



**A DESCRIPTIVE STUDY ON THE LEVEL AND EXTENT
OF CSR DISCLOSURE BY ISLAMIC BANKS IN
MALAYSIA AND BAHRAIN**

BY

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**A dissertation submitted in fulfilment of the requirement
for the degree of Master of Science (Accounting)**

**Kulliyyah of Economics and Management Science
International Islamic University Malaysia**

MAY 2015

ABSTRACT

While several prior studies (Hassan and Harahap 2010; Haniffa and Hudaib 2007 and Maali e. at., 2006) provided evidences that the Corporate Social Responsibility (CSR) disclosures by Islamic Financial Institutions (IFIs) were short falls from the expected Islamic CSR disclosure, Aribi and Gao (2010) suddenly revealed significant differences in the level and extent found between the IFIs and Conventional Financial Institutions (CFIs) which are largely due to the disclosure made by the IFIs of religions related themes and information not found in the Western practices. This highlight which is too early sometimes may be felt sufficiently welcoming by the Muslim society due to their expectation of full disclosure and accountability. Anxious over this conflict and also concern on the image and reputation of IFIs, this study explored the reality of CSR disclosure in two comparable groups of the IFIs. Using the method of content analysis in annual reports, this study specifically examined the level and extent of CSR disclosure made by the Malaysian Islamic Banks (MIBs) and Bahrain Islamic Banks (BIBs) against a set of Social Disclosure Items developed in this study. The two objectives are firstly, to identify the range of CSR subthemes disclosed by the Islamic banks in Malaysia and Bahrain, and secondly to examine the comprehensiveness of the CSR disclosure by the Islamic banks in Malaysia and Bahrain. The results reflect that in terms of the level of CSR disclosure, BIBs in overall scored higher than MIBs at a total of 185 and 149 points respectively while in terms of the extent of CSR disclosure, MIBs scored higher than BIBs at a total of 629 and 613 points respectively. In reality, there are big gaps of CSR disclosure levels by both MIBs and BIBs and the expected Islamic CSR disclosure needs serious attention from respective bodies such as the AAOIFI. The findings of this study have important implications towards the improvement on IFIs' CSR disclosure to run parallel with their establishment objectives and also to provide avenues for the improvement on the role of AAOIFI at the national and international levels in providing revised CSR disclosure requirement and encouraging IFIs to meet the requirement of full disclosure and high transparency. This study originally contributes to the literature of CSR disclosure by IFIs in the context of reality differences in the level and extent of CSR disclosure by IFIs. Both IFIs in Malaysia and Bahrain still require a lot of improvement in ensuring full disclosure. Through this paper, the Muslims' understanding on the current performance of CSR disclosure by the IFIs is enhanced and the anxiousness over the conflict towards the highlight by Aribi and Gao, 2010 is released.

