Malaysia, an Islamic Bank is a “company which carries on Islamic Banking business...Islamic Banking business means banking business whose aims and operations do not involve any element which is not approved by the religion of Islam.” These definitions imply that, contrary to conventional banking, which deals in money, Islamic banking is to do business with money. While money becomes a commodity of exchange in conventional banking, Islamic banking uses money as a means of exchange for dealing in real commodities and assets. While conventional banking is subject to criticism insofar as the exploitative nature of interest-based transactions is recognized, Islamic banking deserves appreciation, so long as it succeeds in averting these transactions.

One of the critical facts underlying the sharp contrast of these two banking systems is that goals concerning social welfare are rooted in the conceptualization of Islamic banking ideas. In other words, social performance or socially responsive and responsible functioning is integral to Islamic banking operations—not something appended to it. This embeddedness of social performance is clearly noted in a prominent author–banker’s brief outlining Islamic banking objectives: “An Islamic Bank is committed to do away with disparity and establish justice in the economy, trade, commerce and industry; build socio-economic infrastructure and create employment opportunities” (Hannan, n.d.). Dusuki (2008), who employs stakeholders’ perspective to further the understanding of Islamic banking objectives, concludes that, in stakeholders’ perception toward Islamic banking, “Social-welfare factors are evidenced as more important objectives than commercial factors.”

Having objectives infused with high social content, Islamic banking operational history began in the mid-1970s with the establishment of the Dubai Islamic Bank in 1975. Allowing it a reasonably longer timespan of a quarter century to pass infancy, its social performance measurement began in the current millennium. Following the early individual efforts toward Islamic banking social responsibility measurement, official standards appeared in the recent past. In 2009, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) introduced governance standards on corporate social responsibility (CSR) to conduct and include disclosure for Islamic banks (IBs). There has been significant improvement in Islamic banking CSR measurement at the conceptual and operational levels. However, there is exist room for improvement in finding a measurement system by segregating process-based and outcome-oriented CSR measures and allocating different weights to these two categories’ measures. Hence, the present paper attempts to contribute toward developing such a measure by accomplishing two objectives. The first is to explain why such

segregation and differential weights allocation are important. The second objective is to offer an illustration as to how we can develop for Islamic Banking a CSR measurement index by allocating differential weights to process-based and outcome-oriented CSR measures.

This paper advocates separation of CSR measures by using the notion of process and outcome. The reason for such separation can be presumed from Islamic Fiqh's classification of illegitimate acts. Al-Misri (1997) claimed that illegal acts can be separated into two. First, the original unlawful in itself, meaning the Sacred Law prohibits it from the start. The other is illegal due to an extrinsic or external reason. In other words, a legal act can be turned into unlawful when an undesirable external situation becomes associated with it. Hence, the means of committing a lawful act also must be lawful. This view nullifies the Machiavellian idea of "the ends justify the means," which succeeds in the modern competitive business world. Equating means to the process and the accomplished act to the outcome; thus, it is possible to appreciate the critical significance of the soundness of the process for the rationality of outcome in the Islamic framework of good deeds.

The rest of the paper is separated into three major sections. Section 2 provides a review of CSR literature on the importance of developing Islamic banking CRS measurement. Section 3 explains the need for proposed measurement. An illustration of how the proposed measurement can be developed is presented in the last section.

## **CORPORATE SOCIAL RESPONSIBILITY (CSR) AND ITS MEASUREMENT**

This section highlights the developments in relation to Islamic banking CSR measurement. Dusuki and Dar (2005) and Sairally (2005) claimed that studies on CSR from Islamic banks perspective are nearly nonexistent. Dusuki and Dar (2005) studied the perceptions of Islamic banks' stakeholders about CSR in Malaysia; whereas Sairally (2005) introduced the concepts of CSR measurement for selected institutions. By investigating over 1500 respondents of multiple stakeholders of two full-fledged Islamic banks, Dusuki and Dar (2005) revealed that the respective stakeholders are concerned with socially responsible and ethical banking. Sairally (2005), on the other hand, revealed that 41.7% of the 250 respondents implemented a "defensive" approach to CSR, as they may concern towards the economics and their legal responsibilities. The mixed and inconsistent conclusions on the Islamic banks' CSR have motivated other researchers to further look into this issue.

