

ISLAMIC BANKING REINTERPRETATION OF THE STAKEHOLDER THEORY

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Abstract:

The Stakeholder theory has become one of the most important developments in the field of business ethics, which is widely regarded as being a key element in Islamic banking, making it of extreme relevance. While the stakeholder concept has evolved and gained prominence as a method of integrating ethics into the basic purposes and strategic objectives of the bank, authors argue that stakeholder theory has retained certain Western assumptions from the wider business literature that limit its usefulness. The use of Islamic banking provides a means of reinterpreting the stakeholder concept in a way that overcomes many of the existing limitations. This reading provides a different understanding of the identity and meaning of Islamic banking, specifically in terms of its relationship to stakeholder groups, such as Islamic banks are a connected body, they should have control over the external environment, and should implement hierarchies.

Keywords: Stakeholders, Islamic Banks, Communication, External Influence, Hierarchies, Influence

Introduction

When observing the Middle East, religion is a key factor in shaping not only people, but also society as a whole due to it being deeply imbedded in social norms and mentality. By studying the stakeholder theory and comparing it with the Islamic banking system, there is room for new possibilities. However, this does not refer to the dismissal of these understandings, it refers to covering a larger range and how they apply to different geographical locations and different ways of life. Especially in the setting of Kuwait, where the banking industry is dominated by specialized state owned and private banks (Al-Shamali, 1998).

Literature on the subject of stakeholder theory has largely concentrated in Western settings, with little regards for Islamic banking. The argument raised in this study is that Islamic banking stakeholders management can be described as a means of considering all networks of stakeholders.

Stakeholder Theory Background

The stakeholder theory origins can be found in business science literature, and dates back to Adam Smith's theory of moral sentiments (Freeman, 1984). The beginnings of stakeholder theory took place in strategic management (Clarkson, 1995; Freeman, 1984; Frooman, 1999); later on it developed in the field of organization theory (Donaldson & Preston, 1995; Jones, 1995; Rowley, 1997), and more recently in the field of business ethics (Starik, 1995; Phillips & Reichart, 2000). Stakeholder theory's focus on the topic of social responsibility has also made it a useful tool in the social issues in management area (e.g., Wood, 1991a, 1991b). The theory has also begun to enter the topic of sustainable development (Sharma & Henriques, 2005; Steurer et al., 2005; Laplume & Reginald, 2008). It can be described as the

method a firm implements to conduct business and the soul purpose of the firm.

As reviewed by Jongbloed et al. (2008), stakeholder's theory current ideologies were developed by Stanford Research Institute, which stated the term in 1963, but only in a sense as to simplify and develop the concept of shareholders as a group that management should be aware and concerned about. Twenty-one years later, Freeman (1984) claimed that business organizations should place more concern towards the interests of neglected stakeholders to better make decisions in a strategic and holistic approach. Freeman did not agree that the firm was developed sufficiently enough to address and explain the complicated communication between different stakeholder groups in firms. Freeman's iconic work, *Stakeholder Management: A Stakeholder Approach*, was the first of its kind to thoroughly present and explain the stakeholder framework. Freeman reviewed many different literatures to develop the stakeholder theory, which included corporate planning, systems theory, and corporate social responsibility. He developed a managerial view that identified four key stakeholder groups that consisted of owners, clients, employees and suppliers; proposing that management theories at the time were not suitable to tackle the issue of quantity and kinds of change which are occurring in the business environment (Freeman, 1984); which included new industrial relations and changes in communication.

More recently, the stakeholder theory has proved of great value with regards to literature in corporate social responsiveness and corporate social responsibility. This progression has assisted in the better understandings of moral visions and the relationship that exists amongst ethics and Islamic banking. With regards to stakeholder management, it has proven to become a constant topic of discussion both in literature and in practice in Islamic banks, however, it is essential that it be re-examined and developed (Iqbal, 1997; Choudhury and Hussain, 2005; Aribi and Gao, 2011).

The motive of the study is to view concepts being discussed in the banking sector today and build a stakeholder relations structure to better suit the contexts of Islamic banking. Re-examination on stakeholder theory, as applied in Islamic banks will highlight what is of importance regarding the theory with the use of critical analysis, innovative thinking and observing developed terms from different perspectives, more specifically, from an Islamic banking stance. The majority of Literature regarding the subject of stakeholder theory has focused specifically to that of studies and concepts within "Western" based settings and have not been applied within the Arab context, in which this study will take place.

