Ethical Decision Making in Islamic Financial Institutions in Light of *Maqasid Al-Sharia*: A Conceptual Framework

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\textbf{ABSTRACT:} This paper develops a conceptual framework for ethical decision making in Islamic financial institution based on the Islamic methodological approaches on ethics. While making use of the similarities between the scientific method and the Islamic jurisprudence method, a framework is developed by means of argumentation and reasoning to integrate Sharia doctrines with the PDCA cycle as a managerial tool. Using Al-Raysuni’s analysis of Al-Shatibi’s work on maqasid al, the paper develops a framework to assess the ethical aspects of Islamic financial operations which is then applied to hypothetical cases. The approach can help overcome the methodological deficiencies in measuring ethical performance in Islamic finance by focusing on the process of ethical decision making that leads to the outcomes of organisational behaviour beyond legality of contracts. The framework outlines the conditions under which an activity that is considered legal and permissible contractually could lead to outcomes that can make it ethical or unethical.

\textbf{Key words:} Islamic ethics, PDCA, Islamic jurisprudence method, ethical decision making, Islamic financial institutions, maqasid al Sharia

1. \textbf{INTRODUCTION}

The Islamic financial services industry (IFSI) has been growing rapidly over the past decade. The global assets of the Islamic financial sector are estimated to reach US$ 1.89 trillion in 2016 with the banking sector accounting for US$ 1.49 trillion (IFSB, 2017). With an annual growth rate of 17.5 present over the three years preceding 2014, the spread of fully-fledged Islamic financial institutions (IFIs) covered 40 Muslim and non-Muslim countries across the world (CIBAFI, 2011; EY, 2013). In some specific jurisdictions, the share of the Islamic banking sector has become large and systematically important. The demand for Islamic banking is growing notably in some markets with predictions that more conventional banks will convert into Islamic banks (Al Ziyadat, 2011). IFIs, which work under the umbrella of conventional
economies and regulatory environments, have also become an integral part of the global financial system¹ (Moodys, 2008).

A unique feature of Islamic finance is its compliance with the *Sharia*. Accordingly, the articles of associations and licences for the operations of IFIs state that their operations comply with the *Sharia*. In many jurisdictions where financial institutions are licenced as Islamic, instituting a *Sharia* governance framework is a regulatory requirement to ensure *Sharia*-compliance. This may require IFIs to not only have a *Sharia* Supervisory Board (SSB) consisting of *Sharia* scholars specialising in Islamic jurisprudence and financial transactions² but also to have *Sharia* control departments that provide the internal advisory and auditing functions (IFSB, 2009). As Islamic legal principles are deemed inherently ethical, consumers and other stakeholders expect IFIs to be ethical. Thus, the use of Islamic jurisprudence is expected to lead to moral and legal norms that are generally accepted by the majority of Muslim communities.

Despite the theoretical assumption that IFIs are ethical, criticisms of their lack of contribution to the aspirations 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 broader *Sharia* objectives (e.g. Badr El Din, 2006; Asutay, 2007; Sairally, 2007; Mohammed, Abdul Razak & Taib, 2008; Zaman & Asutay, 2009; Sanrega & Taufiq, 2012; Bedoui, 2012; Bedoui & Mansour, 2015). Studies addressing this issue vary from subjective arguments to empirical evidence based on models developed to operationalize *Sharia* objectives and accordingly gauge the ethical performance of IFIs.

¹ In its report, ‘Gulf Islamic Banks Resilient Amid Global Credit Woes’, November 2008, Moodys comments on the case of Islamic finance’s spread using the saying, ‘No man is an Island’ to indicate that IFIs do not operate in isolation from their local, regional and even international environments.
² See for example: Central Bank of Bahrain 2011, Rule Book, Volume 2, HC-1.3.15.
The common denominator for empirical studies is that they tend to measure *Sharia* objectives through proxies denoting the achievement of specific ethical aspects of performance (e.g., Sairally, 2007; Mohammed, Abdul Razak & Taib, 2008; Mohammed & Taib, 2010, 2015; Antonio, Sanrega, & Taufiq, 2012; Bedoui, 2012; Bedoui & Mansour, 2015). However, such methods for gauging ethical aspects usually ignore key methodological issues including the intention of the management and shareholders, the context dependence of moral actions, the control of companies over its actions, and the level of disclosure of good deeds (Graafland, Eijffinger & SmidJohan, 2004).

In this paper, we argue that overcoming these deficiencies can be made by developing a framework for assessing how decisions are made and the way that they lead to the end results or outcomes. Our arguments rely mainly on Al-Shatibi’s theory of *Maqasid al-Sharia*, which facilitates the understanding of the links between the *al-ahkam al-taklifiyya* (*Sharia* rulings), the *maslaha* (*sharia* benefit) and the *maqasid* (*Sharia* objectives) to shed light on how *maqasid*-based ethical decisions are made. This is done by developing a conceptual framework for ethical decision making by integrating the contemporary management tool ‘plan, do, check and act’ (PDCA) identified by Neilimo & Näsi (as cited in Lankoski, 2000, p. 6) with *Sharia* doctrines of legal methods related to ethics. We facilitate matching between well-established *Sharia* and managerial concepts to provide new concepts by means of reasoning and argumentation.

2. **SHARIA: THE SOURCE OF LEGAL AND MORAL NORMS**

Islam as a way of life for Muslims and *Sharia* provides a codified system of norms upon which Muslims act in their daily lives (Dusuki, 2008). Meanwhile, Al-Qurtubi (1240/2006), as cited in Bedoui & Mansour (2015, p. 560), defines *Sharia* as ‘the canonical law of Islam’ which comprises both legal and moral norms against which human conduct is judged. In this regard,
not every *Sharia* ruling is legal though all of them are moral. According to Kamali (2008), the difference between a legal ruling and a moral one is that the former has a legal enforceability and can be adjudicated in courts.