Maali et al. (2006) were among the first to introduce a benchmark for social reporting by Islamic banks. The authors compared a set of benchmarks of social disclosures appropriate to Islamic banks with the actual social disclosures contained in the annual reports of 29 Islamic banks from 16 different countries. The authors suggested that social issues were not of major concern for most Islamic banks. One possible explanation of this unexpected finding, according to the authors, is the fact that most Islamic banks operate in less-developed economies, where social concerns, especially issues such as the environment, may be given less importance.

Results from numerous other studies indicate that CSR measurement for Islamic banks is mainly established based on *maqasid al-Shariah* framework, which is classified into four broad areas (Dusuki and Dar, 2005; Maali et al., 2006; Dusuki, 2008; Mohammed et al., 2008; Yusuf and Bahari, 2015). The first is how the operations of the business have affected the well-being of the Islamic community. The second is how Islamic banks help Muslims to perform their religious responsibilities. The third is compliance of the operations of the Islamic banks with Islamic principles, in particular dealing justly with different parties. Fourth is how CSR activities help to educate the Islamic community. The prohibition of *Riba* (usury), the requirement to pay *Zakah*, and the provision of *Qardh Hasan* (interest-free loans) are among examples of the Islamic emphasis on social justice (Maali et al., 2006).

While the past studies generally provides indication that Islam stresses the idea of social responsibility, there is still a shortage of study regarding how CSR is measured for Islamic banks. We have discovered only 13 studies in a span of nine years (2005 to 2013), which are connected to the idea of Islamic banking social performance, although they have reported different findings. It should be noted that these studies, with a single exception, have allocated equal weights to both process-based and outcome-oriented CSR measures. Table 1 shows a summary of all 13 selected studies on Islamic banking CSR.

For our index development illustration, the present study adopts the *maqasid al-Shariah* framework of Mohammed et al. (2008) and Yusuf and Bahari (2015), as these two studies have developed their framework and measurements through a stringent verification process. The measures of these two studies were validated first by experts from various sectors such as *Shariah*, Islamic banking, and Islamic economics through in-depth interviews. The next level of verification was in the form of a questionnaire.

Table 1 Summary of selected studies of the relationship between the corporate social responsibility (CSR) and Islamic banks (IBs)

No	Authors	Findings	Countries
1	Dusuki and Dar (2005)	CSR factors are evidenced as one of the important criteria in Islamic bank's stakeholders banking selection decisions	Malaysia
2	Sairally (2005)	Almost half of the respondents adopt a "defensive" approach to CSR.	19 countries
3	Maali <i>et al.</i> (2006)	Social issues are not of major concern for most Islamic banks.	16 countries
4	Haniffa and Hudaib (2007)	Many IBs put little effort into communicating their values in a consistent manner.	Arabian Gulf region (6 countries)
5	Mohammed <i>et al.</i> (2008)	No single bank is able to realize high performance in all 7 performance ratios.	5 countries
6	Hassan and Harahap (2010)	IBs put little effort into disclosing their CSR activities.	7 countries
7	Aribi and Gao (2010)	Significant differences in the level and the extent of the disclosure between them.	Arabian Gulf region (6 countries)
8	Farook <i>et al.</i> (2011)	Level of social and political freedom and the proportion of investment account deposits to total assets are significant determinants of Islamic banks' CSR disclosure.	14 countries
9	Zubairu <i>et al.</i> (2012)	Poor social disclosure practices.	Saudi Arabia
10	Abbasi <i>et al.</i> (2012)	Little difference between CSR practices of the Islamic and conventional banking.	Pakistan
11	Rashid <i>et al.</i> (2013)	IBs commitments to basic Islamic rules fall far behind the average.	8 countries
12	Kamla and Rammal (2013)	Reported disclosures are lack of detailed information regarding schemes on poverty eradication or enhancing social justice.	11 countries
13	Yusuf and Bahari (2015)	CSR program should pay more attention to the importance of social capital in the society.	Indonesia

