

## ISLAMIC SOCIAL BANKING: A DISTINCTIVE OR INTEGRAL PART OF ISLAMIC BANKING?

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**Abstract:** *Realizing the weaknesses in the conventional banking system, whose aim is to maximize profit without compromising the moral economy, the notion of social banking emerged. To contribute to the development of people and the planet today and in the future, social banks were introduced in Western countries as value-driven institutions that prioritize social and environmental impacts alongside their financial returns. This significant feature of social banking is originally rooted in the aspiration of Islamic banking establishments to promote a balance between social and economic justice. However, scholars have discussed the possibility of setting up a stand-alone distinctive Islamic social banking, as the current practice of Islamic banking has yet to address moral issues. Thus, this study aims to revisit the notions of social banking, Islamic social banking, and Islamic banking to redesign our understanding of the ultimate role of Islamic banking. This paper also discusses the social sustainability features and practices of Islamic banks and social banks using the Maqasid al-Shariah. Considering the current social sustainability contributions of Islamic banks, the study discovers that Islamic banks are practicing and improving their roles in both social and economic well-being, implying that Islamic social banks are unnecessary. The implication of the study is to develop an impact measurement model to gauge the implementation of socio-economic activities by Islamic banks to uphold the role of Islamic banking in promoting a social and fair economy.*

**Keywords:** *Social banking, Islamic social banking, Islamic banking, and Maqasid al-Shariah*

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## Literature Review

### **Social Banking: An Overview**

Social banking positively forms a financial intermediary that pays a deep concern to non-financial standards (i.e., social, ethical, and environmental) on convening a balanced social impact of its services, which could be applied through a social audit mechanism (Cornée & Szafarz, 2014; Hamidi & Worthington, 2020). In its most basic form, social banking encompasses several meanings, including sustainability banking, ethical banking, green banking, and corporate social responsibility. Banking sustainability has evolved, beginning with social banking, which combines philanthropic and social initiatives to promote inclusive growth. This includes ethical banking (the incorporation of business values and ethical practices into banking operations), green banking (the incorporation of sustainability initiatives and the avoidance of financing highly polluting manufacturers), and sustainable banking (which incorporates and manages ESG issues and impacts for sustainable development). In other words, social banking entails conducting banking operations while incorporating ecological, social, and ethical considerations into business strategy and promoting sustainable development. (Hamidi & Worthington, 2018; Kumar & Prakash, 2019; Sharma & Choubey, 2022).

In practise, social banking aims to support local communities and small businesses, as well as invest in projects that have a positive impact on the environment and society. (Tridou Bank, 2018). According to Benedikter (2011), social banking seeks to unleash the innovative potential in three ways: (1) by making decisions that prioritise the "triple bottom line" of people, planet, and profit; (2) by prioritising values over interest rates and profit; and (3) by fostering a different understanding of what money and capital are in general. The right business experts in dealing with social bank's social-sustainability structure are critical to realising its values and ideals in "financial humanism." To remain relevant, banks must develop an environmental risk management framework and standards of practise that include implementing a sustainability approach (UNEP and World Bank Group, 2017).

GLC Bank from Germany, for example, was classified as a social bank and emphasised the incorporation of social, ecological, and economic criteria; offering secure investments, credit policies, and logical monetary transactions. People and nature are taken into account when using money to create a better world to live in. Then, in the Netherlands, Triodos Bank aims to maximise sustainability, embracing the need to be profitable but only to a sustainable end. Profit can be used as a yardstick to determine whether an organisation is operating efficiently, in accordance with moral values, and contributing to the betterment of the community. They make lending and investment decisions in three stages, beginning with evaluating the content of an activity and focusing on its long-term viability.

The key social banking criteria should be noted in light of the previous social banking criteria, which are summarised in Table 1.

