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Empowering CSR, SRI and SE in Islamic Finance

Mohamad Akram Laldin

Introduction

The financial crisis of 2008 affected lives across the globe, and showed that reexamination of current practices is essential. The crisis highlighted the dangers resulting from excessive leveraging, involvement in speculative and risky financial instruments, and lack of due diligence before undertaking business activity. These concerns, in turn, point to underlying issues within the financial sector: the lack of transparency and ethics, the risk of moral hazard in financial practices and the lack of social responsibility and governance in the management of financial institutions. All of these concerns were further exacerbated by shortfalls in governmental supervision.[1]

However, Islamic finance, which has only experienced rapid development during the last 30 years, was able to avoid the full impact of the recent financial crisis, although it did experience lesser effects. This is in part because Islamic finance operates on the basis of *shari'a* principles, which prohibit interest-based transactions and speculative activities.[2] The assets of the top 500 Islamic banks expanded 28.6 percent to a total of US$822 billion by year-end 2009, with bright prospects for future growth.[3] However, the current practices of Islamic finance are not devoid of criticism; the proponents of Islamic economics and many *shari'a* scholars have proposed that Islamic finance should also serve more socio-economic goals, which are another part of the true objectives of Islamic financial institutions, and are among the expectations of their various stakeholders.[4] Therefore, the current practices of Islamic finance can be further improved and strengthened by empowering the noble and virtuous concepts of Corporate Social Responsibility (CSR), Socially Responsible Investment (SRI) and Social Entrepreneurship (SE), as long as they are in line with *shari'a* principles. This will assist Islamic financial institutions to meet their true objectives and their stakeholders' expectations, as well as maximizing the institutions' benefit to society.

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This paper will discuss how the three concepts of CSR, SRI and SE can be implemented in Islamic finance. The paper will begin by outlining the concepts of CSR, SRI and SE from various Western perspectives, followed by a discussion of such parallel concepts and practices in Islam. Then the paper will explore these concepts within the *maqasid* paradigm and, finally, discuss the opportunities and challenges in applying them to the current domain of Islamic finance.

The Western Perspective on CSR, SRI and SE

CSR, SRI and SE are concepts that are targeted at addressing the continual discontent among the business community with the self-interest and self-indulgence that seem to underpin the Western economic worldview.[5] This discontent has been exacerbated in part by an increasing number of business scandals involving fraud, breaches of trust, misrepresentation and other forms of unethical behavior on the part of large corporations such as Barings, Enron, Arthur Anderson, WorldCom and a number of others.[6] In addition, unethical investment has also led to calls for the reexamination of how businesses and investments are conducted. These concepts have also started to figure prominently in public debate regarding social problems such as poverty, unemployment, pollution, and racial, gender-based and religious discrimination.

Corporate Social Responsibility (CSR)

CSR does not have a unified definition, but the European Commission defines it as "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis."[7] Thus, CSR can be defined as corporate activities beyond profit generation, and it may involve protecting the environment, conducting business in an ethical manner and making other significant contributions to society.

CSR requires an institution to be responsible to its stakeholders and address all their interests.[8]Those stakeholders comprise internal and external stakeholders: employees and customers, competitors, public authorities, the communities in which the firm operates and others who could be directly or indirectly affected by the institution's actions. CSR also represents a built-in governance framework that guides the corporation to realize social good and sustainable development. However, subscription to and implementation of CSR is voluntary unless it is part of the corporation's policy or law. CSR requires the corporation to balance the financial and social values of its activities.

Although CSR has its own proponents, it is not without opposition.[9] Some critics point out that CSR may be misused to disguise a corporation's real activities in order to gain public support.[10] Other opponents consider CSR contrary to the purpose of a business corporation—generating profit—and this would make it, in their view, an unlawful use of shareholders' resources. Moreover, the legal definition of a corporation does not entail obligation toward society; only obligations toward its shareholders and the laws of the government.[11] Thus, getting corporations engaged in sustainable development may not be possible.

On the other hand, the proponents of CSR argue that a corporation is responsible to society and therefore has to be socially responsible and accountable for all its actions.[12] They also argue that CSR does not deny the corporation's prime objective of generating profit, but requires the corporation to be responsible in doing so.

Full implementation of CSR programs entails reform in a corporation's human capital management, investment options, corporate governance, business practices and other activities to ensure that the interest of its stakeholders continues to be safeguarded as well. For instance, regarding human capital management, the corporation must commit itself to a better and safer workplace, fair treatment of workers, provision of enhancement training, etc.

Despite wide global acceptance of CSR, its adoption differs from place to place, since local conditions and authority support differ; therefore, its implementation must overcome or accommodate local problems and issues.[13]

Socially Responsible Investment (SRI)

SRI is an investment strategy that makes social good the main consideration in undertaking investments; it is, in part, the incorporation of CSR in investment decisions. There is no single definition for SRI, but it is generally understood to be the practice of incorporating social, ethical and environmental (SEE) factors in investment decisions. Thus, investors who subscribe to SRI would not participate in any investments deemed harmful to society. From the *shari'a* perspective, that would include investments in production or processing of tobacco, unauthorized weapons, military projects and other activities that directly or indirectly injure the society, including development projects that degrade the environment and factories that produce ozone-depleting chemicals.[14]

SRI initiatives are growing in number and are being promoted by various religious and ethical groups and individual investors. Previously, SRI was limited to select religious groups who aimed at achieving certain social goals or complying with and promoting their religious beliefs. SRI is now becoming more widespread as it is regarded as an initiative that supports CSR and general ethical concerns. Current SRI initiatives include thematic screening, community or cause-based investing and promoting SRI to shareholders. Regulators of companies conduct screening in order to determine the companies whose stocks are worthy of investment due to the company's involvement in positive business and sustainable development. Various indexes have been developed to meet specific SRI criteria, such as the Dow Jones Sustainability Index, Domini 400 Social Index, Corporate Responsibility Index, FTSE4Good Index, and others. Many studies have been done on the performance of ethical investment portfolios, and the findings show that the return of SRI investment portfolios is competitive with other socially neutral portfolios.[15]

