Journal of Economics, Finance and Management Studies
ISSN (print): 2644-0490, ISSN (online): 2644-0504
Volume 6 Issue 1 January 2023
Article DOI: 10.47191/jefms/v6-i1-26, Impact Factor: 6.274
Page No. 227-230

Sharia and Corporate Governance of Islamic Banks

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ABSTRACT: Seen as an essential element of economic development, corporate governance has been at the center of the debate since the 1990s. Its crucial interest for the good functioning of financial markets is strongly mentioned. Over the last two decades, the motivations for opting for good corporate governance have been diverse and varied: the Cadbury report, the OECD reports, the reflections of the Basel Committee, the adoption of the Sarbanes-Oxley Act (or SOX) in 2002 in the United States, the work on "corporate social responsibility".
Indeed, governance is one of the main elements to be established in an institution because it is supposed to guarantee and promote the principles of equity, transparency and responsibility in the Islamic banking sector. Unlike the conventional banking approach, the vision of the Islamic banking sector is both: performance and sharia compliance. In fact, Islamic banking institutions are faced with several dilemmas, namely Investment account holders (IAH) are subject to the same risks as shareholders, but do not have the same governance rights as shareholders. Furthermore, an analysis of the measures proposed by the IFSB to remedy this situation concludes that the degree required to protect the interests of IAHs has not yet been achieved, to the detriment of all the recommendations and practices put in place. The purpose of this paper is to highlight, on the one hand, the specificity of corporate governance from an Islamic perspective as system in which an Islamic bank is run by Shariah directors and board. This is what the researchers called "dual governance".

KEYWORDS: Corporate governance; Shariah; Shareholders; Stakeholders; Investment account holders (IAH).

I. INTRODUCTION

Good corporate governance helps to build transparency and trust between the company and its stakeholders. However, studies have shown that despite a high score in the corporate governance index, many companies are not aware of communicating with their stakeholders, which creates an agency problem.

Due to global financial scandals and lack of trust in corporate practices, the idea of corporate governance has become crucial in the business and academic world. It is clear that in order to thrive and achieve market growth, a company must earn the trust of its stakeholders by consistently delivering on its commitments. Hence the importance of direct communication with relevant stakeholders to increase their trust.

The search for an optimal governance structure has received considerable attention in the economic literature and in public policy debates. The notion of corporate governance is diverse, and over time the definition of the term has oscillated between two extremes: from a narrow concept of a mechanism for safeguarding the interests of investors to a broader concept advocating the protection of all internal interests and the rights of external stakeholders.

In this context, two types of governance appear: Corporate governance in the traditional sense and ethical governance arising from Sharia requirements. According to some authors, this situation is qualified as "dual governance".

While traditional corporate governance aims primarily at protecting the interests of shareholders, the Islamic approach proposes a broader model of governance oriented towards stakeholders. This raises issues related to the protection of the rights of investment account holders (IAH)1 - the depositors - as the most vulnerable party. Indeed, this category is disproportionately exposed to risk, particularly in terms of the Mudharabah contract2 that binds them to an Islamic bank.

One of the important questions we will address is how Islamic finance addresses these types of challenges that directly affect its competitiveness. And whether the measures taken to address this issue are sufficient in terms of the required protection of their rights as well as those of their shareholders.

II. STATE OF THE ART OF CORPORATE GOVERNANCE

Good governance ensures a sustainable and efficient value creation process in agreement with all stakeholders, in compliance with legal regulations, internal statutes and ethical principles.

The word governance expresses the way in which the affairs of an entity are conducted. In the context of a company, the realization of a governance system worthy of the name implies a precise definition of the decision-making process and the actors involved in steering it. In this paper, we will study the principles of good governance as well as the mechanisms to be implemented to federate and guide each of the stakeholders in a spirit of sustainable value creation.

We will try to answer the following questions: why is corporate governance essential? Is corporate management less sensitive to individual personal ambitions and financial power? How can we implement a strategy-oriented management in agreement with the stakeholders?

III. IMPORTANCE OF GOOD GOVERNANCE

Corporate governance implies a new conception of the decision-making process, giving full scope to consultation between stakeholders. Framed by laws and accounting rules ensuring transparency, corporate governance defines the duties of each stakeholder: loyalty, for example. In theory, it would be the best way to ensure the multiple interests of the actors concerned.

In any case, it was time, as proposed by "corporate governance", to take charge of the management of the company. In fact, with the dispersal of shareholders, executive management has a free hand. See in particular the theory of stakeholders, which attempts to formalize the design of a strategy and governance based on negotiation with each of the parties directly or indirectly concerned by the value creation process.

Executive management is too often tempted to prioritize the performance of its own bank account over that of the company. So much so that, paradoxically, some economists welcome the empowerment of the most controversial financial instruments, such as hedge funds, private equity and other speculative tools. Despite the absolute quest for profitability, the famous 15% ROE.

By analyzing the functioning of these countries, the OECD5 has formulated some important principles of good corporate governance. The OECD found that good corporate practice is essentially based on a code of ethical conduct. Although these principles are not binding, they have great value in the business world. It is generally accepted that good governance prevents fraud.

IV. THE ROLE OF SHARIA IN THE ISLAMIC FINANCIAL SECTOR

It is important to understand the concept of Shariah governance, as it is essential to have a clear idea of its definition and concept. It is clear that the AAOFI Shariah Governance Standard does not provide a definition on this topic, although it has provided standards on Shariah governance.