**Table 1: Criteria of Social Banking**

| No | Criteria of Social Banking   | Source  |
|----|--|---|
| 1  | Depositors and borrowers are encouraged to work together to make low-interest loans for projects that are worthwhile in terms of social, ethical, or environmental considerations. | Relano (2011)                                       |
| 2  | Local or regional coverage ensures that they are well-versed in the region, projects, and people they finance. It is a component of community development.                         | Relano (2011)                                       |
| 3  | Maintain a proactive dialogue with stakeholders and participate in public discourse.   | Institute for Social Banking (2023)                 |
| 4  | Refuse to participate in financial market speculative operations.  | Relano (2011)                                       |
| 5  | Focus on the real economy, such as savings collections and credit distributions.   | Institute for Social Banking (2023)                 |
| 6  | Business and management activities must be transparent.  | Relano (2011)                                       |
| 7  | Participation and democratic principles are required.  | Relano (2011)                                       |
| 8  | Strive for a fair profit rather than profit maximisation.  |   |
| 9  | Give priority to social, ethical, or environmental aspects of project financing.   | Relano (2011)                                       |
| 10 | Because operational costs are high, there is a pressing need to reduce costs in building physical premises by using phone, email, and the internet.                                | Relano (2011)                                       |
| 11 | Attempt to exercise equality at all levels.  | Relano (2011)                                       |
| 12 | Companies that cause socio-environmental and economic losses, such as pornography, slave labour, heavy pollution, and weapons, are excluded.                                       | Banhalmi-Zakar (2016); Cialowicz & Malawski, (2017) |
| 13 | Provide employee training and education to connect social and financial issues that arise.   | Weber & Remer (2011)                                |
| 14 | Concern about the importance of education in society.  | Weber & Remer (2011)                                |
| 15 | Maintaining a clear ownership structure that prevents dependence on dominant individual interests, could lead to takeovers that could jeopardize the bank's mission.               | Institute for Social Banking (2023)                 |

As a result, rather than focusing on a specific outcome, it is necessary to concentrate on the process and operational practises of socially impactful requirements. The conventions of the social banking concept would pave the way for the banking industry to remain relevant and trustworthy while also extending its emerging moral duty to the community.

### **Islamic Social Banking: Objectives and Aspirations**

The concept of Islamic social banking (hereafter referred to as ISB) emerged from a sustainable model and gained prominence with the Islamic paradigm (Mohd Nor et al., 2016). It is expected to uphold the role of today's Islamic banking with a strong commitment to the achievement of social outcomes goals that seek to foster both economic development and social well-being within the framework of Shariah values. The quadruple bottom line (people, profit, planet, and prophet - guidance from Shariah law) approach of ISB will maximise benefits and improve

overall societal well-being by combining the needs of social reality with Shariah principles (Hamidi & Worthington, 2021).

Furthermore, social interaction values are emphasised in ISB, which is concerned with preserving the *maslahah*<sup>1</sup> value (necessary for humans) of the entire social structure, including stakeholders, shareholders, and communities. A survey of 243 Muslim managers at financial institutions in Malaysia revealed that they are deeply concerned about corporate social responsibility (hereafter referred to as CSR) activities that benefit community enhancement (public *maslahah*) because it strengthens Islamic values within the institution (Muwazir et al., 2012). Another study conducted by Dusuki et al. (2005) discovered that CSR dimensions are important for Shariah governance, employee, community, customer, and environment. There is a positive stakeholder perspective on promoting social responsibility through CSR practised by Islamic banks to achieve religious motivation. The findings also revealed that CSR is an important factor in customers' decision to patronize Islamic banks. In this regard, the company's uniqueness in embracing social-sustainability modern innovation, and accountability for all operational activities will increase stakeholder trust and enable them to facilitate optimal service for the effective use of resources while adhering to Sharia principles (Khansa & Violita, 2021).

Notably, ISB recognizes any acts on social sustainability and ethical responsibility that adhere to Shariah law as valuable practises. ISB's primary goal is to foster 'touch and grow' motivations in the future through socially impactful initiatives that are free of exploitation and harmful practises.

The key criteria of social banking should be considered in understanding Islamic social banking criteria as summarized in Table 2.