Social Entrepreneurship (SE)

SE is a great initiative to bring social good to society and solve real social and economic problems. There is no unified definition for SE, but it is normally defined as the work of a social entrepreneur who acts as an agent of social change by transforming a problem into an opportunity. Martin, Roger and Osberg characterized social entrepreneurship as having "the following three components: (1) identifying a stable but inherently unjust equilibrium that causes the exclusion, marginalization, or suffering of a segment of humanity that lacks the financial means or political clout to achieve any transformative benefit on its own; (2) identifying an opportunity in this unjust equilibrium, developing a social value proposition, and bringing to bear inspiration, creativity, direct action, courage, and fortitude, thereby challenging the stable state's hegemony; and (3) forging a new, stable equilibrium that releases trapped potential or alleviates the suffering of the targeted group and, through imitation or the creation of a stable ecosystem around the new equilibrium, ensures a better future for the targeted group and even society at large."[16] Individuals or enterprises that utilize effort, talent, creativity and nominal capital to reform the society via entrepreneurial principles and tools are good examples of the empowerment potential of SE. For instance, the Grameen Bank microfinance facility does not merely provide a financial facility but also guides its clients in financial matters, maximizing the social good. Thus, it has assisted its clients and given them tools to better their living conditions.[17]

There are many SE initiatives throughout history, but they are outnumbered by the vast number of socio-economic problems that exist in the world. In addition, SE requires endless commitment and action before its fruits become evident. It requires the social entrepreneur to identify the core of the problem, come up with ways to solve it, monitor the process, as well as support the clients, without hoping for a huge short-term return on all the capital, energy and time invested. The main aim is to make a positive impact on society, especially with regards to improving living conditions.

All of these concepts bring good to the society through economic instruments. CSR requires business corporations to strike a balance between business and social benefits, and it acts as a check and balance for the corporation's stakeholders. SRI, on the other hand, provides investors with criteria of social good to guide their investment options, while SE mobilizes the investment of an individual's or a group's capital, energy, time and talents in order to maximize social good. Although various challenges remain, these concepts remain promising. Many parties, individuals and corporate bodies have committed to these initiatives, leading to a larger impact in society.

It should be clear that these strategies depend upon the willingness and initiative of individuals and corporations. This willingness is dependent upon conviction, conscience and a sense of responsibility to the society. They are all voluntary in nature unless made mandatory through legal and regulatory mechanisms.

CSR, SRI and SE from an Islamic Perspective

Having understood the noble concepts of CSR, SRI and SE from various Western perspectives, it is pertinent to understand the Islamic position on such concepts and recognize parallel concepts and applications in the *shari'a*. The following discussion will examine the parallels between concepts in the *shari'a* and the concepts of CSR, SRI and SE discussed earlier.

Corporate Social Responsibility (CSR)

The concept of CSR is not alien to Islam, as numerous Islamic principles support its implementation and achievement. However, it is considered as part and parcel of the human role of *khalifah* (vicegerent) and servant of God, whereby humans are charged with the duty of managing the earth and its inhabitants according to the rules of God (*shari'a*). *Shari'a* entails human compliance to the Islamic system of belief, morality and dealings, which all support CSR principles and permissible initiatives. Thus, the Islamic view on CSR is more comprehensive and holistic, since Islam encourages humankind to pursue worldly gains and social good as well as rewards from God, namely success in the worldly life and the hereafter.

The Shari'a *Basis Of CSR*

Broadly speaking, in Islam CSR is closely related to the concept of *tawhid* (Unity of God), from which the important concepts of vicegerency (*khilafah*) and justice or equilibrium (*al-'adl wal ihsan*) are derived. The Quran[18] emphasizes this when it says:

> Those who remember God standing, sitting and lying down, who reflect deeply on the creation of the heavens and the earth, (saying):

'Our Lord! You have not created (all) this without purpose You are far above that! so protect us from the torment of the Fire.' (3:191)

The above verse provides a fundamental principle of responsibility and governance, implying that everything created by God has a purpose, and that human beings are created to be the world's vicegerents (*khalifah*). The concept of *khalifah* is stated in the Quranic verse that says:

And (remember) when your Lord said to the angels: 'Verily, I am going to place *khalifah* (vicegerent) on earth.' (2:30)

Having entrusted humankind as vicegerent, God constantly monitors and is involved in human affairs, and He is aware of everything at all times. In addition, this divine monitoring system will act as the check and balance to ensure that every human being is discharging his or her duties as prescribed by God.

In another verse God emphasis the important of doing good, which is part of the CSR. He in effect says:

So whosoever does good equal to the weight of an atom shall see it. (99:7)

The principle of *tawhid* makes it clear that God knows everything and that all mankind is answerable to Him and required to do good; this principle is the foundation of the CSR model in Islam. In addition to the above verses, many other verses have a direct or indirect relationship with the issue of CSR. Among them:

And help one another in goodness and piety . . . (5:2)

O you believers! Do not betray God and the Messenger, or knowingly betray your trusts. (8:27)

O you who believe! Fulfill [your] obligations. (5:1)

Essential Ingredients of Corporate Governance

Broadly speaking and as defined above, CSR is closely related to corporate governance, a concept that was developed as a result of increasing awareness of the importance of protecting the rights of all stakeholders, including minority shareholders. There are four essential ingredients of corporate governance: transparency, accountability, disclosure and fairness.[19] None of these four ingredients are new to Islam, as they are articulated either in the Quran, the Sunna or in principles embedded in Islamic law.