As a canonical law, *Sharia* recognises the interests of human beings. In fact, the *Sharia* views human beings as vicegerents of *Allah* (God) on Earth (Al-Shatibi 2005, 5:373). Thus, the higher *Sharia* objective is ‘empowering human beings with what is useful and beneficent for them to achieve the purpose of their existence as *Allah*’s vicegerents on Earth’ (Al-Najar, 2006, p. 17). This is also confirmed by Ibin Ashour (2001, p. 273) who definition of the higher *Sharia* objective as “the preservation and sustainability of the usefulness of the Umma’s system through the righteousness of human beings as the dominator on that system”. The *Sharia* also recognizes that human beings are granted with free-will (Quran, 91:7-8) that makes them accountable to *Allah* and to their societies as well (Quran, 91:9-10). Therefore, the *Sharia* regulates human conduct in ways that guarantee justice and beneficence which constitute two general Islamic commandments (Quran, 16:90). This is because the *Sharia* recognizes that human conduct may lead to conflicts of interest among individuals and between individuals and society.  

Al-Raysuni (2006, p. 34) quotes Imam Al-Shatibi (1320-1388 A.D.) as stating that *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’. This is also emphasized by Imam Izz Al-Din Ib n Abd Al-Salam (1182–1262 A.D.) who states that, ‘the entire Law [*Sharia*] consists of interests: either it prevents that which would cause harm (*mafsada*), or achieves that which would bring benefit (*maslaha*)’ (Al-Raysuni, 2006, p. 32). To functionalise this role of the *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 (*Allah*) or the *Maqasid Al-Sharia* (Al-Raysuni, 2006, p. 46).

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3 Such an argument is found in Imam Al-Shatibi’s theory of *Sharia* objectives, as cited in Al-Raysuni (2006).
Thus, implementation of a legal ruling needs to be projected in terms of the end results (Ma’alat) to reflect the implications in terms of maqasid al Sharia. In this regard, Islamic jurisprudence is keen to assess human actions to achieve their interests in accordance with the strength of the benefit (Maslaha) those actions bring to the Lawgiver’s objectives. This is because the Sharia recognises that there are possible conflicts between human interests and the Lawgiver’s objectives.

Sharia benefit (Maslaha) is ranked according to three levels in relation to the Lawgiver’s higher objectives of Sharia: (1) the essentials (Daruriyyat), (2) the exigencies (Hajiyyat), and (3) the embellishments (Tahsiniyyat) (Abu Zahra, 1997; Al-Najar, 2006; Imam Al-Shatibi as cited in Al-Raysuni, 2006). The daruriyyat are essential things for the individuals and community collectively and their absence would lead to a breakdown of social order and community (Ibn Ashur, 2006). They constitute the essentials entailing the basic elements of a good life and defects in them leading to the non-functioning of the social order of the community. Hajiyyat are needed for the proper functioning of the community and the achievement of its interests as they alleviate hardship and help to attain comfort. Absence of hajiyyat leads to hardships of life of the community members and hampers the functioning of the social order but does not lead to its collapse. Ibn Ashur (2006) opines that the importance given to hajiyyat by the Sharia is almost similar to daruriyyat. The last category of the maslaha, the tahsiniyyat, constitutes the beautifiers and luxuries that lead to a peaceful life and promote splendour and perfection in the condition of a community and social order. These benefits lead to further improvements and refinements that add value to life.

A few things need to be noted with respect to these levels of maslaha. First, they are relative and their classifications would depend on the various contextual factors including the levels of socio-economic development. Kamali (2003, p. 356) maintains that acts may be valued differently at the individual level and the level of society. Thus, contracts such as sale and
leasing are considered an essential interest from a community’s point of view but not from an individual’s point of view (where it can be considered hajjiyat). He asserts that during contemporary times, things such as economic development, employment and protecting the environment can be considered either ‘essential or complimentary interests depending on the priority they may command in a particular country or under a given set of circumstances’ (Kamali, 2003, pp. 356-357). Second, the three levels identified above apply both to maslaha and mafsada. Thus, while daruriyyat in maslaha would be something that is necessary to have, daruriyyat in mafsada would imply a harm that must be removed.

Scholars of the methodologies of Islamic jurisprudence (usul al fiqh) are usually concerned about the link between human actions and the objectives of the Lawgiver. This is because ‘the obligations named by the Law [Sharia] are intended for the purpose of fulfilling its objectives among human beings’ (Al-Raysuni, 2006, p. 108). Scholars such as Al-Shatibi (in Al-Raysuni, 2006), Al-Ghazali (cited by Ibin Ashour (2001, p. 301), and Ibn Ashour (2001, p. 301) identify the objectives of the Lawgiver as the preservation of religion, human life, progeny, human reason and material wealth. Human conduct concerning customs and daily transactions are assessed in accordance with the benefit they bring to the Lawgiver’s objectives (Maqasid Al-Sharia).

Once a human action is ranked in accordance with the benefit it brings to the objectives of the Lawgiver, the status of that action is determined on a scale of rulings (Al-Ahkm Al-Taklifiyyah) which distinguishes five types of acts: Wajib (obligatory), Mandub (recommended), Mubah (permissible), Makruh (reprehensive) and Muharram (prohibited). The first ruling in the top extreme of the scale is the obligatory action (Wajib). This ruling concerns all actions that must be done. On the other extreme of the scale there is the ruling pertaining to all actions that are prohibited (Haram or Muharram). Those two rulings have legal force and can be adjudicated in courts (Kamali, 2008), and they form part of the legal responsibility of a Sharia-compliant
firm. Following the obligatory (Wajib) there is the recommended (Mandub) ruling which pertains to all recommended actions. Parallel to that ruling but in a position preceding prohibition (haram) is the reprehensible (Makruh). This ruling covers all actions that are recommended to be avoided. Mandub and Makruh express moral responsibility as they do not have legal force and cannot be adjudicated in courts. The permissible (Mubah) are all acts that are permissible and are neutral in terms of any moral or legal connotations.4

2.1.Ethical and Legal Dynamics from Maqasid Perspective

Of the aforementioned five rulings, permissible (Mubah) rulings cover the majority of human actions. This is because the majority of human actions are permissible (Mubah) as indicated by Imam Al-Shatibi (Al-Raysuni, 2006). Mubah is neutral not only in terms of obligations and prohibitions but also in terms of its linkage with Sharia benefits (Maslaha) and objectives (Maqasid). Al-Raysuni further highlighted that “scholars have described actions falling into this category as neutral in the sense that there is an equal preference for performing them or refraining from them, and that one is free to choose between these two options” (p. 148).

