

**FACTORS INFLUENCING CORPORATE SOCIAL
RESPONSIBILITY DISCLOSURE BY ISLAMIC
BANKS**

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DISCLOSURE BY ISLAMIC BANKS**

By

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**Thesis submitted to
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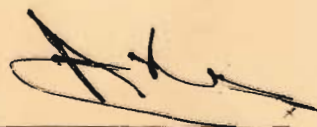
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ABSTRACT

The existing literature on corporate social responsibility (CSR) disclosure in the context of Islamic banks has focussed only on the extent and nature of CSR, rather than on factors influencing the level of CSR disclosure. This study investigates the types and extent of CSR information disclosure in 132 annual reports of Islamic banks from different countries for the year 2008 using a benchmark based on *Shariah* principles and rules. It also examines the impact of corporate governance (CG) mechanisms, consisting of the board of directors' effectiveness (BODE), the effectiveness of *Shariah* supervisory board (ESSB), the audit quality (AUDITQ), and the overall score of CG on the CSR disclosure level based on legitimacy theory. The study uses content analysis and ordinary least square regression to achieve the research objectives. The findings show that there is an increase in disclosure of CSR information. The ranking of CSR disclosure themes (from highest to lowest) is as follows: (1) top management, (2) products and services, (3) Employees, (4) *Shariah* supervisory board (SSB), (5) customers, (6) late repayments and insolvent clients, (7) other aspects of community involvement, (8) vision and mission statement, (9) poverty, (10) *Zakah*, (11) charitable and social activities, (12) unlawful transactions, (13) *Quard Hassan*, and (14) the environment. As for the BOD, the results show that only the board composition has a negative impact on CSR disclosure. Regarding the SSB, cross-memberships are positively associated with CSR disclosure, whilst for the AUDITQ, the members with an accounting degree, the percentage of non-executive directors and the meetings' frequency are found to influence the CSR disclosure. The findings also show that SSBE and AUDITQ significantly influence the CSR disclosure, while BODE has no influence at all. The overall score of CG also significantly influences the CSR disclosure.

Keywords: Islamic banking, corporate social responsibility disclosure, corporate governance mechanisms, legitimacy theory

ABSTRAK

Kajian literatur yang sedi ada mengenai penzahiran tanggungjawab sosial (CSR) korporat dalam konteks bank-bank Islam lebih menumpukan kepada tahap dan sifat CSR, dan bukannya faktor-faktor yang mempengaruhi tahap penzahiran CSR. Kajian ini menyelidiki jenis dan tahap penzahiran maklumat CSR dalam 132 laporan tahunan bank-bank Islam dari pelbagai negara bagi tahun 2008 dengan menggunakan penanda aras berdasarkan prinsip dan peraturan Syariah. Ia juga mengkaji kesan mekanisme tadbir urus korporat (CG) ke atas tahap penzahiran CSR berdasarkan teori legitimasi. Selain itu, ia juga menguji pengaruh keberkesanan lembaga pengarah (BODE), keberkesanan lembaga pengawasan Syariah (ESSB), kualiti audit (AUDITQ), dan kesan skor keseluruhan CG ke atas tahap penzahiran CSR berdasarkan teori legitimasi. Kajian ini menggunakan analisis kandungan dan regresi kuasa dua terkecil biasa untuk mencapai objektif kajian. Hasil kajian menunjukkan bahawa terdapat peningkatan dalam maklumat CSR. Kedudukan tema penzahiran CSR (dari yang tertinggi ke terendah) adalah seperti berikut: (1) pihak pengurusan atasan, (2) produk dan perkhidmatan, (3) pekerja, (4) lembaga pengawasan Syariah (SSB), (5) pelanggan, (6) kelewatan pembayaran balik dan pelanggan yang tidak mampu bayar, (7) lain-lain aspek penglibatan masyarakat, (8) pernyataan visi dan misi, (9) kemiskinan, (10) zakat (11) aktiviti kebajikan dan sosial, (12) urus niaga yang menyalahi undang-undang, (13) *Quard Hassan*, dan (14) alam sekitar. Seterusnya, tidak semua pembolehubah CG adalah signifikan. Penemuan menunjukkan bahawa hanya nisbah pengarah bukan eksekutif mempunyai kesan negatif ke atas penzahiran CSR. Mengenai SSB, keahlian bersilang didapati berkait secara positif dengan penzahiran CSR. Bagi AUDITQ pula, ahli-ahli jawatankuasa audit yang mempunyai ijazah perakaunan, peratusan pengarah bukan eksekutif dan kekerapan mesyuarat didapati mempengaruhi penzahiran CSR. Selain itu, dapatan kajian juga menunjukkan bahawa SSBE dan AUDITQ memberi kesan yang signifikan ke atas penzahiran CSR, manakala keberkesanan lembaga pengarah tidak mempunyai sebarang pengaruh. Skor keseluruhan CG juga mempengaruhi penzahiran CSR.

