

Organisational Ethical Decision Making in Islamic Financial Institutions: A Conceptual Approach*

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Content

IFSI and IFIs



The practical problem



The academic problem



The Islamic ethical context



The argument



The proposed framework



IFSI

- More than 500 fully-fledged IFIs globally (CIBAFI, 2011, The Banker, 2010).
- Operate in more than 40 countries (Muslim and non-Muslim) (CIBAFI, 2011; EY, 2013) .
- Total assets US\$ 1.88 trillion in 2015 (IFSB, 2015).
- High demand on Islamic banking leads to conversion from conventional in some GCC countries (Alziyadat, 2011).
- Operate within the global financial system.



IFIs

- The articles of associations and licences for operation of IFIs state that their operations are *Sharia*-compliant (e.g. Rule book of CBB).
- Have Sharia supervisory boards (SSBs).
- Have Sharia control departments.
- As Islamic legal principles are deemed ethical, consumers and other stakeholders expect IFIs to be ethical.

The Islamic Ethical Context

- Islam is a way of life for Muslims and *Sharia* provides the codified system of norms according to which Muslims act in their daily lives (Dusuki, 2008).
- *Sharia*, the canonical law of Islam, comprises both legal and moral norms against which human conduct is judged (Kamali 2008).
- *Sharia* views human beings as the vicegerents of God on Earth (Al-Shatibi, as cited in Al-Raysuni 2006).
- The higher *Sharia* objective is 'empowering human beings with what is useful and beneficent for them to achieve the purpose of their existence as God's vicegerents on Earth' (Al-Najar, 2006, p.17).

The Islamic Ethical Context

- *Sharia* also recognizes that human beings are granted with free-will (Quran, 91:7-8) that makes them accountable in front of their societies and in front of God as well (Quran, 91:9-10).
- *Sharia* regulates human conduct in ways that guarantee justice and beneficence which constitute two general Islamic commandments (Quran, 16:90).
- *Sharia* recognizes that human conduct may lead to conflict of interests between individuals and individuals and society (Al-Raysuni, 2006).

The Islamic Ethical Context

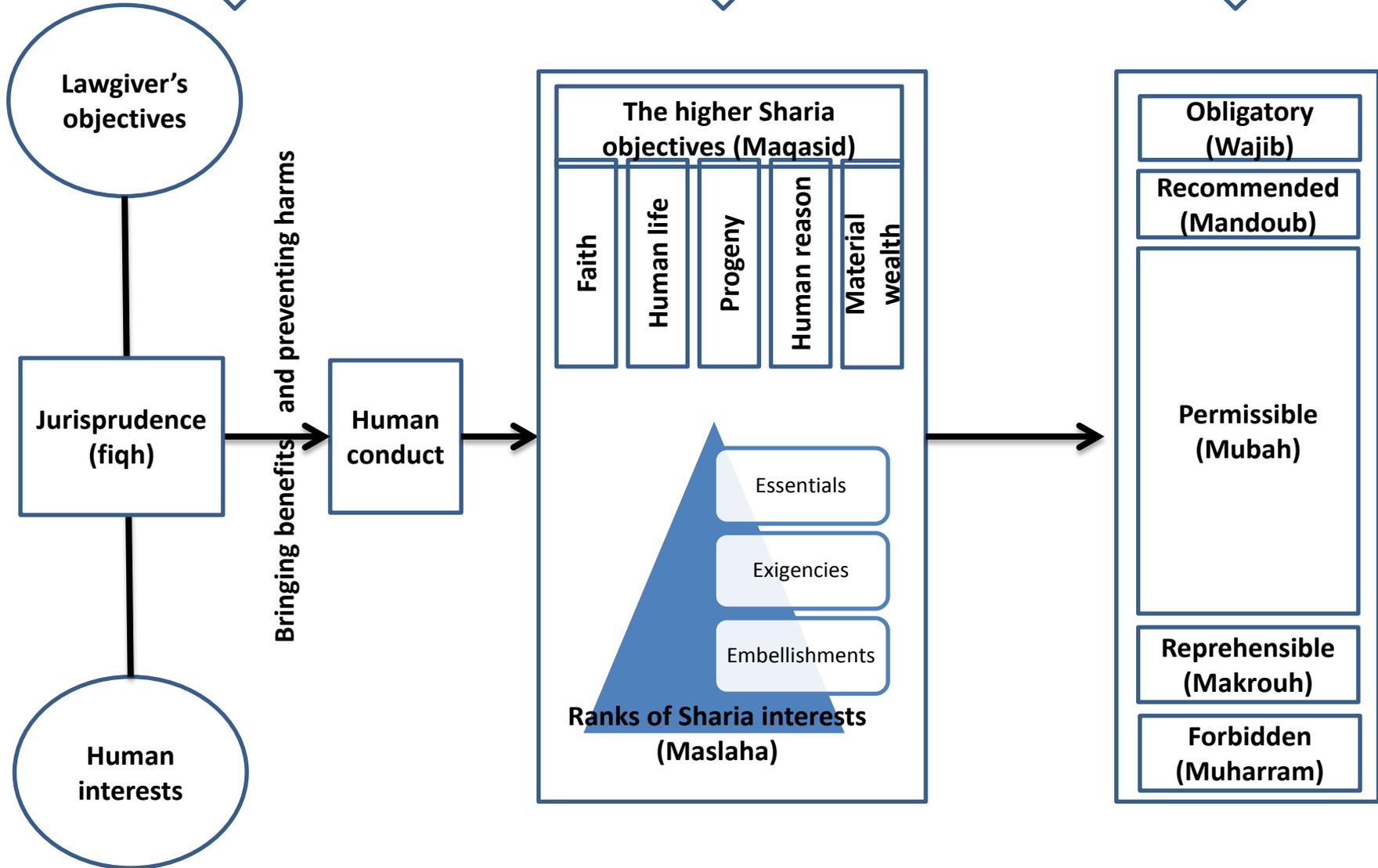
- *Sharia* rests upon ‘the principle that it is obligatory to realize and perfect human interests and minimize and neutralize that which causes harm and corruption’ (Al-Raysuni, 2006, p.34).
- To functionalise this role of *Sharia*, well-established jurisprudential methods are followed by scholars.
- The major concern of the Islamic jurisprudence (*Fiqh*) is to link human interests with the objectives of the Lawgiver (God) (Al-Raysuni 2006, p. 46).

