



## **CONCEPTUALIZING A STRATEGIC FRAMEWORK OF SOCIAL RESPONSIBILITY IN ISLAMIC ECONOMICS**

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### **ABSTRACT**

In developing Islamic economics as a discipline, its proponents have emphasized on religious and ethical postulations of its economic agents as the essential micro-foundation towards the realization of its normative goals. Nevertheless, recent debates have highlighted the growing frustration on the failure of Islamic finance in addressing ethical and socially responsible issues beyond the legal realm of *Shari'ah*-compliance. Likewise, the survey of the literature concerning the multiple aspects to individuals' motivations for the support towards Islamic finance has also revealed mixed results. While the religious aspect has been shown to be a primary concern among the users of Islamic financial services in numerous studies, economic consideration remains an essential component in such decisions and in many instances overwhelmed the normative dimension. Based on these observations, perhaps it is wise to reflect the applicability of Islamic economic theory in the context of the contemporary reality of the Muslim society. In the transitional state where the economic dimension remains as a dominant factor in individuals' decisions, the crucial challenge is to reconcile self-interest motives with the social interest. One of the prospective means to reduce the potential conflict between the two can be found in the literature of strategic or instrumental theory of ethics. This paper seeks to discuss this issue from an Islamic perspective within the transformative paradigm of Islamic economics. The strategic framework of social responsibility is outlined based on a synthesis of the normative and positive dimensions of human instincts, the notion of *falāh*, the moral and price filters of market and the theory of instrumental ethics. The paper argues

that a strategic understanding of social responsibility issues and commitment is not in conflict with Islamic teachings. Nevertheless, it should not be taken as a theory independent of its normative foundation as normally construed in the Western literature. Instead, the strategic theory in Islamic perspective should be seen as complementary in nature with the normative underpinnings as the core, providing additional incentive and motivation for individuals to address social responsibility issues. Additionally, it has also been argued that these normative goals can be facilitated by the presence of an appropriate socio-economic environment. Recognizing that the notions of corporate social responsibility (CSR) and socially responsible investing (SRI) have been often celebrated as a force to tame the vigor of egoistic orientation under Western capitalism, similar 'institutions' can also be introduced in the context of an Islamic economy. This should provide additional economic incentive for businesses to address broader social, ethical, and environmental issues, and reinforce further the strategic understanding of social responsibility and its practice among individuals, businesses and the society as a whole.

JEL Classification: D64, M14, Z12

Keywords: Strategic or instrumental theory, Social responsibility, Ethics, Transformative paradigm

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## 1. INTRODUCTION

The modern Islamic economics project envisioned in the early part of the twentieth century signifies the economic and political revivalism of the Muslim world. Shaped by the Islamic worldview, it was aspired to be civilizationally oriented and concerned with the social justice and human well-being, where critical subjects such as poverty, underdevelopment, illiteracy, inequalities, and the level of health and education of the newly independent Muslim world were prominently addressed in the literature (Siddiqi, 1981). This has made issues such as the fulfillment of basic needs (e.g. food, clothing, shelter, medical care, and education); equitable distribution of income and wealth; equality of opportunity to all; sustainable growth and stability; and individual freedom, social cohesion and moral excellence to be important aspects of the objectives of Islamic economics (Chapra, 1979; Siddiqi, 1996). In other words, Islamic economics must be embedded with the principles

of justice, trust, accountability as well as broader social responsibility towards the society and the environment (Naqvi, 1981).

In the context of this paradigm, its proponents have emphasized on the role of religious and moral dimension of individuals in realizing the desired state of the economy. One of the corner stone of this new paradigm is the assumption concerning its economic agent. Contrary to a rational economic man of the neo-classical economics, otherwise known as *homo economicus*, individuals in an Islamic economic system, often referred as *homo Islamicus*, is described as a socially oriented and altruistically motivated Muslim man whose primary objective is to achieve *falāḥ* (Arif, 1985; Asutay, 2007). Based on the behavioral assumptions deduce from the normative dimension, *homo Islamicus* is claimed to be more accommodative towards the promotion of socio-economic justice and society's well-being. Nevertheless, recent debates have highlighted the growing divergence between the normative assumptions and the actual behavior of *homo Islamicus* as reflected by the players in the field of Islamic finance. This reality is very unsettling for the scholars of Islamic economics (Siddiqi, 2004), especially in the face of the skepticisms level against the discipline which argue that religious norms are not as strong as the economic incentive in shaping the behavior of economic agents in the idealized Islamic economic system (Kuran, 1983).

Perhaps it is wise to reflect the applicability of Islamic economic theory in the context of the contemporary reality of the Muslim society. In the transitional state where the economic dimension remains as a dominant factor in individuals' decisions, the crucial challenge is to reconcile self-interest motives with the interests of the society. One of the prospective means to reduce the potential conflict between the two can be found in the literature of strategic or instrumental theory of ethics. This proposition seems to be very appealing, especially within the context of the 'transformative' paradigm of Islamic economics, where efforts and policies, where necessary, should be in place to bring the 'positive' realm of economics closer towards its 'normative' ideals (Zaman, 2009). This paper seeks to examine an Islamic position on a strategic understanding of social responsibility commitment within this paradigm. Subsequently, the strategic framework of social responsibility is outlined based on a synthesis of the normative and positive dimensions of human instinct, the notion of *falāḥ*, the moral and price filters of market and the theory of instrumental ethics. Additionally, such a framework can be further reinforced through the presence of an

appropriate enabling environment such as the practice of CSR and socially responsible investing (SRI) which creates additional economic incentive for social responsibility commitment in an Islamic economy. The paper concludes by offering two general theoretical propositions in the light of this framework.

