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Constituting Islamic Corporate Governance Theory through Islamic Moral Economy

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1. INTRODUCTION

The financial crisis which led to economic turmoil has brought increased interest into the field of corporate governance as the latter seems to play a vital role that affects the economy due to its essence and determining the nature of the working mechanism of the corporate sector and the financial system as a whole. Corporate governance (CG) affects the behaviour of corporations in achieving its corporate goals thus its implications have effects on corporates' performance.

There has been an increased focus on CG as many claims that its pervasive adverse impact on the global financial system is one of the responsible factors that contributed to the financial failures. Suggesting that the board's involvement is crucial to the corporations, this puts the board in the 'hot seats' as they are criticized for their inadequate level of engagement and inapt with regards to how they play their roles and responsibilities. Weaknesses of CG highlighted are not only on the ill-equipped board but also on senior management, corporate structure, framework, regulations, and the risk management aspects as well. Thus, work has been continuously carried out since the up fold of several crises as evidenced from the development of an enhanced framework, post-mortem, inquiries, and research papers to name a few, in order to improve CG. This posed an important question such as, should Islamic economics principles be applied in CG, perhaps the impact of future financial failures could be mitigated. However, establishing CG from the context of the Islamic moral economy (IME) may not seem feasible as the concept of Islamic economics (IE) is somewhat unverifiable as it is quite blurry in terms of its departure from its conventional counterpart.

This paper insinuates that CG can probably be improved by applying IME principles from Islamic economics. Thus, it aims is to examine that the principles of Islamic Corporate Governance (ICG) can be developed from IE. However, the argument here is, it is hard to encapsulate IE into ICG as these two subject matters have overarching principles thus have not been quite clear in terms of its demarcation. Furthermore, it is not easy to apply IME from IE itself as many claims that IE is not based on strong theoretical grounds. Theorists suggest that IE requires some empirical evidence to develop its own theories before the latter can be operationalized. However, it is envisaged that even if IME is conceptually proven, an element of enforcement is still required. Thus, this necessitated a strong political ground i.e. Islamic political economy to help with setting up laws and regulations to operationalize IE.

The paper is divided into seven sections. While Section 2 discusses the conceptual definitions of CG, theories, and models, Section 3 discusses the principles of IME based on the tenets of IE. This section examines the axioms of IME to see whether the IE principles can be applied in CG and put into practice in the context of Islamic banks. Section 4 discusses how CG is conceptually derived from the perspective of IE of which the axioms of ICG are operationalized or put into practice within the domain of Islamic finance in general and IBs in particular. However, when IBF fails, this requires for some reflection through IME. Section 5 extends the ICG by adding the Shari'ah governance to the system. Section 6 presents a comparison between CG models. Section 7 concludes this paper with how ICG helps to strengthen Islamic finance through the manifestation of IBF through the Islamic political economy to apply IME.

2. CORPORATE GOVERNANCE: CONCEPTUAL DEFINITIONS

Ever since CG became prominent during the 1980s, definitions have emerged from many sources such as theorists, academics, economists, and *etc.* Inevitably, CG is observed from many perspectives. Thus, definitions have been very diverse, and any stereotypical patterns or conceptualizations of the definitions have been distinctive and are subject to the nature of reasoning in defining CG. This depends on the position and disciplinary background of the individual rendering the definition (Clarke, 2011), and a respective perspective, then, affects the particular way CG is applied. As Monks and Minow (1995) observe that CG definitions are often affected by the biases of those giving the definitions. Turnbull says that "The various views on corporate governance can also be related to different cultural contexts, intellectual backgrounds, and interests of scholars" stemming from "different academic disciplines." Thus, "there is often little, or incomplete, integration between various disciplines" (Turnbull, 1997:184) in providing a definition for CG, as in other social science related concepts.

Since definitions of CG often differ in various ways, simple generalisations of CG are difficult as inexhaustible definitions of CG exist in literature. One widely used definition is given by Cadbury (1992), which views CG as a system of control. In other words, Cadbury (1992) sees CG as trying to balance social and economic objectives while simultaneously being a structure promoting efficiency and accountability. Similarly, McRitchie (nd.) sees CG as both the structure and relationship which directs the corporation and determines its performance. Thus, the definitions take the board as the centre where its relationship to other primary participants is critical. This mirrors Cadbury's definition, as CG is highly related to the board of directors. Likewise, Turnbull (1997) sees CG in the context of the board's structure and function. From a broader perspective, Monks and Minow (1995) base their definition on relationships, focusing on corporations that do not perform well, as, to them, CG may be defined as the affairs of the whole company and not just the board.

CG may be seen as a discipline that looks at how incentives affect management, specifically in the sense of financial performance. On a similar note, Wójcik (2002) views CG from an investment perspective. In the narrow sense, he agrees with Shleifer and Vishny (1997:738) who state that "corporate governance deals with the ways in which suppliers of finance to corporations assure themselves return on their investment". In the broader sense, he agrees with O'Sullivan (2003:24), who views it as "concerned with the institutions that influence how business corporations allocate resources and returns. Specifically, a system of corporate governance shapes who makes investment decisions in corporations, what types of investments they make, and how returns from investments are distributed".

In further exploring the concept, Okabe (2004) views CG from two perspectives. First, he views CG as a framework that allows shareholders to supervise management. He calls this a 'finance approach', as it is the corporate fund providers' authority; or an 'agency view', since it regards managers as agents who manage the company for shareholders. This is similar to Wójcik's (2002) narrow definition of CG. Alternatively, Okabe (2004) relates the behaviour of corporations to CG as a relationship in which competing interests are elaborated upon by stakeholders. He regards this later view as a "stakeholder view" as he believes that firms with the structure of authority, responsibility, and interaction among them belong to all stakeholders.

Similar to previous definitions, Monks and Minow (1995) define CG through an administrative viewpoint when he perceives CG as being how companies are directed. He sees good governance as essential to corporate success and sustainable economic growth. In this definition, a corporation exists as a structure allowing parties to collaborate and contribute capital to benefit others. According to him, research in CG is an interdisciplinary topic, which draws primarily from economics and law, and an understanding of business practices stemming from empirical studies in different national systems.

Claessens (2006) defines CG as the relationship between the shareholders, directors, and management of a company, as defined by the corporate policy. Thus, CG is the set of obligations and decision-making structures that shape the complex set of constraints that determine the profits generated by the firm.