Overview of the Function of the Islamic Jurisprudence

Jurisprudence concerns linking the link between the Lawgiver's objectives and human interests

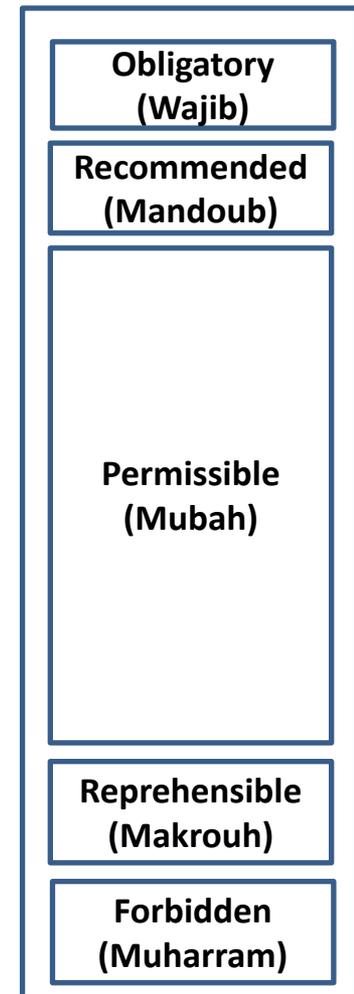
Human actions are ranked according to the strength of the interests they bring to the higher sharia objectives

Rulings concerning human actions are classified according to the strength of the interest they bring to the sharia objectives