## 2. *HOMO ISLAMICUS* AND ITS NORMATIVE ASSUMPTIONS

In the domain of mainstream economics, the discourse of economics is generally divided into the realms of inquiry of ‘what it is’ and ‘what is ought to be’, or commonly known as the positive and normative aspects of economics. The positive inquisition of the economic realities constitutes the predominant approach of the discipline, while the normative aspects are left at the periphery of policy options. On the contrary, the discourse of Islamic economics, reflected by the writings of its founding fathers, has been heavily loaded with normative dimension. This is understandable as the primary sources of the discipline are divine in nature, and therefore, it is expected that these normative assumptions would shape the economic and financial choices and preferences of individuals.

Inspired by the objective of the *Sharī‘ah* (*maqāsid al-Sharī‘ah*), Islamic economics aspires to achieve economic justice and overall human well-being. However, this worldly well-being is not the end of itself; rather it is a condition for the realization of the ultimate happiness, or *falāḥ*, which has been referred to as the eventual aim of *homo Islamicus*- the economic agents in an Islamic economy.<sup>1</sup> *Falah* denotes a comprehensive understanding of success and happiness in life, encompassing both the material well-being and spiritual development.<sup>2</sup> While the former deals with worldly human welfare in all spectrum of life including in economic affairs, the latter dimension that have the final significance in the eternal life of the hereafter (Al-Attas, 2005). In Islam, “spiritual uplift is an essential ingredient of human well-being and any effort to realize it otherwise is bound to fail” (Chapra, 1992: 12). This comprehensive conception of human well-being places *falāḥ* at a unique position from the Islamic worldview in characterizing the overarching objective of Islamic economics, where the interest of this worldly life will not be in conflict with the Hereafter.

The concept of *falāḥ* is significantly different from the notion of utility in the mainstream economics in various ways. *Falāḥ* recognize the sources of happiness not only from the satisfaction of self-interest motives, but more importantly, the realization of social interest and the pleasure of Allah *s.w.t.* *Falāḥ* is also distinct from the notion of multiple utility conception advocated by some moral philosophers and economists, such as the likes of Etzioni (1988) and Sen (1987), as *falāḥ* encompasses not only the worldly plain, but also extends to life of the after world. This provides an inter-temporal perspective to the concept of happiness, where the ultimate happiness goes beyond the achievement of material well-being in this world, that is the eternal salvation in the hereafter. Therefore, an economic agent with this worldview will try to balance self-interest motives and material pursuit on one hand, and social interest and spiritual development on the other. In other words, economic agent with this goal in mind is described as a socially concerned God-conscious individual, who in seeking his or her interests is also “concerned with the social good, conducting economic activity in a rational way in accordance with the Islamic constraints, and in trying to maximize his/her utility seeks to maximize social welfare as well” (Asutay, 2007: 168).

The above behavioral assumptions of the economic agents are argued to be completely rational within the worldview of Islam. In fact, in the contrary, it would be highly irrational for a person to sacrifice his long-term eternal well-being for the sake of a relatively short-term worldly benefit. This is because acting according to the ethics of Islam are promised with manifold increase in rewards and those who desire only the affluence of the world will lose out completely in the hereafter (Qur’an, 42: 20). Therefore, individuals’ sense of prudence, with the long term perspective of well-being in the face of the reward and punishment as well as the accountability before God in the hereafter, forms the motivating factor for individuals to faithfully fulfill their obligations and social responsibility even when this tends to compromise their short-term self-interest (Chapra, 1996; Chapra, Khan and Al Shaikh-Ali, 2008). From this understanding, the incentive of the spiritual rewards provides strong motivation for *homo Islamicus* to go beyond the sole concern of self-interest motive and become more accommodative towards the promotion of social interest. Additionally,

it is also important to emphasize that altruistic behavior has been consistently linked to spiritual development (Qur'an, 64: 16; 31: 4-5; 59: 9). This is very central to *falāḥ* where human well-being is not only dependent on material achievement, but more importantly requires spiritual upliftment. Hence, altruistic behavior and the promotion of social responsibility towards others is the crucial ingredient in the process of realizing one's *falāḥ*.

Another important implication is in the area of growth and development in the light of human well-being. While productive enterprises and commercial undertakings are highly encouraged in Islamic tradition, this should always be balanced with the concerns over the society's well-being. This necessitates the presence of a functioning 'moral filter' in the economy that can facilitate such harmony by "changing individual preferences in accordance with social priorities and eliminating or minimizing the use of resources for purposes that do not contribute to the realization of normative goals" (Chapra, 1996: 27). Therefore, the imperative of *falāḥ* provides the essential element in realizing the harmony between economic and social well-being, where the two dimensions provide the necessary building blocks for a balanced process of development. Additionally, while the pursuit of wealth and material growth is not in conflict with the spirit of Islamic teachings, *falāḥ* broadens the meaning of happiness and therefore downplays the dominant role of material wealth. In other words, welfare of the individual and the society does not necessarily lie only in economic prosperity as other aspects to life such as moral, cultural and socio-political advancement are equally important (Chapra, 1992).

