
COMPARATIVE ADVANTAGE BETWEEN CONVENTIONAL BANK AND ISLAMIC BANK ON CORPORATE SOCIAL RESPONSIBILITY (CSR)

Sani Abdullahi Sule

Fakultas Ekonomi dan Bisnis, Universitas Sebelas Maret
Surakarta, Jawa Tengah

ABSTRACT

Both conventional and Islamic banking has been in the market system for almost 50 years, since it began during the 1960s. Since that time, both conventional and Islamic banking has quick grown and is no longer a strange concept. The products and services provided have been well accepted, not only among Muslim countries and also non-Muslim countries. However, there is a lack of comparative between conventional bank and Islamic bank performance in terms of corporate social responsibility (CSR). The paper aims to analyze the relationship between Islamic bank and conventional bank on their CSR performance. It is a conceptual attempt to discuss on how Islamic principles can influence the implementation of CSR in both conventional bank and Islamic banking system. The religious expect both the conventional bank and Islamic bank to have the strong influence to attract customers by using CSR. For that reason, this paper tries to investigate the relevant literature views and the relationship between conventional bank and Islamic bank concept on CSR. The paper try to find that, the concept of Islamic bank that comply with religious provision should exhibit more proactive CSR activity and policies. Islamic bank performance should be superior to conventional bank counterpart.

Keywords: Commercial Bank, Corporate Social Responsibility, Islamic Corporate Responsibility

1. INTRODUCTION

Most of the literature on Islamic banks asserts that, basically, they perform functions similar to those of conventional banks. However, their approach is different (1–5) commented as follows:

“Although some writers would describe Islamic banks as more than mere financial institutions, the fact remains that an

Islamic bank is actually much like a conventional bank, in that it is a full-service financial intermediary. By definition an Islamic bank abides by the Islamic law, called the Shari’ah. A bank’s commitment to the Islamic law is expressed only in the definition of its modes of financing and its contractual relations with suppliers of funds.” (6) defined an Islamic bank as: “A financial institution that provides a service

to its customers free from interest, and the giving and taking of interest is prohibited in all transactions (7) stated:

“Like conventional banks, an Islamic bank is an intermediary and trustee of other people’s money with the difference that it shares profit and loss with its depositors. This difference introduces an element of mutuality in Islamic banking, making its depositors as customers with some ownership rights in it. However, in practice most Islamic banks have an organizational set-up similar to their conventional counterparts.”

(8) pointed out that the banking operations of Islamic banks are based on Islamic principles. Thus, Islamic banks can be differentiated from conventional banks in three major aspects: (1) foundation; (2) management; and (3) products. (6) and

highlighted five major elements that give Islamic banking and finance its distinctive religious identity: (1) *Ribais* prohibited in all transactions; (2) business and investment are undertaken on the basis of *halal* (legally permitted activities); (3) transactions should be free from *gharar* (speculation or uncertainty) and *maysir* (gambling); (4) *zakat* is to be paid by the bank to benefit society; and (5) to ensure that all activities are in line with Islamic principles, a special *Shari'ah* board supervises and advises the bank on the propriety of transactions.

Based on the above argument, this paper will explore the issues of Islamic bank and corporate social responsibility. Is expecting, that Islamic bank should show more proactive CSR activities compare to conventional counterpart. For that reason, this paper will be presented in the following ways: First, we will discuss on the concept of CSR. Then we will explore the concept CSR base on Islamic perspective. The concept of Islamic CSR discussed in this paper is based on five Islamic principles: (1) *Tawhid*; (2) *Shari'ah*; (3) *justice*; (4) *benevolence*; and (5) *Maslahah*. These principles should be reflected in Islamic organizations' CSR activities and should, theoretically, distinguish Islamic banks' CSR practices from those of conventional banks. The next section will further discuss on the characteristic of Islamic bank and finally the paper will discuss on the relationship between Islamic bank and CSR. (9) mentioned that the emergence of strategic Corporate Social Responsibility as a cover for business enterprises to enhance their natural profit margin and self-interest is thought of by providing anti-corporatists with tools to quickly bring out the various ideas and eagerly shape them as "hypocrites". Moreover, (10) wrote, as Corporate Social Responsibility continues in making inroads into the business arena, the harder its proponents are pressed to provide business exemplars justifying the continued legitimacy as a business practice. The Corporate Social Responsibility goes down in business case routine because of their belief that the Corporate Social Responsibility will evolve

the aged dilemma of possible trade-offs between financial profit and normative morality.