Transparency means timely and accurate disclosure on all material matters, such as financial situation, performance and ownership. The Quran has explained at length the importance of transparency in carrying out a transaction. For instance, verses 282 and 283 of *Surah al-Baqarah* detail a step-by-step process to be undertaken when carrying out a transaction involving debt:

> O you who believe! When you contract a debt for a fixed period, write it down. Let a scribe write it down in justice between you. No scribe should refuse to write: let him write as God has taught him. Let the debtor dictate, and let him fear God, his Lord, and not diminish anything of what he owes. But if the debtor is of poor understanding, or weak, or is unable himself to dictate, then let his guardian dictate in justice. And get two witnesses from among your own men. And if there are not two men (available), then a man and two women, such as you agree for witnesses, so that if one of (the two women) errs, the other can remind her. And the witnesses should not refuse when they are called on (for evidence). Do not disdain to write the debt down, whether it be small or big, for its fixed term: that is more equitable in God's sight, more reliable as evidence, and more convenient to prevent doubts among yourselves. But if the merchandise is present and you hand it over, then there is no sin on you if you do not write it down. But take witnesses whenever you make a commercial contract. Let neither scribe nor witness suffer any harm, but if you do (such harm), it would be a crime on your part. Be mindful of God, and He will teach you. And God is the All-Knower of each and everything.
>
> And if you are on a journey and cannot find a scribe, something should be handed over as security, but if one of you entrusts the other, let the one who is entrusted discharge his trust (faithfully), and let him be mindful of God, his Lord. Do not conceal evidence: whoever does so has a sinful heart. And God is All-Knower of what you do. (2:282–3)

The passage above highlights the importance of proper recordkeeping in debt transactions, so that no party involved suffers injustice. The message of these verses can be extended by analogy to all other transactions and generalized as a management ethic: the principle of transparency and disclosure in an organization shall not be compromised.[20]

The second ingredient of corporate governance is accountability, which means ensuring that management is accountable to the board and the board is accountable to shareholders. When discussing the basis of corporate governance, the verses cited above are sufficient to address the importance of accountability in Islamic teachings. In addition, Prophet Muhammad was reported in one *hadith* to have said, "Each one of you is a guardian, and each guardian is accountable for everything under his care."[21]

In the contemporary context, this tradition implies that all persons involved in an organization are indeed accountable for all their actions. The level and scope of accountability are determined by the respective organizational chart.

As for the third ingredient—disclosure—the rules of contracts in Islam emphasize the importance of full disclosure by the contracting parties. One of the pillars of the contract in Islam is the existence of the subject matter of the contract, and a condition for the subject matter is that the contracting parties must know all the details related to it. For instance, if a person is entering into a sales transaction, the contracting parties must know the object of sale and all its particulars or the contract may be void. This requirement is clear evidence of disclosure as a necessity of Islamic financial transactions. This ingredient can also be extended to organizational management. At an organizational level, all dealings must be disclosed in detail to the relevant authority, such as the board of directors or regulators. The absence of such practice can be considered a violation of *shari'a* requirements and as such is considered a sin.

The last ingredient is fairness, which is inclusive of the protection of shareholders' rights, treating all shareholders including minorities equitably, and providing effective redress for violations. In this respect, the Quran clearly emphasizes the principles of fairness and justice, even against one's enemy, when it says:

> O you who believe! Stand out firmly for God and be just witnesses, and let not the enmity and hatred of others make you avoid justice. Be just: that is nearer to piety, and fear God. Verily, God is Well Acquainted with what you do. (5:8)

Thus, a balance must be established between financial profit and public good. The responsibility to promote and implement CSR is not merely a responsibility to society; it is, in fact, a fundamental *shari'a* obligation.[22] Therefore, the responsibility to promote and apply CSR is not discretionary but, to a certain degree, *compulsory*, so long as the CSR principles are in line with the *shari'a*. The *taqwa* (God-consciousness) paradigm will motivate prioritization of social good and prevention of harm, even if financial gains need to be compromised.[23]

The currently instituted *shari'a* advisory and supervisory bodies should play the role of promoting CSR application in the Islamic finance industry (IFI). Members ought to focus not only on meeting *shari'a* legal requirements but also on upholding the noble values and objectives of *shari'a*, such as those invested in CSR concepts. Only then can it be said that an act or policy is fully *shari'a* compliant. Thus, the *shari'a* board should have a wider *shari'a* governance function in the IFI.

Support for CSR implementation in Islamic finance is evident in AAOIFI's newly introduced Governance Standard on Corporate Social Responsibility Conduct and Disclosure for Islamic Financial Institutions, which imposes the implementation of CSR and the duty of disclosure on Islamic financial institutions and provides various guidelines for the implementation mechanism.[24] The guideline prescribes mandatory and recommended actions that are to be undertaken by financial institutions in relation to policies on CSR and their disclosure. The mandatory actions for financial institutions include installing, implementing and disclosing policies for screening clients, policies for responsible dealings with clients, policies on earnings and expenditures prohibited by *shari'a*, policies on employee welfare and policies on *zakat*. The recommended actions include installing, implementing and disclosing policies for *qard hasan* (benevolent loan), policies for reduction of adverse impact on the environment, policies on investment quotas based on social, developmental and environmental criteria, policies on par excellence customer service, policies for micro and small business and social savings and investments, policies for charitable activities and policies for *waqf* management.