### 3. THE BEHAVIORAL NORMS OF *HOMO ISLAMICUS*

#### 3.1 COMMERCIALY ORIENTED NATURE OF ISLAMIC FINANCIAL INSTITUTIONS

Recent debates have highlighted the growing frustration of scholars and proponents of Islamic economics on the failure of Islamic finance in addressing ethical and socially responsible issues beyond the legal

realm of *Shari'ah*-compliance. Despite being the off-shoot of the Islamic political economy, the practice of Islamic financial institutions has diverged from its anticipated role, that is to be the operational arm of Islamic economics project in realizing its normative objectives. One of the important factors highlighted in the literature for such shortfall is the behavioral norms of *homo Islamicus* which is said to mirror its neo-classical counterpart of *homo economicus* (Asutay, 2007). Time and again, Muslim economists are quick to point on the nature of *homo economicus* whose aim is to maximize material gain and consider economic rationality as the only rationality as the fundamental factor to the failure of the neo-classical mainstream construct in addressing negative externalities and socio-economic problems. *Homo Islamicus* however, given its outlook on the multiple sources of utility that can be derived from worldly gain and spiritual rewards of the hereafter, is claimed to be more accommodative in promoting the interest of the society. While it has become evident that the prevalent of individualistic primacy of the neo-classical paradigm has frustrated the notion of 'invisible hand' which is assumed to transform rationally self-interest behavior into public interest, the behavioral norms of *homo Islamicus*, as observed by the experience of Islamic finance practices have not been too poles apart (Farooq, 2011). Profit motive has been a dominant factor in influencing the behavior of Islamic financial institutions, whereas socio-economic objectives if considered at all, constitutes a mere peripheral status from the overall activities. The doctrine of shareholders' value, which is the bedrock of capitalistic market, has also been shown to be widely shared by Islamic financial institutions (Sairally, 2007). While major prohibitions in Islam are avoided, there seems to be some hesitance in addressing the voluntary aspects of the Islamic normative principles. This is consistent with the Friedman's (1970) doctrine, where profit is maximized within the rule of the game, all be it that the rule here is the legal injunctions and contractual technicalities of the Islamic law of commerce.

Numerous studies on the practice of Islamic financial institutions have shown such tendencies. Examples include the overwhelmingly disproportionate percentage of debt-based instruments as compared to equity-based (Yousef, 2004; Hasan, 2005), rush to mega deals like *shūkūk* instead of micro financing (Abdul Rahman, 2007), the lack of

commitment to support developmental agenda (Asutay, 2007), and the poor record of corporate social responsibility (Sairally, 2007). In fact, some even argue that Islamic financial institutions should be viewed as a commercial entity whose objectives is to remain profitable and continue to survive in the business world. Social objectives however, should be addressed by other entities within the community like non-profit organizations and the government (Ismail, 2002). Such a pragmatic approach to Islamic finance has certainly contributed to the tremendous growth of the sector as huge Western banks jump into the bandwagon in the pursuit of the lucrative profit potentials, while the idealized form of altruistically motivated Islamic institutions remain elusive. In other words, “rather than being part of the Islamic political economy, Islamic finance has been pursuing policies away from the theoretical underpinnings and systemic understanding of Islamic economics and has located a surrogate financial framework in neo-classical economics” (Asutay, 2007: 168).

### 3.2 PROMINENCE OF ECONOMIC MOTIVE AMONG THE USERS OF ISLAMIC FINANCIAL SERVICES

As found in the literature, the pre-dominant role of economic self-interest motive also prevails in the demand side of Islamic finance sector. One of the important areas of behavioral research on the users of Islamic financial services is centered on the study of patronage of Islamic banks. This line of inquiry focuses on the general motivations of customers selecting Islamic banks and its services. In addition to the religious dimension, important aspects of the selection criteria among others include cost and benefits, service delivery (fast and efficient), size and reputation of the bank, convenience, and the friendliness of bank personnel (Dusuki and Abdullah, 2007a; Gait and Worthington, 2008).

Majority of the extant literature reveals that religious motivation is considered to be the primary factor in selecting Islamic banks among the customers (Metwally, 1996; Metawa and Almossawi, 1998; Naser, Jamal and Al-Khatib, 1999; Bley and Kuehn, 2004; Okumkus, 2005; Dusuki and Abdullah, 2007a; Khan, Hassan and Shahid, 2008; Al-Ajmi, Hussain and Al-Saleh, 2009). Nevertheless, despite the studies showing

the religious factor as the most important element in the selection criteria, other economically oriented concerns have been shown to be prominently featured. Some of these concerns, among others include the Rate of return (Metawa and Almosawi, 1998), financial reputation and service quality (Dusuki and Abdullah, 2007a), brand (Ahmad, Rustam and Dent, 2011), cost-benefit factor (Al-Ajmi, Hussain and Al-Saleh, 2009), and low monthly payment (Amin, 2008). In fact, some of these factors trump the religious factor as the most important aspect to the patronage decision as found in other studies. For instance, religious factor are considered less important in the choice criteria of Islamic banks as compared to provision of fast and high-quality services (Haron, Ahmad and Planisek, 1994), product features and quality of service (Awan and Bukhari, 2011), or low service charges (Mansour et al., 2010). Some have even shown that the religious aspect has not been a significant factor in the decision to choose Islamic banks or its products between Muslim and non-Muslim customers (Haron, Ahmad and Planisek, 1994; Gerrard and Cunningham, 1997).

Apart from the general attitude towards the selection of Islamic banks and their financial products and services, some studies have examined specific behavior of depositors in relation to the rate of returns on deposits within the Islamic banking industry. In this respect, it has been shown that one important motivating factor to the depositors in selecting Islamic banks is the higher deposit rate of return (Erol and El-Bdour, 1989; Erol, Kaynak and El-Bdour, 1990; Haron, Ahmad and Planisek, 1994; Rammal and Zurbruegg, 2007; Hamdan, 2007). The importance of this aspect can be reflected by the findings of these studies which reveal respondents' willingness to move their money from the Islamic banks either to another Islamic or a conventional bank if the return on their deposits is not satisfactory or below their expectation. In addition to studies which are attitudinal in nature, few studies have used real empirical data on the level of deposits of Islamic banks in comparison to conventional banks. A recent study found that the level of deposits for both conventional and Islamic banking systems in Malaysia is sensitive to changes to the financial returns, with any increase in interest rates will give rise to the level of deposits in conventional banking system (therefore resulting in a decline in the level of deposits in the Islamic banking system), and vice versa (Haron and Azmi, 2008).