2. LITERATURE REVIEW

2.1 The Corporate social responsibility

(10) concluded in his work that Corporate Social Responsibility is challenging, dynamic and complex areas that business managers face today and one of the most critical, despite the increase in deregulation in most countries thus bring industries under pressure to partake frequency purchase products such as stock brokerage industry, a particular buyer may not buy a particular scrip within the given period of time. In this case the definition of customer retention could be the process when customer intended to buy the product and services at any available favorable occasion'.

(11) opined that customer retention strongly depends on silent attrition rates. Attrition which he defined as process where customers no longer want to use particular goods and services provided by the producer and bring to an end the relationship bond between them by notifying the producer/supplier that he in active role of making the society a better place to dwell for other habitants and not only for them.

The practice of Corporate Social Responsibility is highly debated and criticized. Some critics are of the opinion that there is a strong business case for Corporate Social Responsibility in that benefits that follow are broader and longer than immediate, short term profits; some of the benefits corporations gain from Corporate Social Responsibility and that have been "empirically tested include corporate reputation by Orlitsky et al., 2003) and reducing business risk by (12). Other benefits that have been identified include increasing revenue generated from sales.

However, other critics argued that Corporate Social Responsibility distracts businesses from fundamental economic

role. This is credited to (13). (14) argued that it is nothing more than superficial covering up of the in-depth of the organization, yet (15) on his own point of view, argued that it is an attempt to pre-empt the role of corporate bodies in creating value to goods and services. (16) stated that “although Corporate Social Responsibility is good for both immediate society and the organization both in the short and long run and consumers are also favorable to socially responsible organizations that support these philanthropic variables”.

The most applicable definition of corporate social responsibility to majority cases, is defined by the World Bank Group as “the commitment of businesses to contribute to sustainable economic development by working with employees, their families, the local community and society at large to improve their lives in ways that are good for business and for development” (17)

According to (18), Corporate Social Responsibility is a concept whereby organizations inculcate social and environmental concerns into their business operations and in their interaction with their stakeholders on a voluntary basis’. Meanwhile, there is no set definition of Corporate Social Responsibility to which all scholars accepted, and this has in one way or the other brought confusion regarding what exactly is corporate social responsibility. If anything is to be expected of business organizations as social impact on society, it should not be only the stakeholders’ return.” ‘Corporate Social Responsibility’ is defined by various organizations from their own point of view in order to meet their own objective and aims. For public relations people, Corporate Social Responsibility is often characterized by protection of reputation; for accountants, it is about supply chain auditing; for Non-Government Organizations, it is about humanitarianism and resources preservation; for governments, it is about sharing the burden of sustaining” (19). Corporate Social Responsibility has recently become a key

subject in the field of marketing, advertising and academics.

(20) suggest that Corporate Social Responsibility describes the extent to which business organizational outcomes are consistent with societal values and expectations. CSR is the expression of a corporation’s level of moral development, where the values that guide corporate, socially responsible policies, decisions and programmes are products of a variety of normative systems, depending on the culture, religion, education, etc.

The corporate social responsibility (CSR) concept has had a long and varied history. Although references to a concern for social responsibility appeared during the 1930s and 1940s, the modern era of social responsibility began in the 1950s (21) referred to CSR as the obligations of businessmen to pursue those decisions, those policies, those lines of action which are desirable in terms of societal objectives and values. In the 1960s, in an overview of CSR, (22) defined CSR as an action taken by businessmen to oversee the operations of an economic system so that it fulfills the expectations of the public. In other words, production and distribution must be conducted in such a way that will enhance total socio-economic welfare. (22) drew attention to five major thoughts about business responsibility at that time, each attempting to tackle the problems of power in a complex society and highlighting the importance of businesses’ responsibility to society.