It should be noted, however, that the Mubah action is sensitive to other factors that may convert Mubah to one of the other four categories of Al-Ahkam Al-Taklifiyyah (Al-Raysuni, 2006, p. 149). A key factor that determines the transformation of Mubah is the end result (Ma’al) to which an action leads. In this regard, a Mubah action that distracts the doer from a superior action, or causes the doer to fall into Sharia dangers is no longer considered as Mubah because it becomes a means to other ends. Sharia scholars acknowledge the link between the means and objectives of Sharia as asserted by Al-Shatibi: ‘It is recognized that means fall under the rubric of intentions or objectives, and that the ruling thereon is influenced accordingly’ (Al

4 More details on Sharia rulings are illustrated in (Al-Raysuni, 2006).
Therefore, Al-Shatibi viewed a *Mubah* action as *Mubah* in and of itself; otherwise, it will change to become one of the other four categories of *Al-Ahkam Al-Taklifiyya* based on the function of *Mubah* in the daily lives of individuals and society. Accordingly, actions classified permissible (*Mubah*) can be accompanied by ethical or legal dilemmas due to several factors which transform *Mubah* into one of the other four *Sharia* rulings.

Al-Shatibi identifies the sensitivity of a *Mubah* action to two major dimensions that could lead to a change in its end result and status: (1) the intensity of occurrence (i.e., moderation or excess) and (2) the scale of the impact (i.e. individual vs. collective). Thus, a *Mubah* action is divided into four categories, as Imam Al-Shatibi explained: (1) permissible (*Mubah*) individually, collectively recommended; (2) permissible individually, collectively obligatory; (3) permissible in moderation, undesirable in excess; and (4) permissible in moderation, forbidden in excess (Al-Raysuni, 2006, p. 152).

### 3. THE SHARIA JURISPRUDENCE METHOD AND THE PDCA CYCLE

To resolve those legal and ethical dilemmas, scholars use the Islamic jurisprudence method which provides the general framework to produce *Sharia* rulings concerning human conduct. In his book ‘Research Methods of Islamic Thinkers and the Discovery of the Scientific Method in the Islamic World’, Al-Nashar elaborates extensively on the methods of Islamic jurisprudence used to produce *Sharia* rulings related to different phenomena in actual human life. According to Al-Nashar (1984), Islamic epistemology provides the underlying logic and methods used for knowledge production in accordance with *Sharia* jurisprudence. It is based on the actual life of mankind and has nothing to do with metaphysics. In other words, it consists of pragmatic methods that are used to induce and deduce the *Sharia* rulings that are related to social (including economic and political) phenomena.
Scholars of the theory of Islamic jurisprudence (usul al-fiqh) use jurisprudential analogy, *qiyaṣ fiqhi*, according to induction that is based on two rules. The first is the law of universal causation (*al-illiyyah*), which means that the Sharia ruling is approved because of a legal cause (*illah*). This means that whenever the *illah* exists, the Sharia ruling exists, and the same applies in the case of its non-existence. For example, the *illah* of the prohibition of alcohol is intoxication. The second rule is the law of the uniformity of nature (*al-ittiradh*), which means that when an *illah* exists in similar circumstances then the same Sharia ruling applies. For example, if intoxication exists with a beverage other than alcohol, then the Sharia ruling for that beverage is prohibition (Al-Nashar, pp. 112-113).

Thus, scholars of *usul al-fiqh* based the jurisprudential analogy upon the same two laws that the British Philosopher and political economist John Stuart Mill (1843) based his system of scientific induction on (Al-Nashar, p. 113). Mill considered induction as “a process of inference; it proceeds from the known to the unknown; and any operation involving no inference, any process in which what seems the conclusion is no wider than the premises from which it is drawn, does not fall within the meaning of the term” (cited in Robson, 1974, p.266).

From the perspective of Islamic economics, the inference of the suitable *illah* includes both jurisprudential and economic analysis. This is because gyration, which is the correlation between the ruling and *illah*, requires the induction of various Sharia rulings, and this is, in essence, a jurisprudential analysis. Additionally, the appropriateness (i.e. the ranking of the Sharia benefit or *maslaha* resulting from the implementation of the ruling justified by *illah*) is, in essence, an economic analysis (Al-Suwailem, 2013). Al-Suwailem (2013) here is merely concerned with theorization in Islamic economics. However, the other part of the scientific method of the Sharia is represented by the acknowledgement of the deductive approach to test the real gyration relationship between *illah* and the Sharia ruling for phenomena in actual situations. Thus, proving the relationship of gyration between *illah* and the Sharia ruling is
recognised by scholars of *usul al-fiqh* to be based on experiment: “in fact, it [gyration] is a mere experiment. The more experiments proving the gyration [between the *illah* and the *Sharia* ruling], the more the induction becomes a case of certainty” (Al-Qarafi in his manuscript ‘*Nafae’s Al-Usul Fi Sharh Al-Mahsul*’, cited by Al-Nashar, 1984, p.126).

This method consists of a loop between inductive and deductive approaches to theorizing economic phenomena and then testing for generalisations. When a *Sharia*-compliant firm (namely an IFI) enters the market, it relies on the standardised *Sharia* rulings that are considered as normative rulings already deduced by jurists from the sources of the *Sharia*. The search for normative rulings is considered to be the first step in the *Sharia* jurisprudence method. Examples of normative rulings for IFIs are those related to *murabaha* as a mode of finance which are standardised by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). However, the implementation of *murabaha*, which is permissible in and of itself, should be preceded by projecting the environment in which that *murabaha* is going to be implemented, including the outcomes of that implementation. Such a projection includes economic, social and environmental issues. For example, what if the *murabaha* is going to be a financing facility for an oil extraction project that may affect the health of the local community? In this regard, social and environmental factors may be projected in the end results and affect the higher *Sharia* objective of human lives (*maqasid al-Sharia*).