In providing an integrated definition, Blair (1995) states that CG is about the arrangement in terms of legal, cultural, and institutional which spell out the corporations' actions, the allocation of risks, and return. This coincides with the view that CG is a system of management. By adopting a consequential approach, Gourevitch and Shinn (2005) claim that CG structures are the result of political decisions.

In providing an organisational perspective, Arrow (1974) views CG as starting with an organisation with common objectives. He regards each member as having different goals which are not necessarily in line with the organisation's objectives. He views that not all corporate or external information is shared among members.

Meanwhile, Cochran and Wartick (1988) conceptualise CG from two approaches. They view inconsistencies between practice and the ideal with regards to the management's interactions with stakeholders. Beyond that, they also suggest that CG may be conceptualised through an understanding of CG's fundamental issues, namely the separation of ownership and control as well as clarifying the difference between governance and management. This leads to associated theories of CG, as explored in the following section.

3. ISLAMIC MORAL ECONOMY FOUNDATIONS OF ISLAMIC CORPORATE GOVERNANCE

Economic principles are not new to Islam and can be traced back to the revelation of the Qur'an, the holy book of Islam, to the Prophet Muhammad (Ayub, 2007). However, as far as literature is concerned, work on Islamic economics in the modern sense began as late as the 1940s (Kahf, 2004). Historically, classical Muslim scholars, such as Ibn-Khaldun, Ibn Taimiyya, and Imam Ghazali among many others, had written extensively on economics and finance related matters evidencing that the 'great gap' in economics postulated by Schumpeter did not exist (Ali and Thompson, 1999), as Muslim scholars with their original work filled that gap. Using such historical heritage, Muslim economists in the 20th century aimed to revive Islamic economics in a constructivist manner as an alternative system of understanding for the economic development of the Muslim world and beyond. In contemporary times, the development in Islamic economics is further initiated by the work of Mawdudi and Sadr, to name a few (Zaman and Asutay, 2009).

As far as Islamic economics is concerned, rising interests in this area are not confined only to specific Muslim countries (like the Middle East, Pakistan, Bangladesh, and Malaysia) but also the West (Iqbal and Molyneux, 2005). The first commercial Islamic bank was established in 1975, which paved the way for the emergence of developments in Islamic finance in the modern sense. From the 1990s until the early part of the 2000s, Islamic banks (IBs) began to grow but at a relatively slower pace. Not until late in the 1990s did IBs begin to show a significant presence.

Being located within Islamic economics, the early discourse of Islamic finance articulates the essentialised principles of Islamic economics including profit-and-loss sharing while making reference to the social justice dimension (Asutay, 2012). Even though Islamic financial instruments in origin predate modern Islamic civilization, its re-emergence did not occur until after the post-colonial period, triggered by the quest for the meaning of 'Islamic economic development' that brings about IME (Asutay, 2012). Thus, as an important part and main institution of Islamic economics, the emergence of Islamic banking and finance (IBF) as institutions had to wait for the last quarter of the 20th century when developments in legal frameworks and regulations began to take place (Asutay, 2012).

IME, and therefore IBs, emerged out of a need for fairness and freedom since Islam itself promoted social equality and economic fairness (Chapra, 1985). This resulted in the inception of IBs, objectives may be served which aimed to perform interest-free activities based upon the *Shari'ah*, *halal* transactions, and risk-sharing among investors, banks, and borrowers. Siddiqi (1989), for instance, regards Islamic economics as emphasising social justice. As an alternative to socialism and capitalism, Islamic economics is defined by the *maqasid as-shari'ah* and benefits from *fiqh* structures in determining the nature of how Islamic economics is seen as opposed to the actual financialised nature of Islamic finance.

In his attempt to bring about the realisation of Islamic economics, Chapra (1992:4) stresses that the crucial test for an economic system lies not in the professed goals but in the realisation of the goals itself, in which he highlights the significance of world view to addressing the issues of the economic system. He sees the worldview as providing the function to support the foundation and strategy of the economic system before its goal can be attained, and he sees the economic questions as value-laden.

Choudhury and Malik (1992) state that Islamic economics should play a part in building up the economic structure from Islamic sources of thought rather than being merely a discipline which studies the problems of the system as it was originally aimed as a discipline by which the foundation of ethical economics would be derived from the ideological viewpoint of the world as operating according to the will of God and his laws.

Islamic economics relies on a worldview that needs to be filtered before being able to be effective (Chapra, 1992). Similarly, Nomani and Rahnema (1994:41) view Islamic economic realities as socially constructed, and thus on no account is any human endeavour value-free. Each action is produced and acted in a socially constructed manner which then justifies the difference in life's undertakings (Asutay, 2007).

3.1. Definition

IME is defined by the conceptual foundations of Islamic economics through the axiomatic approach. IME or Islamic political economy is an Islamic economy with a systemic political economy in nature in which epistemology, institutions, and functions are all interlinked through a revealed knowledge.

Formed by the philosophical foundations that themselves were built through the conceptual axiomatic foundation, Islamic economics or IME is a distinct discipline of economics with morals derived from the Islamic rationale embedded into it (Asutay, 2007). It is not a complete theory, a simple application (Wilson, 2008), nor a substitute for mainstream economic theory but rather a way of approaching economics moralistically and rejecting the extremes of both capitalistic markets and command economies, and its utilitarian approach focuses on the maximisation of individual material satisfaction.

Choudhury and Malik (1992) regard the Islamic political economy as a discipline that endeavours to study the relationships between policy, economics, and politics while also aiming to integrate these with ethical and philosophical concerns. By integrating the epistemology of Islamic political economy into the wider Islamic economic structure and studying the theoretical structure of such endeavours, Choudhury (1999) views the Islamic political economy as a form of humanistic political economy which values humans as equals in all moral and ethical values. Meanwhile, Naqvi (1981) views Islamic economics as a system in which religious, economic, and social dimensions are all integrated to form an overall Islamic system. Still, within the context of an order, Asutay (2007) sees Islamic economics as the economic and financial activities outlined by Islamic principles and undertaken by institutions. He views it is as part of the religion dealing with production that is based on specific ideology with its own underpinnings.