Source: Alamer *et al.* (2015) and authors' compilation. CSR: Corporate social responsibility and IBs: Islamic banks.

## PROCESS-BASED AND OUTCOME-BASED MEASUREMENTS

Based on the AAOIFI (2010) classification, this study defines process-based measurement as an evaluation on the bank CSR's activities that are related to investment, research and development, and human resources. Alternatively, outcome-based measurement denotes an evaluation on three dimensions of bank CSR's activities: Shariah Supervisory Board (SSB); social activities and sharing; and environment. For better understanding of this process-outcome segregation of CSR measures with unequal weights, we offer explanations based on charity, human resources, and investment, which are significant dimensions of the Islamic CSR measurement (Usmani, 2002).

## Charity

Islamic banking stands against interest. The contradictory of interest is charity. From a sociological perspective, charity breeds brotherhood and interest eliminates or diminishes the spirit of brotherhood. Charity is the most pervasive component in CSR performance. From the Islamic point of view, however, the validity of the highly encouraged act of charity is conditional. “O you who believe! Spend of the good things which you have (legally) earned...and do not aim at that which is bad to spend from it...” (Surah al-Baqarah: 267). Even if given out of legitimate earnings, charity may be abortive. “O you who believe! Do not render in vain your charity by reminders of your generosity or by injury, like him who spends his wealth to be seen of men...” (Surah al-Baqarah: 264). Yusuf Ali (1992) note that according to this verse hence, “rob Peter to pay Paul” is not acceptable in Islam. Islam does not accept any fouled property. Its economic code entails that every achievement should be honest and honorable.

The overriding significance of the process can be easily recognized from the two Hadiths as follows, which underscore the prominence of exactly how earning is earned.

Ibn Mas’ud narrated that the Messenger of Allah (peace be upon him) said: “The feet of the son of Adam shall not move from before his Lord on the Day of Judgment, until he is asked about five things: about his life and what he did with it, about his youth and what he wore it out in, about his wealth and how he earned it and spent it upon, and what he did with what he knew” (Tirmidhi, Hadith no. 2416 and Thabrani, Hadith no. 9772)

The Messenger of Allah (peace be upon him) mentioned [the case] of a man who, having journeyed far, is disheveled and dusty, and who spreads out his hands to the sky saying “O Lord! O Lord!” while his food is haram (unlawful), his drink is haram, his clothing is haram, and he has been nourished with haram, so how can [his supplication] be answered? (Sahih Muslim, Hadith no. 1015 and Tirmidhi, Hadith no. 2989)

The essence of the above discussion is that, for charity to be valid and acceptable, the process of earning out of which charity is given and the process of giving charity should be pure and decent.

## Human Resources

Employee rights and satisfaction can be inferred from the Quranic verses.

*“O you who believe! Eat not up your property among yourself unjustly; but let there be among you trade by mutual consent...”*

(Surah al-Nisa’:29)

*“Woe to al-Mutaffifin (those who give less in measure and weight (decrease the rights of others)]. Those who, when they have to receive by measure from men, demand full measure, and when they have to give by measure or weight to men, give less than due.”*

(Surah al-Mutaffifin: 1-3)

Trade implies exchange. Also, giving and receiving means exchange. Employer–employees are two parties of an economic and social exchange relationship. As stated in the respective verses, it is mandatory for both parties to act in the exchange relationships in a just and equitable manner. Because the organization or the employer generally holds power over employees, the implications of the verses are construed more to accentuate the employer’s concern to maintain the rights of employees. Any exploitation is not permitted in Islam. The employee should be paid in full if he has fulfilled his responsibilities.