The projection of the end results is the positive description that is required for the normative ruling to be rational; that is, to find the set of economic incentives and market forces under which this ruling will serve the objectives of optimal welfare (Al-Suwailem, 2013). However, the positive description of the environment in which the normative ruling is going to be implemented is linked to the legal cause of the ruling (*illah*). Thus, if a legal cause is projected to exist in such a way that leads the aforementioned *murabaha* example to have harmful outcomes when implemented, then the normative *Sharia* ruling of *murabaha* as a *mubah*
(permissible) contract might be consequently affected and transformed into one of the other four Sharia rulings. The theorization process of the Sharia jurisprudence method represents the inductive approach of the method (Al-Nashar, 1984).

Once the ruling is implemented, then the Sharia method extends to the deductive approach to test the conformity between the projected end results and the actual end results of the implementation of the Sharia ruling. As explained earlier, the appropriateness and the gyration aspects of the legal cause (illaah) of a Sharia ruling can be based on experimentation (Al-Nashar, 1984). Furthermore, Islamic economists assert that Islamic knowledge accepts both deductive and inductive approaches when it is related to an economic matter (Khan, 1987; Nienhaus, 1989; Chapra, 1995; Naqvi & Qadir, 1997). This can be explained by referring to Al-Shatibi’s view concerning the shift of a permissible (mubah) action into other Sharia rulings. He states that a mubah action can be permissible in moderation but undesirable in excess. Similarly, what can be permissible in moderation is forbidden in excess (Al-Raysuni, 2006, p.152). The word ‘excess’ is subjective if it is left to individual opinion because what is considered as an ‘excess’ for one person may not be the same for another person. In economic and social phenomena, the word ‘excess’ should be determined objectively because it touches on the public interest. The deductive testing can be conducted by the Sharia advisory boards (SSB) of IFIs by consulting with professionals to understand specific technical issues concerning Islamic finance as stipulated by standards of the IFSB (2009) and AAOIFI (2007 a,b).

Therefore, when returning to the example of the murabaha financing of the oil extraction project, if the positive ruling of the murabaha financing was based on projected results that the community will not be affected, then the implementation should include checking and assurance related to whether or not what has been projected is true. In the case of non-conformity between the end results and the projected end results, then there are two possibilities: either the testing of conformity has not been appropriate or the positive ruling has not been properly induced to
achieve the rationale of the legal cause (illah) of the Sharia ruling. In fact, if the former is true, then a re-test is required. Managerially speaking, the checking and assurance system of an IFI should be enhanced. However, if the latter is true, then the positive ruling is to be re-conducted. In both cases, a reaction or a response must take place accordingly. In the case of a mistake in the projection of the positive ruling, then harm is caused to the stakeholders (i.e. to the health of the community in the aforementioned example of the murabaha financing of an oil extraction project). In the case of harm being caused, then corrective measures must be taken place in order to stop the harm. Those corrective measures not only target stakeholders but are also directed to amending the positive ruling.

3.1. Sharia Jurisprudence and PDCA Cycle

Taking the scientific method into the arena of business, 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 which he later on changed to a cyclical process where specification, production and inspection correspond to hypothesizing, carrying out an experiment, and testing the hypothesis (Moen & Norman, 2010). 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 (Tsutsui, 1996; Moen & Norman, 2010). Later on, the Japanese⁵ amended this to ‘plan, do, check, and act’ (PDCA) (Tsutsui, 1996; Moen & Norman, 2010).

The development of the PDCA cycle was aimed at the prevention of errors by establishing standards and on-going modifications to those standards (Moen & Norman, 2010). Thus, the PDCA cycle has been widely used in the field of quality improvement, process

⁵According to Masaaki Imai (1986), Japanese executives recast the Deming wheel into the PDCA cycle. He did not provide details on how the PDCA was developed and who developed it, but nobody disputed Imai’s claims nor claimed the ownership of the PDCA (Moen & Norman 2010).
control, innovation and learning (Bader, Palmer, Stalcup & Shaver, 2003; Tricker, 2005). Furthermore, the PDCA is the core philosophy around which the ISO standards and their management systems, and especially ISO 9000, revolve (Lee, Leung & Chan, 1999; Piskar & Dolinsek, 2006). The most distinctive feature of the PDCA cycle as used by researchers is that there is no ‘one size fits all’ model in terms of the details underlying each step. In other words, the PDCA cycle is used for different research and application purposes, and accordingly the details under each phase of the cycle vary from one researcher to another (e.g. Marquis, 2009; Asif, Searcy, Zutshi, & Fisscher, 2011; Chen, 2012).

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 & Krope, 2007; Kubenka & Myskova, 2009; Asif et. al., 2011; Chen, 2012; Drieniková & Psakál, 2012). Thus, given that the scientific method underlies the PDCA framework and that the Islamic jurisprudence method is similar to the scientific method, the later can underlie the PDCA framework as the former does. However, developing a PDCA-based framework for implementing ethically-based decisions requires the integration of the Sharia jurisprudence method into the management systems of IFIs where the Sharia jurisprudence method plays the same role as the scientific method upon which PDCA is based.

In IFIs, the Sharia supervisory boards (SSBs) have the responsibility to give Sharia rulings governing the development and projected implementation of products and services (IFSB, 2009). This responsibility, in fact, represents the first stage of the Sharia jurisprudence method. However, given that almost all normative Sharia rulings governing Islamic finance products and services have already been standardised within the AAOFI Sharia Standards and the rulings (fatwas) of Islamic Fiqh academies, the role of the SSBs will be mainly directed towards the projection of the contexts in which the already standardised Sharia rulings are going
to be implemented and the prediction of the end results that will facilitate the achievement of Sharia interests (maslaha) leading to the achievement of Sharia objectives (maqasid al-sharia).

Additionally, SSBs have the responsibility for reviewing and auditing the implemented products and services (IFSB, 2009). This responsibility represents the second stage of the Sharia jurisprudence method in terms of testing the conformity between what have been issued as Sharia rulings governing products and services and what has been implemented. In practice, such a stage is achieved through Sharia auditing (AAOIFI, 2007b).