ملخص البحث

في حين قدمت العديد من الدراسات السابقة (حسن وهرهب (2010)، حنيفة وهديب (2007)، المعالي وآخرون (2006))، الأدلة على أن الإفصاح عن المسؤولية الاجتماعية من قبل المؤسسات المالية الإسلامية (IFIs) لم يكن بالقدر المتوقع من شركات تعمل في إطار الدين الإسلامي ، كشف عريبي وغاو (2010) فروق ذات دلالة إحصائية في مستوى ومدى الإفصاح الموجود بين المؤسسات المالية الإسلامية (IFIs) والمؤسسات المالية التقليدية (CFIs) والتي ترجع - إلى حد كبير- إلى أن الإفصاح في المؤسسات المالية الإسلامية يتعلق بموضوعات ومعلومات دينية غير موجودة في الممارسات الغربية. هذا الاكتشاف الذي يعد مبكراً جداً قد يجد في بعض الأحيان ترحيباً كافياً من قبل المجتمع المسلم بسبب توقعهم الإفصاح الكامل والمساءلة الكاملة. انطلاقاً من أهمية البحث في واقع هذا التناقض بالإضافة إلى ضرورة الاهتمام بصورة وسمعة المؤسسات المالية الإسلامية، تناولت هذه الدراسة واقع الإفصاح عن المسؤولية الاجتماعية للشركات في المؤسسات المالية الإسلامية ، حيث تم إجراء دراسة تطبيقية على مجموعتين متماثلتين من المؤسسات المالية الإسلامية باستخدام أسلوب تحليل المحتوى في التقارير السنوية. بحثت الدراسة على وجه التحديد مستوى ومدى الإفصاح عن المسؤولية الاجتماعية للشركات الذي أدلت به البنوك الإسلامية الماليزية (MIBS) وبنوك البحرين الإسلامية (BIBS) ضد مجموعة من عناصر الإفصاح الاجتماعية التي وضعتها هذه الدراسة. أهداف هذه الدراسة أولاً، تحديد المواضيع الفرعية في المسؤولية الاجتماعية للشركات التي كشفت عنها البنوك الإسلامية في ماليزيا والبحرين، وثانياً دراسة شمولية الإفصاح عن المسؤولية الاجتماعية للشركات من قبل البنوك الإسلامية في ماليزيا والبحرين. وتعكس النتائج أنه من حيث مستوى الإفصاح عن المسؤولية الاجتماعية للشركات، سجلت BIBS نتيجة إجمالية أعلى مما سجلته MIBS في ما مجموعه 185 و 149 نقطة على التوالي، بينما من حيث مدى الإفصاح، سجلت MIBS نتيجة إجمالية أعلى مما سجلته BIBS في ما مجموعه 185 و 149 نقطة على التواليكما كشفت الدراسة عن وجود فجوات كبيرة بين مستويات الإفصاح عن المسؤولية الاجتماعية للشركات من قبل كل من MIBS و BIBS ومستويات الإفصاح المتوقعة في الإسلام ، مما يستدعي الحاجة إلى اهتمام جاد من الهيئات المعنية مثل هيئة المحاسبة والمراجعة للمؤسسات المالية الإسلامية AAOIFI . هذه النتائج لها آثار هامة في تحسين إفصاح المؤسسات المالية الإسلامية عن مسؤولياتها الاجتماعية التي تتلاءم مع أهداف إنشائها ، وكذلك توفير سبل لتحسين دور AAOIFI على الصعيدين الوطني والدولي في تقديم الإفصاح المنقح عن المسؤولية الاجتماعية للشركات وتشجيع المؤسسات المالية الإسلامية لتلبية متطلبات الإفصاح الكامل والشفافية العالية. كما تساهم هذه الدراسة في أدبيات الإفصاح عن المسؤولية الاجتماعية للشركات في سياق واقع الخلافات في مستوى ومدى الإفصاح عنها من قبل المؤسسات المالية الإسلامية. ولا تزال كل من المؤسسات المالية الإسلامية في ماليزيا والبحرين تتطلب الكثير من التحسن في ضمان الإفصاح الكامل. تساهم هذه الورقة أيضاً في تعزيز فهم المسلمين على الأداء الحالي للإفصاح عن المسؤولية الاجتماعية للشركات من قبل المؤسسات المالية الإسلامية وإزالة القلق حيال التناقض الذي أشار إليه العريبي وغاو.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Accounting.

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DECLARATION

I have declared that this dissertation is the results of own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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ACKNOWLEDGEMENTS

I am greatly indebted to Dr. Akhyar Adnan and Assoc. Prof. Dr. Hafiz Majdi Abd. Rashid, whose excellence in supervision and devotion to research has greatly inspired my work. Without their untiring assistance, direction, encouragement, comments, suggestions and constructive feedbacks throughout this study, this research would not have been completed. It is definitely an honorable experience to be working with them. Special thanks to Prof. Dr. Nazli Anum Ghazali, the Research subject lecturer who is very dedicated and her constant encouragement have made the unachievable possible. I would also like to thank Assoc. Prof. Dr. Hafiz Majdi Abd. Rashid, Prof. Dr. Dr. Nik Nazli for their constructive criticisms and ideas during the initial development of this dissertation. I wish to express my deepest gratitude to my beloved husband, Mr. Azizi Abd. Rahim, who has spared his valuable time and commitment during the entire research process. Without his endless support, assistance and patience, my dissertation would have been a difficult journey. I dedicate this research to my father, Kadir Md. Zin, my mother, Zainah Jusoh, my daughter, Arissa Sofea Azizi and my son, Aris Danial Azizi. Beyond a simple thank you, I want them to know that I love them all very dearly.