This corroborates earlier findings of Ramlee (2000) and Sukmana and Yusof (2005), where considerable outflows of deposits from the Islamic to the conventional banking were observed, as a result of a relatively lower rate of return declared by the Islamic banks. Nevertheless, a relatively similar study by Nezhad and Askari (2006) who examined the role of interest rates in influencing the decision of money demand and investment in five selected Muslim and non-Muslim countries, found that religious values played a strong influence on the economic behavior. The results revealed that the investment decision was completely inelastic to changes in interest rates in the sample Muslim countries (i.e. Jordan, Algeria, Morocco, Egypt, Iran and Guinea), unlike in the selected non-Muslim countries (i.e. Peru, Bolivia, Guatemala, Colombia, Philippines and Ecuador), where such decision was significantly influenced by changes in interest rates.

In sum, while the religious dimension has been shown to be dominant in most studies, the economic aspect of such decision remains as an important element for some individuals. In fact, in some cases, this has been given priority over the religious factor. This can be further corroborated by the finding of Dar (2004) where religious commitment to comply with *Shari'ah* principles in banking and finance among Muslims has been shown to vary widely. Perhaps, it cannot be simply assumed that *homo Islamicus* will necessarily always act in the Islamicly ideal behaviors, and positively responding to the religious incentive (in the form of the promised rewards and punishments in the hereafter).

#### 4. A STRATEGIC UNDERSTANDING OF SOCIAL RESPONSIBILITY

While the normative postulations of the behavioral tendencies of *homo Islamicus* reflect the ideal nature of individual behavior, many factors have changed the state of the current Muslim *ummah*. Therefore, the process of Islamization needs to consider the present stage of the society, and necessary steps should be considered to address the challenges and facilitate the transformation towards the idealized situation (Ahmed, 2002). Assuming individuals have two dimensions in their decision

making process; to pursue self-interest motives on one hand, and social interests on the other, it is important that the ideal behavior is promoted in the Endeavour to realize the normative goals of the economy. As highlighted by Chapra (1996), Islamic economics and finance can benefit from the vast knowledge available in the realm of mainstream economics, particularly with respect to the increasing literature on ethics and altruistic behavior. One of the possible reconciliations of the potential conflict between the two can be found in the literature on strategic or instrumental theory of ethics. The appealing feature of the strategic understanding is the idea that being ethical will not necessarily require sacrifice in the pursuit of self-interest, and possibly promote long term economic well-being. For instance, socially responsible behavior can benefit businesses through better human resource and customer loyalty, reduced reputation and legal risk, as well as enhanced public image (Davis, 1973). Cooperative approaches as opposed to opportunistic behaviors are also argued to reduce various costs and potentially contribute to the business' competitive advantage (Jones, 1995). In the context of investment, concerns towards social, ethical and environmental issues have also been shown to be important criteria in identifying financially sound investments (Kinder, 2005). Such an understanding will necessarily change the attitude of businesses, managers and investors towards social responsibility issues and commitment beyond what is strictly required by law.

In the light of this, the preceding discussion seeks to examine such a strategic understanding from the Islamic perspective, and determine whether such framework can be adopted to create an appropriate economic incentive in shaping the behavioral tendencies of *homo Islamicus*.

#### 4.1 COMPLEMENTING THE NORMATIVE FOUNDATION WITH A STRATEGIC UNDERSTANDING

While Islam provides numerous normative principles for the conduct of individuals, it is not devoid of positive economic statements about the nature of human. Based on the extensive examination on the Qur'anic verses related to economics, Hasanuzzaman (1999) identified various

instincts of man which have a bearing upon his economic behavior. This includes “the lust for accumulating wealth”, “the desire to acquire material resources quickly”, “temperamentally stingy and ungrateful with regard to his acquisitions”, “overcautious in maintaining his solvency which leads him to be judicious in utilizing his resources”, and “exults his worthiness and resourcefulness” (Hasanuzzaman, 1999: 93).

The inclination towards worldly gains by individuals is featured strongly in the Holy Qur’an. While maximization of *falāḥ* necessarily means prioritizing the eternal happiness and salvation, for some, the preference of worldly well-being has overpowered the lasting rewards in the hereafter (Qur’an, 87:16-17). However, the love of worldly well-being is not all negative. Some of the descriptions of man in the Qur’an such as enduring one’s livelihood for old age and children and to live in social harmony (Hasanuzzaman, 1999: 99) can be considered to be the positive side of human love for good worldly living. In fact, the desire for comfort and adornment (Qur’an, 18:46; 42:36) or for an easy livelihood is described as one of the pleasures of this world rather than an evil, and Muslims are allowed to seek and earn such things, even during the pilgrimage (Qur’an, 2:198; McAuliffe, 2002).

Additionally, while seeking the love and pleasure of God is the ultimate goal of human beings, often such ‘pure’ aims are concurrently followed by rewards in the form of eternal happiness in paradise. This understanding shows that Islam does not only recognize normative principles at the deontological realm, but also acknowledge the role of instrumental perspective. Spiritual rewards and relief of punishments are instruments of incentive, in persuading individuals to behave in the desired normative manner. In some instances, the relationship between the two is described as commerce.<sup>3</sup> In encouraging the believers to act in accordance of the divine commandments, rewards are not only promised in the hereafter, but also associated with positive outcomes in the present worldly context. Act of virtues such as gratefulness to God (*shukr*), pioussness (*taqwā*) and beneficence (*iḥsān*) are frequently associated with positive benefits, which is applicable to both worlds.<sup>4</sup> In fact, Muslims are called upon not to fear economic losses as a result of obeying the commandments of Allah *s.w.t* in avoiding economic activities that have been prohibited in Islam.<sup>5</sup> Similar understanding can also be found in the opposite context. For instance, those who

commit acts of injustice are asked to repent (Qur'an, 5:39); they are warned that their punishment in the hereafter will be severe (Qur'an, 39:24); and that there will be negative consequences even in this world (Qur'an, 29:31; McAuliffe, 2002).