Applying the Stakeholder Theory to Islamic Banks

With regards to application of the stakeholder theory in the Islamic banking context, two key points make it of significance. Firstly, there are number of critical trends that have occurred and will continue to progress the banking industry with great influence. Altering older "Western" representations of the theory, with regards to the Islamic banking industry, is valuable to those who wish to enhance the banks reaction and flexibility in an industry that has proven to be quickly changing at a global scale and economy.

The increase of Islamic banks around the world represents significant and influential trends in the banking industry (Khan and Bhatti, 2008; Mellahi and Budhwar, 2010; Chazi et al., 2010). During the past ten years, the success and growth of Islamic banking and finance has increased significantly, especially for stakeholders investing in overseas Islamic projects (Devaux, 2005). Islamic banks, on a global scale, have been well perceived by stakeholders and their reputation continues to improve (Choudhury and Hussain, 2005). Global markets can expect more Islamic banks to appear in the future, with over 500 Islamic financial institutions around the world and with assets exceeding \$1 trillion dollars; the industry is striving strong (Akram et al., 2001; Khalid and Amjad, 2012).

The second point arises from the concern regarding morals in the banking industry. The purpose of the stakeholder theory was to create awareness and responsibility that banks have

towards both internal stakeholders and external stakeholders. Hence, the banks responsibility is not limited to the focus of increasing of annual revenues, but for the wellbeing of all stakeholders. Keeping this in mind, there is room for expansion. Many possible conclusions that can be reached by substituting Western views with those of Arab views within the Islamic banking industry, which may place more attention on religion, culture and social norms.

Applying the stakeholder theory in an Arab context will provide useful in aiding the study to better understand and represent the purposes and values with regards to the Islamic banking industry. Also, the application of the stakeholder theory in an Arab context should prove valuable and effective for a better reflection of realities faced in the Islamic banking industry and in assisting banks that wish to develop the responsiveness and flexibility of their bank.

Approach to Data Collection

Interpretive research paradigm with in depth interviews has been the method selected to be conducted for this research. An adaptable method suitable to provide thorough data in a contrasting setting is the in depth interviews approach. This approach is effective in specific research that is facing a lack of knowledge (Hastings and Perry, 2000). The use of the in depth interview method is regarded as an appropriate technique when honest dialogue is used to extract detailed information (O'Donnell and Cummins, 1999).

All in depth open-ended interviews were conducted with managers in Kuwaiti Islamic banks and prearranged with the five banks, which are listed in Table 1. All interviews took place in the setting the managers offices. The objective of this qualitative study, and the mentioned benefits of in depth interview, clarifies why this approach of data collection was chosen (Al-Shamali *et al.*, 2012).

1	Kuwait Finance House
2	Al-Ahli Bank of Kuwait
3	Kuwait International Bank
4	Boubyan Bank
5	Warba Bank

Table 1: List of Islamic banks in which interviews were conducted

Islamic Banking Views on the Stakeholder Concept

Arab understandings with regards to Islamic banking and how banks operate within these environments naturally have an effect how the stakeholder theory also may be viewed. Though stakeholders all have unique identities, this doesn't mean they are completely independent or that language and culture have no influence on their views and thoughts. Looking at the stakeholder theory from an Arab perspective, when the identity of the Islamic bank is viewed, it can be seen that influence of different stakeholders declines and the identity of the bank is clear and communicated through a large body of networks both inside and outside the bank. As stressed upon by interviewed managers, the Islamic bank stakeholder's interpretation of Islamic bank can be extracted from this. Also, the high majority of managers interviewed have stated that Islamic banks are consisting of multiple networks that exist amongst employees, clients, communities, businesses and the Shariah board.

If managers within Islamic banks choose to maintain a remote position from their

stakeholders and external environments, they will have put themselves and the bank at risk of being unable to function productively, as mentioned by the managers interviewed.

Islamic Banks Encountering Threats and Uncertainty

With regards to the Islamic bank stakeholders, it is proposed that factors that may have been viewed as threats and disadvantages now may be able to become tools in achieving diversity, creating multiple opportunities and innovations. This may be achieved from adjusting to change rather than resisting changing. This reflects the importance of not viewing the bank and its managers as remote, but rather as interactive and not disconnecting themselves from the external environment and unwilling to change, as stated by managers interviewed. Managers interviewed believe that evidence from the global banking industry supports that this point is of relevance and should not be taken lightly. Multiple organizational theorists that interdependence continues to increase as change and interference is at a constant growth have reviewed it. Interdependence is also critical for the growth of banks and the industries they operate in (Gray, 1989; Astley and Fombrun, 1983). Managers of Islamic banks much accept the fact that as time passes approaches and means to achieving success must evolve. Also, theories and approaches must be subject to flexibility to adjustments. It is essential for stakeholder groups to take full advantage of their interdependence, as to advance forward and progress. Applying interdependence assists the bank in meeting changing needs and opportunities of each group with regards to communicating with the Shariah board. In Islamic banking industry, view this approach as unsuitable, when facing a global banking system in which making threatening decisions are the only choices made available.

