

The Islamic Models Of Corporate Governance

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Abstract: Corporate governance is one of the crucial elements of any corporation development as it plays roles to strategize and promote principles of accountability, fairness and transparency. Nevertheless, it is observed that there is not much discussion or literature on the issue of corporate governance from the Islamic standpoint. It is strongly indicated that any Islamic corporation needs to have a strong governance model and proper strategies that will stimulate the adoption of solid and operative corporate governance within the Islamic paradigm. Current study is envisioned to offer an overview on the concept, principles and model of corporate governance from Islamic standpoint focuses on the governance framework of Islamic institutions.

Key words: Corporate governance, Islam, *Tawhid*, *Shura*, Stakeholders.

1. Introduction

According to O'Sullivan (2000), prior to 1997 the research carried out on corporate governance around the world was negligible. However, the failure of several famous names (e.g. WorldCom, Enron and Parmalat) and the crisis that swept the financial markets and economies of the major Asian countries in 1997 that have occurred in the last twenty years led to questions over the importance and significance of good corporate governance practices. Therefore, interest in corporate governance has grown and attracted considerable attention in the area of academic research and public policy in both developed and less-developed countries (Mallin, 2004; Sternberg, 2004; Okike, 2007; Tsamenyi et al, 2007; Mansor, 2015). The objective of this study is to provide the conceptual framework of corporate governance in Islamic perspectives. The initial study submits that Islam presents distinctive values and special characteristics of corporate governance with aim to uphold and maintain the principle of social justice not only to the shareholders of the firm but to the all stakeholders.

2. The concept of corporate governance in islamic perspective

There are not many studies have been carried out in the context of Islamic corporate governance (i.e. Islamic financial institutions) to come up with alternative models of corporate governance. The findings from those studies seem to recommend that Islamic corporation may adopt a totally different model of corporate governance or to adopt and adapt the Stakeholder based model as an alternative for its corporate governance framework. The former refers to the corporate governance framework based on the principle of consultation where all stakeholders share the same goal of *Tawhid* or the oneness of Allah (Choudury and Hoque, 2004; MICG, 2007; Hasan, 2008) and the latter concerns on adopting and adapting the stakeholders' value system (Chapra and Ahmed, 2002; Iqbal and Mirakhor, 2004; Hasan, 2008).

In the Islamic context, the stakeholders interest is beyond the financial return or profit maximization; it covers the element of ethic, *Shari'ah* or Islamic law and principle of *Tawhid* i.e. the oneness of Allah (Hasan, 2008). To address the issues, the rest of this paper is organized as follow: Subsection 2.1 discusses the *Tawhid* and *Shura* based model and Subsection 2.2 explain the Stakeholders based model.

2.1 *Tawhid* and *Shura* Based Model

According to Choudury, an Islamic corporation is a legal entity where the principle and proportionate of the firm's shares owned by the shareholders based on equity participation and profit sharing ratios. Meanwhile, governance of corporation deals with legal and organizational structures that control the internal governance of a firm with an objective to define and attain an objective criterion by way of understanding the relations between variables supported by policies, programs and strategic coalition (Choudury and Hoque, 2004; Kasri, 2009). As an Islamic corporation, it has to have a distinct corporate governance values that enable to differentiate it with the western concept of corporate governance (Raju, 2021).

There are four principles and instruments governing Islamic governance i.e. extension of *Tawhid* unity of knowledge through interactive, integrative and evolutionary process to the interacting envioning factors, the

principle of justice, the principle of productive engagement of resources in social and the principle of economic activities and recursive intention amongst the above stages (Chetty and Phung, 2018). All of these principles are the main premises of the Islamic corporate governance where the *Shari'ah* rules embedded in *al-Quran* and *al-Sunnah* make the Islamic corporation market driven and at the same time uphold the principle of social justice (Choudury and Hoque, 2004; Kasri, 2009). Figure 2.1 illustrates the *Tawhid* and *Shura* based corporate governance model as summarized by Choudury.