The above discussions have highlighted two important issues. Firstly, the nature of individuals to pursue material well-being is acknowledged in Islam, and such a motivation is completely allowed, and even encouraged as long as the limits of the *Shari'ah* are duly observed. Secondly, it is important to note that the implications of human actions, in terms of the positive outcome or negative consequences are applicable in both worlds. Therefore, the sense of prudence for individual's well-being can also be applicable to the present worldly realm, and should not only be emphasized on the rewards or punishment in the hereafter. Within this understanding, the promotion of good through the commitment of various social responsibility concerns in aspects of individual's life will not only serve the interest of the life to come, but also contribute to positive benefits in the worldly life. Therefore, a case for a strategic or instrumental approach as a complementary feature to the normative ethics can be a base for shaping the behavioral norms of economic agents in the discipline of Islamic economics.

#### 4.2 THE STRATEGIC UNDERSTANDING OF SOCIAL RESPONSIBILITY: SOME QUALIFICATIONS

While it has been argued earlier that the strategic understanding is not in contradict with Islamic principles, it should be noted that from the perspective of spiritual dimension, it is less ideal in comparison to the normative deontological understanding; act of good is done because it is divinely prescribed and by doing so acquire God's pleasure. However, from a pragmatic point of view, the strategic understanding of social responsibility may prove to be accommodating in bringing social responsibility issues to the forefront with favorable attitude and greater acceptance by the general public, especially in matters of business and finance. In this respect, looking from a business point of view, Dusuki (2008a) provides a description on the social responsibility continuum, with five levels of behavior; 'irresponsible', 'minimalist', 'apathy',

‘strategic’ and ‘purely altruistic’ behavior. While the purely altruistic behavior -where social responsibility commitment is upheld regardless of its financial outcome- is the idealized state of nature, such aspiration may not be applicable to most individuals as reflected by the behavioral norms of the economic agents in the field of Islamic finance. In the context of the transitional stage, the recognition of a strategic or instrumental understanding of the issue will bring the social responsibility commitment to a much higher level in the continuum. As a result, social responsibility issues will be addressed in a regular and organized manner (strategic level), as compared to a mere compliance of the minimum requirement of legislation (minimalist level), or a minimal and piecemeal approach towards social responsibility initiatives (apathy level).

Another important feature of the strategic understanding relates to its end goal. While the emphasis of the mainstream strategic theory focuses on the potential financial benefits that can be ripped from socially responsible practices, the Islamic perspective only consider this as part of the ingredient for the ultimate goal of realizing overall well-being and the state of *falāḥ*. In this context, the prospect of realizing positive impact from social responsibility practices is considered as an additional incentive to the religious or moral commitment in reducing the potential conflict between social and self-interest motives, and therefore contributes to favorable environment for the realization of the normative goals. Again, the sources of positive returns must not be seen only in terms of financial gain or any other pecuniary returns, but should include any form of benefits in terms of individual or collective well-being, consistent with the broad notion of *falāḥ*. This will in turn prove to be instrumental in creating a conducive situation for the promotion of social responsibility. Therefore, the outcome of the strategic framework of social responsibility from an Islamic perspective is defined within the context of realizing society’s *well-being* and *falāḥ*, and such a framework reflects a transitional stage in the ongoing journey of individuals towards higher level of spiritual development.

In summary, it is important to emphasize that the strategic understanding of social responsibility as discussed here is distinct from the mainstream understanding in the literature of instrumental or strategic theory as postulated in the West. Some of the qualifications and assumptions of this framework are as follows:

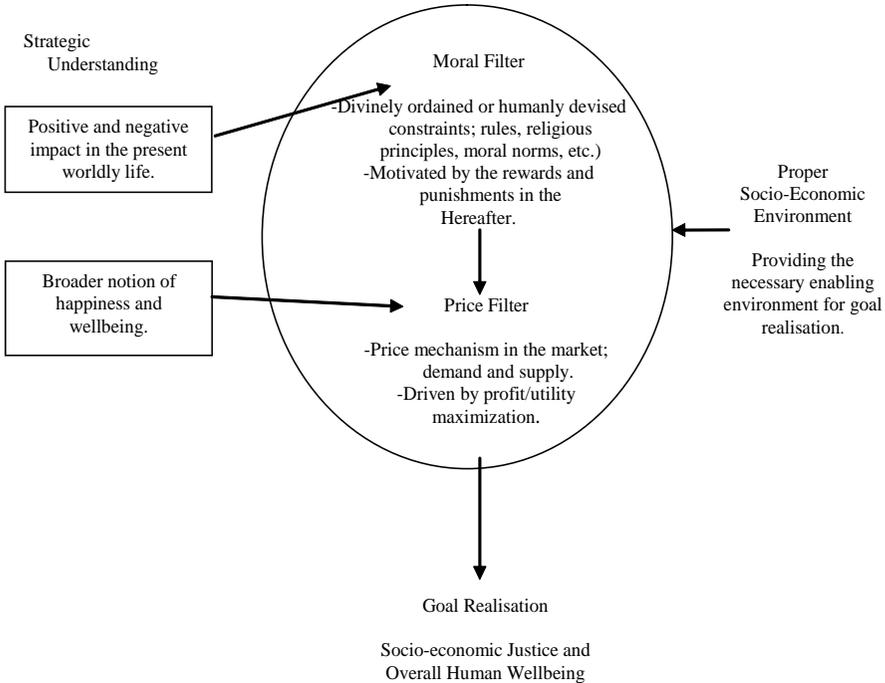
- i. It needs to be recognized that the strategic framework of social responsibility is less ideal as compared to the normative deontological understanding,
- ii. Following the above, a strategic framework of social responsibility must not be discussed in isolation, but must always be linked to its normative underpinnings,
- iii. The purpose of the strategic framework is to bring about greater support from all parties for social responsibility concerns into the realm of economic undertakings,
- iv. While the motivation to address social responsibility concerns may not be entirely driven by normative considerations in this respect, the positive implications would nevertheless contribute to the well-being of the society,
- v. Sources of positive returns must not be seen only in terms of financial gain or any other pecuniary returns, but should include any form of benefits in terms of individual or social well-being, consistent with the broad notion of *falāh*, and
- vi. The determination of what is good and bad must always be based on the divine sources of the *Shari'ah*, and the strategic framework must never contravene *Shari'ah* limits; the ends must never justify the means.