Logically speaking, the results of Sharia auditing should provide information not only about the aforementioned conformity but also about the viability of the projection of the context and the prediction of the end results, the correct implementation of the Sharia rulings represented by the correct offering of products and services, and the efficiency of the auditing process. The link between the two responsibilities of the SSBs (i.e. as they represent the two stages of the Sharia jurisprudence method) is represented by the Sharia reports that are issued by SSBs after auditing. These reports are provided to the top management and consequently shareholders (AAOIFI, 2007b) and stakeholders at large. Thus, the real implementation of the Sharia jurisprudence method is merely the production of knowledge for IFIs that is similar to the implementation of the scientific method underlying the PDCA framework.

In a PDCA framework, the ‘plan’ phase is simply represented by answering the question of “What to do?” and “How to do it?” (Tricker, 2005). Because IFIs are Sharia-compliant, they decide what to do and how to do it in accordance with the Sharia. Those two questions require projections and environmental scanning that are important for the top management’s decision-making process as well as for the SSBs for the projection of the end results of the products and services when implemented. Therefore, the first stage of the Sharia jurisprudence method (i.e. the induction stage) underlies the planning phase of the PDCA as indicated in Figure 1. As for
the search for normative Sharia rulings in the sources of Sharia, this is considered to be outside of the planning phase because the majority of the Sharia rulings governing the business of IFIs are standardised.

The second and third phases of the PDCA are ‘do’ and ‘check’. The ‘do’ stage is a mere implementation of what has been planned by management (Tricker, 2005) in accordance with what has been deduced to be Sharia-compliant by the SSB. The ‘check’ phase is related to testing whether or not what has been implemented is in accordance with what had been planned (Tricker, 2005). In the actual business implementation of the PDCA, however, checking overlaps with implementation although there is a final auditing because the testing provides real-time data about conformities and disconformities (Martensen & Dahlgaard, 1998; Kotnour, 1999; Speroff & O’Connor, 2004). Therefore, the deduction stage of the Sharia jurisprudence method underlies both the ‘do’ and ‘check’ of the PDCA (see Figure 1).

The fourth phase of the PDCA is ‘act’. This phase is related to measures and steps to be taken to produce improvements in the future (Tricker, 2005). From a Sharia viewpoint, this requires, if needed, amendments to the projection of the context in which the Sharia ruling has been implemented (i.e. gaining more experimental evidence about the appropriateness of the legal cause with the Sharia ruling) and the prediction of the end results of the Sharia ruling in accordance with their correspondence to maslaha and Sharia objectives. Thus, the amendment phase of the Sharia jurisprudence method underlies the ‘act’ phase of the PDCA.
4. ORGANISATIONAL DECISION-MAKING FRAMEWORK FOR SHARIA COMPLIANCE

In most cases, the articles of associations of Islamic banks and financial institutions (IFIs) clearly state that they work in accordance with the Sharia. To ensure Sharia compliance, these organisations have Sharia advisory boards (SSBs) that oversee their transactions and operations. Another feature is that these organisations have Sharia departments that provide first line advisory and internal auditing (IFSB, 2009). The major role of an SSB is to assure stakeholders that the IFI is Sharia-compliant through engaging in several roles and duties which revolve mainly around two major functions. The first is the ex-ante advisory review of the design and development of the services, products, and contracts of the IFI before they are offered to the customers. The second role is the ex-post review or auditing of the offering of products and services to clients and the engagement of the IFI in contracts (IFSB, 2009)\(^6\).

\(^6\)For more explanations about these two functions see: Paras 15-19 of the IFSB (2009).
two roles of the SSB are similar to the steps of the Islamic jurisprudence method. Therefore, the first concept underlying the organisational decision-making framework (ODMF) for Sharia compliance is that the Islamic jurisprudence method can be integrated with the business models of IFIs.

In IFIs, Sharia audit can take place internally and externally. Audit provides evidence to SSBs regarding the compliance of IFIs with the rulings issued by the SSBs. In reality, SSBs build their Sharia-compliance reports for stakeholders based on this evidence (AAOIFI, 2007). Thus, the second concept underlying the ODMF is that the Sharia audit practiced in IFIs can provide the feedback that maintains the loops between the steps of the jurisprudence method when integrated within IFIs’ business models. The ODMF can be operationalized in IFIs by using the PDCA cycle which, as indicated, is a managerial structure widely used by organisations for different purposes. The key aspects of ODMF in light of PDCA are discussed below.

Plan Phase: The planning phase embeds managerial practices that proactively enrich the Sharia-compliant decision-making. The planning phase starts with the collection of information from two sources: scanning the environment and engaging with stakeholders. Environmental scanning comprises of the study of the economic, social and environmental surroundings of an organisation (Wheelen & Hunger, 2004). Stakeholder engagement is the action taken by an organisation to create a dialogue with one or more of its stakeholders with the aim of providing an informed basis for the organisation’s decision (ISO 26000, 2010, clause 2.21).

Together with stakeholder engagement, environmental scanning provides a proactive identification of the social, economic and environmental concerns and interests of both an IFI and its stakeholders. From a Sharia point of view, every benefit is called Maslaha and every harm is called Mafsada. Once those expected benefits and harms are identified, they can be
linked to their normative Sharia rulings as indicated in the Islamic jurisprudence method. Table 1 provides a matrix that facilitates the identification of the issue that an IFI should examine to assess the ethicality of products at the planning stage.

<table>
<thead>
<tr>
<th>Categories of Maqasid</th>
<th>Essentials (daruriyyat)</th>
<th>Exigencies (hajiyat)</th>
<th>Embellishments (tahsiniyyat)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Maslaha</td>
<td>Mafsada</td>
<td>Maslaha</td>
</tr>
<tr>
<td>Religion</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Human Life</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Progeny</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reason</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wealth</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Authors’ own.