(23) CSR into socio-economic obligation and socio-human obligation. As regards socio-economic obligation, the businessmen’s role is to manage economic units in the society, with a broad obligation to the community with regard to economic development and public welfare. As regards socio-human obligation, businessmen are obliged to nurture and develop human values, such as morale, cooperation, and motivation. These two obligations should underlie businessmen’s decisions and actions should be taken for reasons at least partially beyond the firm’s direct economic or technical interests.

Economic Responsibility: The ideal of business activity base it thinking on what way that at the same time achieve it economic pattern and also drive the attention of it immediate customers means it help the company to gain a lot of profit, also at the same ban it customers need assisting them to provide economic activities like employment their youth the society, road maintain, hospital equipment, classroom rehabilitation and water supply (24)

Legal Responsibility: In order to avoid risks and failure of the business activities in any environment where the company operate should obey by the rule and regulation act by incorporation lay under law and order giving them to operate in a place provide to them, so this situation it is very important the business activity should take it first in they all activity within the environment where it operate, the European Union; and the Foreign Account Tax Compliance Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 or the UK Bribery Act, 2010 at an international level.

Ethical Responsibility: under this condition any firm operating in any society should obey code and conduct of its societal, means business should done their activities base on ethical norm, so the people living in the area would help the organization to continue its activities without problem, the basic principles of any organization integrity, fair conduct, respect and transparency in the financial sector. The ethical value it very important to the stakeholders in which to promote the business environment (25)

Philanthropic Responsibility: It cannot be interpreted through external expectations; it is a voluntary activity, however, it has become common practice among banks, contributing to the better reputation of the financial sector, in addition this responsibilities it is are part in which the organization operating in the community should act as a citizen of that society means that they should give out some benefit to that people settle in the

area where the firm running it activity as a charity(26)

2.2 The Corporate Social Responsibility in Islam

Islam provides a complete code of behavior for life since it embraces every aspect of life. CSR is therefore not isolated in the Islamic view and is one of the main concepts in Islamic teaching. (27) stated that the concept of CSR is deeply inscribed in the *Shari'ah*. Therefore, any corporation such as an Islamic bank that claims to follow *Shari'ah* based principles should naturally practice CSR, as it enshrines Islam's true spirit.

(28) study on the compatibility between the tenets of Islam and the United Nations' Global Compact found that the teachings of Islam not only appear to be in close conformity with the Ten Principles of the United Nations' Global Compact, but in many respects, go further than the minimum standards adopted by this framework. In their study, Williams and Zinkin (2010) found that Islamic teachings exceed the requirements of the Global Compact in a number of important ways:

1. They appear to be wider in scope, for example, in the development of human capital and transparency requirements in business transactions.
2. They have a clear codification defining what is permissible or *halal* and what is forbidden or *haram*.
3. Islam has an explicit enforcement mechanism in the *Shari'ahas* well as in the community and there is the final accountability of the individual for unethical behavior on the Day of Judgment.

Thus, an investigation of Islamic financial institutions (Islamic banks) was relevant in this study since they should establish or implement CSR practices and natural environmental management policies which are at least comparable with or at best exceed those followed by conventional non-Islamic banks. In addition, this study sought to identify whether religion influenced Islamic bank managers' perceptions of attitudes to natural

environmental management since the study aimed to identify differences between conventional banks' and Islamic banks' approach to environmental issues. In order to gain a better understanding of Islamic CSR, the next section focuses on Islamic principles that should be reflected in Islamic organizations' CSR practices.