The call for CSR implementation is also supported by the survey conducted by Dar Al Istithmar and Dinar Standard with the support of AAOIFI on application of CSR by Islamic financial institutions. The survey shows that IFIs have made some efforts and display a certain amount of commitment to realizing CSR, although there is great room for further improvement.[25] Among the key findings of the survey were that all respondents (Islamic financial institutions) affirm having a policy to screen prospective clients. Most of them also affirm having an organizational policy that deals with client responsibility. Most respondents similarly affirm having policies on various aspects of employee welfare. A majority of institutions also have policies for charitable activities. However, only 55 percent of all respondents affirm having some policy for investment quotas on social, developmental and environmentally orientated investments, with environmental investment quotas receiving the least attention. Lastly, it was found that not many respondents have a policy to manage *waqf* properties and *zakat* on behalf of their clients.

Socially Responsible Investment (SRI)

The concept of SRI is actually an integral part of Islamic economics, which is based on the principle that wealth is an *amanah* (trust) from God and as such it has to be managed according to the guiding principles provided by the Quran and *Sunna*. Islam emphasizes fair distribution of wealth, achievement of social justice and welfare-enhancing activities. SRI initiatives such as thematic investment, shareholders' advocacy and community investment are not contrary to *shari'a*; they are considered noble acts that assist in shared prosperity and the practice of socially responsible finance.

Various *shari'a* texts support encouragement to perform SRI in order to achieve social welfare and fair distribution of wealth. The Quran states:

> Whatever gains God turned over to His Messenger from the people of the townships belong to God, to the Messenger, and to kindred, orphans, the needy and the traveler in need this is so that they do not just circulate among those of you who are rich . . . (59:7)
>
> God commands justice, the doing of good, and generosity toward relatives, and He forbids what is shameful, blameworthy and oppressive. He instructs you so that you take heed. (16:90)
>
> Give relatives their due, and the needy, and travelers; do not, squander your wealth wastefully. (17:26)

Prophet Muhammad also said:

> None of you truly believes until he likes for his brother what he likes for himself.[26]
>
> You see the believers in their mutual mercy, love and kindness resembling one body; if any part of the body is not well then the whole body shares with it in sleeplessness and fever.[27]

As for the duty of ensuring that wealth is invested in a manner compliant with *shari'a* requirements, stocks are subjected to a screening process to determine whether or not the activities of a company comply with *shari'a* requirements. In the current practice of Islamic finance, stocks and companies' activities have to undergo strict screening before they are endorsed for a *shari'a*-compliant investment portfolio. The screening requires prospective investment avenues to pass the religious, social and moral filters; thus, it is stricter than the requirements placed under generic SRI.[28]

The following are examples of the necessary steps before a stock is approved as *shari'a* compliant:

Dow Jones Islamic Market Indexes Screening Process[29]

DJIM's screening process involves two stages:

1. *Screens for Acceptable Business Activities*

In this stage, companies whose primary activities are impermissible shall be excluded from the index. Among those activities are conventional financial services (banking, insurance, etc.), the production or sale of alcohol, pork-related products, entertainment (hotels, casinos or gambling, cinema, pornography, music, etc.), arms, defense, tobacco and any other activity discouraged under Islam.

2. *Screens for Acceptable Financial Ratio*
After eliminating companies that profit from unacceptable business activities, Dow Jones Indexes evaluates remaining companies using several financial screens, or ratios. These ratios are established by the *Shari'a* Board to exclude companies that have unacceptable levels of debt or earn impure interest income.

According to the financial ratios, each of the following amounts must be less than 33 percent:

- Total debt divided by trailing 24-month average market capitalization
- The sum of a company's cash and interest-bearing securities divided by trailing 24-month average market capitalization
- Accounts receivables divided by trailing 24-month average market capitalization

Companies that pass these screenings are included in the Dow Jones Islamic Market Index Universe.

The Malaysian Screening Methodology[30]
The Securities Commission of Malaysia applied standard criteria to the activities of the companies listed on Bursa Malaysia. Subject to certain conditions, companies whose activities are not contrary to *shari'a* principles are classified as *shari'a* compliant. On the other hand, companies are classified as *shari'a* noncompliant if they are involved in the following core activities:

a. Financial services based on *riba* (interest);
b. Gambling and gaming;
c. Manufacture or sale of non-*halal* products or related products;
d. Conventional insurance;
e. Entertainment activities that are impermissible according to *shari'a*;
f. Manufacture or sale of tobacco-based products or related products;
g. Stock broking or share trading in *shari'a*-noncompliant securities; and
h. Other activities deemed impermissible according to *shari'a*.

The screening process also takes into account the amount of interest income received by the company from conventional fixed deposits or other interest-bearing financial instruments. In addition, dividends received from investment in *shari'a*-noncompliant securities are also considered in the analysis. The percentage of noncompliant activities contributing to the company will be analyzed against the following benchmarks:

1. Five percent for clearly prohibited income, e.g., *riba*-based companies, gambling, liquor and pork;
2. Ten percent for prohibited elements that affect most people and are difficult to avoid, e.g., tobacco-related activities;
3. Twenty-five percent for the generally permissible elements that still involve non-*halal* that are not easily identifiable, e.g., hotels, resorts, share trading and stock broking.

If the company's involvement or its contributions from these activities supersedes the above benchmarks, the stock of the company shall not be considered *shari'a* compliant.

For companies with activities comprising both permissible and impermissible elements, two additional criteria are considered:

a. The public perception or image of the company must be good; and
b. The core activities of the company should be important and beneficial to the nation and the country, while the impermissible elements are a very small proportion and involve matters such as *umum al-balwa* (common plight and difficult to avoid), *urf* (custom) and the rights of the non-Muslim community which are accepted by Islam.

Therefore, the different activities of the company will undergo both quantitative as well as qualitative screening before the final decision is made as to whether it is *shari'a* compliant.