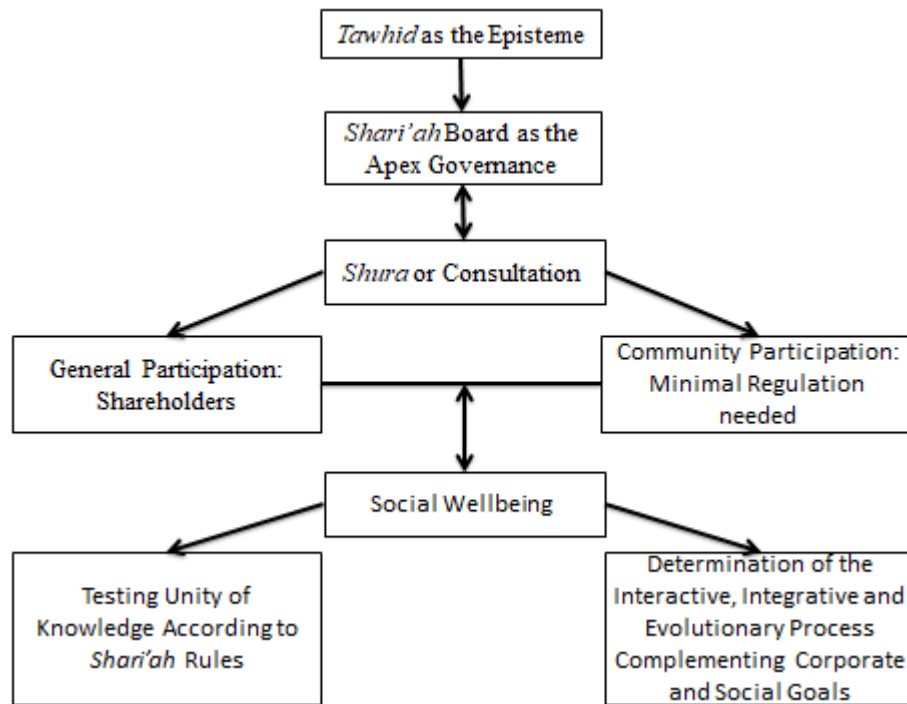


Figure 2.1 *Tawhid* and *Shura* based model (Choudury)

Figure 2.1 shows that the functional roles of corporation are working through the *Shari'ah* rules. The principle of *Tawhid* derives important concept of *khilafah*, and justice or equilibrium. The stakeholders as *khilafah* of Allah have fiduciary duty to uphold the principle of distributive justice through the *Shuratic* process. Here, the practice of *Shura* is an obligation (Chapra 1992; MICG, 2007). The constituent of *Shura* provides broadest possible stakeholders participation in the affairs of the state including corporation either directly or through representatives. There are two main institution involved in the above process of corporate governance namely the *Shari'ah* board and the constituent of *shura*'s groups of participants i.e. all the stakeholders. In determining the *Shari'ah* scope, the institution of *Shari'ah* board comes into a picture and it plays critical role to ensure that all corporation activities are in line with the *Shari'ah* principles (Hasan, 2008; MICG, 2007).

Furthermore, the shareholders also play a significant role as dynamic participants and conscious stakeholders in the decision making process and policy framework by considering the interest of direct and indirect stakeholders rather than only focusing on maximizing their profit (Raju, 2021). The other stakeholders including community should also play their roles to provide mutual cooperation to protect the interest as a whole and to stimulate the social wellbeing function for social welfare. All of these processes are centered on toward satisfying the final objective of Islamic corporate governance of complementing the private and social goals through upholding the principle of distributive justice (Choudury and Hoque, 2004; MICG, 2007; Hasan 2008).

2.2 Stakeholders Based Model

Iqbal and Mirakhor (2004) suggested that the corporate governance model in Islamic economic system is a stakeholder based model in which the governance style and structures protect the interest and rights of all stakeholders rather than the shareholders per se. The definition of stakeholders refer to those who have active participation in the decision making process but it also includes non-investor or non-owner stakeholders i.e. any party who has direct or indirect participation in the corporation. Their major arguments are based on two imperative concepts of Islamic law namely principle of property rights and commitment to explicit and implicit contractual

agreements that govern the economic and social behavior of individuals, society and state. These two principles provide strong defense for the opinion of classifying Islamic corporate governance as a stakeholder based model (Iqbal and Mirakhor, 2004; Hasan, 2008).

The principle of property rights in Islam clearly provides an inclusive framework to identify, recognize, respect and protects interest and rights of every individual, community, corporation and the state (Raju, 2018). In fact, rights of ownership, acquisition, usage and disposition of the property itself are considered as property (*al-mal*) which has beneficial use and value. In term of the rights of ownership, Islam affirms that Allah is the sole owner of property and human being is just a trustee and custodian in which it suggests the recognition to use and manage the properties in accordance with *Shari'ah* rules (Iqbal and Mirakhor, 2004; Hasan, 2008). There are many verses of *al-Quran* mentioned the principle of property rights and one of them is in surah 57:7 Allah says: *Believe in Allah and His Messenger and spend of that whereof He made you trustee*". The implied meaning of this verse lays down the principle of property's ownership where the mankind is only regarded as a trustee of God. In brief, the concept of property rights in Islam is based on these fundamental principles i.e. the rights on the property is subjected to *Shari'ah*, the enjoyment of rights to property is balanced with the rights of society and the state, every individual, society and the state is stakeholders and the recognition of rights of stakeholders by Islamic law (Iqbal and Mirakhor, 2004; Hasan, 2008).

Contractual framework is also very exclusive in Islam. In al-Quran surah 5:1 Allah clearly reminds the Muslims on the principle of fulfilling each of their contractual obligations where He says: *"O you who believe, fulfill contracts"*. This verse presents a basic foundation the notion of contract that every individual, society, corporation and the state are bound by their contracts which defines the rights and obligations of the parties. In relation with the issue on corporate governance, each stakeholder has duty to perform his contractual obligations in accordance with the term stipulated in the contract directly or indirectly. For example, the shareholders has duty to provide business capital, the management to manage and run the business, the employees to perform their respective duties and the state to ensure enforceability of the contracts in case of violation by any party. All of these duties arise through contractual framework and they are subjected to the rules of *Shari'ah* (Iqbal and Mirakhor, 2004; Hasan, 2008; Kasri, 2009; Azahari, 2018).