Therefore, to the best of our knowledge, IFSB (2009) seems to provide the most comprehensive definitions, in that it defines Shariah governance as "a set of institutional and organizational arrangements by which an Islamic financial institution ensures the implementation of independent Shariah compliance controls at each of the levels of structures and also processes, namely: Publication of declarations, sharing of information on declarations, day-to-day monitoring of compliance for each level of operations and each transaction, internal Shariah compliance audit, where any incident of non-compliance is recorded and reported, and if possible, addressed and rectified, and finally an annual Shariah compliance review or audit properly conducted and findings duly noted by the Shariah Board.

Islamic banking is based on Shariah, therefore, non-compliance of Islamic financial institutions (IFIs) would destroy their fabric. Any business, whether conventional or Islamic, must focus on stakeholder values to ensure its long-term success. As far as the Islamic finance sector is concerned, it is essential to gain the trust of stakeholders by presenting the stability of the sector, higher financial performance and most importantly Shariah compliance.

Thus, the foundations of Shariah are the basis for the practice of Islamic finance through compliance with the principles, conditions and guidelines adopted by Shariah. Full compliance with Shariah would provide the general public and the financial markets with confidence in the credibility of Islamic financial operations.

In order to establish Sharia compliance in all its aspects. The credibility and independence of the Shari'ah board must also play an important role in the legitimacy of the products. This will be achieved through a policy framework or regulation to ensure the necessary independence of the Shariah board.

As for issues related to competence, conflict of interest and confidentiality, the Sharia board must have the necessary professional knowledge and training as well as expertise in the operational field. He further insists that a member of the Sharia board can only serve one institution, otherwise he can cause an agency problem and consequently, he can deny the public trust with a test with

allegations of Sharia arbitration. Therefore, it is necessary to regulate with clear restrictions that a member of the Sharia board can serve only one institution.

Sharia audit and review is one of the essential elements of Sharia governance. The potential conflict of interest could arise due to the compensation decided by the management.

On the other hand, this could compromise the independence of board members. Hassan's (2012) survey findings show that only 38.8% of IFIs disclosed their sharia review process. We believe that there is an urgent need for a good Shariah governance framework that can mitigate the problems already mentioned. Therefore, Shariah corporate governance would help the Islamic financial industry to achieve its ultimate goal, i.e., to achieve Maqasid Acharia.

V. INVESTMENT AND FINANCIAL PERFORMANCE IN THE CONTEXT OF GOVERNANCE

The catalyst for better financial and operational performance, winning more business by valuing and eliminating agency problems, is probably corporate governance. A survey of the Indian market found that companies with better governance not only have higher market valuations, but also lower debt and better interest coverage. The study also concluded that companies with good governance have higher returns on net worth and capital employed, which generate stable profit margins.

Corporate governance data can help improve market share. For example, companies with good governance perform significantly better than poorly governed companies, which lose 15% of their performance on average, a study on corporate governance performance evaluation comparisons in Japan found. In addition, the study pointed out that companies with good governance arrangements positively affect share price value.

According to another study of 14 emerging markets, the World Bank found that better corporate governance is strongly correlated with better operational performance. In addition, the study found evidence of the need for corporate governance provisions in companies operating in legally weak countries, suggesting that these companies can partially compensate for weak laws and ineffective enforcement by establishing good corporate governance rules that offer credible protection to investors. It also allows for the maximization of shareholder value, which is one of the key motivations for the establishment of good corporate governance rules, which positively contributes to the growth of the stock market.

In contrast, poor governance practices usually lead to companies in distress, facing agency problems and deteriorating overall corporate performance and credit ratings. Corporate governance provides a sense of openness and professionalism that sends a positive signal to all stakeholders of the company. Therefore, a company should consider integrating governance as brand building strategy.

VI. CORPORATE SUSTAINABILITY THROUGH GOVERNANCE

Sustainable business practices focus primarily on CSR practices, eco-efficiency and eco- innovation. Corporate sustainability relies heavily on the adoption of governance. With a focus on reducing carbon emissions and recycling materials, the highest ranked companies are those whose long-term achievements are focused on energy sustainability and respect for the environment and social framework. Ensuring transparency and accountability to all its stakeholders, the corporate governance system always functions as a safeguard against social and environmental issues that can lead to a company's vulnerability.

Corporate governance has a significant impact on performance during the period 2007- 2008 marked by the global financial crisis. Indeed, a good corporate governance always focuses on long-term directions and tries to gain the trust of customers through a good reputation in the market. Several studies have shown the benefits of CSR disclosure, also research work has been conducted over time to describe the relationship between the nature of a company and its governance.

Thus, there is a positive relationship between corporate governance and social responsibility, it is empirically proven that good governance leads to better CSR performance. All these benefits of CSR and corporate governance ultimately help to ensure the sustainability of a company.

CONCLUSION

In the context of governance, good communication can foster support for the company by positively influencing the public opinion, attitudes and behavior of relevant stakeholders, including potential customers, executives and decision makers. In addition, governance in branding can help gain a competitive advantage in the marketplace and ultimately attract investors.

Sound corporate governance is vitally important to any organization because it undoubtedly strengthens a company's public image. For example, companies must not only develop strong governance, but also communicate meaningfully and effectively with stakeholders. Failure to disclose and communicate responsibly can create confusion and mistrust among stakeholders, which in turn damages the organization's image and its acceptability in society.

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Corporate governance in Islamic finance faces different types of challenges. Excluding those experienced in conventional finance, these challenges, as explained above, arise mainly from sharia compliance requirements. From this, many issues arise, the complexity of which depends on the size of the Islamic institution concerned. But, on the whole, the protection of stakeholders' rights seems to attract more attention from all operators in the Islamic financial sphere because of the stakeholder approach that governs this type of institution in accordance with Islamic economic philosophy on the one hand and the vulnerability of the IAH status on the other. However, despite all the efforts made in this area through standardization, the required degree of protection has not yet been achieved

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