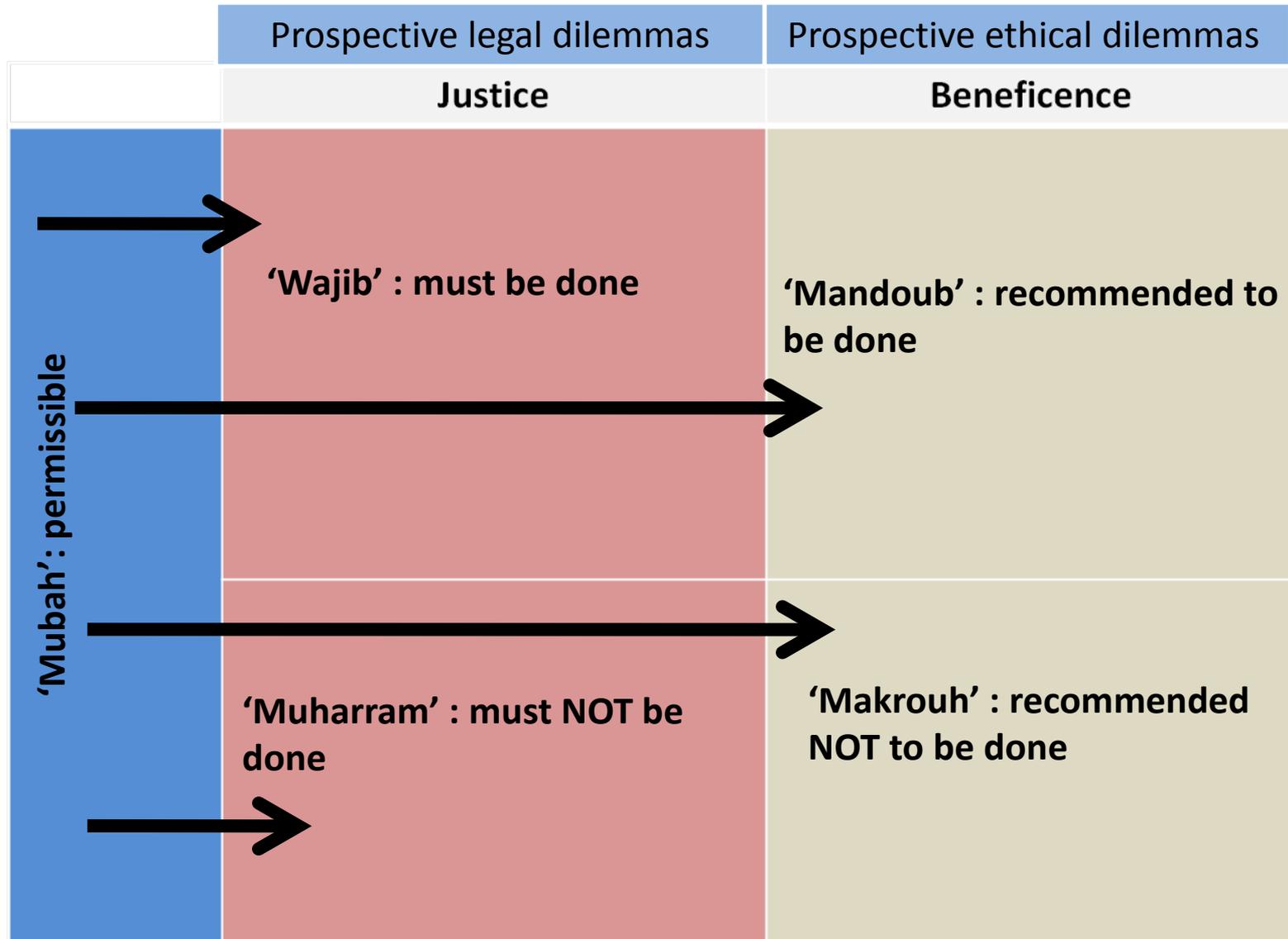


Ethical and Legal Dilemmas

- Mubah is:
- neutral by its essential meaning;
- sensitive to other factors that may convert it to one of the other four categories;
- judged by the end results it leads to; so:
 - permissible individually, collectively recommended;
 - permissible individually, collectively obligatory;
 - permissible in moderation, undesirable in excess; and
 - permissible in moderation, forbidden in excess



Ethical and Legal Dilemmas



The Practical Problem

- The transformation of Mubah into one of the other types of the the Sharia rulings:
 - IFIs do not much care about end results.
 - IFIs do not care about factors affecting Mubah.
 - Therefore:
 - IFIs do not fully comply with the role of vicegerents.
 - IFIs do not fully achieve the Lawgiver's objectives

Examples:

Sharia arbitrage; excess of debt-financing; lack of equity-based financing (PLS).