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LIST OF ABBREVIATIONS

| | |
|------------|--|
| AAOIFI | Accounting and Auditing Organization for Islamic Financial Institution |
| ALBA | Albaraka Islamic Bank |
| BAHR | Bahrain Islamic Bank |
| BIBF | Bahrain Institute of Banking and Finance |
| BIBs | Bahrain Islamic Banks |
| BIMB | Bank Islam Malaysia Berhad |
| BMA | Bahrain Monetary Agency |
| BNM | Bank Negara Malaysia |
| BRAKYAT | Bank Kerjasama Rakyat Malaysia Berhad |
| CBB | Central Bank of Bahrain |
| CFIs | Conventional Financial Institutions |
| CSR | Corporate Social Responsibility |
| CSRD | Corporate Social Responsibility Disclosure |
| et al., | others |
| FAS | Financial Accounting Standards |
| FRS | Financial Reporting Standards |
| FSMP | Financial Sector Master Plan |
| GCIBFI | General Council for Islamic Banks and Financial Institutions |
| GSIFI | Government Standard for Islamic Financial Institutions |
| i.e., | that is |
| IFI/ IFIs | Islamic Financial Institution / Islamic Financial Institutions |
| IIFM | International Islamic Financial Market |
| IIRA | Islamic International Rating Agency |
| ISRF/ISRFs | Islamic Social Reporting Framework / Islamic Social Reporting Frameworks |
| | /The Conceptual Framework of Islamic Social Reporting |
| KHAL | Khaleeji Commercial Bank BSC |
| MASB | Malaysian Accounting Standards Board |
| MIBs | Malaysian Islamic Banks |
| MUA | Bank Muamalat Malaysia Berhad |
| p.b.u.h | Peace Be Upon Him |
| PLCs | Public Listed Companies |
| RHIB | RHB Islamic Banks |
| S.W.T | Suhbanahu Wa Ta'ala (Praise be to Allah and the Most High) |
| SDI/SDIs | Social Disclosure Item / Social Disclosure Items |
| SPI | Skim Perbankan Islam |
| viz., | namely |
| WSRF | Western Social Reporting Framework |
| | /Conventional Social Reporting Framework |

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND AND MOTIVATION OF THE STUDY

Corporate social and environmental disclosures have been increasing internationally over the last two decades, but it is also arguable that they remain at a minimum level in a number of respects (Imam, 2000). Most of the existing Corporate Social Responsibility (CSR) studies are cross-sectional and focus on developed countries and few studies were conducted on developing countries. The question of what factors contribute to CSR disclosure has become a matter of discussion since a few decades ago which includes theories like the agency theory, stakeholder theory, legitimacy theory and also a few other theories such as the accountability theory. Besides that, there are few elements that cannot be ignored for example the political, economic, culture and environment as well as not neglecting the religious aspects.

The emergence of Islamic Financial Institutions (IFIs) and their aggressive development have encouraged a few researchers to look further on the CSR disclosure practices by the IFIs. In 2010, Aribi and Gao who presumed Islam as a key factor inspiring the CSR disclosure of IFIs and differentiating corporate behaviors between the IFIs and Conventional Financial Institutions (CFIs) in disclosing CSR revealed significant differences in the level and extent found between the IFIs and CFIs. These significant differences are largely due to the disclosure made by the IFIs on religions related themes and information such as *Sharia*' Supervisory Board, *Zakah* and Charity donation and free interest loan which are not covered by the Western practices. Aribi and Gao however, compared CSR disclosures of two different groups of Financial

Institutions which are not comparable as they are from two different worldviews; the Islamic Worldview and Conventional Worldview. The comparison made on these two groups of Financial Institutions definitely revealed significant differences which are due to their differences in nature and establishment of objectives where the foundation of IFIs' business philosophy is closely connected to religion which contrasted to that of CFIs. As there are only a few studies conducted on the CSR disclosure of IFIs, the highlight of this finding which is considered too early sometimes may lead to complacent among Muslims towards the IFIs' performance on CSR disclosure especially those who lack knowledge in Islamic banking and Islamic Corporate Social Responsibility.