Having said that, although such a filter is in place, most of the investment vehicles endorsed are just those related to responsible and safe investments. Not many investment vehicles are aimed at fulfilling the needs of the society, serving social welfare or engaging in environmentally friendly activities. Therefore, there is a need to expand the considerations of the stock screening process beyond screening *haram* activities. If a company is known to engage in activities detrimental to the society at large or the company is not environmentally friendly, it should be excluded from the compliant list.

Social Entrepreneurship (SE)

The Islamic call for humans to perform good deeds ('*amal salih*) and to assist fellow human beings supports the concept of social entrepreneurship (SE). An individual or group's SE initiative is a great contribution to the society, as it brings prolonged benefits to the society as well as addressing core problems and basic needs. This is supported by various *shari'a* texts. The Quran states:

> Help one another in righteousness and piety, but do not help one another in sin and rancor. (5:2)
>
> Be quick in the race for forgiveness from your Lord and for a Garden whose expanse is that (of the whole) of the heavens and of the earth, prepared for the righteous, those who spend (freely) whether in prosperity or in adversity; who restrain anger and pardon (all) men; for God loves those who do good. (3:133–134)
>
> It is not righteousness that you turn your faces toward East or West; but it is righteousness to believe in God and the Last Day and the Angels and the Book and the Messengers; to spend of your substance out of love for Him, for your kin, for orphans, for the needy, for the wayfarer, for those who ask, and for the ransom of slaves; to be steadfast in prayer and practice regular charity; to fulfill the contracts which you have made; and to be firm and patient in pain (or suffering) and adversity and throughout all periods of panic. Such are the people of truth, the God-fearing. (2:177)
>
> Those who recite the Book of God, establish regular Prayer, and give secretly and openly from what We have provided for them, may hope for a commerce that will never fail: for He will repay them in full and give them extra from His bounty. He is Oft-Forgiving Most Appreciative. (35:29–30)

Prophet Muhammad also said:

> A Muslim is a brother of another Muslim, so he should not oppress him nor should he hand him over to an oppressor. Whoever fulfills the needs of his brother, God will fulfill his needs; whoever brings his (Muslim) brother out of a discomfort, God will bring him out of the discomforts of the Day of Resurrection, and whoever screens a Muslim, God will screen him on the Day of Resurrection.[31]

In the Islamic finance sphere, various *shari'a* partnership contracts support SE initiatives. They allow the sharing of existing resources to be mobilized or invested to obtain shared returns. Partnership ventures (*shirka*) in Islam can exist with the capital of monetary contribution (*mal*), assets (*milk*), labour (*'amal*), reputation (*wujuh*) or a combination of monetary contribution and labor, such as in *mudaraba*. For instance, the *mudaraba* contract allows for the combination of the entrepreneur's labor with monetary capital to create a business venture for profit, to be shared between the capital provider and the entrepreneur according to their agreement. *Sharikah al-wujuh* is a partnership based on the creditworthiness of the partners without any monetary capital injection. Therefore, via existing resources or capital, not necessarily monetary, an enterprise may be created to acquire more gains and to spread the benefit of these gains to the shareholders.

SE can also be initiated when an Islamic financial institution receives a viable project proposal from a potential entrepreneur. It can venture into a *mudaraba* contract in which the IFI provides the startup capital for the enterprise. This will allow the Islamic financial institution to participate in the creation of new business and job opportunities. In addition, an IFI may invest in a social enterprise and fund its activities as part of its philanthropic initiatives or social obligations. This can be in the form of capital injection as part of a partnership, or by a voluntary donation, or the IFI may provide a *qard hasan* (benevolent loan) to the social enterprise.

Notwithstanding Islamic financial institutions' contributions and participation, there are other Islamic sectors that may assist in the development of SE initiatives. Achievement of social justice and welfare is also part of the Islamic state's responsibility, as it is the guardian of all Muslims, particularly the poor and the needy. Traditionally, the responsibility of the state is executed through the *Baitul Mal* (Islamic Treasury), which assists in distributing state resources and *zakat* to those in need. At present, the challenge to the *Baitul Mal* is to ensure that the assistance, whether monetary or other, reaches all deserving recipients.

Another important institution in Islam, *waqf* (charitable endowment), can assist in SE initiatives by mobilizing *waqf* property so that the social entrepreneur can utilize it to achieve social good and to ensure the maximum benefit out of the *waqf* property. There are actually many ways to empower *waqf*, and many potentials of *waqf* can be explored.[32] These include developing *waqf* assets through SE initiatives.

In addition, the *takaful* industry may be empowered to assist in providing better health and education to the poor. However, the *takaful* contribution or premium must be affordable to the poor or the government should introduce incentives to assist the needy to obtain *takaful* coverage.

Voluntary donations in the form of *sadaqa* (donation), *hibah* (gift) and other forms of *tabarru'* (charity) may be channeled via social enterprises apart from the common practice of delivering them directly to the needy.

CSR, SRI, SE: The *Maqasid* Paradigm

Understanding how these concepts (CSR, SRI and SE) fit into the objectives (*maqasid*) paradigm requires an understanding of the *maqasid al-shari'a* and their underlying principles, which are realizing benefit (*maslaha*) and repelling harm (*mafsadah*).

Maqasid al-shari'a *(The Objectives of the* Shari'a*)*

There are inherent objectives behind the revelation of *shari'a*, which were explained by Muslim scholars who analyzed and examined *shari'a* rules and the texts of the Quran and the Sunna.[33] Various texts of the Quran and the Sunna indicate direct and indirect purposes of *shari'a* rulings. The scholars' findings are not complete, as they involve the wisdom and secrets behind God's rules, but the main objectives of *shari'a* are securing benefit for the people and protecting them against corruption and evil.