2.3 The Concept of Unity (*Tawhid*) and the Principle of Vicegerent

In Islam, the concept of CSR is consistent with the concept of Unity (*Tawhid*). According to this concept, Allah is the Creator, Owner and Source of all things and has entrusted mankind to use and manage all things wisely. In return for the use of the physical universe, mankind agrees to be accountable for how they use and manage the universe (29). thus, the purpose of man is to live his life in submission and obedience to Allah (30).

The principle of vicegerent denotes that mankind is the representative of God on Earth and, as such, Allah (God) has entrusted mankind with stewardship of His possessions.

"Al Quran 2:30: "And remember when your Lord said to the angels: "Verily, I am going to place (mankind) generations after generations on earth...."

Al Quran 35:39: "He is who has made successive generations after generations on the earth...."

The concept of vicegerent in Islam requires mankind to take care of God's creation (31,32). God will question everything that has been done in this world during the Day of Judgement. Therefore, all actions must be based on God's rules and regulations. According to the vicegerent concept in Islam, the human being has responsibility towards other human beings, society, and the natural environment. (33) indicated that Islam has prescriptions that are consistent with a modern view of what needs to be done to enhance the social, human, and natural environment. Zinkin also found that Islamic principles are in harmony with the principles of the UN Global Compact.

2.3.1 Justice in Islam

Islam is a religion that emphasizes justice. (30) relate the principles of justice in Islam to several types of business activity. First, justice includes the fulfillment of promises, pacts and contracts. Therefore, Muslims should be honest, sincere and truthful in their business dealings, and ensure exactness in terms of promised products and specifications. Second, justice encourages equal treatment in labour management. Hiring people and wage payment should be based on merit and competencies. Finally, justice in Islam also includes the equitable distribution of wealth. In the *Quran* there are several verses that discuss justice:

"We sent aforetime our messenger with clear signs and sent down then The Book and the Balance (of right and wrong), that mankind may establish justice" (Quran 57:25).

"Allah commands justice, the doing of good (equity), and charity to kith and kin, and He forbids all shameful deeds and injustice and rebellion: He instructs you, that you may receive admonition" (Quran 16:90).

Besides the above, Islam promotes justice and the equal treatment of all living beings. Based on the principles of justice, Muslims need to be fair, not only amongst themselves but also in their dealings with others and even with their enemies (33). The concept of vicegerent also implies that human beings are equal, except on the basis of piety and good character(34). As vicegerents in this world, the concept of justice is important as humans are not only responsible to God but also to society and the natural environment. Thus, they must not only consider every act and decision for their own self-interest but also for society and the natural environment. Kamla et al. (2006) indicated that human beings' responsibility towards nature is not only related to benefits for themselves, it is a comprehensive responsibility which includes society and future generations, and extends to the valuation of nature itself, irrespective of man's or other creatures' use of it. Based on this concept, Islamic

organizations are expected to be more proactive in natural environmental management than conventional organizations. Do they consider Islamic principles in their CSR practices?

In economic activities, in order to achieve social justice in society, Islam provides a foundation for establishing socio-economic justice and therefore social responsibility. For example, Islam imposes obligatory payment of income and wealth (*zakat*), philanthropic trusts (*waqf*), alms and charity (*sadaqah*), and interest free loans (*Qard al Hassan*). To ensure socio-economic justice, *zakat* is compulsory in Islam and is one of its five pillars. Non-fulfilment of this requirement is a sin and results in punishment in the Hereafter. Economic competition is encouraged as long as it is healthy, raises efficiency, and helps promote human well-being.

According to (35) there are six matters of justice that need to be fulfilled by Islamic business organisations in daily business activities:

1. Fulfilment of promises (pacts and contracts, verbal and written).
2. Exactness in weights and measures (specifications) in all business related items, including work, wages and payment, and labour movement.
3. Truthfulness, sincerity and honesty.
4. Efficiency, for example, jobs should be carried out without any lapse or omission, with best planning, and to the best of one's ability and competency.
5. Selection of merit.
6. Investigation and verification. These are essential because they constitute a prelude to right and ethical conduct.