Broadly speaking, Asutay (2007) views Islamic economics as an ecological order, articulating the concept as a combination of working components that work within the Islamic ethical foundation. Whilst Islamic economics recognises the failures of the current system in promoting welfare, it may also be described as the summation of all Islam's ethical propositions and encourages considering the welfare of others and may also help in regards to the voluntary movement of wealth from rich to poor for welfare purposes (Asutay, 2007).

The Islamic political economy is sourced from Islamic sources of knowledge like the Al-Quran and Sunnah and its operationalisation has been derived from the premises of law and the realities of the market (Choudhury and Hoque, 2004). Choudhury and Hoque (2004) stress that with this base structure, essential elements relating to cooperation and economic stability are unlikely to manifest without there also being an ethical policy to support it. It is thus the axiomatic nature of this order which makes the formation of the Islamic political economy in operationalising the Shari'ah in the Islamic economy possible.

Naqvi (1981) tries to analyse Islamic economics by combining the religious and social aspects with the economic dimension. This is in an attempt to develop a distinctive framework capable of solving economic problems uniquely. He believes that ethical guidelines as the dominant force in economics will allow its rules to be derived from Islamic principles and thus help establish clear economic guidelines for policymaking. In referring to the ethical foundations, Naqvi (2003) highlights how important religious morality is in achieving moralistic values due to how Islamic economics focuses on the behaviour of the individual human.

By the same token, Kahf (1989:43) is of the opinion that the ethical base provides the value system which governs all forms of Islamic economic activities. Ethics represents an integral part of the Shari'ah which helps provide the foundations for Islamic economic theory formulation (Choudhury and Malik, 1992). Through the ethical value, Islamic order provides the economic system in which the process is managed by a set of axioms and principles to achieve the economic objectives (Asutay, 2007:4). In summation, IME and the Islamic political economy is an Islamic economy with a systemic political economy in its nature in which epistemology, institutions, and behaviours are all interlinked through the revealed knowledge.

3.2. The Structure of IME/IPE: The Axiomatic Framework

IME is theoretically developed through strong foundational axioms based upon the al-Quran and Sunnah to create a world order with an authentic value system in the economy (Asutay, 2007:167). In a socially constructed manner, IME aims to develop socially concerned and altruistically motivated individuals which can be defined as 'homoislamicus' as opposed to utility maximising individual 'homoeconomicus' modelled by neo-classical formulation (Ariff, 1989; Asutay, 2012)

In regards to IME's axioms, Choudhury (1986) sees Islamic economics as being devised by humans but itself deriving primarily from independent sources, thus allowing it to be considered an alternative economic system. Choudhury (1999) regards Islamic economics as comprised of a few key principles: *Tawhid* and solidarity, felicity, distributive equity, as well as work and productivity which themselves are connected to IPE principles. It is a derivation of Islamic principles that allow the basis for an alternative economy based upon human welfare (Asutay, 2007).

Islamic economics is made up of elements of *din* or religion commitment, and the right of the poor to the wealth of the rich. Naqvi (1981) stresses that secular and religious ethics should not contradict each other. Furthermore, Islamic economics acts as a mechanism that accentuates the naturalistic human desire to perform good deeds (Ahmad, 1976).

Tawhid, as Islam's foundation, carries tenets of the Islamic faith, which governs all fundamental domains of human faith and actions (Choudhury, 1993) and it is not merely an abstract religious doctrine or metaphysical concept as it enumerates a comprehensive ideology and philosophy of life (Khan, 2012:9). Khan (2012:9) looks at *Tawhid* from three different levels: individual, socio-cultural, and politico-economic. According to him, the individual level is a revolutionary concept requiring the liberation of man from all desires and temptations, thus fully submitting oneself to God.

On the socio-cultural level, he sees *Tawhid* as freeing man from the superimpositions of other men (Khan, 2012:9). Similarly, on the politico-economic level, Khan (2012:9) views *Tawhid* as seeking to liberate man from the political oppression and economic injustice of other men. Choudhury (1993:6) views the *Quranic* concept of *Tawhid* from three perspectives: psychological, moral, and social phenomena, which assume the principle of integration. Meanwhile, Asutay (2007) regards *Tawhid* as a vertical horizon to equality, in which everyone is equally close to God and where everyone is part of the whole system that allows economic activities to take place.

The second axiom, *ad'l*, ensures that everyone receives what they deserve. It refers specifically to equilibrium. Mawdudi (2011), however, does not see it as referring to equality. Different from *Tawhid*, he says that everyone is only equal with regard to their claim to resources. However, for this to work, *al ad'l* (justice) must be supported by *al-ihsan* (Naqvi, 1981). This, together with *Tawhid*, helps create balance in the system by fulfilling the needs of people and society. This translates to a quality of life via the equitable distribution of wealth used for growth through the making of suitable policies.

The third axiom, *fard* (mandatory action) means that everyone has obligations they must fulfill. This means that performing social good is meant to be a compulsory part of the religion rather than a voluntary action (Asutay, 2007). Thus, Islam fixes western concepts of individualism and capitalism by establishing concepts of *fard 'ala al-ain* (individual responsibility) and *fard 'ala al-kifayah* (collective responsibility) (Naqvi, 1981).

Ikhtiyar, another foundational axiom, is about the free-will of humans. This freedom is entirely unrestricted and up to the human's discretion (Naqvi, 1994). It constitutes functional norms of economic activity in Islamic economic systems by actualising justice through its given individual freedoms (Asutay, 2007:7).

Rububiyyah, another axiom of Islamic micro-foundations, refers to the development path of all things in either a personal, social, or natural context (Ariff, 1985), thus implying the integration of economic and social components. As an axiom, it suggests a divine arrangement for nourishment, sustenance, and directions to perfection (Ahmad, 1979:12), implying that everything has a 'development' path through which to grow. Thus, human beings, the biological environment, and the social environment all have to develop through identified paths for sustenance and perfection (Asutay, 2007:8).

Tazkiyah, an important moral axiom, is implicative of purified growth in trying to attain *falah* (a fortune in the world and the hereafter). It deals with growing towards perfection through the purification of attitudes and relationships (Ahmad, 1994). *Tazkiyah* operationalises the fundamental axioms and principles of the Islamic economic system. It is a result of the integration of *Tawhid*, *ad'l*, *fard*, and *rububiyyah* in order to make humans move towards self-development and hence social and economic development (Asutay, 2007).

