Islam and the Contemporary World

Volume 1, Issue 1, Spring 2023, pp. 1-8
Original Research Paper (DOI: 10.22034/ICWJ.2023.173877)

A Comparison of Sharia Law and CSR with an Application to Investment: Responsibility, Causing and State of Mind

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Submitted: 2023.04.11 | Accepted: 2023.06.05

Abstract

The purpose of this study was to compare Sharia law with corporate social responsibility (CSR) with an application to financial investment. Promoting economic growth through business whilst ensuring that society and the environment do not become victims of businesses financial gains are one of the fundamental challenges faced by modern society and businesses. CSR suggests businesses should conduct themselves in ways that benefit society or reduce social problems. Islam stresses the concept of social responsibility. It is legitimate for a business to aim to achieve profit, but this goal should be pursued according to Sharia. CSR and Sharia law share the principle of the conduct of individual entities being regulated by its consequences. On the other hand, there are some differences between corporate social responsibility and sharia law. These differences and the question "are CSR and sharia law compatible?" have been explained with particular application to the financial sector. In Sharia law primary focus is on the individual; whereas in CSR main attention is to the corporation. To answer the above-mentioned question, justice is the supreme purpose and ruling spirit of the Sharia. Islam stresses the concept of social responsibility. In Sharia law the social responsibilities of individuals also apply to firms. Thus it is legitimate for a business to aim to achieve profits, but its goal should be pursued according to Sharia.

Keywords: Sharia law, CSR, Islamic investment

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1. Introduction

Promoting economic growth through business whilst ensuring that society and the environment do not become victims of businesses financial gains are one of the fundamental challenges faced by modern society and businesses. Because of a growth in size in power of the corporations and their impact on today's society, there is significant demand from consumers that corporations should devote greater responsibility toward social, economic and environmental issues. This relationship between corporations and society as a whole which is in order for corporations to align their values with societal expectation and avoid conflict and reap tangible benefits is known as Corporate Social Responsibility (CSR). CSR suggests that businesses should conduct themselves in ways that benefit society or reduce social problems. Businesses should recognise that they have a responsibility toward society and act according to that responsibility. From one perspective there is nothing new in this.

A new emerging perspective on business and corporation conduct is the Islamic perspective. According to Zinkin and Williams (2006) Islam's focus on personal responsibility and non-recognition of the corporation as a legal person, could undermine the concept of corporate responsibility.

Islam binds its followers with a set of laws that dictate to them the way they should conduct their relationships with everyone and everything around them, living or not. The Sharia law (Islamic law) instructs individuals about how to conduct themselves and its expressed purpose is promoting the social good. In addition, Islam stresses the concept of social responsibility. The goals of Islam are based on Islamic concepts of human well-being and good life which emphasise brotherhood/ sisterhood and socio-economic justice and require a balanced satisfaction of both the material and spiritual needs of all humans (Chapra, 1992).

Thus, CSR and Sharia law share the principle of the conduct of individual entities being regulated by its consequences. For instance, CSR requires firms to pay adequate wages, because anything less than that contributes to poverty, which is socially undesirable. Whereas, Islam forbids the charging of interest. The explanation behind the prohibition of interest charge is because it promotes inequalities in wealth which are also socially undesirable.

However, it cannot be clear in every particular instance that the net social effect of cutting wages or charging interest will be adverse. For example, a wage cut may prevent the entry of a competitor with worse working conditions; or a loan may be being made to a rich man. In both systems an act is prohibited because it tends to cause some socially undesirable outcome.

On the other hand there are some differences between CSR and Shaira law. CSR and Sharia law differ in the primary focus of their attention. For instance, in

the case of Sharia law this is the individual; whereas in CSR the primary focus is on the corporation. Never the less, Sharia law extends through individuals to corporations. According to Maali et al (2006) in Sharia law the social responsibilities of individuals that are derived from the word of God (contained in the Qur'an) and from his Prophet Mohammed's deeds and sayings (the Sunah) also apply to firms (Maali et al, 2006). Thus, firms according to Sharia should also satisfy the will of God, through following the Quran and Sunah. An individual cannot simply evade a duty under Sharia law by incorporating a company and having the company act instead of himself. Conversely, a company pursuing socially responsible behaviour depends on individuals associated with the company to actually do things.

In the context of these parallels and differences, the primary research question I want to address is: are CSR and Sharia law compatible? I intend to answer this question with particular application to the financial sector.

2. Islamic Banking and Investment

Twenty-percent of the world's population is Muslim by religion. Thus, the number of Muslims around the world today in itself dictates that they are, as a group, a mass market holding in total a considerable sum of money. This has made it very tempting for firms around the world to try and exploit this market. However, as any marketing manager knows, when trying to penetrate any market you have to be extremely familiar with that market's characteristics and with the Islamic market this has proven to be a bit tricky.