Based on the concept of justice, (36) divided stakeholders in Islam into three main categories based on their priority in a business. First are those who are directly and substantially affected by the success and failure of the business. Owners and employees come under this category. The second category refers to those who are affected by the success and failure of the business and its activities, such as suppliers, customers and

government. In the third category are those who are subject to the externalities of the business. The environment and community are grouped under the third category.

3.0 Islamic Banking Business Characteristics

Riba or interest is the common factor that differentiates Islamic banking from conventional banks. One of the reasons for the establishment of Islamic banks was to avoid interest in banking transactions (37). Much of the literature states that one of the major reasons for the establishment of Islamic banking was to provide an interest free banking system (7,8,34,37-40).

Interest in Islam is defined as predetermined return on capital (41) For (6) interest refers to the addition to the amount of the principal of a loan according to the time for which it is loaned and the amount of the loan. (42) indicated that interest may occur as a contractual increase arising from a loan, whether in money or barter. With *riba*/interest, there is no risk of loss (40). (2) defined *riba* based on the *Shari'ah* and *Fiqh* perspectives. *Riba* in the *Shari'ah* technically refers to the premium that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or for an extension in its maturity. In the *Fiqh*, *riba* means an increase in one or two homogenous equivalents being exchanged without this increase being accompanied by a return. (2,39) pointed out that prohibition of interest is mentioned in four different revelations in the *Quran*. First, the *Quran* states that interest will deprive the one taking it from the wealth of God's blessings. Second, imposing interest is wrongful and inappropriate. Third, Muslims are enjoined to avoid interest for the sake of their own welfare and, last, a clear distinction is established between interest and trade. The prohibition of interest is also cited in the *Hadith* (the sayings of the Prophet).

Interest is prohibited in Islam due to its negative effect on society and the economic system. Interest is viewed as an act of exploitation and injustice and as such is inconsistent with Islamic notions of fairness and property right (6,43) discussed the serious consequences of bank financing based on interest. A business may incur losses arising from difficulties in repaying both the principal and the stipulated interest, and have to make up the deficiency from its assets. This is why the concept of interest is related to injustice. (43) stated:

“If the results of the enterprise are uncertain due to the nature of the world, the supplier of capital should be guaranteed a fixed positive return rather than the burden of uncertainty, in the form of loss, falling entirely on the entrepreneur.”

The same situation is faced by the lender (depositor) in a conventional bank, especially when the return on their deposit, which has been channelled by the bank to entrepreneurs, is not commensurate with the actual performance of the investment (6). (34). Thus, the prohibition of interest is Islam's response to arresting social imbalances arising from inequitable distribution of income created by the credit system.

Given the above, Islamic banks deliver a set of distinctive products in the financial market (37,40). As an alternative, profit and loss sharing (PLS) contracts has been introduced to substitute for interest in banking activities. Profit and loss sharing (PLS) contracts is predominantly based on the *mudarabah* (profit-sharing) and *musharakah* (joint venture) concepts of the Islamic contract (44). There is a partnership between the Islamic bank and its depositors on the one side and between the bank and its investment clients on the other. An Islamic bank does not charge interest but participates in the yield resulting from the use of funds, and the depositors share in the profits of the bank according to a predetermine ratio (6). the relationship between Islamic banks and their customers compared with

conventional banks and their customers as follows:

3.1 Islamic Bank Risk of Transfer and Risk of Sharing

a) Source of Funds

Investor profit sharing investment account holders share the risk and return with Islamic banks. The return of the investment is not guaranteed and depends on the bank's performance (37)

b) Used of Funds

Banks shares the risk in profits and losses sharing (PLS) contracts

3.2 Risk Sharing in Conventional Banking System

a)Source of Funds

Depositors transfer the risk to the bank which guarantee a pre specified return

b) Used of funds

Borrowers are requiring paying interest independent of return on their project. Banks transfer the risk through securitization or credit default swaps. Financing its debt based Hassan and Dridi 2010.