**Table 2: Criteria of Islamic Social Banking**

| No | Criteria of Islamic Social Banking  | Source   |
|----|---|--|
| 1  | The promotion of the concepts of cooperation, solidarity, and shared responsibility stems from the wellsprings of faith, as do human brotherhood and faith-born brotherhood, as does the concept of vicegerent (khalifah) and unity.  | Buckley (2000); Attia (2010, p. 137)   |
| 2  | Empower low-income micro-entrepreneurs to generate more sustainable income, become financially resilient, and subsequently contribute back to the community through various initiatives. Example: iTEKAD program which blends social finance with microfinancing and structured training. | BNM – iTEKAD (2020)  |
| 3  | Sharing of practical banking operations that are impact-driven to a wider stakeholder. Such activities promote healthy dialogue and help in raising ethical awareness.  | Value-Based Intermediation: Strengthening the Roles and Impact of Islamic Finance – VBI (2018) |

<sup>1</sup> Anything that guarantees or safeguard the preservation of the shari'ah objectives (Maqasid al-Shariah) in realizing public benefit is called *maslahah*.

| No | Criteria of Islamic Social Banking  | Source   |
|----|---|--|
| 4  | Inclusive governance requires Islamic banks to proactively engage their stakeholders in key decision-making processes, akin to the principles of consultation ( <i>istisharah</i> ).  | Value-Based Intermediation: Strengthening the Roles and Impact of Islamic Finance – VBI (2018) |
| 5  | Prohibits the practices of <i>riba</i> (interest-based transactions), <i>gharar</i> (gambling), <i>maysir</i> (speculation transactions), and production of products that violate Islamic norms, which are believed to be the financialization of the economy and the sources of financial crises.  | El-Gamal, (2006); Chapra (2007)  |
| 6  | Investment in the real economic sector.   | Tarique et al. (2021)  |
| 7  | The comprehensiveness of transparency will influence the key stakeholders' perception and decision-making. Safeguarding the rights of stakeholders through fair and transparent disclosure of all transactions and decisions by Islamic banks is also a demonstration of best conduct. Incorporation of corporate and Shariah governance could ensure corporate fairness, transparency, and accountability. | VBI (2018); (Hasan, (2009)   |
| 9  | Islamic banks are not supposed to make excessive profits at the expense of their customers, nor are they supposed to undermine and disregard their social responsibility and commitments to their various stakeholders.   | Ahmad (2000)   |
| 10 | Islamic banks uphold the responsibilities to promote the development of the underprivileged group, promote social welfare, and protect the needs of society.  | Amran et al. (2017)  |
| 11 | Encouragement of green business/ investment to clients. Examples: renewable energy projects, clean water supply projects, and wastewater treatment plants.  | Julia & Kassim (2019)  |
| 12 | A higher level of diversity within an organisation provides significant benefits to both the organisation and its employees. It has the potential to foster equality and social stability, which in turn can support economic development.  | Jabari & Muhamad (2022), Bank Muamalat (2021)  |
| 13 | Possession of material resources is linked to accountability for their use. This restores balance to the natural ecosystem by granting humans rights followed by responsibilities.  | Bukhari et al. (2019)  |
| 14 | Provide consultation services including technical assistance to other countries, training for staff involved in development activities, and research on economic, financial, and banking activities in Muslim countries to conform to the Shariah law.  | Roy (1991)   |
| 15 | Promote intellectual development through, (i) preservation of intellect to safeguard the well-being of the senses, nervous system, and brain (ii) utilization of intellect to strengthen the faith of those who already believe and lead the unbelievers to faith.  | Attia (2010)   |

Incorporating social values will motivate the institutions to be more creative, innovative, and inclusively relevant to service in every layer of the community while also paving the way for significant new dimensions of humanistic value-economic activities (Mohamad Nasir & Abu Seman, 2022).

### **Islamic Banking: Paradigm and Practices**

The first modern banking venture based on Islamic law principles was established in the late 1950s in a rural area of Pakistan, where the institutions were backed by a few landlords who made interest-free deposits; credit (free interest) was advanced to poorer landowners for agricultural improvements at a low administrative cost. As a pilot project, this bank could only survive for a short time (Roy, 1991). In a similar vein, Ahmad al-Najjar established the first contemporary Islamic bank, Mit Ghamr, in 1963 in a small Egyptian town, where it primarily served the community's social needs, such as encouraging lower-income farmers and agricultural workers to save and mobilize their earnings for developmental investment based on the concept of Sharia. Exploitative elements, such as *gharar* (uncertainty) and *maysir* (speculation), are banned from the economic and social spheres as part of a set of interconnected coherent values. Even though it was closed down after two years, it had a huge impact as an excellent example and pioneer of Islamic banks (Islahi, 2018).