Scholars of the objectives of *shari'a* provided many definitions of *maqasid*. Ibn 'Ashur defined *maqasid* as the purpose and wisdom behind the enactment of all or most of the *shari'a* rulings.[34] 'Allal al-Fasi defined *maqasid* as "the end sought behind the enactment of each of the rulings of the *shari'a* and the secrets involved."[35] Imam al-Ghazali detailed the *Maqasid al-shari'a* as follows: "The objective of the *shari'a* is to promote the well-being of all mankind, which lies in safeguarding their faith, lives, intellect, posterity and wealth. Whatever ensures the safeguarding of these five serves public interest and is desirable."[36]

These definitions explain that the objectives of the *shari'a* are the ends sought by each of the rulings of the *shari'a* and the wisdom behind such rulings. The comprehensive ends include development of the world and preservation of a system of co-existence and maintenance of good on earth through the betterment of people, who are obliged to live their lives justly and virtuously and to act and think for the good of the world.

Thus, scholars need to consider the *maqasid* of *shari'a* when deriving legal rules and providing guidelines for people to conduct their lives according to *shari'a*. It is essential that the legal rulings be consistent with the *maqasid* of *shari'a*, that is, the intended purposes behind its laws, especially because the *maqasid* allow flexibility in application of *shari'a* and highlight *shari'a*'s dynamism.

Classification of Maqasid al-shari'a

The different injunctions of *shari'a* aim at protecting the interests of mankind (*masalih*) and repelling harm (*darar*). These objectives of *shari'a* can be divided into three categories, namely, the essentials (*daruriyyah*), the complementary (*hajiyat)* and the embellishments *(tahsiniyyah)*.[37] All the different injunctions of *shari'a* aim at realization of one or more of these objectives.[38]

1. *The Essentials (*al-Daruriyat*)*

The essentials are those matters on which the religious and worldly affairs of the people depend; their neglect will lead to total disruption and disorder and could lead to an evil ending. These must be protected, whether by the individual or by government authorities. These values including the five fundamental matters in life, namely upholding and protecting religion (*al-din),* life *(al-nafs),* dignity or lineage *(al-'ird),* intellect *(al-'aql)* and property *(al-mal).*

2. *The Complementary (*Al-Hajiyyaat*)*

The complementary interests, or *al-hajiyyaat,* are a supplement to the five fundamental matters. They are interests whose neglect leads to hardship for the individual or community, although it does not lead to the total disruption of normal life. Examples of such interests in *mu'amalat* include the permissibility of trading and other kinds of transactions such as leases (*ijara*), *mudaraba*, etc.[39]

3. *The Embellishments (*Al-Tahsiniyyaat*)*

The embellishments, or *al-tahsiniyyaat*, are interests whose realization leads to improvement and the attainment of that which is desirable. The disappearance of *tahsiniyyaat* would not interrupt normal life; however, it might lead to discomfort. Examples of such application in *mu'amalat* include the prohibitions against selling items that have no material value and the prohibitions against selling public properties.

Scholars have agreed that the essential interests (*daruriyat*) shall take priority over other interests. They are followed by the complementary interests and lastly by embellishments. This is because the basic and essential interests of human beings need to be addressed first before attempting to attain higher facilities or luxuries in life.

Underlying Principles of Maqasid al-shari'a

The aim of *shari'a* is to realize the well-being of humankind, which involves attaining public good or interest (*Maslaha*) and preventing harm or evil (*darar*). Therefore, it is essential to discuss these two concepts as outlined by the *shari'a*.

I. Maslaha *(Public Interest)*

Maslaha is a legal concept used in Islamic jurisprudence to promote public benefit and prevent evil. Imam al-Ghazali defined it as the consideration that secures a benefit or prevents harm and is harmonious with the aims and objectives of *shari'a*.[40] Thus, what constitutes *Maslaha* (pl. *masalih*) or public interest cannot be determined by the unaided human intellect; it must be with the guidance of *shari'a*. The legal texts of the Quran and Sunna have identified certain *masalih* that are approved or disapproved by *shari'a*, and *shari'a* scholars are allowed to make efforts to identify other *masalih* which may be acceptable so long as they are not in contradiction with *shari'a*.[41]

The *maqasid* paradigm has categorized *maslaha* into three categories to be achieved according to their priority: essentials, complementaries and embellishments. This means that even upon achievement of the third-level *maslaha*, efforts to maintain the first- and second-level *maslaha* need to be continued and given emphasis. This principle can help in corporate decision-making, regarding which objectives should be given priority in a certain situation or moment. It provides an ethical filter in the face of conflicting interests, helping to determine which interest should take priority, as the different degrees of *maslaha* outline their levels of importance. It also assists decision-making in CSR, SRI and SE initiatives regarding which sector is to be given preference.

Maqasid may require Islamic financial institutions to support activities that bring benefit and good to the society although this may sometimes involve sacrificing some of their resources and profits. It also calls for the inclusion of positive investment portfolios or those that support the SE cause in investment choices, which may include investments in sectors such as education and health care.

The promotion of *maslaha* is further guided by a variety of legal maxims,[42] for example:

1. Al-mashaqqah tajlibu al-taysir: "Hardship calls for facility."

2. Dar'u al-mafasid awla min jalb al-manafi: "Repelling harm is preferred to the attainment of benefits."

II. Darar *(Prevention of Harm)*

Similar to *maslaha*, what constitutes *darar* must follow *shari'a* guidelines. As a matter of fact, *shari'a* has outlined various rules on dealing with situations of *darar*. They have been summarized in the following maxims:[43]

1. *La darara wa la dirar*: "Harm shall not be inflicted nor reciprocated."
2. *Al-dararu yuzal*: "Harm should be removed."
3. *Al-dararu yudfa'u bi qadr al-imkan*: "Harm should be repelled as far as possible."
4. *Al-dararu la yakunu qadiman*: "Harm must not be sustained."
5. *Al-dararu la yuzalu bi mithlihi*: "Harm cannot be displaced with its like."
6. *Yutahammal al-dharar al-khas li daf' al-dharar al-"am*: "To repel a public harm, private damage is tolerated."
7. *Dar'u al-mafasid awla min jalb al-masalih*: "Repelling harm is preferred to the attainment of benefits."