Khilafah refers to how humans are accountable before God as human freedom and accountability are parts of *khilafah* (Naqvi, 1981). The role of humans as vicegerents on earth is considered the only reason for their worldly existence. Ahmad (1979) asserts that this axiom leads to such unique concepts as individual trusteeship alongside various rules of social organisation. This implies that the *khilafah* axiom includes notions of universal solidarity, sustainable consumption in pursuing a humble lifestyle, and freedom to lead a life (Asutay, 2007:8). Asutay (2007) further explains that *khilafah* also relates to social accountability in terms of being aware of the consequences of the hereafter in all human actions.

As a methodological paradigm, *maqasid-al-shari'ah*, a process-oriented concept meaning 'the objective of *Shari'ah*' with 'the objective' defined as human welfare, is achieved when institutions aim to maximise human welfare. It operationalises institutions in which there are Islamic economic systems by providing them with the working mechanism's nature. In other words, *maqasid-al-shari'ah* is associated with *shari'ah* objectives, in the sense that it provides the structure for conducting economic activity. Furthermore, it is also a form of instruction and helps to draw the line between licit and illicit sources of income as defined by the *Shari'ah*.

As mentioned by Asutay (2010), IME determines the economic value system's structure, its foundational and operational dimensions, and how individual Muslims are to behave normally. Asutay (2010) regards IE as a discipline to interpret and solve economic problems using Islamic sources of knowledge. As mainstream economics was deemed inadequate in dealing with issues of uncertainty, the Islamic economic paradigm was created as a response to that (Asutay, 2007).

IME can be defined as a system as it was developed based upon a system of understanding, which defines the foundational axioms, values and norms, methodology, operational principles, and functional institutions. As such, IBFs should operate in such a framework so that IME's aims and objectives may be served better. Thus, IBFs may be regarded as functional institutions if operating within the IME system. Thus, as a form of IME's institutionalisation, IBFs must regulate the economy while being confined by the Islamic framework and the limits this framework entails, all of which are delineated in the CG framework (Asutay, 2010).

4. ISLAMIC CORPORATE GOVERNANCE

Being a structure, ICG encompasses the methodology with embedded moral values provided by Islamic principles to indirectly bring moral elements into the system. The previous section provides the rationale for Islamic corporate governance by laying down the micro religious/Islamic foundations. In other words, Islamic corporate governance, by definition, is developed from the Islamic norms, principles, and values. Such foundational principles, having implications on every aspect of life, by definition, hence, define the nature of corporate governance in Islam. Thus, Islamic corporate governance in its fundamental nature is not voluntary but dictated through the Islamic values by definition of Islamic ontology and epistemology, as explored in the following sections.

The need to locate IBF in IME was hastened after a series of financial crises affected many economies. As crises are claimed to result from ethical deficiencies within the financial system and its related institutions (Kayed and Hassan, 2011), the ethical approach suggested by IME may prove useful in solving the problem. As some ethical deficiency-related failures have manifested themselves within corporate governance practices, it is thus important that an appropriate system of CG is created to provide an ethical outcome. Hence, IME's foundational axioms can help to provide a structure for this undertaking.

Islamic economics' foundational axioms are aimed at creating a system of economics that is primarily human-focused (Asutay, 2007). The axioms define foundational principles and incorporate elements of social justice (Asutay, 2007:5). On this, Naqvi (1994:47) demonstrates that deducing economic statements from ethical axioms is a scientifically correct procedure.

Thus, because CG sees a definition in Islamic law and because of the value and norms implications of IME, a distinct ICG is possible. The operational axioms are all summarised under the Islamic corporate governance structure which will help every entity and itself.

Therefore, a distinct ICG is possible by moving away from such axioms since they all refer to a particular aspect of creating an ICG with a distinct value system. To proceed with, some highlights on conceptual definitions of ICG may be deemed necessary.

4.1. Conceptual Definition

Corporate governance is about regulating the rights and responsibilities of parties through a legal system of enforcement. It is responsible for determining how parties behave and what their duties are and also that these duties are taken care of (Chapra, 2003). Despite its diverse definitions, Hassan (2010) views that the conceptual definition of CG does not differ much between the mainstream and Islamic. However, a standard definition of Islamic CG has yet to be achieved (Tapanjeh, 2009).

On the other hand, as the above does not differ significantly from conventional CG, Ibrahim (2006) sees the distinctiveness of ICG as being in its structure, which requires validation to ensure all transactions are *Shari'ah* compliant. However, Tapanjeh (2009:556) says that ICG dimensions have a broader horizon and are unable to compartmentalise roles and responsibilities in which all actions and obligations fall under the jurisdiction of the divine law of Islam.

Despite several underlying principles that support ICG, the following section attempts to rationalise CG from the perspective of the IME by referring to the foundational axioms. It is important to revisit the objectives of IME, within which ICG must be located, to understand the underlying principles of ICG, and the deficits which trigger factors underlining IBF issues.

4.2. Rationale for Islamic Corporate Governance

According to Asutay (2007), the above axioms are associated with the state of all human activities and are thus combined to produce harmony and justice in all human endeavours. Furthermore, these activities are undertaken by human agents given free will and thus they are also responsible for the consequences those activities may bring (Naqvi, 2003). In advocating the entirety of Islamic economics, Nomani and Rahnema (1994) uphold that all methodologies in Islamic economics are deduced via the *Shari'ah*, thus allowing for an element of clarity to be had as far as ethical values are concerned.

These axioms, hence, in addition to *tawhid*, *adalah*, and *ihsan*, represent the core foundations of ICG, as corporations should strive to bring about the realisation of these axioms' consequences within the greater *tawhidi* framework, which, in turn, requires that all stakeholders be made to share the objective of achieving human well-being.

In articulating the larger stakeholder nature of ICG, IME also assumes *rububiyyah* and *tazkiyah* as part of its axioms. While the former refers to developmental paths given by the creator to individuals, society, and the environment, the latter refers to the purification of stakeholder relationships and goals.

ICG, being an IME model, refers to an ethical proposition and framework for Islamic banking. IME's distinctive values are aimed at upholding ethical values in all human affairs inclusive of economic and financial matters that have consequences for organisational management, thus implying a distinct governance mechanism by essentialising the Quranic paradigm.