Figure 2.2 depicted the Islamic corporate governance based on stakeholders model. It presents an impression on the stakeholders' model for Islamic corporate governance which is preoccupied by two fundamental concepts of *Shari'ah* principles of property rights and contractual frameworks. The governance of any Islamic corporation is ruled by *Shari'ah* where all the stakeholders including the shareholders, the management, other stakeholders such as the employees, the suppliers, the depositors and the community (Iqbal and Mirakhor, 2004; Hasan, 2008).

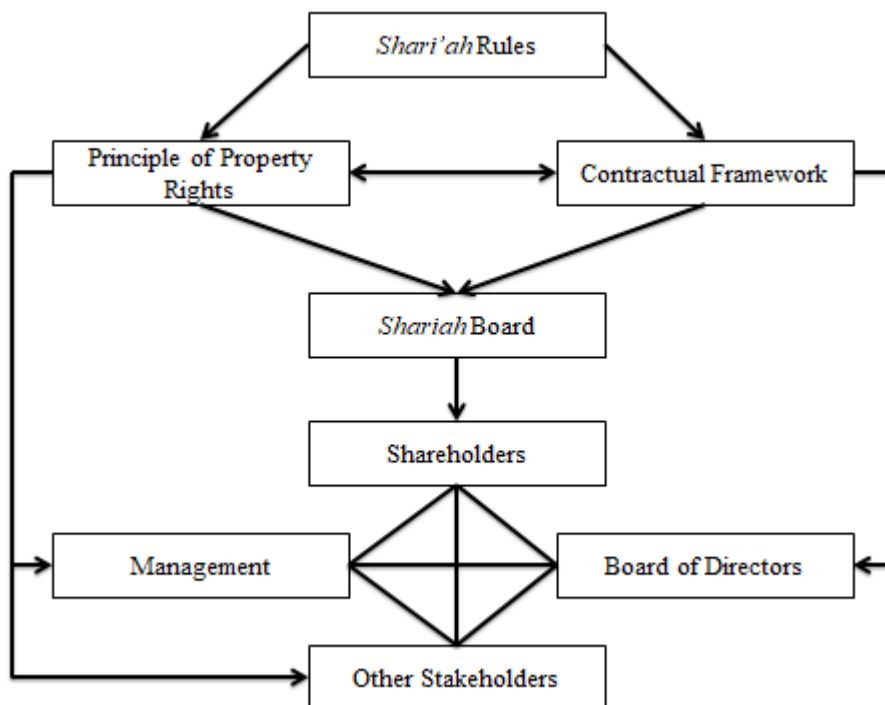


Figure 2.2: Islamic corporate governance based on stakeholders model

The roles of *Shari'ah* board are to advise and supervise the operation of the corporation to ensure that it complies with the *Shari'ah* principles. The board of directors representing the shareholders has duty to monitor and oversee overall business activities. On the other hand, the corporation managers have fiduciary duty to manage the corporation as a trust for all the stakeholders and not for the shareholders alone. The other stakeholders such as employees, depositors, customers have duty to perform all of their contractual obligations (Iqbal and Mirakhor, 2004; Hasan, 2008).

In addition, the state as a stakeholder will be the external institution to provide regulatory framework and its enforcement. Based on the earlier discussion, the notion of classifying Islamic corporate governance as stakeholders based model is premised on two fundamental concepts namely the principle of property rights and the principle of contractual obligations. Hence, there are two tests to determine any individual to qualify as a stakeholder, firstly, whether the individual or group has any explicit and implicit contractual obligations and secondly, whether the one whose property rights are at risk due to business exposure of the corporation (Iqbal and Mirakhor, 2004; Hasan, 2008).

3. Conclusion

Current study offer an overview on the concept and principles of two different Islamic corporate governance models namely: *Tawhid* and *Shura* based model and Stakeholders based model. The *Tawhid* and *Shura* based model combines the element of *Tawhid*, *Shura*, interactive, integrated and evolutionary process, *Shari'ah* rules or Islamic law and maintains the private goal without ignoring the duty of social welfare. On the other hand, the stakeholders based model governance style aims at protecting the stakeholders as a whole. In considering an Islamic interpretation of the definition of the stakeholders, it enhances the interpretation beyond to those participate in governance of the corporation to the religion of Islam itself. Therefore, the corporate governance model from *Shari'ah* standpoint considers Islam as the supreme stakeholders beside the other stakeholders' entity. The concept of Islam as the sovereign stakeholder affects the structure of the corporate governance system where it puts the *Shari'ah* as the governing law of all affairs of the corporation in which leads to the establishment of the *Shari'ah* Board as part of the corporate governance institutions.

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