International Journal of Islamic Banking and Finance Research
Vol. 1, No. 1; 2017
Published by Centre for Research on Islamic Banking & Finance and Business

Corporate Governance: An Islamic Institution Perspective

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Received: November 23, 2017 Accepted: November 28, 2017 Online Published: November 30, 2017

Abstract
This brings the paper into discussion, including its objectives, procedures, on some of the most important elements of corporate governance, including on tools. The resolution of the conflict of interests of the primary/agent in order to promote the interests of all One of the most important priorities is that of stakeholders, as well as the soundness and stability of the financial system. The Board of Directors, Senior Executive, shareholders and the depositors for this objective are the most important structures. The paper outlines the steps that need to be taken to improve the Board and management 's effectiveness and accountability. To encourage shareholders and depositors to play a higher role in protecting their own interests in the performance of their positions. Then, the article describes some of the popular resources available to make the Board and the Executive more efficient and responsible.

Keywords: Islamic View, Corporate Governance, Financial Institution.

1. Introduction
The term ‘corporate governance’ has gained prominence only during the last two decades[1] and all its ramifications have not yet become fully spelled out even though a substantial volume of literature has become available on the subject. It has been defined in different ways depending upon the author's centre of concern. The Organisation for Economic Co-operation and Development (OECD) has defined it as the “set of relationships between a company’s management, its board, its shareholders and other stakeholders.”[2] This is a value neutral definition in the normal tradition of Economics and does not indicate the objective of corporate governance, which is bound to be value oriented. However, Mr. Wolfensohn, World Bank President, has gone a step further and indicated the purpose behind corporate governance to be “fairness, transparency and accountability.” [3] This definition makes it clear that the objective is to ensure “fairness” to all stakeholders to be attained through greater transparency and accountability. Fairness may also be taken to imply, in the case of shareholders, a ‘fair’ growth in the value of their equity. Several other definitions of corporate governance are available but it would not be of great benefit to reproduce them here.

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1 Zingales, 1997, P.1.

2 OECD, April 1999, P.2.

3 Financial Times, 21 June 1999, cited by the Encyclopaedia of Corporate Governance in the article on “What is Corporate Governance” (www.encycogov.com), 11 July 2001, P.1.

2. Data Analysis

There are a number of players and stakeholders in Islamic financial institutions. This raises the issue of whether it is necessary to safeguard the interests of all stakeholders. The Western academia is divided into two groups in their discussion of this subject. One of these, the Anglo-American model of corporate governance, focuses exclusively on the maximization of shareholder value. According to this model, if the objective of maximizing shareholder value conflicts with the interests of other stakeholders, those other interests should be ignored.1 The Franco-German model, by contrast, places the same amount of emphasis, at least in theory, on protecting the interests of other stakeholders. There is, however, doubt whether corporate governance in the US is in practice as closely aligned with the interest of shareholders as it appears to be in theory and whether the Franco-German model actually protects the interests of non-shareholder constituencies as much as it is claimed.

The fact that deposits in Islamic banks are not treated as a liability on the balance sheet does not mean that they should not have a minimum capital requirement and improved corporate governance as Emphasis on improved corporate governance and having minimum capital requirement go hand in hand with the need for improvements in risk management standards. Sound risk management practices will minimize adverse consequences faced by financial institutions during periods of uncertainty. Robust internal controls to provide qualitative standards are also necessary to complement the quantitative analysis of risk to provide a check and balance in the overall risk management practices.

An effective risk management system is central to supervisory efforts. The risk management system in Islamic institutions need to be able to address the unique characteristics and attributes associated with Islamic financing operations involving financial contracts and instruments which may give rise to other risks besides credit risk. The risk management infrastructure needs to be in place to facilitate the identification, measurement, monitoring and control of all inherent risks present in all the various types of financing so that the specific risks involved may be ‘unbundled’. The complexities of the respective risks in the Islamic financial instruments therefore need to be fully explored and quantified to provide for their effective assessment and management.

Institutionalization of ethics is one of the best approaches to promote and implement the Islamic ethical principles as highlighted above in any organization. Basically, the process of institutionalization of ethics requires a formal initiative to guide key stakeholders in the corporation to implement and promote ethics. Such process is very important in order to control the problem of ethical issues in the corporations (Vitell and Hidago, 2006). The existing practice shows that institutionalization of ethics in corporation can be in the form of establishing permanent board-level committee that responsible to set the policy on ethics, issuance of code of ethics, organizing ethics training, reinforcing the employee’s organizational commitment, and encouraging an ethically-oriented organizational culture (Sim, 1991)[4]. All of these actions would be able to create awareness about ethics and at the same time to promote the implementation of ethics as part of corporate governance framework.

Any action and effort to institutionalize ethics adheres most to its key players, within the corporate governance structure of the organization. This raises an issue as to the need for specific agent for such purpose. At this point, several key participants of corporate governance either external such as regulatory and supervisory authorities or internal as in the case of BOD, shareholders, managers, employees and Shari’ah board are considered as agents of ethics.

[4]The Institutionalization of Organization Ethics. Journal of Business Ethics, 10 (7), 493-506.

2.1 Key Players in Corporate Governance (CG) of Islamic Financial Institutions (IFIs)

	Significant Problems	**Purposes / The Obligations in CG**
Environment		
The economic, financial, and legal system as a whole	In the legal system, productivity Contracts enforceability Statute of Law	Encourage good market and legal settings that endorse CG
The Government (IFIs Laws and Regulations)	Laws that promote Islamic financial institutions' operations	Provide specific rules and laws that meet the needs of IFIs.
Accounting System	Standards for accounting and audit of direct and transparent communication of information	Provide reliable, simple and straightforward principles of accounting
Public Institutions		
The Managers	Financial system stability and soundness (eliminating systemic risk) Establish internal controls, protocols for risk management, and disclosure standards	Provide instructions for FIs Evaluate business functions in general or in specific risky actions
Associations in Banking	Provide limited CG requirements	Set standards and practices of sound
Institutional		
The stockholders	Rights to Shareholders Share in gain	Electing members of the board
Panel of Directors	Ensuring a strong leadership team Oversight in leadership Protect the interests of stakeholders and equity investors	Set the policy and plan overall Transparency of management
Senior staff	Effectively running the institution. Proper mix of risk and return Efficient stimulus-structure	Implement in a logical and professional manner the guidelines set by the board
The Internal Audit	Quality of information and quantity Transparency with respect to knowledge	Ensure that the organisation implements the guidelines supervisory board (Compliance)
Employees	Competency and work ethics Appropriate incentive-structure	Meet the objectives set by the organization Reduce hazards to activities

Boards from Sharī'ah	Set rules and values associated with Sharī'ah	Supervising consistency with its decision
Others		
Depositors	Better service: good service The Returns Comparable	Responsibly behaving Track the standard
External Auditors	Data quality and quantity Informational accountability	Assess the specificity of the quality and quantity of information
Sharī'ah Audit	The binding to the Sharī'ahah	Ensure conformity to the verdicts of the Sharī'ah Board.

3. Conclusion

Islamic banks have made commendable progress over the last two to three decades. They are, nevertheless, relatively very small in terms of their assets and capital, and have not been able to create for themselves a large enough niches in the fields of domestic as well as international finance. It is, therefore, necessary to take all measures that would help promote their expansion.

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