Along the way, Malaysia systematically took note of developing the country's first Islamic financial institution, Tabung Haji, in 1962, paving the way for Muslims to be able to invest their funds in interest-free bank accounts. As a pioneering effort to provide Muslims with the opportunity to invest in interest-free bank accounts. It is a trailblazing step toward the implementation of Islamic finance in Malaysia. During this period, there was rapid expansion, with some countries, including Sudan and Iran, adopting completely Islamic banking models (Alharbi, 2015). While primarily concentrated in three regions of the world: the Middle East, South Asia, and Southeast Asia, the Islamic banking and finance industry maintained its growth momentum by pursuing innovation and broadening its range of products, customers, and markets (Khan & Batti 2008).

Furthermore, Islamic banking strongly encourages the social impact of financial activities, which is an integral part of the Islamic system and represents a unique feature that distinguishes Islamic banks from other banks with different philosophies. Islamic banking considers the social consequences of any decision or action it takes in all of its banking and development activities. Despite its importance and priority, profitability is not the only criterion used to evaluate the performance of Islamic banks, as they must meet both material and social goals (International Association of Islamic Banks as cited by Khan & Watson 2003, p. 93-94; Hamidi & Worthington 2020). In other words, Shariah-based businesses must incorporate social commitments and contributions without neglecting the profit side. Indeed, this practice goes beyond the traditional capitalist mindset of profit maximization.

### **Islamic Social Banking: An Integral Part of Islamic Banking**

Social banking exists on the deep concern towards the society, the economy, and the environment which truly represents the significant role of Islamic banking. This is especially true with the development of the social banking model within the existing Islamic banking system (Mohd Nor et al., 2015). It should function with respect to what constitutes social practices by Islamic banking that they intend to contribute to human well-being (public interest). As a result, when assessing Islamic banks' performance, it is critical to consider not

only their financial aspects but also their adherence to religious principles (Rosmanidar et al., 2021).

According to Asutay (2007), Shariah (Maqasid al-Shariah) aims to establish a legal and reasonable framework within which economic operations should be conducted and ensure human well-being through respect for human rights and provision for all human needs. On a different note, achieving Maqasid al-Shariah entails practicing social values. Mohammed & Taib (2015) stated unequivocally that the vision and objective of Islamic banks should reflect their devotion to Maqasid al-Shariah in their activities and aspirations. However, some argue that Islamic banks are becoming more siding with mainstream banks (Asutay, 2007; Mohd Nor, 2016; Hamidi & Worthington, 2021). Some efforts have been made to redirect this tendency in order to achieve socioeconomic impacts and align Islamic banking with Shariah's intended outcome (Asutay & Harningtyas, 2015; Alamer et al., 2015; Gilani, 2015; Azman & Ali, 2019). Recognizing the importance of these two components (Maqasid al-Shariah and socioeconomic progress) is crucial for unravelling their relationship. The connection could serve as the foundation for the Maqasid al-Shariah-based indicator of socioeconomic growth.

Moreover, the latest central observation on Islamic social banking is also supported by the arising of sustainability agendas such as Sustainable Development Goals (SDGs) and Environment Social Governance (ESG), the resurgence of Islamic social finance institutions, and the Value-based Intermediation (VBI)<sup>2</sup>. Hence, it is timely to suggest that Islamic banks place a higher priority on meeting social objectives that go beyond their commercial goals. In some ways, Islamic social banking should be regarded as an integral part that will enhance the true intention of the establishment of Islamic banking institutions.

The ISB criteria are consistent with the paradigm and practise of Islamic banking. These criteria are in line with Maqasid al-Shariah, which is based on five essential dimensions presented by al-Ghazali: (i) safeguard the faith, (ii) safeguard the wealth, (iii) safeguard the life, (iv) safeguard the progeny, and (v) safeguard the intellect. Following Chapra's (2007) framework as disclosed in Table 3, it shows that the enrichment of one of the five maqasid also requires the enrichment of the others. This relationship has been agreed upon by the pioneers of Maqasid al-Shariah theory such as Al-Ghazālī and Al-Shāṭibī. Chapra (2007) has made significant progress in operationalizing the contemporary dimensions of Maqasid al-Shariah in the context of socioeconomics.