#### 4.3 INTEGRATING THE STRATEGIC UNDERSTANDING OF SOCIAL RESPONSIBILITY WITH THE MORAL AND PRICE FILTERS OF THE MARKET

It is assumed that in Islamic economics that a form of 'moral filter' which accommodative of goal realization is present in the market. This filter is shaped by Islamic values; and the notion of accountability and the rewards and punishment in the life to come serve as the motivating factor to persuade individuals to follow the desired path for goal realization. As shown in Figure 1, the presence of the moral filter is argued to be instrumental in removing undesirable elements in the market such that the subsequent equilibrium achieved through the second filter

of price mechanism would be potentially more favorable towards the realization of the normative goals (Chapra, 1996).

FIGURE 1  
Moral and Price Filters in an Islamic Economy



Nevertheless, as the commitment to subscribe to the principles of the *Shari'ah* may greatly vary between individuals and the worldly material well-being may overpower the promised rewards in the hereafter, the actual effect of such a filter may potentially be weak on some individuals. Even for those who commit to subscribe to this moral filter in conducting economic activities, this may primarily concerned with the observance of certain 'constraints', which are limited to issues related to major prohibitions and legal rules. This is then exacerbated by the predominance of profit maximization paradigm in the market and the lack of economic incentive in influencing economic agents to

go beyond the rules and injunctions in addressing broader social responsibility issues.

Therefore, the strategic understanding of social responsibility provides another dimension to the moral and price filter in the economy. The sense of prudence in the context of individual's self-interested well-being is recognized not only in terms of rewards and punishments in the hereafter, but also positive and negative impact in the present worldly life. Additionally, in line with the broad notion of well-being in the context of realizing *falāḥ*, the decision of economic agents within the price mechanism of the market will not only be responsive towards narrowly defined monetary benefits (e.g. profits or other pecuniary motives), but also on broader sources of happiness and well-being (e.g. social cohesion, security or clean environment). These two aspects of the strategic understanding of social responsibility can be instrumental in creating a favorable attitude towards social responsibility issues to be adopted by economic agents in the economy.

#### 4.4 REINFORCING THE STRATEGIC UNDERSTANDING OF SOCIAL RESPONSIBILITY WITH THE NOTION OF CSR AND SRI

As also shown in Figure 1, it is presumed that in an Islamic economy the realization of its normative goals can be facilitated by the presence of an appropriate socio-economic environment. This can be achieved “by properly educating the public, creating an effective framework of checks and balances, and reforming the existing socio-economic, legal and political institutions or building new ones” (Chapra, 1996: 27). In this context, the emergence of the doctrine of CSR and the practice of SRI is an interesting aspect for the creation of such an ‘enabling environment’ for social responsibility. The increasing awareness towards CSR has change public expectations on the role of businesses in the society. This entails that firms are expected to not only fulfill their obligation to become profitable from the economic point of view, but also they are expected to meet other obligations from the legal, ethical and Philanthropic responsibilities towards the society (Carroll, 1979, 1991). Concurrently, social responsibility issues have also flourished in the area of investment. Investors, individual and institutional alike, are

taking an increasing interest in the activities of companies they are investing. These companies are evaluated not only on their financial standing, but also increasingly to a wider spectrum of their activities, such as in terms of their products and services, their impact on the environment and on local communities, or on how they treat and develop their workforce.

Drawing from the literature on the instrumental theory of ethics, it has been argued that in a market where ethical concerns and awareness have increasingly becoming popular and a norm, it will be mandatory for businesses to engage in social responsibility initiative that goes beyond mere legal compliance (Wagner-Tsukamoto, 2007). Furthermore, social and environmental risks are becoming an important area of risk management by corporations alongside financial risks. It has become apparent to investors and shareholders that social and environmental misbehaves may prove to be a huge disadvantage to the businesses' profits and stock prices.<sup>6</sup> Perhaps, the most significant development is the democratization of the economy in terms of the increasing stake of working people in the ownership of corporations through pension and mutual funds all over the world. The public, who have their long life savings and pensions invested in shares of corporations, has become the 'new capitalist'. While it is to everyone's interest that businesses remain profitable, such pursuit must not be at the expense of the society, because in this new 'civil economy', "society and shareowners are becoming one and the same" (Davis, Lukomnik and Pitt-Watson, 2006: 52). Against these backdrops, it is evident that the issue of social responsibility has gained considerable attention from both corporations and investors, and this can be reflected by the increasing popularity of CSR policies and the tremendous growth of the SRI industry.

In the light of the above, and the criticisms leveled against the practice of Islamic finance, the move towards incorporating broader principles of Islamic ethics in the practice of businesses and investment is an appealing proposition. Despite its western origin, the universal values of social responsibility in CSR are commonly shared in Islamic ethics (Dusuki, 2008a; Williams and Zinkin, 2009). Recent developments have also suggested that the call to address social responsibility issues by Islamic finance have gained momentum, and received increasing attention by the main players of the industry (Zawya.com, 2006).