3.3 Differences in Management Structure

Islamic banks can also be differentiated from conventional banks based on their management structure. From the management perspective, Islamic banks are under a different corporate governance structure since they are obliged to appoint a board comprising Islamic scholars called the *Shari'ah* Supervisory Board (SSB) (8) The objectives of the SSB are to ensure Islamic banks operate in conformity with the *Shari'ah* and to minimise (45) If the terms agreed in a contract do not effectively comply with Islamic jurisprudence they are not valid under Islamic law. SSB members' existence ensures the audit systems in Islamic banks encourage them to strictly follow and abide by Islamic principles. Any divergence from Islamic principles can expose Islamic banks to non-*Shari'ah* compliance and heavy penalties. Accordingly, with regard

to CSR management issues, especially natural environmental risk management, Islamic banks are expected to show more comprehensive and active management.

4.0 The Feature And Differences Between The Islamic Banking And Conventional Bank

According to Dusuki 2008, Ahmad and Hassan 2007 narrated as follow

4.1 Based on Islamic ideas

1. Based on the principles of the Islamic shari ah. Functions and operation are guided by sources of the shari ah, namely the Quran and the sunnah, traditions of the prophet Muhammed p.b.u h.
2. Investment based on risk sharing between the provider of capital investor and the user of funds entrepreneur.
3. Profit maximization is allowable but subject to shari ah restrictions.
4. Zakat obligation.
5. Participation in partnerships business is the fundamental function of the banks.
6. The banks have no provision to charge any extra money from defaulters.
7. The PLS paradigm of the banks operation makes the banks pay greater attention to developing project appraisal and evaluations.
8. Islamic banks give greater emphasis to the viability of projects
9. The bank and client relationship is considered to be between partners' investors and traders.
10. Islamic banks need to show social and economic zakat a compulsory religious levy out of their incomes.
11. Islamic banks are prohibited from participating in economic activities which are unethical and prohibited by the shari ah such as financing businesses involving alcohol, prostitution, pork, environmental pollution.

4.2 Based on conventional bank ideas

1. Based on human made descriptions policies. Functions and operations are guided by secular principles and not based on any religious doctrines and values
2. The investor is assured of a predetermined rate of interest.
3. Profit maxamition without any restriction.
4. No zakat obligation
5. Lending money and getting it back with interest is the fundamental function of the banks.
6. Banks can charge additional money compound rate of interest in the case of default.
7. Since income from advances is fixed, banks attach little importance of developing expertise in project appraisal and evaluations
8. Banks place greater emphasis on the credit worthiness of client
9. The bank client relationship is considered to be between creditors and debtors
10. There is no requirement to perform charitable acts
11. There is no such restriction

5. CONCLUSION AND RECOMMENDATION

Since the aforementioned (44) study suggests that current Islamic banking activities deviate from the Islamic spirit, and their implementation and practice are no different from those of conventional banking activities, a study of the current practice of Islamic banking was important to identify if differences exist between Islamic banks and conventional banks. In this way the correlation between theory (compliance with religious norms) and practice can be ascertained. It was also important to study if and how Islamic teachings and views have impacted upon Islamic banking activities.

(46) contended that Islamic ethical principles provide a broader framework for

CSR and should motivate Islamic banks to actively pursue it. Islamic banks should also have a greater affinity to CSR because they are guided by strong religious/ethical principles and obligated to adhere to these principles. Importantly, Islamic principles must be translated into action and actual practice in Islamic banks' activity. If not, such principles and guidance become theoretical only. A recent study by (44) found that Islamic banking practices in Malaysia do not much differ from those of conventional banks and therefore concluded that Islamic banks exist in theory only. The rapid development of Islamic banks in the world also requires an instructive examination of their CSR practices. It has been argued by (34) that Islamic banks should play a leading role in CSR implementation such as environmental risk management, human resource development, human rights and community development. Therefore, it is advisable for the future study to be conducted empirically to measure and compare the performance of CSR between conventional and Islamic bank institutions

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