It is in fact worrying if the findings by Aribi and Gao (2010) may be felt sufficient by the Muslims a whole as there is a need to conduct a CSR disclosure comparison study between two comparable groups of IFIs which may reveal differences in the level and extent of CSR disclosures. According to Aribi and Gao (2010), Islam is a factor for the CSR differences between IFIs and CFIs, but it is definitely not a factor for the CSR disclosure differences between two different groups of IFIs as Allah S.W.T has clearly clarified this in the Holy *Quran* which means “*And every one has a direction to which he should turn, therefore hasten to (do) good works; wherever you are, Allah will bring you all together; surely Allah has power over all things.*” (*Quran 2: 148*). This verse encourages Muslims to do good as much as possible and remain obedient to Allah and thus, it is meaningful to assess the IFIs' performance in terms of fulfilling their obligation to God, society and eco-system which is less emphasized by previous studies. Thus, this current study examines the level and extent of CSR disclosures on two comparable samples that were found lacked in Aribi and Gao (2010). Furthermore, there was also lack of focus

on comparison study on Islamic CSR disclosure between IFIs of two different countries with different accounting standards in prior studies as most of them compared the actual Islamic CSR disclosure practices by IFIs of more than two countries against the expected Islamic CSR disclosure (Hassan and Harahap, 2010; Haniffa and Hudaib, 2007 and Maali et. al, 2006). The findings of this current study are expected to provide meaningful information on the level and extent of CSR disclosure made by the IFIs as an addition to the Muslims' understanding on the findings by Aribi and Gao (2010) specifically. This is because their findings which are due to the disclosure made by the IFIs on religions related themes and information could not conclude that the IFIs has reached a satisfactory standard for their CSR disclosure. Moreover, they only examined a number of words during content analysis to presume Islam as a key factor inspiring the CSR disclosure of IFIs and differentiating corporate behaviors between the IFIs and CFIs. As noted by Milne and Adler (1999), words by itself do not bring any meaning without referring to both the sentence and its context.

It is believed that with the focus on two comparable samples from two countries of two different accounting standards to determine the level and extent of CSR disclosure in this current study, the revealed findings will be of importance in the literature of CSR disclosure by the IFIs. Previous studies (Hassan and Harahap, 2010; Haniffa and Hudaib, 2007 and Maali et al., 2006) have contributed to the literature of CSR disclosure by the IFIs in which gaps were found between the expected CSR disclosure and actual CSR disclosure among the IFIs. Hence, it is hoped that the findings of this current study will initiate another discussion to provide suggestions on how to improve both the level and extent of CSR disclosures by the IFIs. It is expected that all IFIs will be able to meet the principles of full disclosure in

disclosing their CSR involvement so that Muslim users will be able to make appropriate decision in accordance to the Islamic teaching. Haniffa and Hudaib (2007) suggested that a full disclosure in the annual report of relevant and reliable information may assist the Muslim stakeholders to make both economic and religious decisions as well as assisting the management in fulfilling their accountability to Allah SWT and the society.

Hence, this current study that measures the level and extent of CSR disclosure by IFIs helps the IFIs in reviewing its' performance that will make the IFIs' CSR disclosures different from the CFIs, which in turn supports the proposition by Aribi and Gao (2010) that Islam is a key factor inspiring the IFIs' CSR disclosure and differentiating corporate behaviors between the IFIs and CFIs in disclosing CSR.

1.2 OBJECTIVES OF THE STUDY AND RESEARCH QUESTION

Judging that the Islamic Worldview is the basis for the IFIs establishment, both groups of IFIs may have formed their vision, mission and objective in accordance to both Business and Sharia' Objectives. Accordingly, they are supposed to strive together in achieving as high as possible for their accountability to Allah S.W.T as this has been mentioned clearly in the Holy *Quran* which means "*And every one has a direction to which he should turn, therefore hasten to (do) good works; wherever you are, Allah will bring you all together; surely Allah has power over all things.*" (*Quran 2: 148*).