The matrix illustrated in Table 1 helps provide a general, high-level understanding of the interests and harms projected to face the IFI when operating with their products and services. Thus, a phase of projecting the end results of the activities of the IFI is required to determine the viability of implementing the normative legal ruling. In this regard, prioritising benefits and avoiding harms are based on a Sharia compliant projection of the end results of the normative rulings if they are implemented. It should be noted that to assess the impact of any product of the five elements of maqasid would require social science (economists, sociologists, etc.) and environmental science experts. Once the rulings are generated in accordance with the projected end results and the benefits they bring to Sharia objectives, these should be operationalized as key performance indicators and reflected in the IFI’s manuals, policies and procedures.

**Do Phase:** The ‘do’ phase comprises of implementing what has been planned (Tricker, 2005). It includes the interaction between the IFI and stakeholders through the products, services, and contracts that have been developed in accordance with the planning phase. The ‘know-how’ is represented by the already developed manuals, procedures and processes providing the guidance for implementation.
**Check Phase:** The ‘check phase’ includes both internal and external *Sharia* auditing. In a similar manner to internal *Sharia* auditing, external auditing should be based on the actual achievement measured by the KPIs which the IFI is already committed to achieve. It should be extended to include any deviation from the desired end results (*Ma’alat*) of the products, services, contracts and charitable projects.

**Act Phase:** The final phase requires the IFI to ‘act’ in accordance with the results of the *Sharia* auditing. The ‘act’ phase involves improving the inputs in the planning phase as well as following corrective actions to ameliorate faults resulting from mistakes in implementation. Furthermore, the ‘act’ phase is linked to improving the *Sharia* structures, of the products and services in addition to the improvement of the whole *Sharia* compliance system within an IFI. From an Islamic jurisprudence perspective, the ‘act’ phase is represented by amendments to the projections of the contexts and the end results (if needed) in such a way that maintains the *Sharia* rulings in a continuous linkage with the *Sharia* objectives. In fact, because the PDCA is a generator of a profound level of knowledge for organisations (Martensen & Dahlgaard, 1998; Speroff & O’Connor, 2004), the ‘act’ phase in the framework for Islamic OEDM should include research and development based on the outputs of the external and internal *Sharia* auditing in order for IFIs to improve their contribution to the achievement of *Sharia* objectives and interests.

Given the above framework, the way in which the PDCA framework can be used to assess the ethicality of products is explained below. After determining that the industry is going to produce a legitimate (*halal*) product, the steps used to assess the ethical perspectives of any financing decision are summarized in Table 2 below:

<table>
<thead>
<tr>
<th>Phase</th>
<th>Steps</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Plan</strong></td>
<td>• Come up with the ethical assessment framework as identified in Table 1.</td>
</tr>
</tbody>
</table>

Table 2: Phases and Steps to Assess Ethics of Financial Decisions.
5. APPLICATION OF THE FRAMEWORK: HYPOTHETICAL CASE STUDIES

The framework presented above is used in hypothetical cases to clarify how ethical decisions will be made in light of the maqasid al-Sharia focusing on the phases of the PDCA. Following Kamali’s (2003) assertions, things such as economic development, employment and protecting the environment can be discussed under the realm of the levels of maslaha and mafsada. To examine how ethics can be incorporated into decision making, consider the hypothetical example of an Islamic financial institution (IFI) operating in a developing country that has received funding requests for factories that have different risk-return features and social and environmental impacts. Using the framework outlined in the planning stage of the PDCA, the IFI would determine the specific outcomes and its implications on the broader maqasid for the projects in the DO stage. Table 3 shows that there are two maslaha and two mafsada outcomes for the hypothetical projects considered. While Outcomes 1 and 2 affect the maqsad (singular of maqasid) of wealth, outcome 3 impacts human life and outcome 4 has implications for progeny.
### Table 3: The *Maqasid* Implications of the Industrial Project

<table>
<thead>
<tr>
<th>Benefit/Harm</th>
<th>Specific Outcomes</th>
<th><em>Maqasid</em> Affected</th>
</tr>
</thead>
</table>
| *Maslaha* (MS) | 1. Higher production/contribution to economic development  
2. Profitability for shareholders | 1. Wealth  
2. Wealth |
| *Mafsada* (MF) | 3. Adverse impact of environmental degradation on community health  
4. Impact on environmental degradation on future generations | 3. Human life  
4. Progeny |

Source: Authors’ own.

As indicated above, dynamic *maqasid* can be viewed in terms of the ‘intensity’ of occurrence (low, medium and high) and the ‘scale’ of the impact related to the individual (private) or the collective (public). For the latter category, more weight is given to collective than private *maslaha/mafsada*. Kamali (2003) asserts that the assessment of *maslaha/mafsada* is context-based and whether a specific activity is considered an essential or complimentary interest would depend on a given set of circumstances and the priority that a particular country puts on them. He further maintains that a lawful government or a person in charge of community affairs (*ulu al-amr*) should have ‘the authority to identify and declare them as such and then take the necessary measures for their realisation’ (Kamali, 2003, p. 357).

While the assessment of *maqasid* and the *maslaha/mafsada* levels are context-based and should be determined by an authoritative body, we present the tentative relationships between the intensities of the outcomes of the project and the corresponding *maqasid* levels used for this study in Table 4 as an example. Although this classification is done subjectively in this paper, the actual classifications should be done objectively by an authoritative body within an organization or government as suggested by Kamali (2003). It should be noted that during contemporary times, several multilateral and global financial institutions have incorporated screening according to environment, social and governance (ESG) related factors.\(^7\) Assessment criteria that is similar to these frameworks can be developed to ascertain the *maqasid* specific metrics.

\(^7\) For a discussion on incorporating ESG issues in financial decisions see IFC (2012) and UNEP (2011, 2014).
Traditional growth theory predicts that higher levels of employment leads to higher production and economic growth.\(^8\) Since high employment and growth can be considered as collective *maslaha*, it can be considered *daruriyyat* at different levels of intensities (low, medium and high) depending on their levels of output. Thus, projects producing higher output levels will have greater weight in *daruriyyat* than a project that produces lower quantities.