Similarly, the social responsibility performance and disclosures of Islamic financial institutions have emerged as one of the growing fields of inquiry within the Islamic finance literature (Farook, 2007, 2008; Haniffa and Hudaib, 2007; Hassan and Harahap, 2010). Perhaps the recent survey on the social responsibility trends among Islamic financial institutions constitutes a significant milestone in the promotion of broader social responsibility practices among Islamic financial institutions. Apart from the mandatory aspect of screening on prohibited earnings and expenditures, other areas examined also include customer services, treatment of workers, community contributions and investments, prioritizing small and medium enterprises, and the care towards the environment (CSR-IFI, 2010).<sup>7</sup>

In addition, some researchers have even laid down a framework in which social responsibility concerns can be practiced by Islamic firms in various circumstances within the framework of the objectives of the *Shari'ah* (Dusuki and Abdullah, 2007b). Consequently, Islamic financial institutions will inevitably need to address such concerns in order to remain relevant and meet the changing public expectations. In fact, recent findings have shown that the practice of social responsibility issues is found to be one of the highly ranked factors in the patronage decision of Islamic bank's customers (Dusuki and Abdullah, 2007a; Al-Ajmi, Hussain and Al-Saleh, 2009;). Addressing social responsibility issues is also considered as one important aspect to the objectives of Islamic banks by their customers and depositors (Dusuki, 2008b). This development is relevant in this strategic framework as the potential increase in the reputation, goodwill and the level of patronage creates economic incentives for Islamic financial institutions to commit to social responsibility issues in their operations.

Similar trends can also be observed in the area of investment. Many scholars of Islamic finance have called for the industry to build bridges with the SRI movement (DeLorenzo, 2004; Wilson, 2004). Although Islamic investment may be concerned with a very different set of ethical criteria from the Western ethical or socially responsible investment, the issues of social responsibility are of mutual interest, and there is much that Islamic investment institutions can learn from the SRI experiences (Wilson, 1997; Sairally, 2007). The challenge now is to move from a 'legal-compliant' approach, which mainly focuses on the avoidance of

major prohibitions and the observance of Islamic legal rules, to a more proactive and positive approach in addressing broader social responsibility issues in line with the normative goals of Islamic economics (Lewis, 2010). The launch of Dow Jones Islamic Sustainability Index is one important step towards this direction. More importantly, the recent introduction of the CSR framework for Bursa Malaysia and the launch of the Hawkamah Index for the NENA region provide the awaited catalyst to the potential offerings of investment products which address broader social responsibility issues, especially in the context of businesses operating within the Muslim world.<sup>8</sup>

In the context of Islamic investment, the strategic framework can emphasize on the potential benefits of investing based on social responsibility concerns. Not only that the investors will be able to generate financial returns from investment, they will also gain long term benefits from the positive impact of the responsible and sustainable policies of businesses. As the operations of businesses often have huge implications on the well-being of their employees, customers, suppliers, local community, environment and overall economic condition, these will inevitably affect the life of most people, including the investors themselves. Additionally, the increasing democratization of the capital market through mutual or unit trusts and pension funds means that the investors of the businesses are likely to be part of the working class, and a good practice of social responsibility on workers will directly benefit them. In short, the strategic understanding of social responsibility helps to create a more favorable attitude among economic agents to consider broader social responsibility concerns consistent with the normative goals of Islamic economics.

On another level, as practiced in the west, SRI is used to promote changes in the manner corporations doing their business. While there are some criticisms against SRI in this respect (e.g. Haigh and Hazelton, 2004; Scholtens, 2006), the role of SRI in rewarding socially responsible policies and initiatives of corporations through their investment are well acknowledged in the industry, and the launch of the United Nations' Principle of Responsible Investment reflects its global recognition (UNPRI, 2006). If Islamic investment embraces social responsibility dimension, it will not only distance itself from activities considered repugnant to the *Shari'ah*, but also reward companies with responsible

business policies. This will provide economic incentives for corporations to conduct business responsibly and to put more effort towards broader social responsibility initiatives in their operations.

Figure 2 describes the relationship between the different stakeholders that interact in this process. Investors with social responsibility concerns will express their ethical preferences and values onto the Islamic fund managers. As the ones who carry the mandate of the investors, the fund managers reflect such concerns in their investment decision. In doing so, research and advisory support from specialized institutions which make assessment on social responsibility performance of businesses will be an important infrastructure to facilitate such investment style. Consequently, the integration of social responsibility performance in the investment decision will create incentive for businesses to consider these concerns in their operation to remain attractive for investors. Likewise, the assessment and continuous monitoring of social responsibility records and performance will in turn create a standard of acceptable conduct of businesses where they need to respond to. As the social responsibility issues and practices become widely recognized in the market, this will contribute to more funds invested based on such criteria and therefore, strengthen the standing of such an investment style. The growing awareness of investing responsibly can also contribute to greater practices of wider socially responsible behaviors. This is consistent with the numerous studies in SRI, where ethical investing is associated with other forms of pro-social behaviors such as green purchasing, recycling, and involving in community works and charities (Rosen, Sandler and Shani, 1991; Woodward, 2000). As the issues and circumstances changes and other social responsibility issues gain intensity than others, the input from the investors will continue to shape the investment practices.



The prospect of Islamic investment to incorporate social, ethical and environmental concerns and to promote broader aspects of Islamic ethics in the financial realm creates a promising outlook for the discipline of Islamic economics. Such concerns will not only bring the sector closer to its idealized aspiration, but in a larger context, increase the awareness of investors and the public on various issues including environmental protection, labor standards, responsible business practices, equal opportunities, as well as the broader notion of social welfare and justice, which are still very much lacking in the Muslim world (Rice, 1999; Brammer, Williams and Zinkin, 2007). In the light of the SRI experience, such a new approach of Islamic investment can play an instrumental role in creating market incentive and exerting market discipline on the social responsibility practices of businesses, and therefore provide a new institutional platform in which the behavior of economic agents can be shaped to conform to its normative assumptions in Islamic economics.