The aim of this paper is to identify the reality of CSR disclosures among IFIs by filling the gap of the lack of two comparable sample groups in Aribi and Gao (2010) and also the gap of lacking of focus comparison on CSR disclosure by two groups of the IFIs from two different countries in prior studies. Hence, this current

study specifically examined the level¹ of CSR disclosure reached by two comparable IFIs with the objective to identify the range of the CSR subthemes disclosed by Islamic banks in Malaysia and Bahrain. Secondly, this current study also specifically assessed the extent² of CSR disclosure by two comparable IFIs with the objective to examine the comprehensiveness on the CSR disclosure by Islamic banks in Malaysia and Bahrain.

In Islam, all individuals and businesses are accountable to God and the society at large by recognizing the rights of others. Baydoun and Willet (2000) suggested that from the perspective of corporate reporting, two essential principles underlie the concept of accountability in Islam, viz., the principle of full disclosure and the concept of social accountability. This indicates that the principle of full disclosure requires the preparer of accounts to disclose everything that is believed to be 'of importance to the Islamic users for the purposes of serving God'. Realizing this relationship, both the level and extent of CSR disclosure are essential to be measured in this current study. Moreover, it is understood that making full disclosure also means forming part of accountability to Allah S.W.T and the society.

These are to help the Muslims understand the IFIs' achievement on CSR disclosure in addition to their comprehension on the findings by Aribi and Gao (2010) that the IFIs are different from the CFIs. The findings of this study are targeted to help the IFIs in assessing their performance on the CSR disclosure practiced and also the AAOIFI to serve its role in assisting the IFIs to meet the requirement of full

¹ The level of CSR disclosure is examined based on the present or absent of each subtheme of which the score '1' is given to each subtheme disclosed and the score '0' is given to each subtheme not disclosed.

² The extent of CSR disclosure is examined based on the number of occurrence of each subtheme (each SDI code) in annual report.

disclosure of CSR information so that they can finally enhance their image and reputation globally, as well as to remain competitive.

1.3 LIMITATION AND SIGNIFICANCE OF THE STUDY

Similar to other previous researchers, the researcher of this current study also developed a benchmark of Islamic CSR disclosure (i.e. a set of SDIs) based on the researcher's understanding on prior literatures of Islamic CSR to examine the level and extent of CSR disclosure by two groups of IFIs. The use of this set of SDIs which is believed to be 'of importance to the Islamic users' in accordance to the researcher's understanding, will thus contribute to different interpretation on the CSR disclosures by IFIs. This has been suggested recently by Adnan et al. (2012) that interpretations of researchers about CSR disclosure practice of corporations depend on the CSR disclosure measurement. Having adopted the set of SDIs that is believed to be 'of importance to the Islamic users', future research can be extended to more groups of IFIs from all nations without bordering the other factors influencing the CSR disclosures by IFIs. Furthermore, the set of SDIs introduced in this current study is simple and thus enabling more IFIs of all countries to be studied. Such study is possible as it is believed that the Islamic worldview is the basis of the establishment of IFIs, thus all IFIs should be in accordance to the Islamic teaching as indicated by this verse which means *"And every one has a direction to which he should turn, therefore hasten to (do) good works; wherever you are, Allah will bring you all together; surely Allah has power over all things."* (Quran 2: 148). Accordingly, the future study is expected to reveal more meaningful information as to the overall

performance of IFIs on CSR disclosure rather than probing the reasons for making their disclosure.

The originality of this study is that the actual differences in the level and extent of CSR disclosure by two groups of IFIs from two different countries are revealed. High appreciation and support to Haniffa (2002) who emphasized on high accountability and transparency in the ISRF introduced are also demonstrated in this current study through the development of a set of SDIs to be employed in this current study. This set of SDIs is essential to help establish an Islamic Social Reporting Framework (ISRF) as an alternative to the Western Social Reporting Framework (WSRF) which is not suitable for Islamic enterprises (Maali et al, 2006). Hence, these findings are significant towards the improvement on IFIs' CSR disclosure to run parallel with their establishment objectives. These findings also offer avenues for the improvement on the role of AAOIFI at both the national and international levels in providing revised CSR disclosure requirement based on an ideal ISRF and encouraging IFIs to meet the requirement of full disclosure and practice high transparency. Hassan and Harahap (2010) stressed that the CSR disclosure in Islamic banks studies have an important implication for Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in developing a CSR reporting standard if Islamic banks are to enhance their image and reputation globally, as well as to remain competitive.