The Academic Problem

- Despite the theoretical assumption that IFIs are ethical, criticisms of their lack of contribution to the aspiration of *Sharia* and Islamic socio-economic objectives have been increasingly noticed in recent literature.
- When trying to diagnose the issue, researchers usually subscribe to the claim that IFIs do not work to achieve *Sharia* objectives **but:**
 - without identifying the deficiencies in the jurisprudential framework;
 - Without taking into consideration the transformation of *Munbah*;
 - Without taking into consideration the contextual aspects of rulings;
 - Therefore:
 - Subjective arguments are not sound most of the time; and
 - Models developed to measure the ethical performance of IFIs are inappropriate; and
 - Measuring the ethical performance of IFIs has been inappropriate

E.g. Badr El Din, 2006; Asutay, 2007; Sairally, 2007; Mohammed, Abdul Razak & Taib, 2008; Zaman & Asutay, 2009; Mohammed & Taib, 2010, 2015; Antonio, Sanrega, & Taufiq, 2012; Bedoui, 2012; Bedoui & Mansour, 2015

The Aim of The Study

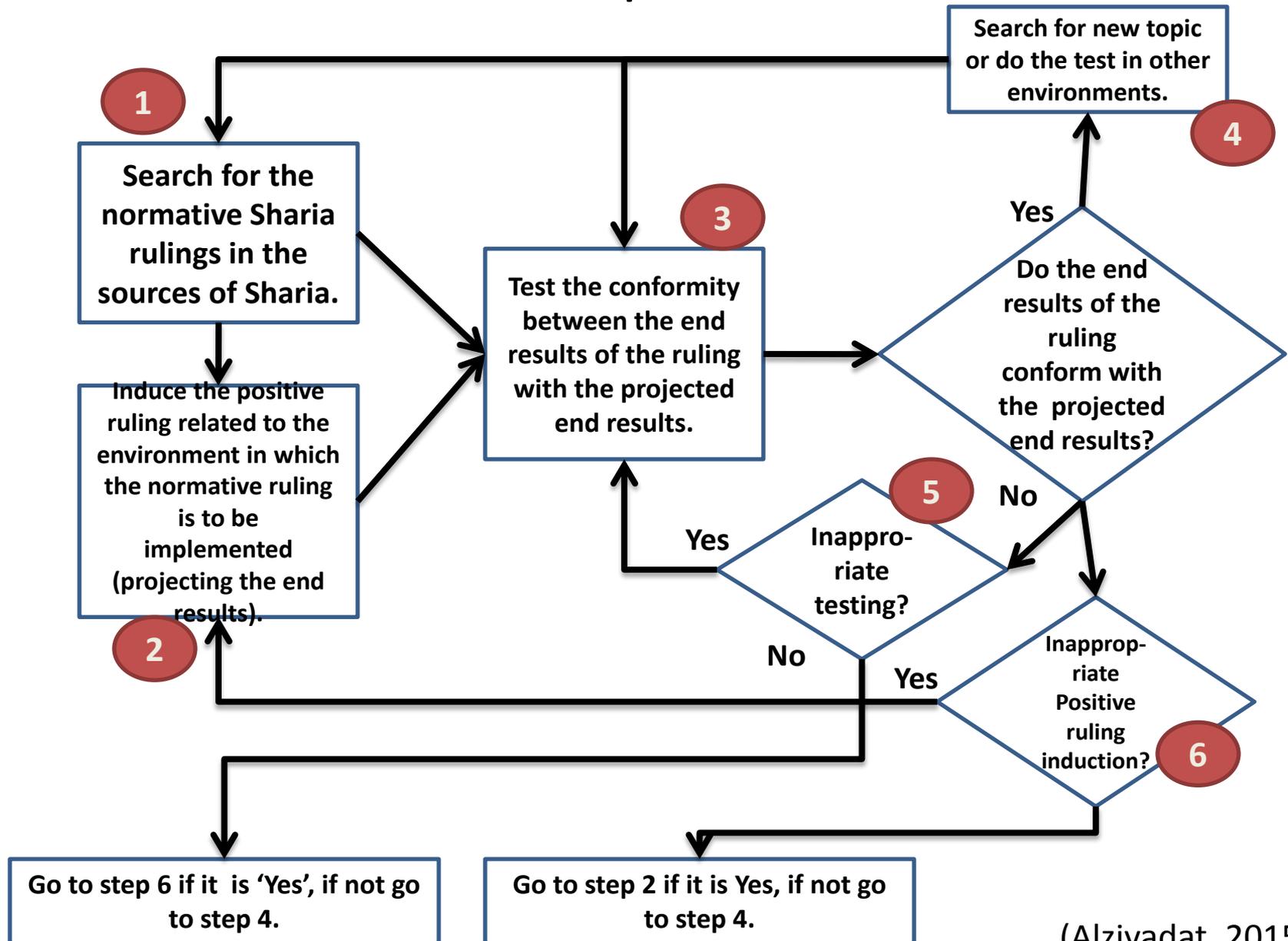
- To develop a conceptual framework for ethical decision making in Islamic financial institution.
- The framework can help overcoming the methodological deficiencies in measuring ethical performance by focusing on the process of the ethical decision making that leads to the end results of the organisational behaviour rather than the end results themselves