Because of these Islamic banking stakeholder views, it is preferred that a more reasonable approach be taken, where by conflicts of interest can be adjusted into beneficial situations which create a more suitable and satisfying situation for everyone, to a certain extent. The majority of Islamic bank managers interviewed are confident that this is the strength in Islamic banking, where the interests of all parties are met. Especially profits making for the bank and the following of Shariah law for the clients in which the bank and the stakeholders are satisfied.

Skills such as strong communication is vital in order to resolve conflicts and complications and turning these situations into successful collective actions, especially when stakeholder interests are conflicting and are leading to a crisis for the bank (Gray, 1989). This reinforces that placing great importance on these relationships makes communication a critical practice for the Islamic banking industry. Communication is essential especially when relationships are required to work together in order to achieve mutual improvement. Promoting communication also has a positive effect when decisions are required to be made. As more and more banks embrace forms of cooperation, collective action, managers are stressing on communication, as stated by managers from Islamic banks interviewed.

When banks are willing to give stakeholders a say in matters and a certain amount of authority over other stakeholders, it makes it acceptable for stakeholders to accept second-rate results. This is because the stakeholders are now exposed to each other and recognize differences, making them more accepting to issues they may not have favored previously. Also, this shows stakeholders that indeed their opinions are taken into consideration by the bank and also by the Shariah board. Avoiding acknowledging stakeholders will create a sense of appreciation and disregard from the bank towards the stakeholders. Hence, this will damage the relationship and prevents cooperation, collective action and authority, which the bank requires in order to succeed.

Islamic Banking Stakeholders networks

As presented in Fig.1, Shariah Compliant Banks are in mutual communication with a number of key stakeholders, which include the board of director, external audit, internal audit, customer, bank supervisors, Shariah supervisory board, employees, environment, public,

competitors, suppliers, shareholders, and executive management. By creating a sound-enabling environment, the Islamic bank has a crucial role in influencing and communicating with other key players. This is vital in understanding the role and importance of different stakeholders, as explained below.

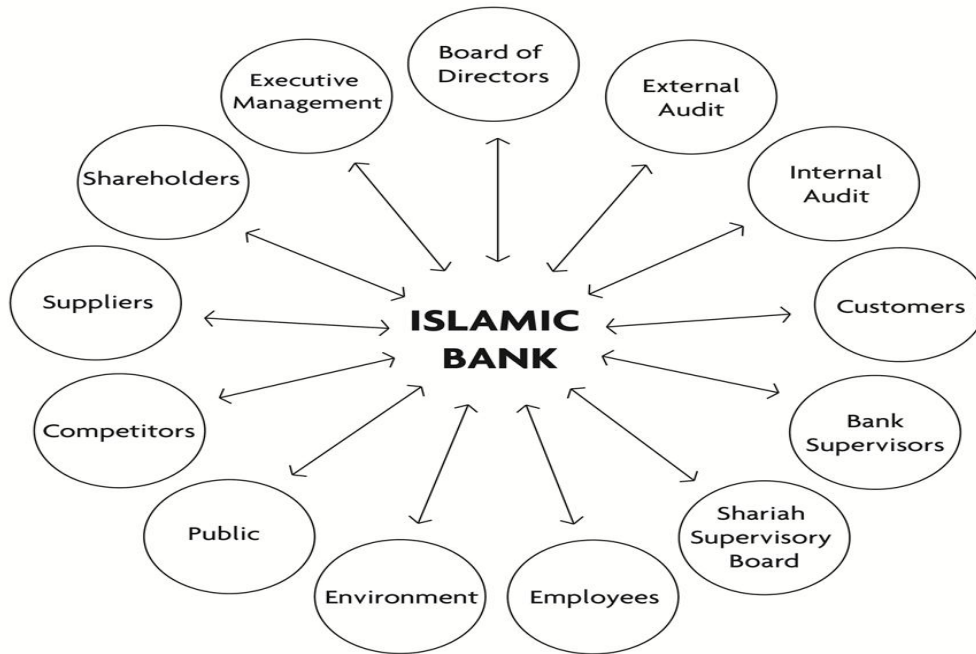


Figure 1: Key Stakeholders in Communication with Shariah Compliant Banks (Beekun and Badawi, 2005; Greuning and Iqbal, 2008)