4.3. Locating ICG within Moral and Political Economy of Islam

Combining moral economics and the Islamic economic system via IBFs makes it an integral world system (Oshodi, 2010). Oshodi (2010:10) claims that by "allowing a combination of the moral economic core and the Islamic economic system via Islamic banking and finance would make this integral world system to reduce acts of immorality and corruption; influence better state and market coordination…" to consistently reduce poverty level. Thus, it can be said that institutional, political vision, aims, and leadership is some elements that are present in CG. ICG, meanwhile, introduces a distinctly Islamic ideology via the IBF.

In terms of the functionality or articulations of ethics and morality, ICG is similar to the conventional CG as it sees transparency and ethical concerns such as accountability and honesty as part of their key principles. However, with regards to structure and framework, ICG is distinct as it places the Islamic norms and values at the topmost, above the shareholders' level, so that the ideals of human affairs may be achieved (Choudhury and Hoque, 2004).

As such, a thorough and comprehensive framework named Islamic corporate governance is located in IPE to provide the norms for the organisation to achieve the aim of the IME. Whether this is achievable through IBF, it depends on whether IBFs are able to establish that legal, economic, social justice, and other such dimensions are to be incorporated into its methodological framework. Islamic finance theorists like Choudhury, Naqvi, Siddiqi, and many others mention that the operational axioms of *'Tawhid', 'adl', 'fard', 'rububiyyah', 'tazkiyyah', 'khilafah',* and *'maqasid al-Shari'ah'* are important elements in outlining the operationalising nature of IBF (Islamic Banking and Finance), which includes corporate governance. By upholding the concept of *addin*, these axioms are conceptualised and operationalized into the various dimensions of ICG: board; structure, committees and senior management; regulatory disclosure and transparency; audit; policies and procedures; support and operations as well as risk management dimensions. The proceeding section explains the principles of CG based on axioms as developed by Naqvi (1994) and Ariff (1983) as cited by Asutay (2007). There on '*falah*' is achieved as described through the following:

'Tawhid' when operationalised is reflected through the 'board' and 'structure' dimensions in ICG. The vertical power between man and God can be translated into the power vested in the board in performing their mandate. As much as the board is highly empowered, they are liable for their action, as there is a supreme and utmost power beyond them. As for the horizontal power, this is operationalized between all levels in the structure. Mankind, regardless of their levels in the structure, they are all alike in the eyes of God which brings them vertically equal to God. As for their position between them, they should be horizontally equal in teams of rights. Through *'Tawhid'*, this assures equal rights to resources as Islam asserts that there is the poor right in the riches' wealth. Furthermore, between the employee and employer, among the employees, stakeholders, shareholders, and society at large, there is no issue on oppression by the powerful on the weak as all mankind is at the same horizontal line to God. By conceptualising this axiom into ICG, the power vested in the board and shareholders is superseded by the divine power, at the utmost layer of the organisational structure that governs everything. As such, any decision making triggered regardless of from which level, will be in line with Shariah principles as such, decision made should be at the 'discretion' of God. In this manner, oppression between mankind is liberated as everyone is owned by God thus by no means that man is subjected to oppression of his own mankind.

With *'adl'*, its conceptualisation into ICG reflects in the way the shareholder and the stakeholders are being treated in whatever manner for instance, in terms of profit and loss, charges, payments, and penalty, salary, and benefits. As Islam acknowledges rights and responsibilities, committees such as the remuneration and nomination as well as the senior management that work through the conceptualisation fare better in terms of taking care of the interest of the employees as no one will be deprived. Their actions are transparent, with trustworthiness and honesty instilled in them which creates better working environments among the staff and management. The element of equilibrium can be operationalized. When *'adl'* is conceptualised in ICG through comprehensive policies and procedures, this ensures standardisation and uniformity as Islam instills fairness, justice, and transparency. This axiom, when conceptualised into ICG through risk management, also instils the elements of justice and fairness as Islam prohibits financial oppression or any kind of injustice and discrimination.

The operationalization of *'fard'* into ICG improves the 'support and operations' dimension in ICG as each person has his own commitment towards God, himself, the bank, society at large, etc. By instilling accountability and commitment, moral hazards do not exist. In fact, along this line, with the axiom *'ikhtiyar'* imposed by Islam, Muslims are forbidden from giving up and, should not lament that everything has been decided by God as the element of freewill is also operationalized alongside the *'fard'*.

As for '*rububiyyah'*, it is the element or concept of obligation to show respect to the divine arrangement. From the 'board' and 'structure' dimensions of ICG, this improves the working environment through clear reporting lines as '*rububiyyah'* promotes concern for order and unity. From the perspective of the employee, the conceptualisation of '*rububiyyah',* when operationalised into the support and operations dimension of ICG, creates a peaceful and harmonious working environment. As for the axiom of '*ihsan'*, when it is operationalized, this helps to maintain social and environmental concepts for nourishment and hence harmonious relations between different spheres of life. In addition, the axiom of *'shura'* promotes discussions and feedback to ensure effective interactions thus employees and stakeholders are willing to adhere to rules and Muslims have to oblige to undertake their responsibilities and accountabilities through orders assigned to them. In the ICG context, *'shura'* when contextualised in IBs ascertains fair and just decision-making in the Board meeting.

'Khilafah' is conceptualised through the ethical criteria possessed by the 'board', 'committee', and 'senior management'. They earn respect from staff and stakeholders due to their ethicality, honesty, knowledge, and fairness to name a few. As much as they are superior in terms of power, this does not entail taking advantage of the weak or allowing moral hazards to pursue one's own interests. This axiom necessitates maintaining harmonious relationship among all as their aspect of decision making brings justice to everyone.

As for '*Tazkiyah',* conceptualising this reflects in the good performance of banks with staff working in harmony. As this axiom sustains development, it uses the element of monitoring to ensure the right ways of doing things. Hence this is operationalized through the 'audit dimension' to ensure a check and balance to ascertain a harmonious environment as there should not be unethical and immoral actions between staff. In addition to the combination of *tawhid, adl, fard* and *rububiyyah,* there should also be transparency and standardization in terms of actions taken as everyone should be treated fairly regardless of their position.

As mentioned, IME is developed through the formulation of Islamic economics in an attempt to develop its axiomatic foundations. These foundational axioms of IME are the articulation and operationalised aspects of *maqasid al-Shari'ah* which represent the ultimate aim within the *tawhidi* framework. This debate, hence, has consequences for ICG (Asutay, 2012).