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<sup>2</sup> VBI is a blueprint which proposed by the Central Bank of Malaysia in 2018.

**Table 3: Dimensions and its Corollaries in Constructing Maqasid al-Shariah-based Index of Socio-Economic Development**

| <b>Dimension</b>         | <b>Corollaries</b>  |
|--------------------------|---|
| <b>Human Self (Nafs)</b> | <ol style="list-style-type: none"> <li>1. Dignity, self-respect, human brotherhood, and social equality</li> <li>2. Justice</li> <li>3. Spiritual and moral uplift</li> <li>4. Security of life and property</li> <li>5. Freedom</li> <li>6. Education</li> <li>7. Good governance</li> <li>8. Need fulfilment</li> <li>7. Employment and self-employment</li> <li>10. Equitable distribution of income and wealth</li> <li>11. Marriage and proper upbringing of children</li> <li>12. Family and social solidarity</li> <li>13. Minimization of crime and anomie</li> <li>14. Mental peace and happiness</li> </ol> |
| <b>Faith (din)</b>       | <ol style="list-style-type: none"> <li>1. Values (for example, justice, freedom, honour, honesty, etc.)</li> <li>2. Removal of poverty, need fulfilment of all, employment, and self-employment opportunities</li> <li>3. Equitable distribution</li> <li>4. Enabling</li> <li>5. Role of the State</li> <li>6. Human Brotherhood</li> </ol>  |
| <b>Intellect ('aql)</b>  | <ol style="list-style-type: none"> <li>1. High quality of religious and science education at affordable prices</li> <li>2. Library and research facilities</li> <li>3. Freedom of thought and expression</li> <li>4. Reward for creative work</li> <li>5. Finance</li> </ol>  |
| <b>Posterity (nasl)</b>  | <ol style="list-style-type: none"> <li>1. Moral and intellectual development</li> <li>2. Proper upbringing and family integrity</li> <li>3. Need fulfilment</li> <li>4. Healthy environment</li> <li>5. Freedom from fear, conflict, and insecurity</li> </ol>  |
| <b>Wealth (mal)</b>      | <ol style="list-style-type: none"> <li>1. Education, research, and improvement in technology, and management</li> <li>2. Security of life, property, and honour</li> <li>3. Good governance</li> <li>4. Freedom of enterprise</li> <li>5. Employment and self-employment opportunities</li> <li>6. Removal of poverty, need fulfilment, and equitable distribution</li> <li>7. Social solidarity and mutual trust</li> <li>8. Savings and investment</li> <li>9. Optimum rate of development</li> </ol>   |

Thus, there is the potential for Islamic banks to develop a systematic and visible means of giving back to the community in terms of what constitutes social practises that they intend to achieve under the purview of Maqasid al-Shariah.

Using Chapra's (2007) framework, the similarities and convergencies between Islamic social banking and Islamic banking are analyzed. As far as the characteristics of Islamic social banking and Islamic banking are concerned, the findings appear to support the notion that Islamic social banking is an integral part of Islamic banking. This is explained in Table 4, driven by Maqasid al-Shariah.