1.4 ORGANIZATION OF THE CHAPTERS

Chapter One begins with the general review on what have been done by previous researchers. This chapter also defines the gaps that the paper tries to fill in via The Background and Motivation of The Study. A few other sections like the Objective of

The Study and Research Question, and Limitation and Significance of The Study are also highlighted in this chapter to give a clear picture on what the researcher is attempting to contribute.

Chapter Two reviews the relevant literature on the Western Corporate Social Responsibility covering Reporting Practices and Theoretical Argument for Disclosing CSR Information. Islamic Corporate Social Responsibility comprising The Accountability Theory, Islamic CSR Reporting Practices, and also The Themes and Subthemes of Islamic CSR Information Measured by Prior Studies were also elaborated in this chapter. The discussion is then followed by The Direction of Current Research and Conclusion.

Chapter Three begins with a discussion on the rationale of the proposed research. This section also covers an introduction to Islamic banks in Malaysia and Bahrain to allow for comparison. This is then followed by the research design. The subsections are concerned with the selection of countries, unit of analysis (annual report) and data collection. Also discussed in this chapter is the content analysis including Coding Structure to Examine the Level and Extent of CSR Disclosure in Annual Report, Examining the Level and Extent of CSR Disclosure in Annual Report, and Reliability and Validity of The CSR Reporting Measurement. This chapter ends with the discussion of Statistical Analysis employed in this current study and conclusion of the Chapters.

Chapter Four discusses on A Comparison on The Level and Extent of CSR Disclosure between MIBs and BIBs. The Trends and Ranks of The Level and Extent of CSR Disclosure by MIBs and BIBs were also addressed in this chapter to denote the positions of each individual bank in the samples of study. The researcher also

highlighted on the Summary of Major Findings and Additional Observations in this chapter before the conclusion of the chapter is made.

The summary of the results are presented in Chapter Five. This study finds empirical evidences that there are differences in the level and extent of CSR disclosure made between these two comparable groups of IFIs. It is suggested that those who scored low for CSR disclosure in their annual reports need to increase their scores as making full disclosure and practicing high transparency mean forming part of accountability to Allah S.W.T and the society. This finding is expected to provide meaningful information to the Muslims as a whole in addition to the findings revealed by Aribi and Gao (2010). This chapter also signifies the conclusion of the research and suggests for avenues for future research on similar topic but covering more IFIs worldwide.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

The Western Corporate Social Responsibility (CSR) is not yet relevant for Islamic Financial Institutions (IFIs) as they are different in the nature and establishment in comparison with the Conventional Financial Institution (CFIs). As an alternative, the Islamic CSR would be the ideal aim of every Islamic Financial Institution. In order to explain this clearly, this chapter differentiates between the Western CSR and Islamic CSR. This chapter reviews on the relevant literature on Western CSR in terms of the Reporting Practices and Theoretical Argument for Disclosing CSR Information and also the Islamic CSR comprising of the Accountability Theory and Islamic CSR Reporting Practices. This chapter also further discusses on The Themes and Subthemes of Islamic CSR Information Measured by Prior Studies. This topic elaborates on the themes and subthemes of Islamic CSR information measured by prior literature studies which include the Disclosure Index Items developed via an extensive review of prior studies by Othman and Md. Thani (2010), the CSR Disclosure Benchmark based on Islamic perspectives of accountability, CSR justice and ownership for social disclosures by Hassan and Harahap (2010), the Checklist Instruments designed based on prior research in CSRD generally and the Arab Muslim countries particularly by Aribi and Gao (2010), A Benchmark of Ideal Ethical Identity developed based on the Islamic Ethical Business Framework by Haniffa and Hudaib (2007) and The Benchmark Set of Social Disclosures derived by applying Islamic principles in an *a priori* manner by Maali et. al (2006). This is essential to