IME is socially constructed with emphasis given on the consequentialist nature of economic development and its substance. Thus, the anticipated result is a social welfare or social good with the embedded concept of *adalah*, justice, and *haqq* as the core objectives.

As evidenced, a thorough and comprehensive framework named Islamic corporate governance is located in the IPE to function through the IBF as Islam provides the norms for the organisation to achieve the aims of the IME. The IBF thus needs to establish that legal, economic, social justice, and other such dimensions are to be incorporated into its methodological framework.

4.4. Social Failure of IBF and ICG

IBFs are supposed to offer ethical solutions to economic and financial dilemmas, something which is unique to ICG and should be capitalised upon by Islamic financial institutions (Asutay, 2012). As mentioned by Tapanjeh (2009:561), corporate governance in Islamic law provides and embodies much larger and vaster guidelines with encompassing duties and practices on how to deal with economic transactions with the moral conduct of a Muslim without even defining the modern world corporate governance as such Islamic laws impetus corporate governance in every individual action of Muslim up to the social environment.

When IBs began to pick-up in the late 1990s, they were unable to function properly as they were developed without operational and methodological axioms, as research on IME was still under-developed. Consequently, IBs resorted to adopting the neoclassical economic approach, resulting in convergence with mainstream banking. Based on recent developments, IBs are claimed to be neglecting the spiritual and ethical dimensions (Atzori and Mattei, 2009) by converging with mainstream economics, thus not fulfilling the institutional and policy requirements of IE (Asutay, 2012). Whilst analysing the paradigm shift from IMEs to IBs, Asutay (2012) observed divergence between IME's aspirations and the IB's realities. The divergence demonstrates ethical and social expectations that validate the claim of failure. Asutay (2007, 2012) has deliberated on this by reverting to the source of the IBs' failure for a remedy to fix the shortcomings.

Despite claims that IBs would be highly insulated from the financial crisis, the credibility of such statements was shaken since its position as an alternative banking system was found to be questionable following its failure to uphold the foundational aspects of Islamic economics (Asutay, 2007). As a matter of fact, Asutay (2007) sees IBs often become too occupied with profit maximisation and lose sight of their goals. However, since its adoption in the 1970s, IBs have yet to fully be in line with the foundational aspirations of IME.

Islamic economics is deprived of its aspirations to create a world order, as IBs diverge from their initial aim to support moral economics. As mentioned by Asutay (2012), IME, which prioritises social good, is not simply about prohibiting certain activities like *riba* and *gharar*, but it is also about harmonising the various aspects of the economy. Thus, this manifests in IBF, an institutional tool for IME which is aimed at helping human economic development.

CG is considered as one of the areas that the social failure of IBF is observed; as despite the fact that it is expected that IBF's essentialise and operationalise around ICG values and notion, the observations indicate that they are rather share-holder oriented entities in their CG structure (Hassan, 2011), which implies that they only endogenise the interest of their shareholders with some charitable activities. However, ICG, which is an IME-based model, is commended for its endogenising efforts of larger stakeholders in CG as compared to the Anglo-Saxon share-holders and stake-holder models. In fact, Hassan (2009) claims that the unique model of ICG actually fares much better than either Anglo-Saxon systems or the German and Japanese systems. However, the experience shows that the Anglo-Saxon practice of CG is prevailing. With IME, IBs should focus on the interests of stakeholders instead, through the ICG framework, which places emphasis on ethical and moral value (Hassan, 2009). Considering that one of the main reasons for the recent global financial crisis is CG failures, the importance of ICG is essential for IBFs to embed in their structures and operation.

4.5. Theoretical Perspectives on Islamic Corporate Governance

After rationalising and providing the distinctive nature of ICG, this section focuses on theoretical perspectives developed to explain ICG.

Stakeholders theory and ICG

Most of the Islamic scholars and analysts encountered so far agree with stakeholders theory due to the nature of its accountability towards the interests of a wider scope of constituents, *i.e.* that of stakeholders and shareholders and not just shareholders. To a certain extent, as far as stakeholders theory is concerned, its accountability with regards to the stakeholders' roles and the protection of their rights can be extended in the context of ICG, as it looks at property rights and responsibilities not limited to human beings alone but encompassing all aspects of life.

Chapra (2003) acknowledges that stakeholder theory may be able to work with the Islamic framework with regards to the emphasis on the equality of stakeholders (even if they do not own equity). In relation to the principle of property rights, his view is in line with the model proposed by Iqbal and Mirakhor (2004) where he opines that the CG model in the Islamic economic system helps protect stakeholders also rather than just shareholders. Chapra (2003), however, doubts that an ICG model would be effective without Islamic elements within it, even if stakeholder theory covers much more area than shareholder theory.

Stakeholders theory supports property rights and ensures contractual obligations are honoured as prescribed by Islam. Iqbal and Mirakhor (2004) agree that stakeholders theory aligns with ICG since they see the two as converging on the notion of protecting property rights. Firms in Islamic economic systems are seen as the hub of contracts, which are aimed at maximising returns and minimising transaction costs while also not performing any unethical activity to do so (Iqbal and Molyneux, 2005). In pursuit of this, firms are therefore required to adhere to implicit and explicit contracts without also imposing on the social order. Apart from property rights, stakeholder theory from the Islamic perspective also involves responsibilities. On this, Iqbal and Mirakhor (2004) are of the view that stakeholder theory is not just a matter of taking care of the stakeholders' rights but also on sustaining their rights.

On the same note, Obaidullah (2004) agrees that stakeholders theory could see use I Islamic ethics since it also takes care of non-shareholders' interests. This, however, demands CG to take care of the legislation and regulation in relation to issues of CG. On a slightly different note, Obaidullah (2004) highlights how ownership works in Islam as it is comprised of two tiers: as belonging to God (first tier) and as belonging to man (second tier). Thus, Obaidullah (2004) agrees that the stakeholders' theory of the firm provides a clear outlining of what rights the various stakeholders have in firms in accordance with the Islamic state.

Agency Theory and ICG

As discussed earlier, agency problems have posed a lot of issues and conflicts in conventional CG. Supporting agency theory is difficult since many past efforts to overcome agency theory issues have led to a divergence from *Shari'ah* principles (Safieddine, 2009). As much as the contribution of stakeholder theory in the CG aspect is concerned, the basis of its application in ICG is questionable.