The Argument: Premises and Conclusions

- The two major roles of the Sharia supervisory boards are (IFSB, 2009):
 - the ex-ante advisory review.
 - the ex-post review or auditing.
- There Islamic Jurisprudence method comprises a cycle of inductive-deductive stages
- Therefore, the Sharia Jurisprudence method can be integrated within the business models of IFIs.

The Islamic Jurisprudence Method



The Argument: Premises and Conclusions

- Sharia audit provides evidence to SSBs regarding the compliance of IFBs with the rulings issued by the SSBs (i.e. the link between the ex-ante and ex-post functions) (AAOIFI, 2007).
- There Sharia Jurisprudence method maintains a cycle of inductive-deductive stages
- **Therefore, *Sharia* audit practiced in IFBs can provide the feedback that maintains the loops between the stages of the jurisprudence method when integrated within IFBs' business models.**

The Argument: Premises and Conclusions

- the Islamic jurisprudence method is similar to the scientific method of Sir Francis Bacon (1561–1626). Bacon insisted that scientists should proceed through inductive reasoning, from observations to axiom to law, in order to complete the interplay between deductive and inductive logic that underlies how knowledge is advanced (Moen & Norman, 2010; Ullmer, 2011).
- The scientific method underlies management systems through the PDCA Cycle (Tsutsui, 1996; Moen & Norman, 2010).
- **Therefore, the jurisprudence method can underlie the PDCA and can be integrated into management.**

The PDCA Cycle

Shewhart's Statistical Method from the Viewpoint of Quality Control (1939) introduced the concepts of specification, production and inspection as a straight-line three-step scientific process.

William Edwards Deming, a student of Shewhart, modified Shewhart's proposal and introduced the idea of the constant action among four steps of design, production, sales, and research.

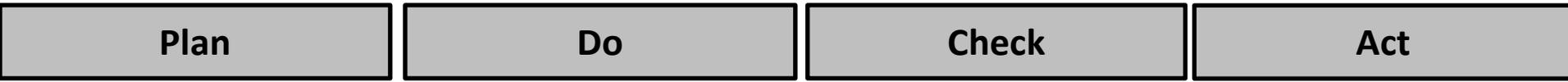
Deming presented his cycle during a seminar organised by the Japanese Union of Scientists and Engineers (JUSE) in 1950 . The JUSE later developed it to PDCA.



The Argument: Premises and Conclusions

- The PDCA cycle has been proposed by authors for use in order to improve ethically connected corporate social responsibility activities and integrate them within the management systems of organisations (e.g. Kralj, Šmon & Krobe, 2007; Kubenka & Myskova, 2009; Asif et. al., 2011; Chen, 2012; Drieniková & Psakál, 2012).
- The Jurisprudence method can underlie the PDCA
- **Therefore, the PDCA embedding the jurisprudence method can be used to integrate Islamic ethics within IFIs management systems.**

The OEDM Framework



- Proactive environmental scanning for ethical/legal interests/concerns.
- Stakeholder engagement
- Identification of prospective conflicts of interests leading to ethical /legal dilemmas
- Searching for the normative rulings concerning the dilemmas in the sources of Sharia.
- Projecting the end results of the implementation of the normative rulings
- Prioritizing interests in accordance with Sharia interest (Maslaha)
- Reflection of rulings on manuals, policies, and procedures.
- Development of KPIs
- Employee training, awareness

Operate in accordance with what has been planned for, conduct internal audit for real time feedback, and maintaining records of incidents of harming others

Internal and external auditing to check the conformity of the projected end results with the actual ones

Feedback to enrich the planning stage, confirm or amend the rulings.

Induction

Deduction

Amendments

Islamic jurisprudence method

Thank you

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