Outcome 2 in table 3 relates to the profitability for shareholders which is an individual benefit. This outcome would therefore be classified as a *daruriyyat* for low levels, *hajjiyyat* for medium, and *tahsiniyyat* for higher levels. This is because lower levels of income are likely to be used for basic necessities, and, as income levels increase, money will be spent on other non-essential items and luxuries.

Outcomes 3 and 4 are *mafsadah* that affects the society as a whole (collective). As indicated, the *Sharia* goals for *mafsada* would be to mitigate them. Production would result in some level of pollution affecting the environment adversely which can affect the *maqasid* of human life and progeny. Since pollution mitigation is costly, mitigating low levels of pollution can be considered *tahsiniyyat* since all production leads to some emissions. However, when the pollution levels are medium, eradication of its adverse impact can be deemed *hajjiyyat*. Finally, if the intensity of environmental degradation is high, its preservation could be considered *daruriyyat*. Table 4 summarises the classification scheme that is used in the examples that are discussed subsequently.

**Table 4: Classification Scheme of Intensity and Maqasid Levels**

<table>
<thead>
<tr>
<th>Outcomes</th>
<th>Type</th>
<th>Individual/ Collective</th>
<th>Maslaha/mafsada and Intensity Levels</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Higher production/ contribution to economic growth</td>
<td>MS</td>
<td>Collective</td>
<td>Low, Medium, High</td>
</tr>
<tr>
<td>2. Profitability for shareholders</td>
<td>MS</td>
<td>Individual</td>
<td>Low</td>
</tr>
<tr>
<td>3. Adverse impact of environmental degradation on community health</td>
<td>MF</td>
<td>Collective</td>
<td>High</td>
</tr>
</tbody>
</table>

\(^8\) For a discussion on traditional growth theory see Solow (1956, 1970) and for endogenous growth theory see Romer (1986).
4. Impact on environmental degradation on future generations

<table>
<thead>
<tr>
<th>Source: Authors’ own.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>MF</th>
<th>Collective</th>
<th>High</th>
<th>Medium</th>
<th>Low</th>
</tr>
</thead>
</table>

5.1. Hypothetical Cases

Assume an IFI operating in a developing country has received a funding request for factories that have different risk-return features and social and environmental impacts. The IFI uses a profit-loss sharing product so that its profit share is positively related to the profitability of the projects it invests in. All project proposals pass through the due-diligence in terms of risk-return features and it is concluded that funding the projects would yield a net-profit. If that IFI operates with a purely legalistic perspective with respect to Sharia compliance, it would invest in projects with higher profitability without considering any ethical issues. However, if the ethical dimensions based on maqasid al-Sharia are included in the decision-making process, the financing decisions could turn out to be different. The following hypothetical case studies illustrate this point.

The intensities of the outcomes of Project 1 and various dimensions of ethics from an Islamic legal methodological perspective are shown in Table 5. The project leads to higher production which is considered daruriyyat and also to higher profitability which is categorised as tahsiniyyat (see Table 4). Furthermore, this project produces a low impact on the environment which is also ranked as tahsiniyyat. Since harmful environmental impacts are low and the benefits to society in terms of higher production are necessary (dururiyyat), the ethical judgment on this project can be that it is preferable (mandub).

**Table 5: Outcomes and Ethical Assessments of Project 1**

<table>
<thead>
<tr>
<th>Outcomes</th>
<th>Type</th>
<th>Intensity</th>
<th>Individual/Collective</th>
<th>Maslaha/mafsada Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Higher production/contribution to economic development</td>
<td>MS</td>
<td>High</td>
<td>Collective</td>
<td>Daruriyyat X Hajiyat</td>
</tr>
<tr>
<td>2. Profitability for shareholders</td>
<td>MS</td>
<td>High</td>
<td>Individual</td>
<td>X</td>
</tr>
<tr>
<td>3. Adverse impact of environmental degradation on</td>
<td>MF</td>
<td>Low</td>
<td>Collective</td>
<td>X</td>
</tr>
</tbody>
</table>
community health

4. Impact on environmental degradation on future generations

<table>
<thead>
<tr>
<th>Outcomes</th>
<th>Type</th>
<th>Intensity</th>
<th>Individual/Collective</th>
<th>Maslaha/mafsada Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Higher production/contribution to economic development</td>
<td>MS</td>
<td>Medium</td>
<td>Collective</td>
<td>Daruriyyat</td>
</tr>
<tr>
<td>2. Profitability for shareholders</td>
<td>MS</td>
<td>Medium</td>
<td>Individual</td>
<td>Hajiiyyat</td>
</tr>
<tr>
<td>3. Adverse impact of environmental degradation on community health</td>
<td>MF</td>
<td>Medium</td>
<td>Collective</td>
<td>Tahsiniyyat</td>
</tr>
<tr>
<td>4. Impact on environmental degradation on future generations</td>
<td>MF</td>
<td>Medium</td>
<td>Collective</td>
<td>Daruriyyat</td>
</tr>
</tbody>
</table>

The ethical assessment of Project 2 is presented in Table 6. Production increase with medium intensity retains the status of *daruriyyat* since it results in higher growth. As indicated in Table 4 above, medium profitability to shareholders can be considered *hajiyyat*. Similarly, for outcomes 3 and 4, reducing the environmental impact of medium intensity is ranked as *hajiyyat*. Given the *daruriyyat* status of the *maslaha* of higher production and the *hajiyyat* status of the *mafsada* of environmental impacts, an ethical conclusion for project 3 can be *mubah*.³⁹

Table 6: Outcomes and Ethical Assessments of Project 2

<table>
<thead>
<tr>
<th>Outcomes</th>
<th>Type</th>
<th>Intensity</th>
<th>Individual/Collective</th>
<th>Maslaha/mafsada Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Higher production/contribution to economic development</td>
<td>MS</td>
<td>Medium</td>
<td>Collective</td>
<td>X</td>
</tr>
<tr>
<td>2. Profitability for shareholders</td>
<td>MS</td>
<td>Medium</td>
<td>Individual</td>
<td>X</td>
</tr>
<tr>
<td>3. Adverse impact of environmental degradation on community health</td>
<td>MF</td>
<td>Medium</td>
<td>Collective</td>
<td>X</td>
</tr>
<tr>
<td>4. Impact on environmental degradation on future generations</td>
<td>MF</td>
<td>Medium</td>
<td>Collective</td>
<td>X</td>
</tr>
</tbody>
</table>

Table 7 presents the assessment for project 3 that have high intensities for all the outcomes. Table 4 shows that while higher production is still considered *daruriyyat*, high profitability is considered *tahsiniyyat*. Mitigating higher levels of environmental impact makes both outcomes 3 and 4 *daruriyyat*. Since the adverse impact of the maqasid on human life and progeny is significant, this project can be judged as *makruh*.