There have not been many reviews on agency theory pertaining to corporate governance from the Islamic viewpoint. Nevertheless, Khan (1989) uses agency theory in comparing *mudharabah* and interest-based loans with respect to economic efficiency (Zarka, 2008:12). Interestingly, according to Zarka (2008:12), Khan's work, which shows the benefit of agency theory through the use of control cost on Islamic contracts to compare between different contracts, has triggered several other studies (on the cost control cost) to delve deeper into. Zarka (2008:12) also brings up a point on the importance of information asymmetry between the parties of the contract with respect to the control of cost in agency theory.

In its quest to take into account the interests of the whole stakeholders as opposed to just the profit maximisation objectives, stakeholder theory plays a part in upholding the principles of *Tawhid* through its emphasis on ethics as confined by the *Shari'ah*. Nonetheless, with respect to decision-making, there are still three fundamental questions (by whom, for whom, and with what resources) that need to be responded to by firms in an efficient manner (Azid *et al.*, 2007:17). In this regard, Azid *et al*. (2007:17) suggest that stewardship theory could be considered to address some of the Islamic CG issues as they state that the firm's decision making is made in consideration of the spirit of partnership, taking into account the benefits of the firm.

To date, there has not been much research developed on the conceptual formation of ICG with respect to its underlying theories[1]. This could be due to it having to rely on conventional

[1] Except for Choudhury's (2004) philosophical view on Islamic corporate governance.

theories to support the framework. As far as IBs are concerned, its distinctiveness relates also to its Islamically determined CG structure which also includes *Shari'ah* governance in its hierarchical structure.

5. *SHARI'AH* GOVERNANCE AS PART OF ISLAMIC CORPORATE GOVERNANCE

Since the operation of IBs requires, their operation to comply with *Shari'ah*, *Shari'ah* governance through *Shari'ah* Boards, the nexus of ICG, is often used interchangeably with ICG. For the sake of this paper, the term *Shari'ah* governance refers to the functions of the *Shari'ah* board only, which is a key component of ICG.

Shari'ah governance utilises the *Shari'ah* Supervisory Board (SSB), a special board that ensures the operation of the IB is in accordance with the *Shari'ah*. Thus, if an institution desires to offer Islamic products, it must first appoint a *Shari'ah* board (or *Shari'ah* counsellor), and this has become the norm amongst IBs (Solé, 2007). The *Shari'ah* board is meant to be comprised of Islamic scholars who are knowledgeable in economics and it plays a role different to the mainboard.

As Islamic finance is based on principles established by the *Shari'ah* and other jurisprudences or rulings (known as fatwa, issued by qualified Muslim scholars), it is always faced with complex issues, forcing involved institutions to seek the assistance of experts in interpreting them (Solé, 2007). In essence, the *Shari'ah* board is aimed at advising IFIs and monitoring transactions while also contributing to the creation of *Shari'ah*-compliant products (Ahmed, 2011).

Rammal and Parker (2010:7) list the functions of SSB as issuing formal legal opinions pertaining to *Shari'ah*, reviewing and revising transactions and dealings, holding a regular meeting to keep abreast with issues, preparing contracts, preparing studies and research in relation to *zakat* resources, carrying out technical reviews, and following up to ensure that controls are implemented as per *Shari'ah* requirements.

Solé (2007) highlights that regulator's rulings and decisions are supposed to be consistent with those of the *Shari'ah* boards of foreign supervisory agencies. It is widely agreed that *Shari'ah* matters are always open to interpretation and it is widely mentioned it is difficult to standardise Islamic products due to this fact scholars in the field. Often, IBs are criticized for a lack of uniformity in the way the *Shari'ah* principles are applied and supervised (Rammal and Parker, 2010:3). Having said that, IBs, or institutions offering Islamic products, must therefore utilise a Shari'ah Supervisory Board in order to make sure that their products comply with Islamic principles. However, different IBs often share the same scholars as there are not many scholars in the field.

To a certain extent, the standardization of *Shari'ah*-compliant practices has actually increased the acceptance of Islamic products and IBs. Based on Ibrahim *et al.* (2009:233), IBs' rapid growth is attributed to its value-oriented ethos, of which, based on his findings, more than 95% of the respondents felt that "compliance with *Shari'ah* law is a fundamental requirement in terms of 'halal' type of investment and investment structure". This confirms the factor that the compliance attraction plays an important role in increasing the share of *Shari'ah*-compliant property investment, which then contributes highly to the growth of IBs.

To achieve growth and stability, IBs must maintain customer confidence. By implementing good *Shari'ah* governance, it may be possible to mitigate issues of non-compliance with Islamic principles.

6. COMPARING CORPORATE GOVERNANCE MODELS

After discussing the various aspects of CG and ICG, this section presents a comparison table to depict the difference between the CG models applied throughout the countries. The details can be found in Table 1, which helps to locate the differences between various models and also helps to essentialise the ICG.

Table 1: Comparing the Corporate Governance Models

Aspects	Anglo Saxon Model	German Model[2]	Japanese Model	Shariah Model[3]
Theory orientation	Shareholder	Stakeholder	Stakeholder	Stakeholder
Episteme	Rationalism and rationality	Rationalism and rationality	Rationalism and rationality	'Tawhid'

[2] The German corporate governance model differs significantly from both the Anglo-US and the Japanese model, although some of its elements resemble the Japanese model.
[3] In an ideal situation

Aspects	**Anglo Saxon Model**	**German Model**[2]	**Japanese Model**	**Shariah Model**[3]
Country practicing	UK, US, Australia, Canada, New Zealand	German, Austrian and *etc.*[4].	Japan	No-specific country - depending on IB's locality.
Corporate goal	Shareholding control managers in increasing profit	Shareholding control managers in increasing profit	Shareholding control managers in increasing profit.	'Shari'ah' objective
Nature	Management dominated	Controlling shareholder dominated Governed by Supervisory board[5] and Management board[6].	Controlling shareholder dominated.	Concept of vicegerency and 'shura' process.
Structure	One-tier	Two-tier[7]: executive and supervisory responsibility separate	Two-tier board.	No tier-specific- Shari'ah board
Board Composition	"Insiders" and "Outsiders"[8]	Boards' size is smaller than Japan but bigger than the US and UK. Supervisory board size is set by law[9]	Insiders[10] Large boards[11] Many-sided *i.e.* main bank and financial network or *keiretsu*[12].	Shari'ah scholars[13]
Regulatory Framework	Well-regulated system for shareholder communication[14]. The larger flow of information to the directors.	The smaller flow of information to the supervisory board. Strong federal tradition[15].	Routine corporate actions requiring shareholder approval[16].	Country –specific.
Disclosure requirements	Very stringent Comprehensive and complex	Stringent[17] Disclosure and mechanisms communication between corporations-shareholders largely resolved.	Stringent	For transparency

[4] Some elements of the model also apply in the Netherlands and Scandinavia. France and Belgium have recently introduced some elements of the German model

[5] The supervisory board appoints and dismisses the management board, approves major management decisions; and advises the management board. It usually meets once a month. Executive and supervisory responsibilities are separate.