Kata Kunci: Perbankan Islam, Penzahiran Tanggungjawab Sosial Korporat, Mekanisme Tadbir Urus Korporat, Teori Legitimasi

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LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
AC	Audit Committee
ACACC	Accounting or Financing Degree of the Audit Committee Members
AIDS	Acquired Immune Deficiency Syndrome
AUDIT	Auditor Type
AUDITQ	Audit Quality
BCBS	Basel Committee on Banking Supervision
BIMB	Bank Islam Malaysia Berhad
BMI	Bank <i>Muamalat</i> Indonesia
BOARD	Board of Directors' Effectiveness
BODE	Board of Directors Effectiveness
BODs	Board of Directors
BSIZE	Bank Size
CEO	Chief Executive Officer
CG	Corporate Governance
CGSCORE	Corporate Governance Score
CHAIRP	Chairperson Position
CROSS	Cross-memberships of <i>Shariah</i> Supervisory Board Members
CSD	Corporate Social Disclosure
CSR	Corporate Social Responsibility
CSRD	Corporate Social Responsibility Disclosure
DBS	Development Bank of Singapore
EII	Ethical Identity Index
ESSB	The effectiveness of <i>Shariah</i> supervisory board
IAHs	Investment Account Holders
IAIB	International Association of Islamic Banks
IASC	International Accounting Standards Committee
ICD	Intellectual Capital Disclosure
ICDI	Intellectual Capital Disclosure Index
ICWC	Intellectual Capital Word Account
IFH	Ihlas Finance House
IFSB	Islamic Financial Services Board
INDs	Independent Non-Executive Directors
KLSE	Kuala Lumpur Stock Exchange
MB	Market to Book Value
MEET	Meetings Frequency of the Audit Committee
MUSP	Proportion of Muslim Population to Total Population
NAC	Number of the Audit Committee
NEAC	Non-Executive Directors on the Audit Committee
NEBOD	Proportion of Non-Executive Directors to Total Directors on the Board
NED	Non Executive Directors

NSSB	Number of <i>Shariah</i> Supervisory Board
OECD	Organization for Economic Co-operation and Development
OLS	Ordinary Least Square
OSHIP	Ownership
PENED	Proportion of Expert Outside Directors on the Board
PERFOR	Performance
PHD	Doctor of Philosophy of <i>Shariah</i> Supervisory Board Members
PNED	Proportion of Non-Executive Director on the Board
ROA	Return on Assets
ROE	Return on Equity
REP	Reputable Scholars on the <i>Shariah</i> Supervisory Board
R & D	Research and Development
SCEO	Separation role of CEO and chairman
SSB	<i>Shariah</i> Supervisory Board
SSM	Saudi Stock Market
UAE	United Arab Emirates
UK	United Kingdom
US	United States
VIF	Variance Inflation Factors

GLOSSARY OF ISLAMIC BANKING TERMS

<i>Bay'al-salam</i>	Pre-paid purchase. Full payment is made in the time of purchase, while the delivery of goods is deferred to a specified time.
<i>Gharar</i>	Uncertainty, speculation.
<i>Hadith</i>	The sayings, doings, and traditions of the Prophet.
<i>Halal</i>	Legal.
<i>Haram</i>	Unlawful.
<i>Ijarah</i>	Leasing contract whereby an Islamic bank buys an asset for a client and then leases it back over a specific time.
<i>Ijarah-wa-igtina</i>	Similar to <i>Ijarah</i> except that the client is able to purchase the asset at the end of the agreement.
<i>Mudharabah</i>	Trustee financing contract, where an Islamic bank (the financier) entrusts funds to the other party (the entrepreneur) for carrying out an investment.
<i>Murabahah</i>	Resale with profit margin; an Islamic bank buys an asset and sells it to the customer on the basis of a cost plus profit margin.
<i>Musharakah</i>	An equity partnership contract whereby two or more partners participate with funds to undertake an activity.
Prophet Muhammad	The last messenger to the human-being.
<i>Quard Hassan</i>	Benevolent loan (interest-free).
<i>Qur'an</i>	The Holly Book, the revealed word of <i>Allah</i> (God), followed by all Muslims.
<i>Riba</i>	Literally “increase” or excess” that includes both usury and interest.
<i>Sadaqah</i>	Voluntary religious charity.
<i>Shariah</i>	Islamic religious law derived from the Holly <i>Qur'an</i> and the <i>Sunnah</i> .
<i>Shariah</i> Supervisory Board	The committee of Islamic scholars setting on an Islamic financial institution for guidance and supervision in the development of <i>Shariah</i> compliant products.
<i>Sunnah</i>	Source of information regarding the practice of Prophet Muhammad and his Companions; the second source of Islamic law.
<i>Ummah</i>	The Islamic community.
<i>Zakah</i>	Mandatory religious levy and one of the five pillars of Islam.

CHAPTER ONE

INTRODUCTION

1.1 THE INCREASE OF CORPORATE SOCIAL RESPONSIBILITY

According to Reverte (2009), the last few decades have witnessed an increase in public awareness about the importance of corporate social responsibility (CSR). The importance of CSR arose due to the growth in communication between various stakeholder groups and business organizations in society. The growing communication reflects the accountability of corporations in meeting their stakeholders' needs (Gray, Kouhy, & Lavers, 1995a).

Nowadays, CSR is one of the important success factors for business organizations desiring to continue their existence with a good reputation, toward achieving maximum profitability and improving corporate growth, and at the same time acting as a socially responsible enterprise. This means that an organization should be held responsible for any of its activities that have an effect on citizens, communities, society at large, and the environment (Gustafson, 2002). With this concept, Islamic business organizations such as Islamic banks provide CSR information to show their responsibility and accountability towards society and towards *Allah* (Muwazir, Muhamad, & Noordin, 2006); and for their continued existence (Farook & Lanis, 2005); so they have to be seen as social enterprises (Maali, Casson, & Napier, 2006).

Companies use CSR as a strategic weapon for competition in the era of globalization (Will, 2007). Because of the increasing importance of the impact of CSR,

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