Islamic Finance industry is growing at 10-12% annually. According to World Bank (2015), "The assets of Islamic financial institutions now approach the US$2 trillion, covering bank and non-bank financial institutions, capital markets, money markets and insurance ('Takaful')." More than 428 Islamic banks together with Islamic non-banking financial institutions operate throughout the world. In addition, Islamic financial products are now sold in more than 75 countries.

Since, the Islamic market has become extremely sophisticated as well as increasingly competitive, it is important to know that the self-declared purpose of Islamic law is to improve the social interest by inducing social responsibility. According to Islamic law, the Sharia, these banks and financial institutions are not allowed to pay or charge interest. Usury according to Islamic Law is defined as any amount of increase to the capital of an individual due to the issuance of debt, deposit or a like for like trade. Islam only recognizes the time value of money when it is behaving as capital. Islamic law does not approve of any increase in the amount of debt redeemed on top of the original face value. Therefore, the explanation behind the prohibition of usury is contained in the unjust centre of the transaction. The unfairness of the usury of debt lies in that the

debtor by paying the creditor interest on his funds invested is in fact giving the creditor a higher benefit then what he received from the use of the funds. The payment of interest from people who need to borrow to people who have money to lend, in the aggregate, increases economic inequality. In addition, usury displaces worthwhile economic activity which will affect social interest.

As Islam prides itself in covering all aspects of a human beings' life, it has put down a few strict laws about trade and economic transactions that have baffled financial engineers trying to find the right formulas to construct financial products that would be Muslim compliant.

Islamic scholars have undertaken a thorough examination of significant verses from the holy Quran and the Sunnah and have long recognized the basic principles, which oversee the obligations and requirements of participants in a financial system.

3. Socially Responsible Investment

Socially Responsible Investment (SRI) is a term that has increasingly captured investors' eyes during the last four decades. According to Sparkes (2001) the SRI sector has become one of the fastest growing areas of finance. Thus, it is claimed that SRI is about to enter into mainstream finance. According to Dunfee (2003) SRI fund could comprise "any investment strategy based upon identifiable non-financial criteria incorporating a social or religious dimension". In addition, "Socially responsible investment" is, in brief, a means whereby social, environmental and ethical concerns are recognised in a policy which aims to change the behaviour or business of companies through the exercise of the rights and powers of shareholders (Mackie, 2000).

Traditional investors care only about financial return from their investment, whereas SRI investors demand products that not only provide reasonable returns but also match their moral preferences. Thus, based on this principle, SRI has been considered as one of the drivers of Corporate Social Responsibility (CSR) (Lozano et al, 2006).

SRI investors, thus, take into account, in their selection of portfolios, an analysis of the social, environmental, and ethical behaviour of the corporation. SRI investors explicitly incorporate social analyses, as well as conventional financial analyses, in deciding which shares to buy, sell, or hold. Portfolios under SRI parlance are subject to both positive and negative social screens, which result from explicit analyses of the firms' performance in areas such as environmental responsibility, corporate governance, labor and human rights, and product safety. This is the triple bottom line approach to investing, whereby companies voluntarily take on board social and environmental concerns, besides their economic ones.

According to Lozano et al (2006, p.306),

> The socially and environmentally responsible policies and practices developed by corporations provide investors with a good indication of the development of internal and external management of corporations. In addition, social, environmental and ethical business indicators can be incorporated into the financial analysis of a company, thus contributing to minimising risk by anticipating and preventing crises that might affect corporate reputation and cause a drop in share prices.

Thus, it has been argued that a company which taking into account social and environmental features will outperform other in the longer term. According to Christensen and Guyoton (2003), SRI funds, which are targeting companies that integrate the social and environmental factors with financial analysis, are promoting a new type of corporate governance. Therefore, in this case, SRI can be a powerful lever to help change corporate governance practices. In addition, in a world in which shareholder value is dependent on intangible assets such as brand and management quality, it is more beneficial to look at social, environmental, and ethical performance indicators as well as traditional indicators. This approach includes assessing the corporate governance of corporations as part of an investment decision.

Investors are increasingly aware of the potential risks to their portfolios of human rights violations committed by companies in their portfolios. A growing body of research suggests that higher standards of corporate responsibility may be correlated with improved profitability. Risks to shareholders associated with corporate violations of human rights include: damage to firms' reputations; lawsuits; interruptions of operations because of work stoppages; and loss of public trust in corporations (Schilling et al, 2004). Religious investors have long been concerned about the human rights records of companies in their portfolios. Thus, mainstream investors recently included human rights criteria in their proxy voting, shareholder advocacy, or investment decisions.