These maxims show that *shari'a* places great emphasis on the prevention of harm and achievement of *maslaha*. The principles of *maqasid*, *maslaha* and prevention of *darar* also provide guidelines to CSR, SRI and SE practitioners in decision-making as well as in conflict resolution. Thus, whenever a subject matter gives rise to benefits and harm at the same time, the prevention of harm is to be given priority over attainment of benefit. In CSR, these principles serve as guidelines for decision-making and should be part of an institution's governance policy. They also support the practice of excluding negative, harmful and illegal investment portfolios as well as the practice of community investing in SRI. Similarly, they encourage the initiation of SE projects and social welfare centers that aim to alleviate the problems of disadvantaged members of society. Therefore, both principles strongly encourage the implementation of CSR, SRI and SE.

CSR, SRI, SE and Maqasid al-shari'a *in Islamic Finance*

This section will discuss the concepts of CSR, SRI and SE from the *maqasid* dimension. It will shed light on how the *maqasid* can guide these concepts and their application in Islamic finance.

CSR: The *Maqasidic* Dimension

The objectives (*maqasid*) of *shari'a* allow flexibility, dynamism and creativity in social policy. In the context of CSR, realization of *maslaha*, which is the foundation of *maqasid al-shari'a*, has to be seen as a consideration of public interests rather than merely individual interests. It provides a framework for making decisions and a mechanism for adapting to change, especially for corporations willing to commit to CSR. In propagating the concept of CSR, the three categories of *maqasid*, as prescribed by the scholars and explained earlier, can be the guiding principles, particularly in giving priority to the areas related to CSR that should be emphasized. The division of *maqasid* into *daruriyat, hajiyyaat* and *tahsiniyyaat* creates a framework and a general ethical filter, providing administrators with three levels of priority to resolve the ethical conflicts that inadvertently emerge when applying CSR programs and initiatives. The levels also reflect the different degrees of importance in terms of fulfillment of responsibility. The essentials constitute the most fundamental responsibilities to be fulfilled, as compared to the complementary and the embellishment categories. Therefore, as the priorities move from the level of essentials to embellishments, the impact of decision-making and the implementation of adequate processes will be less fundamental, albeit more virtuous, so as to attain social good and well-being. It is assumed that individuals and corporations will strive for the next level of priorities as soon as the prior level goals have been fulfilled.

In order to illustrate the above argument, we shall analyze the different levels of the decision-making process based on the above priorities. On the first level of priority (the essentials), managers are expected to strive to preserve their stakeholders' essential needs and the public good in general. For example, under the CSR precept, IFIs must protect their employees' basic needs by providing adequate remuneration and safeguarding their safety and health in the workplace as well as providing adequate facilities for them to practice their religious requirements. This will reflect their responsibility to safeguard the values of life and religion. In addition, they must confine their operations to those that safeguard the above-mentioned essential values. Accordingly, corporations have a moral and social responsibility to avoid activities that may cause disruption and chaos in people's lives, even though such activities might bring higher profits to the organization.

After fulfilling this level of responsibilities, the priority will move to the second level, the complementary. Here, it is deemed beneficial to remove difficulties that may not pose a threat to the survival of the normal order. For example, managers may want to extend their commitment to social responsibility by offering continuous training and programs for their employees. The latter is not essential per se, for neglecting it does not threaten the employees' continued existence. However, assuming such a responsibility fulfills the complementary interest of advancing the workers' intellectual capability. In some cases, such an effort may be considered one of the essentials, particularly if neglecting such an effort might lead to the disruption of the core function of the organization. For example, Islamic banks must provide their employees adequate *shari'a* training concerning the products offered in order to ensure that stakeholders are satisfied with the "Islamicity" of the products.

The final level of priority is fulfilling the embellishments. Corporations are expected to engage in activities or programs that improve public life. Donating to the needy, offering scholarships to poor students, and providing correct and clear information regarding all products are some of the examples of CSR commitment with respect to realizing the goals of this level.

SRI: The *Maqasidic* Dimension

The *maqasid* would require Islamic financial institutions to approach Islamic investment from a perspective wider than the legal contractual relations of *fiqh al-mu'amalat*. The *maqasid* approach would look into all aspects of *shari'a* investments and prioritize investments in relation to the plethora of public interest (*maslaha*) for the specified time and place. It would promote investment strategies that are not driven solely by profits but also by ethical or religious motives.

For instance, economic or sociological experts may decide that investments in education, food supply and health care should be prioritized for a certain country, as these are necessities (*daruriyat*) of the people of the respective places. On the other hand, investment in housing might be of complimentary status, while investment in recreation and tourism would have less priority, as they are considered embellishments (*tahsiniyyaat*). With or without government encouragement, Islamic financial institutions should make significant investments in priority areas. This will create new jobs, business projects and wealth, as well as foster entrepreneurship. The other example worth mentioning here is in the area of fund raising through instruments such as *sukuk*. At present, most of the *sukuk* issued are used to fund mega-projects, such as tourism resorts, which may not necessarily benefit large segments of society.[44] Furthermore, the current trend tends to focus on investing funds in well-to-do countries rather than assisting less fortunate countries. This is partly because the likelihood of good return may be higher in wealthier countries, and investment strategy is often heavily weighed toward returns rather than need. Such strategy must be reviewed, as *shari'a* should serve the public interest in investment rather than merely focusing on the return factor.