The board of directors plans and implements the strategic directions, appoints management and is responsible for ensuring that the bank is healthy. External auditors have come to play an important role in evaluating the quality of risk-based financial information. The internal auditors perform an independent assessment of a bank's compliance with its internal control, accounting practices, and information systems. Most internal auditors provide assurance regarding the bank's corporate governance, control systems, and risk management processes. Bank supervisors communicate with the bank in terms of acting as organizers in the practice of risk management. They also enhance and monitor the legal framework in which risk management is practiced. Customers are accountable for their own actions. The Shariah board is composed of religious scholars and they protect the rights of all stakeholders according to Shariah law. Islamic banks cannot introduce a new product approval of their Shariah board making communication vital between the Shariah supervisory board and bank. Communication with employees mainly deals with hiring and firing; emphasis on competence and fair working conditions; rejection of sexism; wages and working condition and privacy. The environmental role involves acting and communicating responsibly. The public is responsible for their own investment decisions, and this requires transparent disclosure of financial information and informed financial analyses. Competitors are expected to communicate and compete fairly. Communication with suppliers involves cost of inputs; transparent production process; provision of Islamic approved (halal) products/services. Shareholders have the ability to appoint people in charge of the corporate governance process. Executive management must have the capability and experience to manage the bank. Because the management is responsible

for implementing the board’s policies, it is vital that managers have rich knowledge of the financial risks being taken (Beekun and Badawi, 2005; Greuning and Iqbal, 2008).