In addition, socially responsible businesses place a heavy emphasis on product safety. Since public perception of a company's socially irresponsible or unethical behaviour might result in severe financial setbacks, it is essential that institutional investors review this important issue according to well-defined moral and ethical principles.

4. A framework for Analysis and Comparison

In the earlier review, several issues arise, especially issues of duty. However, there is no generally accepted framework to analyse these. The reason for this might be that there are various distinctions between acts and consequences and between principals and agents in respect of the various duties. In other words,

there is a need to model how one person's acts and omissions can affect another or others. In doing this, from both a practical and an ethical perspective, we need to allow for uncertainty.

Young et al (2004) introduced a model for a kind of causal chain that connects acts and omissions to their consequences and allows uncertainty in the connection. For instance, if an act A leads, with some probability, to an undesirable (adverse) outcome D, then A can derive wrongfulness back up the causal chain from D. In addition, if the causal connection is very close, then A can be as wrongful as D. Whereas when the causal connection is weaker, only a small fraction of the wrongfulness in D may derive back up the causal chain to A.

Thus, this model of the relationship between acts and consequences can be used to analyse each of the four linkages in the following diagram.

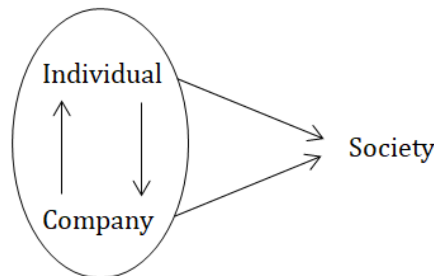

Figure 1

The conduct of the company depends on the acts and omissions of individuals associated with the company, such as its directors and employees. Indeed, sometimes the acts and even states of mind of a company consist of the acts and states of mind of individuals. In English law, for example, the company is a separate legal person from any individual, but companies can commit criminal acts, which require them to have a particular state of mind, such as an intention. This is possible because the law imputes to the company the state of mind of an individual in a sufficiently senior position of control of the company. Thus, by virtue of the acts, omissions, and states of mind of individuals, the company as such can do things that are wrongful. Although the connections between the company and individuals are, perhaps, less clearly worked out, the same applies in respect of Sharia law and CSR.

In this type of connection also there is uncertainty. When an individual acts wrongfully, this may lead to the company doing wrong, but it does not necessarily do so. On the other hand, it is not certain that if an individual chooses not to do wrong the company will necessarily be free of wrongdoing. Let A be the act that a particular internal auditor covers up an irregularity in the company's records, and let D be the outcome that the company publishes misleading accounts. A may make D more likely, but it does not make it inevitable. An external

auditor might spot the 'mistake'. In addition, it is not certain that but for A D would not happen. Misleading accounts might be created without that internal auditor being involved. So the connection from the individual can be modelled using a causal chain with uncertainty and with wrongfulness deriving from consequence to act.

Similarly, the arrow from the company to the individual represents the effects of the company's acts and omissions on the individual. These include consequences of the company's rules and procedures for the individual's conduct. In the diagram, these two causal relationships are contained within an oval indicating that they are internal to the company.

Externally, both the company's acts and omissions and those of the associated individuals have consequences for society, in particular for the social good. Whereas Sharia law focuses on the duties that the individual owes to society, CSR begins with the duties owed by the company. Correspondingly, in the diagram we have a causal chain running from the company to social good, and another running from the individual.

If we impute to each causal connection a duty, i.e. one person's acts affect another person or affect the society to which he has a duty to conduct himself accordingly, then we can resolve the relationships in Figure 1 into the following triangles of agency duty.

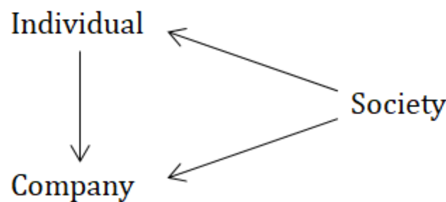

Figure 2

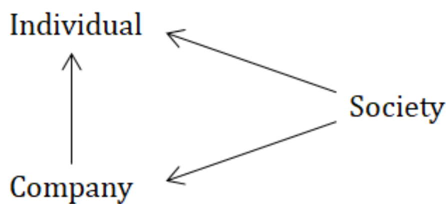

Figure 3

In each of these triangles of agency there is a potential conflict. Either the individual or the company (or both) is an agent in respect of two principals. In each case, the interests of society are potentially in conflict with the interests of another principal. The difference in the emphasis that Sharia law and CSR place on the individual and on the company may well have implications for whether a

conflict actually arises and, if so, what form it takes and how it may be resolved. This illustrates the ways in which this framework could be applied.

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