Now, people employed in an organization are its most critical resource. The degree of criticality of this resource is presumably high in the Islamic banking system, where employees need to appreciate modern conventional banking on the one hand and Islamic finance on the other. In reality, the quality of Islamic banking service completely depends on the knowledgeable, psychological, and spiritual development of its workers. If this development is cooperated for costs saving, and at the same time financial assistance to students is offered in form of scholarships, then the question of process fairness for the validity of outcome becomes equally relevant. Cost saving is a process of generating a surplus or income, and offering scholarship is a kind of charity, an outcome (income)-based activity. Thus, the act (i.e., offering scholarship) can be considered a violation of the well-known maxim “charity begins at home,” which is consistent with Islamic teaching. To reiterate, the fairness of the process is a prior concern for the validity of an act or an outcome.

## **Investment**

Islamic banking is a system of immense importance for the realization of the objectives of Islamic economics. Among other, the objective is derived from the Quran; “wealth must not circulate only among the rich ones among you” (Surah al-Hashr: 7). Muhammad and Shahwan (2013) study the synchronization of the objectives of Islamic economics and the objectives of Islamic banks based on Maqasid al-Shariah. The findings report the insufficiency of Islamic banking operations in addressing Islamic economic objectives in a holistic manner. This insufficiency is largely attributable to the investment function of Islamic banks, as Hannan (n.d.) plainly acknowledges:

Most of the Islamic banks operate on Bai-Murabaha, Bai Muazzal, Bai-Salam, Istisna, Hire Purchase/Leasing mode of investment, i.e., Islamic banks always prefer to run on markup/guaranteed profit basis having Shariah coverage. For this reason, sometimes the conventional economists and general people failed to understand the real difference between Islamic banking and conventional banking.

Mohammad and Shahwan (2013) document that Islamic banking and conventional banking is different specifically in their investment characteristics. They conjecture that Mudaraba and Musharaka investment contracts for example, can bring sustainable qualitative changes in banking and financial markets. By excluding these two contracts

from the markets, they argue that the banks are subject to the criticism as they regularly aim at revenue and wealth maximization goals rather than focusing towards social contribution and content. Mohammad and Shahwan (2013) subsequently infer that the Zakah payment, money spent on charitable activities and other social contributions made by Islamic banks from markup-based investment incomes are unable to avert the criticism by the public. Their argument implies that the purity of the process of earning appears to be considerably more important and vital when measuring a CSR activity made by an Islamic bank.

## **INDEX DEVELOPMENT ILLUSTRATED**

Overall conclusion from previous discussion is that, from an Islamic point of view, it is generally more important for an organization to perform its business functions ethically and responsibly than how it uses and spends its earnings. An aspect that has not been clearly addressed in previous studies is the extent to which the components of the CSR segregated by ‘process-based’ and ‘outcome-based’ measurement are relevant. An interesting question, therefore, is whether the process-based CSR measurement should be given more weights than the outcome-based measurement? If it is yes, the next question should be by how much more? Therefore, should the process-outcome weights measurement ratio be 90/10 or 60/40 or 50/50 or something else? How to decide it? Finally, are the dimensions and elements or items of measures considered processes related and others considered outcome oriented? Before proceeding to address these questions, we need to clarify that what follows is an illustration of how a differentially weighted CSR index for Islamic banking can be developed; it is not a developed or ready index for CSR measurement.