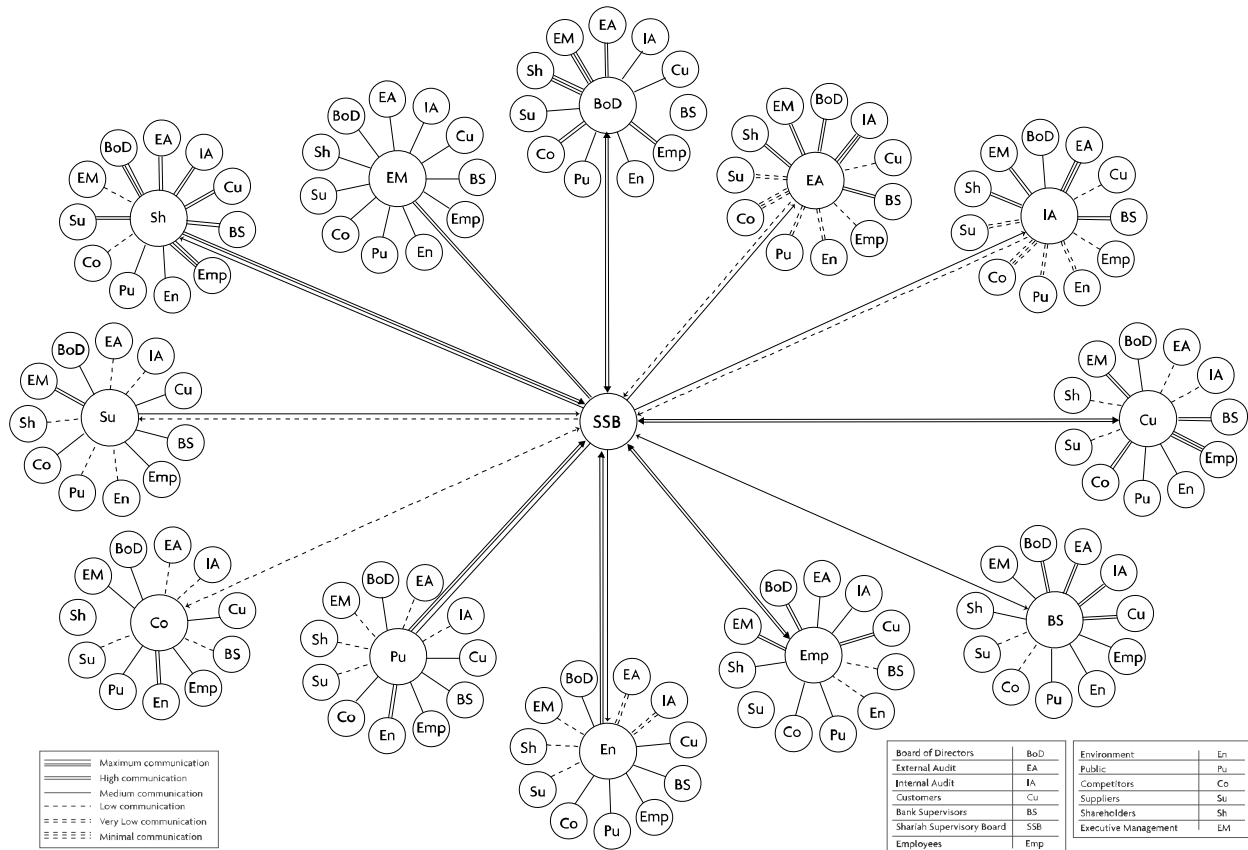


Figure 2: Inter-relationships between various stakeholder groups

As can be seen in Fig. 2, a model has been developed with regards to the inter-relationships between various stakeholder groups. Interviews conducted with the bank management have partially focused on the strength of communication amongst various stakeholder groups. The importance of communication is critical; the engagement of employees can contribute significantly to drive excellent performance. Furthermore Robinson et al. (2004) stated that, "engagement has a positive reflection towards the organizational goals and values. An engaged employee therefore understands and appreciates changing business contexts, works effectively as a team member and aims at improving both his own and the organization's performance". Lucey (2009) has described, "Employee engagement is how each individual connects with the company and the customers".

Increasing productivity has been linked with numerous noteworthy relationships that have been studied and proven to exist including communication, job satisfaction and organizational climate. (Singh and Pestonjee, 1990; Joshi and Sharma, 1997). It has been tested and confirmed that organizational communication has proven to be a moderator in connection with both job performance and satisfaction of employees (Pettit et al, 1997).

Due to these studies and findings, progressive organizational strategy has placed great importance on internal communications. Companies which place importance on increasing communication skills of managers and supervisors to improve the "line of sight" and "commitment of employees" have been found to be high-effectiveness companies. The importance and proven effectiveness of organizational communication in determining

engagement levels is greatly influencing and is visible (Nordin et al, 2011). Udegbe et al (2012) reported that around 75 to 80 percent of a manager's time is spent involving some form of business communication with various stakeholders. Business communication is the act of continuous information flow, including feedback from vital parts of the business communication. He also stated that current organizations are large in terms of size, naturally meaning that they will have a large number of stakeholders involved in the communication with the organization.

Approaching Strategy as Unity

Conventional banking stakeholders may expect managers to make decisions based on "dictated by the numbers" or as "business decisions". On the other hand, Islamic banking managers stated that stakeholders expect decisions by management to be based on responsibilities and relationships they have with specific stakeholders decisions made by the Shariah board.

Islamic bank managers interviewed believe that when in the process of identifying problems, instead of the Islamic banks limiting themselves to just considering topics such as science, statistics, and facts, Islamic banking stakeholders understanding would prefer by beginning with making several stakeholders work through the process of fixing together their diverse opinions. Islamic bank stakeholders, topics regarding experience and religion should be greatly considered when creating a structure, in order to identify both problems and their solutions. This also highlights the diversity of stakeholders perceptions involved.

It is encouraged that bank managers place less priority on achieving objectives and place more priority on the pursue on unity and effective communication, as stated by the managers interviewed. With regards to the strategic direction of Islamic banks, profits should not be the motivation. Rather, stakeholders and their interests, desires, needs should determine the strategic direction of the Islamic bank. Hence, there should no be a separation by the bank from their stakeholders into a remote position. It is stressed upon that numbers and abstract surveys are not the influencers of the strategic direction on the bank.

Conclusions

The argument raised in this paper is that Islamic banking stakeholders view stakeholder management as a means of considering all networks of stakeholders when building value, as can be viewed from inter-relations graph amongst various internal stakeholders. This can be achieved through the hierarchy approach, gaining influence on the external environment and building strategic direction by using constant communication as a key means. It is of highest importance that Islamic bank managers support and develop the networks of communication with stakeholders and employees, encourage creativity, authority and distribute power when faced with decision-making. It is also noted that the Islamic banking industry is under researched, with regards to analyzing different stakeholder groups, and more so using quantitative empirical research. When examining the applications of different management and communication models, it has been found that little research has been applied in both the growing Islamic banking industry and the Arab world.

Developments of the stakeholder concept are evident because of how much significance is placed upon the stakeholders in order to address the most practical, ethical and religious issues. Similar studies should be conducted in order to better understand the functions and needs of all stakeholders involved with Islamic banks. Studies should not be limited to Arab countries, but also at a global scale regarding the issues of Islamic banks.

It is suggested in this paper that there be movement in favor of Arab understandings of the stakeholder theory, while keeping in mind these multiple arguments raised which help, develop the current Islamic banking practices. Academics and practitioners are encouraged to carry this study out further in order to gather more data on Islamic banking management for a stakeholder, which currently lacks research. It is hoped that this paper puts forward an initial step.

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