[6] Management board is responsible for daily management of the company. The management board is composed solely of "insiders", or executives. Supervisory board contains no insiders", it is composed of labor/employee representatives and shareholder representatives. Management board is responsible for daily management of the company. The management board is composed solely of "insiders", or executives.

[7] Composition of the Management Board ("*Vorstand*") and Supervisory Board ("*Aufsichtsrat*") in the German Model

[8] Board composition and representation is main concern.

[9] And cannot be changed by shareholders Supervisory board includes labour/employee representatives

[10] That is, executive managers, usually the heads of major divisions of the company and its central administrative body

[11] Generally larger than boards in the UK, the US and Germany. The average Japanese board contains 50 members.

[12] The main bank system and the *keiretsu* are two different, yet overlapping and complementary elements of the Japanese model.

[13] Shariah scholar act as the Shariah advisor (or some banks have a Shariah committee) that monitors and ensures compliance (Hassan, 2011).

[14] In the UK and US, a wide range of laws a well-developed legal framework defining the rights and responsibilities of three key

[15] Both federal and state (*Laender*) law influence corporate governance

[16] Such as: payment of dividends and allocation of reserves; election of directors; and appointment of auditors

[17] But not as stringent as in the US. Corporations are required to disclose a wide range of information in the annual report and/or agenda for the AGM

Aspects	**Anglo Saxon Model**	**German Model**[2]	**Japanese Model**	**Shariah Model**[3]
Monitoring	By a wide range of institutions.	Strong relationship between a corporation and the main bank.	A strong relationship between a corporation and its main bank.	Ethics[18]
Financial Relationships	Non-affiliated shareholders[19] Relationships are prohibited by antitrust legislation	Banks are key shareholders. Banks develop strong relationships with corporations [20]. Relationships are prohibited by antitrust legislation. Investors not affiliated with a corporation[21]	A strong relationship with a network of affiliated companies. Interaction and relationships among players. Relationships are prohibited by antitrust legislation.	Strong relationship within the network.
Share Ownership Pattern	Wide range of financing sources[22] Representatives of affiliated shareholders ("insiders") seldom sit on boards.	Relying on a single bank - banks are key shareholders to obtain financing. German banks and corporations hold ownership of the equity market-dominant shareholders Neither banks nor corporations are key institutional investors[23].	Banks are key shareholders[24] Strong banks-corporations relationships. Preferably affiliated parties[25].	
Role of Stock Exchange	Strong role in corporate finance	Reduced		
The market for corporate control	Hostile takeovers are the 'correction mechanism' for management failure	Takeovers restricted.		
Role of banks	Banks play a minimal role in corporate ownership	Important both in corporate finance and control		
Ownership structure	Widely dispersed ownership; dividends prioritised. Separation of ownership and control Legal liability for the acts of the corporation is avoided.	Banks and corporations are major shareholders; dividends are less prioritised. Co-determination[26] Share ownership of the individual, and increasingly institutional.	Dividends less prioritised Co-determination Financial institutions and corporations firmly hold ownership of the equity market[27].	Dividends are less prioritised, as organisations are expected to also maximise *Maqasid as-Sha'riah.* Depending on the jurisdiction of IB's country of origin.

Source: Adopted from Hassan (2011:4); Clarke and Chanlat (2009:146)

7. CONCLUSION

[18] Sha'riah audit is accountable for compliance. Also corporations should apply ethical codes of conduct as instruments of self-regulation (Sacarcelik, 2013).
[19] Have no voice in AGM. As a result, there are few truly independent directors, that is, directors representing outside.
[20] Due to overlapping roles and multiple services provided
[21] known as outside shareholders or "outsiders";
[22] Including the well-developed securities market.
[23] The mandatory inclusion of labour/employee representatives on larger German supervisory boards further distinguishes the German model from both the Anglo-US and Japanese models.
[24] and develop strong relationships with corporations, due to overlapping roles and multiple services provided
[25] In contrast, outside shareholders represent a small constituency. "Outsiders" seldom sit on Japanese boards.
[26] Regulate the size and determine the composition of the supervisory board; they stipulate the number of members elected by labour/employees and the number elected by shareholders
[27] Shift during the postwar period has been away from individual ownership to institutional and corporate ownership.

As discussed, CG systems in different countries are varied. As much as the differences between the conventional CG models are seen, the models of CG between the conventional and Islamic point of view is even more distinct in many aspects. The main criterion of ICG is that it is based on epistemology sourced from the *Qur'an* and *Sunnah*. Its substance brings insights of how Islam takes care of every aspect of life not only in economics, politics, and the financial sector but all other aspects of life too. Its consequence in the financial sector can be operationalised through IBs. Thus, in achieving its aims and objectives, ICG is being steered and navigated by Islamic principles and shaped in accordance with morals and ethics.

In concluding the meaning of IME should be looked at beyond economics. It is generally viewed as an economic system embedded with ethics and moral values. Despite its various definitions, depending on which perspectives it is looked from, IME is a complete humanistic system that blends religion, economics, and social aspects to reach balance from many aspects such as politics, economics, society, and religion. It is to achieve equilibrium in order to form a unity by linking all the elements together as an integrated relationship, which deals with observations and interactions in addressing the many aspects of life. Such a paradigm inevitably has consequences for CG as well in shaping the relationship within an organisation. As explored in this chapter, the details of the IME do rationalise such a view in developing a particular notion and mechanism of CG in the form of ICG with distinct values, norms, and operational framework.

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