Table 7: Outcomes and Ethical Assessments of Project 3

<table>
<thead>
<tr>
<th>Outcomes</th>
<th>Type</th>
<th>Intensity</th>
<th>Individual/Collective</th>
<th>Maslaha/mafsada Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Higher production/contribution to economic development</td>
<td>MS</td>
<td>High</td>
<td>Collective</td>
<td>X</td>
</tr>
<tr>
<td>2. Profitability for shareholders</td>
<td>MS</td>
<td>High</td>
<td>Individual</td>
<td>X</td>
</tr>
<tr>
<td>3. Adverse impact of environmental degradation on community health</td>
<td>MF</td>
<td>High</td>
<td>Collective</td>
<td>X</td>
</tr>
</tbody>
</table>

³⁹Given that outcomes 3 and 4 both affect the society collectively, the judgement can also be inclined towards a weaker *makruh*.  

25
Finally, the results of project 4 reported in Table 8 show the intensities of outcomes to be low for the collective *maslaha* and high for the *mafsada*. From Table 4, these intensities imply that outcomes 1, 3 and 4 would be categorised as *daruriyyat*. However, the high profitability of the project being a private benefit is ranked as *tahsiniyyat*. Since, both *mafsada* outcomes 3 and 4 have high intensity impacts and their removal becomes necessary (*daruriyyat*) and the production level is low, the ethical judgment of this project could be a strong *makruh*.

### Table 8: Outcomes and Ethical Assessments of Project 4

<table>
<thead>
<tr>
<th>Outcomes</th>
<th>Type</th>
<th>Intensity</th>
<th>Individual/ Collective</th>
<th>Maslaha/mafsada Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Higher production/contribution to economic development</td>
<td>MS</td>
<td>Low</td>
<td>Collective</td>
<td>X</td>
</tr>
<tr>
<td>2. Profitability for shareholders</td>
<td>MS</td>
<td>High</td>
<td>Individual</td>
<td>X</td>
</tr>
<tr>
<td>3. Adverse impact of environmental degradation on community health</td>
<td>MF</td>
<td>High</td>
<td>Collective</td>
<td>X</td>
</tr>
<tr>
<td>4. Impact on environmental degradation on future generations</td>
<td>MF</td>
<td>High</td>
<td>Collective</td>
<td>X</td>
</tr>
</tbody>
</table>

Table 9 presents a summary of the different projects and the resulting ethical judgments. Assume that, given its limited resources, the IFI has to decide to finance two projects of the five proposals. If the ethical considerations are not taken into consideration then it would base the choices based on profitability. Thus, if the IFI uses a purely legalistic perspective it would choose from projects 1, 4 and 5 as these projects yield the highest profits. However, when ethical considerations are taken into account, projects 4 and 5 do not qualify as they are *makruh*. From an ethical point of view, project 1 and another from either project 2 or 3 should be chosen. This example also highlights that in certain cases a trade-off between profitability and ethics can arise. Which one of the projects will ultimately be chosen will then depend on the priorities of the IFI and whether it gives a priority to ethical considerations when making decisions.

### Table 9: Outcome Intensities of *Maqasid* and Ethical Judgements
<table>
<thead>
<tr>
<th>Outcomes</th>
<th>Type</th>
<th>Project 1</th>
<th>Project 2</th>
<th>Project 3</th>
<th>Project 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Higher production/contribution to economic development</td>
<td>MS</td>
<td>High</td>
<td>Medium</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>2. Profitability for shareholders</td>
<td>MS</td>
<td>High</td>
<td>Medium</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>3. Adverse impact of environmental degradation on community health</td>
<td>MF</td>
<td>Low</td>
<td>Medium</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>4. Impact on environmental degradation on future generations</td>
<td>MF</td>
<td>Low</td>
<td>Medium</td>
<td>High</td>
<td>High</td>
</tr>
</tbody>
</table>

**Ethical Judgement**

<table>
<thead>
<tr>
<th>Ethical Judgement</th>
<th>Mandub</th>
<th>Mubah</th>
<th>Makruh</th>
<th>Strong</th>
</tr>
</thead>
</table>

Once the *maslaha*-weighted projects are chosen and implemented, the internal and external *sharia* audit shall provide feedback on the conformity between the projected *masalih* and the results with what has really been achieved. Assuming that the audit on Project 1 after implementation provides feedback that the impact on the environment has not been as projected (i.e. it has been high), the way the environmental impact was projected should be reviewed and improved.

**5. CONCLUSION**

*Sharia* has both legal and ethical connotations. While IFIs have focused on legal compliance, they have been criticized for neglecting the ethical aspects of *Sharia*. After presenting an overview of the ethics from an Islamic perspective, the paper provides a framework that can be used by IFIs to implement ethical decisions in their operations. Using the concepts from the contemporary managerial method of PDCA and notions from Islamic legal methodologies, a framework to assess the ethicality of Islamic financial operations is presented. Being based on Islamic jurisprudential methods, the suggested framework to evaluate ethical outcomes can be used by IFIs to make their operations *Sharia*-compliant both in legal and ethical terms. The hypothetical case studies show that when ethics becomes an integral part of decision-making, IFIs may make decisions that are different from those based on a purely legalistic basis. While IFIs should incorporate both legal and ethical notions of *Sharia*.
compliance, implementing the framework will, however, ultimately depend on the whether there is the will at the highest levels of the organization to make the operations ethical.

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