**Table 4: Islamic Social Banking as an integral part of Islamic banking under the purview of Maqasid al-Shariah**

| No | Criteria of Islamic Social Banking as an Integral Part of Islamic Banking   | Maqasid al-Shariah Dimension |
|----|---|------------------------------|
| 1  | The promotion of the concepts of cooperation, solidarity, and shared responsibility stems from the wellsprings of faith, as do human brotherhood and faith-born brotherhood, as does the concept of vicegerent (khalifah) and unity.  | Safeguard the Faith          |
| 2  | Empower low-income micro-entrepreneurs to generate more sustainable income, become financially resilient, and subsequently contribute back to the community through various initiatives. Example: iTEKAD program which blends social finance with microfinancing and structured training.   | Safeguard the Wealth         |
| 3  | Sharing of practical banking operations that are impact-driven to a wider stakeholder. Such activities promote healthy dialogue and help in raising ethical awareness.  | Safeguard the Faith          |
| 4  | Inclusive governance requires Islamic banks to proactively engage their stakeholders in key decision-making processes, akin to the principles of consultation ( <i>istisharah</i> ).  | Safeguard the Faith          |
| 5  | Prohibits the practices of <i>riba</i> (interest-based transactions), <i>gharar</i> (gambling), <i>maysir</i> (speculation transactions), and production of products that violate Islamic norms, which are believed to be the financialization of the economy and the sources of financial crises.  | Safeguard the Wealth         |
| 6  | Investment in the real economic sector.   | Safeguard the Wealth         |
| 7  | The comprehensiveness of transparency will influence the key stakeholders' perception and decision-making. Safeguarding the rights of stakeholders through fair and transparent disclosure of all transactions and decisions by Islamic banks is also a demonstration of best conduct. Incorporation of corporate and Shariah governance could ensure corporate fairness, transparency, and accountability. | Safeguard the Faith          |
| 8  | Islamic banks are not supposed to make excessive profits at the expense of their customers, nor are they supposed to undermine and disregard their social responsibility and commitments to their various stakeholders.   | Safeguard the Faith          |

|    |  |  |
|----|--|--|
| 9  | Islamic banks uphold the responsibilities to promote the development of the underprivileged group, promote social welfare, and protect the needs of society.   | Safeguard the Life/<br>Safeguard the Progeny |
| 10 | Encouragement of green business/ investment to clients. Examples: renewable energy projects, clean water supply projects, and wastewater treatment plants.   | Safeguard the Life                           |
| 11 | A higher level of diversity within an organisation provides significant benefits to both the organisation and its employees. It has the potential to foster equality and social stability, which in turn can support economic development.                         | Safeguard the Life                           |
| 12 | Possession of material resources is linked to accountability for their use. This restores balance to the natural ecosystem by granting humans rights followed by responsibilities.   | Safeguard the Life                           |
| 13 | Provide consultation services including technical assistance to other countries, training for staff involved in development activities, and research on economic, financial, and banking activities in Muslim countries to conform to the Shariah law.             | Safeguard the Faith                          |
| 14 | Promote intellectual development through, (i) preservation of intellect to safeguard the well-being of the senses, nervous system, and brain (ii) utilization of intellect to strengthen the faith of those who already believe and lead the unbelievers to faith. | Safeguard the Intellect                      |
| 15 | The promotion of the concepts of cooperation, solidarity, and shared responsibility stems from the wellsprings of faith, as do human brotherhood and faith-born brotherhood, as does the concept of vicegerent (khalifah) and unity.                               | Safeguard the Intellect                      |

The criteria of ISB are highlighted to provide a clear social objective that specifies what constitutes social practices by the Islamic bank. The ultimate aim is to achieve maqasid al-Shariah.

### Summary

This paper is a humble attempt to revisit the notions of social banking, Islamic social banking, and Islamic banking to reconstruct our comprehension of the fundamental role played by Islamic banking. The growing social-sustainability phenomenon in the banking industry has also led many researchers to delve into how banks can be evaluated impactfully within the targeted group, as there are currently no mechanisms in place and this needs to be addressed. As a result, Islamic banking institutions are expected to promote social justice and actively contribute to all segments of society by providing a diverse range of products and services that meet a variety of needs, utilising efficient distribution channels, and engaging in sustainable activities.

Research on the concept of Islamic social banking remains limited. This paper aims to contribute to expanding the body of knowledge by providing a clearer perspective on Islamic social banking through examination of; (i) such practices can be adopted pragmatically without compromising the current existence of Islamic banking or if it adheres to its own set of operating principles, (ii) such practices have been discovered and practiced in their unique ways and to the best of their capacities in the current Islamic banking system.

Islamic banks therefore have an onus to provide transparent reporting and ensure their activities meaningfully contribute to community development and human well-being. Rather than fleeting ‘touch and go’ gestures, Islamic banks should aim to strengthen socioeconomic progress through long-term, sustainable ‘touch and grow’ commitments, disclosed via good quality reports. Moving forward, an impact measurement model is required to assess the implementation of socioeconomic activities by Islamic banks to maintain their role in promoting a social and equitable economy. As the reality is constantly changing, the implementation of Maqasid al-Shariah principles in Islamic banking should be constantly evaluated, discussed, and explored.

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