

## **An Exploration of the Ethical Contributions of the Islamic Banks**

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**Abstract:** *This paper examines the ethical contributions of Islamic banks by assessing ethical values in their financial reports, review of their ethical practices, investigation of reasons behind the ban of interest in their procedures, and analysis of their investment guidelines. This research acknowledges the ethical practices of Islamic banks.*

**Keywords:** *Bank, Contribution, Ethics, Islam, Islamic bank.*

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### **I. Introduction and Background**

This paper scrutinizes the ethical contributions of Islamic banks and hence investigates their ethical behaviors. It focuses on the implementation of ethical codes in their financial statements, the moral aspects of their movements, their rationales for the ban of interest and their investment policies to create a clear image regarding their moral implications. Wu (2007) found that Islamic banks attract public attention in many countries and are grown in different parts of the world. Moreover, their rapid global development encourages scholars to value their expansion. Ethics and morality of Islamic banks are suggested as key elements of their growth.

Administration of banking procedures with the Islamic principles is known as the Islamic banking system while the power of Islamic regulations in promoting ethical behaviors is indisputable (Ariff 1988). The moral perspectives of financial reporting are greatly highlighted during the preparation and presentation of financial statements of Islamic banks while the legitimacy and accuracy of their financial reports are regularly monitored by Islamic experts to prevent any immoral disclosure in their financial reports (Ahmad & Karim 1995). Islamic philosophers emphasize morality in Islamic banking. Moreover, Islamic banks practice ethical codes of conduct that are adopted by western financial institutions (Busler 2011). Furthermore, Aggarwal and Tarik (2000) showed that the investment goals of Islamic banks are based on Islamic laws and the Islam principles regarding the appropriate trading methods are highly appreciated.

#### *1.1. Statement of the Problem*

According to Hassan and Mahlkecht (2011), Islamic banks implement Islamic rules in their financial statements and practice Islamic-based financial reporting to ensure compliance with ethical codes. San-Jose, Retolaza and Goiria (2011) found that ethical banks respect moral requirements of their society. However, the well-being of the community is endangered because of unethical practices and irresponsible activities of unethical banks. Non-Islamic banks are ineffective to overcome ethical concerns of their society (Mitchell, Lewis & Reinsch 1992). Interest exploits weaker people in society. Therefore, Islamic banks ban interest because of its detrimental consequences. Islamic banks do not invest in unethical projects and do not support unethical organizations (eds Kabir Hassan & Lewis 2007).

### **II. Literature Review**

Islamic banks heavily engage with social activities and follow codes of ethic. Islamic banks value their social responsibilities more than their profit. Hence, if they need to choose between their ethical principles or profit, ethical principles are chosen. In Islamic banks management, employee, staff, and all other participants are reliable for their activities (Benson et al, 2006). Islamic banks provide legally enforceable agreements to ensure compliance with Islamic code of conducts (Ahmad, 2000). Snider and Martin (2003) mentioned that Islamic banks are responsible to improve their society. Thus, they invest in the public good such as healthcare or education, aiming to improve the standard of living of the public.

According to Khan and Mirakhor (2004), lending on interest enables a loaner to take advantage of its funds without participating in risks that are associated with its loan. Obtaining interest is an unethical method to

accumulate wealth, increasing the unemployment rate because a lender does not need to work to gain profit. Obtaining interest is a legal way to transfer funds from poor to rich people. Therefore, the wealthy become wealthier and the poor become poorer. This creates social irregularity, disagreement, unhappiness and sometimes revolution. Usury honor lenders who do not work. Rich people do not grant a loan to help poor people of their society, using their loan as a systematic way to exploit poor people (Metwally, 1989).

Islamic banks are required to evaluate their investments. They consider ethical outcomes of their investments, are involved with companies that value ethical investments and keep a formal procedure to meet their society's moral preferences (Cowton, 1994). Islamic banks carefully choose their investments to enhance the well-being of their society. They invest in beneficial projects, improving the people's standard of living. They are heavily engaged with socially responsible investments (SRI). They do not fund any project that may damage the environment. Moreover, they do not require a secured reimbursement of the principal sum and a fixed return regardless of the financial capacity of their borrowers (Alam, 1998).

Islamic banks have a precise and exact framework for their financial reports. They apportion the benefits of their customers on their assets and reimburse their creditors at the end of financial years to guarantee preciseness of their financial reports (Adnan and Gaffikin, 1997). They use fair values in their financial reports to ensure the accuracy of their financial statements. They require full disclosure and audit of financial transactions. Auditors are expected to ensure ethical accuracy of financial reports. They include their income statements, cash flow statements, and other relevant statements to fully disclose their compliance with Islamic principles. Their staff are frequently updated regarding the latest ethical requirements of their society to ensure full compliance with ethical principles (Karim, 1995).

Financial reports affect the decision making of financial statements' users. Moreover, the contribution of Islamic banks on corporate social responsibility is clear. Hence, an analysis of ethical movements of Islamic banks is desirable. Furthermore, Islamic banks' reasons to ban interest should be investigated because it changes the trading system. Further, their investment strategies should be evaluated to determine the extent of their commitments to moral codes of conduct. Hence, this study aims to obtain a clear picture of the ethical practices of Islamic banks. It aims to answer the following research question:

RQ: Do Islamic banks have any ethical contribution?

### **III. Findings**

#### *1.1. Ethical Financial Statements*

El-Din (2004) mentions Islamic banks follow a special framework to prepare and present their financial reports. For example, they consider owners and managers as two separate parties, frequently disclose their financial position, and fully disclose their uncertainties. Moreover, their financial statements aim to promote their role as charitable funds because of the disclosure of detailed information and comprehensive notes about their financial transactions. Different organizations such as Sharia Supervisory Board, Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), and professional Islamic auditors ensure the compliance of Islamic banks with Islamic principles (Casson, Maali & Napier 2006).