### **Processes-Outcome Weights Ratio**

Based on a sample of 13 articles studied on social responsibility of Islamic Banks, we document that the effort to assign different weights to dimension and items of CSR measures is found only in one case. Summary of the 13 articles in a span of nine years (2005 – 2013) are presented in Table 1. The table shows that all items of measurement received equal weights in 11 studies that used the Ethical Identity Index (EII) measurement or AAOIFI’s index or variants of these with the exception of Mohammed et al. (2008) and Yusuf and Bahari (2015). However, Yusuf and Bahari (2015) measure is based on the six basic criteria of 34 CSR measurement that have different weights and not clearly justify whether the items were important enough to be incorporated under a particular criterion for CSR measurement. Mohammed et al. (2008), on the other hand, introduced CSR performance measures of Islamic banking based on Maqasid framework. They introduce a Maqasid Index (MI) based on 10 elements under three objectives, as shown in Table 2, which were allocated differential weight.

Weighted Corporate Social Responsibility Index

Table 2 Weighted average of CSR performance measures of Islamic banking

Objectives	Weighted Average	Elements	Weighted Average
Objective 1. Education	0.30	El-1. Education Grants/Donations	0.24
		El-2. Research	0.27
		El-3. Training	0.26
		El-4. Publicity	0.23
		<b>Total</b>	<b>1.00</b>
Objective 2. Justice	0.41	El-5. Fair Returns	0.30
		El-6. Fair Price	0.32
		El-7 Interest free product	0.38
		<b>Total</b>	<b>1.00</b>
Objective 2. Welfare	0.29	El-8 Bank's Profit Ratios	0.33
		El-9 Personal Income Transfers	0.30
		El-10 Investment Ratios in real sector	0.37
<b>Total</b>	<b>1.00</b>	<b>Total</b>	<b>1.00</b>

Source: Mohammed *et al.* (2008)

The above allocation of weights to 10 elements and three (3) objectives offers us important clue to establishing an initial process-outcome weights ratio of 55:45. The process on how we arrived at this preliminary ratio is discussed in Table 3. The table shows a process-outcome ratio calculation of 53.85: 46.15, which has been rounded to 55:45. It should be noted that, for actual development of the CSR index of our interest, this ratio will have to be authenticated through a panel of experts via on-line Delphi or some other suitable techniques.

Table 3 Process measures and outcome measures: preliminary weights ratio development

Objectives (weighted average)	Elements		Outcome-Based	Weights Calculation*
	Process-Based	Weights Calculation*		
Objective 1 Education (0.30)	El-1. Education Grants/Donations	0.30x0.24=0.72		
	El-2. Research	0.30x0.27=0.81		
	El-3. Training	0.30x0.26=0.78		
	El-4. Publicity	0.30x0.23=0.69		
Objective 2 Justice (0.41)	El-5. Fair Returns		0.41x0.30=0.123	
	El-6. Fair Price	0.41x0.32=0.1312	El-7. Interest free product	0.41x0.38=0.1558
Objective 3 Welfare (0.29)	El-8. Banks Profit Ratios		0.29x0.33=0.0957	
	El-9. Personal Income Transfers		0.29x0.30=0.087	
	El-10. Investment Ratios in real sector	0.29x0.37=0.1073		
<b>Total (Process)</b>		<b>0.5385</b>	<b>Total (Outcome)</b>	<b>0.4615</b>

\*weight of objective x % weight of element

### Weights Allocation and Items Selection

As discussed earlier, the other important question for the index development is in regards to items comprised in the index. Based on summary of the 13 articles in Table 1, we compile 101 items of CSR measurement for Islamic banking consists of nine (9) dimensions and 28 sub-dimensions. As a means of illustration, we have selected seven (7) items under outcome-oriented measures that belong to two (2) dimensions and five (5) sub-dimensions. Similarly, nine (9) items have been chosen as process-based measures, which fall under three (3) dimensions and four (4) sub-dimensions. Table 4 shows all these selections categories. How actual selection should be made and various weights should be allocated are briefly described in the notes below the table.