SE: The *Maqasidic* Dimension

The *maqasid* dimension helps enhance the current SE frameworks by providing guidelines on how SE will best contribute to the society. It assists in identifying the critical areas that should take priority and the relevant SE that need to be established in certain areas at specified times and situations. The various categories of *maqasid*, namely *daruriyat*, *hajiyyaat* and *tahsiniyyaat*, shall be the main guidelines. For instance, these can indicate the areas that need to be the main focus of social entrepreneurs. Although food supply, living conditions and health care may be identified as areas that should take priority, the *maqasid* dimension will guide social entrepreneurs in providing education as well so the underprivileged will be able to themselves work for better living conditions. For example, although individuals may be provided with food in the initial stage, they may also be taught ways to plant and produce food or obtain microcredit to embark on small businesses. They will hopefully then climb the ladder from the stage of necessity to the complementary stage, if not the embellishment stage. Therefore, Islamic financial institutions should not only give financial assistance to the poor but also come up with a structured plan or strategy to assist them to achieve better living conditions.

Opportunities and Challenges

The effort to implement CSR, SRI and SE using the *maqasid* of *shari'a* in the Islamic financial sphere will expose the industry to new challenges, as some reform will be necessary. Notwithstanding that, various opportunities, some of which are discussed below, will also open for the industry.

Enhancing the CSR, SRI and SE initiatives would distinguish Islamic financial institutions as providers of ethical banking and deflect the criticism against them. It would help Islamic financial institutions promote and practice the *maqasid* of *shari'a* in a strategized and structured way. The Islamic finance industry would serve its true purpose of achieving socio-economic objectives and responsible and ethical finance. Although financial institutions are commercial entities, they would also assume social responsibility and promote the agenda of social welfare and social justice.

Furthermore, it would also demonstrate that Islamic financial institutions have a comprehensive governance framework that encompasses ethics and social responsibility apart from a corporate and *shari'a* governance framework. All of these are actually part of Islamic financial institutions' duties as prescribed by the *shari'a*. The objectives of *shari'a*, as well as the Islamic system of belief, morality and law of dealings, should be the main reference in the governance structure, thus creating a holistic and comprehensive governance framework.

Islamic financial institutions would be recognized as agents of change in the society, playing vital roles in socio-economic and social welfare sectors. It is time for Islamic financial institutions to transcend the function of financial intermediaries and become real contributors to socio-economic agendas.

One crucial element for realizing the Islamic finance industry's initial promise is the challenge of developing Islamic microfinance. Its conspicuous absence or underdevelopment highlights the IF industry's distance from its supposed social role, as Islamic financial institutions should not only be involved in philanthropic activities but should also should be active in providing microfinance to the public. Without microfinance services, Islamic finance will be deemed incomplete. Some have suggested that a new form of Islamic bank needs to be established: Islamic social banking.[45] A number of studies have been conducted, in which researchers have proposed various models to implement Islamic microfinance; indeed, it is high time that the viability of these models be assessed and serious effort be made to introduce viable Islamic microfinance services.[46] Offering Islamic microfinance is not impossible, for the early history of the Islamic finance industry witnessed the initiative of Mit Ghamr Bank in Egypt, which provided Islamic microfinance services to its customers.

Apart from that, Islamic finance must be wary of bad corporate governance. We have already seen examples of governance failure in IFI, the Dubai Islamic Bank (DIB) cases being ready examples.[47] Islamic financial institutions need to instill both a strong *shari'a* governance framework as well as a CSR framework within their structures. The incorporation of CSR with Islamic specifications should assist in ensuring good governance of Islamic financial institutions. Understanding and internalizing the *taqwa* paradigm would restrain IFI staff from transgressing Islamic law or its code of ethics.

It has been emphasized on many occasions that *shari'a* advisory and supervisory bodies will need to play a central and significant role in implementing the noble objectives of *shari'a*, the concepts of CSR, SRI and SE, as well as the governance of Islamic financial institutions. In considering a product's endorsement, they should examine the social impact of the product, not merely the economic impact or its legal status under the *shari'a*. They also need to use their utmost diligence to assess and uphold the *maslaha* that they think needs to be given priority when confronted with conflicting and competing interests.[48] They also have a responsibility to guide Islamic financial institutions to fulfill the true spirit and objectives of *shari'a* and not to merely comply with the letter of Islamic law. Thus, there is a need for a paradigm shift and change in the practice of the *shari'a* advisory and supervisory bodies. IFI's delivery of services also should be enhanced. It will require the members of *shari'a* boards and advisory services to give more time and attention to Islamic financial institutions and to play more proactive roles. It is worth considering the appointment of permanent *shari'a* members who will dedicate their full time and thinking to supervising and shaping the institutions to fulfill the true functions the *shari'a* demands of them.

Conclusion

The above discussion illustrates that there is a close link between CSR, SRI and SE and Islamic finance, as the former can assist Islamic financial institutions in serving their real functions as outlined by *shari'a*. This assistance corresponds with the opinions of proponents of Islamic economics. However, the concepts of CSR, SRI and SE require some modifications to comply completely with *shari'a*; in fact, *shari'a* has a more holistic overview of these concepts, considering them as part of Muslims' religious obligations and not merely of social utility. Therefore, there is a vital need to implement and give credence to these concepts in current Islamic financial practices and systems. Many benefits are anticipated from this shift, financially, socially and economically. The implementation will not be without obstacles, but it also has the potential to provide IFI with many positive opportunities and bright prospects.

Endnotes

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