Baydoun and Willet (2000) mention that objectivity and honesty are fundamental principles of Islamic financial reporting. Islam bans using unethical techniques to create a better image regarding the financial position of a company. Moreover, Islamic norms are used to interpret different accounting standards. Furthermore, Islamic corporate reports are good examples of Islamic banks' contribution to social accountability because their contents are determined based on their impact on users. Further, Islamic principles ban accountants to use their expertise to take advantage of legal loopholes to show a better image regarding their company's financial position. The accomplishment of Quranic rules regarding financial matters, consideration of Islamic community's prosperity, prevention of behaviors that may damage the welfare of a community, prohibition of interest, and encouragement of Muslims to pay Zakat are some fundamentals of Islamic financial reports. Moreover, Islamic banks believe to the unity of God, equality among humans, reduction of economical differences among different people, protection of the environment against devastating practices of corporations, and fulfilment of Islamic principles during the preparation of financial statements (Baydoun & Willet 2000).

#### *1.2. Ethical Practices*

Islamic banks aim to satisfy their social responsibilities rather than to make profits. Moreover, they should remain environmentally friendly. Furthermore, they are banned to engage in risky transactions and fraudulent activities. Islamic principles aim to reduce uncertainty in commerce (Haniffa & Hudaib 2007). Elbeck and Dedoussis (2010) found that marketing plans of Islamic banks are based on Islamic criteria and any persuasive tactic is forbidden. Moreover, Islamic banks are banned to exploit females, use deceptive language,

or include misleading information to attract more customers. Furthermore, they favor their social to monetary objectives. Further, they appreciate their customers' preferences as far as they are not in contradiction with Islamic values (Elbeck & Dedoussis 2010).

Kunhibava and Rachagan (2011) found that Islamic banks practice *Jahala* (ignorance), meaning that their transactions become invalid and lose their right of possession if their buyer is unaware regarding an item's value. This principle is because information asymmetry disadvantages buyers which are against Islamic values. Moreover, the notions of *Limais* and *An-Nibadh* authorize participants to acquire a complete picture of their deals. Furthermore, Islam prohibits *gharar*, meaning trading of uncertain and unclear objects. Further, Islamic banks are expected to respect *Halal* (permissible) and *Haram* (sinful).

### *1.3. Ban of Interest*

Hossain (2009) mentions that Islam prohibits interest to disallow unethical income generations. Social costs of interest are irrecoverable because it expands the gap between wealthy and poor, leading to the exploitation of poor people. Moreover, interest has serious moral harms as it destroys people's aspiration to lend for good and change people's motivation to earn interest rather than help others (Al-Qardawi 1984). Hossain (2009) found that interest-based banks damage their country's financial system because it discourages people to work. Moreover, interest encourages people to maintain their funds in interest-based banks rather than to spend them, reducing economic growth. Moreover, businessmen are less likely to invest, increasing the unemployment rate. Furthermore, people may fall into a cycle of borrowing from an interest-based bank to repay the interest of another bank, prevent them to prosper (Maudoodi 1987). Ismail (2005) found interest payments during international financial transactions may lead to a financial crisis as they are artificial ways to create money. Moreover, interest enables rich countries to exploit poor countries disabling poor countries to invest in their public good. Hence, interest is an evident tool of abuse, broadening the gap between developed and developing countries. Interest brings substantial political, economic, and social disorders for developing countries. Furthermore, small companies may lose their position in the financial market as they are unable to repay hefty interests. Hence, larger companies can improve their position regardless of their investment attitudes.

### *1.4. Investment Strategies*

Greuning and Iqbal (2008) showed that Islamic banks adopted a profit and loss sharing system to share profits and losses of investments. Investors can assess their investments and associated risks to make their decision. Moreover, Islamic banks make the necessary disclosures. Islam bans investments in *Haram* businesses such as pork, alcohol, or pornography. Furthermore, Islam bans speculation because of speculators' involvement in short-term sales increases the riskiness of the financial market (Wilson 1997). Tahir and Brimble (2011) found that moral investments of Islamic banks encourage non-Islamic banks to finance ethical investments. Islamic banks are required to consider all features of their investments. Thus, on top of *Halal* deals, they should also ensure ethicality of all relevant parties such as trade unions, creditors, or suppliers.

Anas and Mounira (2009) mentioned that Islamic banks are required to assess the moral implications of their investments before signing a contract. Islam demands brotherhood while undertaking any business activity. Moreover, it requires non-discrimination and equality among business partners. Furthermore, it disallows a deal whenever ownership of a product is uncertain to maintain integrity in the business. The Shariah Advisory Council advises regarding the investment needs of the Muslim community to incorporate them into Islamic banks' operation (Anas & Mounira 2009).

## **IV. Conclusions**

This paper investigated the ethical contributions of Islamic banks and hence analyzed their ethical behaviors. It focused on the implementation of ethical codes in their financial statements, the moral aspects of their movements, their rationales for the ban of interest and their investment policies to create a clear image regarding their moral implications. It highlighted the moral values of Islamic banks during the preparation and presentation of financial reports. It found that Islamic principles direct Islamic banks to fairly disclose their financial position without any attempt to deceive their readers.

This paper found that Islamic banks aim to satisfy Islamic principles rather than achieve economic benefits. It evaluated economic, social, and moral costs of interest, justifying the ban of interest in Islam. The ban of interest protects weaker people in Islamic society. This paper found that Islamic banks engage in ethical investments to support their society rather than to merely maximize their shareholders' wealth. However, this study did not analyze all ethical notions of Islamic banks such as *Istisna'a*, *Wadiah*, or *Ijara*, providing an opportunity for future research to investigate them.

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