Table 4 Example of anticipated format for process-outcome differentiated index to measure corporate social responsibility (CSR) and Islamic banks (IBs)

Weights	Dimensions*	Weights**	Sub-dimension	Weights**	Measurements items*	Weights**
<b>Process</b> <b>(0.55)</b>	Investment	0.50	Empowerment of communities	1.00	M1: Equity investment / total investment.	0.20
					M2: Musharakah investment / total investment	0.20
					M3: financing to poor families and small businesses	0.20
					M4: investment in deprived areas	0.20
					M5: selecting companies that represent industries of the future	0.20
	R&D	0.25	Advancement of Knowledge	1.00	M6: Research expense / total expense.	1.00
	HR	0.25	Investing in education and training	0.50	M7: educational grant/total income ratio	0.50
					M8: Training Expense / total expense	0.50
					M9: fairly in terms of wages, working hours	1.00
<b>Total (Process)</b>		1.00				

Table 4 (Cont.)

<b>Outcome (45)</b>			Supporting charities	0.50	M10: Zakah / net income.	0.50
					M11: Sadaqah amount	0.50
	Social activities and sharing	0.70	Playing the role of welfare without looking for profitability	0.25	M12: amount of Qardh Hassan interest free income/ total income	0.50
			Fair Returns.	0.25	M14: Net profit/ total asset.	1.00
			In work place.	0.50	M15: Energy conservation.	1.00
	Environment	0.30	Protecting the environment	0.50	M16: Undertake initiative to promote environmental responsibility	1.00
<b>Total (Outcome)</b>		1.00				
<b>Overall</b>						

\* Measurement dimensions and items will have to be carefully selected to mirror and capture the concept of outcome and process, and the choice should be subsequently authenticated through a panel of experts using on-line Delphi or some other suitable techniques.

\*\* These weights are randomly allocated for illustrative purpose only. For actual development of the index, preliminary weights will have to be justified and decided based on past literature, which will then be authenticated by the same procedure as mentioned above.

## CONCLUSIONS

This paper attempts to contribute to the development of a CSR index for Islamic banking, which assigns differential weights to two categories: process-based measures and outcome-oriented measures. In doing so, the paper first explained the importance of having an Islamic banking CSR measurement index, which allocates more weight to the process-based measures than to outcome-oriented measures. Following this explanation, we demonstrated the process of how such an index could be developed.

As for the importance of a differentially weighted index, three important dimensions of Islamic banking CSR measurement were taken for discussion. The dimensions were charity, human resource development, and investment. The discussion revealed that, for the charity to be valid and acceptable, the process of earning out of which charity is given and the process of giving charity should be pure and decent. The essence of the discussion was the recognition of the fact that the (degree of) purity of the process of earning is a prior and more important question for the earning-based CSR activities to be recognized as sufficiently viable. Process-based measures are concerned with the methods of generating the very earning, which makes possible the performance of earning-based CSR activities. Thus, the process-based CSR measures deserve to have greater weight than outcome-oriented CSR measures.

The second objective was about illustrating the index development process. A significant achievement here was the ascertainment of the overall weightage for process measures and outcome measures, which are, respectively, 55 and 45. After arriving at this overall process-outcome ratio of weightage, the subsequent tasks of selection of items from both categories of measures, assigning weight to each item and validation of the selection and weight assignment has been explained. A tabular format for the purpose of facilitating actual development of differentially weighted CSR index by interested researchers or practitioners has been offered.

Islamic banks will have different standings on the scale of social performance. The CSR index of our interest suggests that banks with a higher CSR score should not be automatically assumed to be superior to other banks with lower scores in discharging social responsibilities. When calculation of CSR scores is done without discriminating the CSR activities in the process-outcome framework, a bank ignoring equity investment, R&D, and human resource development may obtain a higher score by virtue of earning-based charity than another bank, which stands low on charity but seriously attends the matters that the high-scoring bank has ignored. This insight is of immense importance for Islamic banking, which governs authorities when they want Islamic banking to accomplish the original socially imbued objectives, and which justify its very existence in the modern economic environment.

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