## 5. CONCLUSION

This paper has conceptualized a strategic framework of social responsibility within the transformative paradigm of Islamic economics. Implicit in this theory is the recognition of the strong and sometimes dominating influence of economic self-interest motive in the behavior of *homo Islamicus*. This reality needs to be reflected in the theoretical literature of Islamic economics, and hence the strategic or instrumental understanding of social responsibility is believed to be a plausible interim solution in the transition state towards the idealized behavior. This framework of social responsibility is outlined based on a synthesis of the normative and positive dimensions of human instinct, the notion of *falāḥ*, the moral and price filters of market and the theory of instrumental ethics. The focus of this understanding is the creation of additional incentives for economic agents in an Islamic economy to adopt broader social responsibility practices in their economic decisions. Individuals, managers or investors are theorized to be more accommodative towards social responsibility commitment within this strategic understanding. The sense of prudence in the context of individual's self-interest well-

being is recognized not only in terms of rewards and punishments in the hereafter, but also positive and negative impact in the present worldly life. Additionally, in line with the broad notion of well-being in the context of realizing *falāḥ*, the decision of economic agents within the price mechanism of the market will not only be responsive towards narrowly defined monetary benefits (e.g. profits or other pecuniary gains), but also on broader sources of happiness and well-being (e.g. social cohesion, security or clean environment). As a summary, the implications of this strategic understanding for social responsibility can be represented by the following two general propositions:

- The recognition on the potential positive impact from social responsibility practices will increase the acceptance of such a commitment among individuals/managers/investors, and
- The recognition on the broader sources of happiness beyond the pecuniary and material gain will increase acceptance of social responsibility commitment among individuals/managers/investors.

Additionally, recognizing that the notions of CSR and SRI have been often celebrated as a force to reign in self-interest egoism under Western capitalism, similar ‘institutions’ can also be introduced in the context of an Islamic economy. Recent developments in the area of Islamic finance indicate a favorable atmosphere in which such an ‘enabling environment’ can be formed, and subsequently creating economic incentives for businesses to incorporate broader social responsibility issues in their operations. As a final note, it is important to highlight that the strategic framework of social responsibility as presented here should not be taken as a theory independent of its normative foundation as normally construed in the Western literature. Instead, strategic understanding in Islamic perspective should be seen as complementary in nature with the normative underpinnings as the core, providing additional motivation and enabling environment for the realization of the Islamic socio-economic objectives in the context of the contemporary reality of the Muslim society.

## ENDNOTES

1. This can be reflected by some of the definitions proposed for the discipline; Islamic economics: “aims at the study of human *falāḥ* achieved by organising the resources of earth on the basis of cooperation and participation” (Khan, 1984: 55); and “Islamic economics is the study of Muslim’s behavior who organises the resources which are a trust, to achieve *falāḥ*” (Arif, 1985: 97).
2. The literal meaning of *falāḥ* is to thrive, to prosper, to become happy, to have luck or success. It covers both worlds and its dimension constitutes various aspects including spiritual, economic, cultural as well as political (Khan, 2003: 60).
3. “Those who rehearse the Book of Allah, establish regular Prayer, and send (in Charity) out of what We have provided for them, secretly and openly, hope for a commerce that will never fail” (Qur’an, 35:29).
4. Example for the act of gratefulness (*shukr*); And remember! your Lord caused to be declared (publicly): “If ye are grateful, I will add more (favours) unto you; But if ye show ingratitude, truly My punishment is terrible indeed.” (Qur’an, 14:7).
5. “O ye who believe! Truly the Pagans are unclean; so let them not, after this year of theirs, approach the Sacred Mosque. And if ye fear poverty, soon will Allah enrich you, if He wills, out of His bounty. For Allah is All-Knowing, All-Wise.” (Qur’an, 9:28).
6. The oil spill disaster in Alaska for instance, which had cost Exxon to a total USD3.4 billion in criminal fines, cleanup costs and compensation payments, and battling to escape another USD2.5 billion of punitive damages represent a classical example in this respect (Sloan, 2008). Most recently, the oil spill disaster in the Mexican Gulf has caused BP to sustain more than USD20 billion of similar costs, not mentioning the huge plunge in its stock prices.
7. The survey assessment covers 13 areas of social responsibility issues which include; Screening client for *Shari’ah* compliant; responsible dealing with client; earnings and expenditures prohibited by *Shari’ah*; employees’ welfare; *zakāt*; *qard ḥasan* (benevolent loan); reduction of adverse impact on environment; social, development and environment based investment quotas; customer service; micro, small business and social savings and investments;

charitable activities; *waqf* management; and other miscellaneous activities related to social responsibility.

8. The Malaysian stock exchange authority, Bursa Malaysia has introduced a framework for corporate social responsibility among the listed companies since 2006 and plans to launch a CSR index in the near future. Recently, Hawkamah, a Dubai-based institution in collaboration with Standard & Poors and supported by International Finance Corporation, launched the first ever MENA-wide Environmental, Social and Corporate Governance Index – the S&P-Hawkamah Pan Arab ESG Index (HASPI)- that ranks and tracks the performance, transparency and disclosure of regional companies on ESG issues. The constituents of the index are drawn from the largest and most liquid companies listed in the stock exchanges of the United Arab Emirates, Saudi Arabia, Qatar, Bahrain, Oman, Kuwait, Jordan, Egypt, Lebanon, Morocco and Tunisia (Saidi, 2011).

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