RESEARCH IN CORPORATE AND SHARI’AH GOVERNANCE IN THE MUSLIM WORLD
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RESEARCH IN CORPORATE AND SHARI’AH GOVERNANCE IN THE MUSLIM WORLD: THEORY AND PRACTICE

EDITED BY

TOSEEF AZID
ALI ABDULLAH ALNODEL
AND
MUHAMMAD AZEEM QURESHI

emerald PUBLISHING

United Kingdom – North America – Japan – India – Malaysia – China
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About the Editors

Toseef Azid is a Professor of Economics at College of Business and Economics, Qassim University, Saudi Arabia, and international visiting scholar, Economics Department, Wayne State University, Detroit, MI, USA. He holds PhD in Economics from the University College of Wales (UCW), Aberystwyth, UK (1993), and MSc in Economics from Quaid-i-Azam University, Islamabad, Pakistan (1979). He received COT Scholarship from the Government of Pakistan to study at UCW, overseas research scholarship from British government, and a Fulbright Award Scholar in Residence (2006), where he worked on a research project, ‘Economics of Middle Eastern Countries’. He was a Visiting Fellow at the Markfield Institute of Higher Education (MIHE), UK (2005–2006 and 2007), and then in 2012 he served as a Professor at MIHE. He taught in Pakistan, Brunei, United Kingdom, United States and Saudi Arabia. His research focusses on technological changes, development economics, labour economics, Islamic economics and Islamic finance. His recent book titled *Labour in an Islamic Setting: Theory and Practice* is published by Routledge, UK (2017). He has published more than 60 papers in local and international journals. He participated in several conferences held in Canada, Australia, United Kingdom, France, Iran, Saudi Arabia, Turkey, Indonesia, Malaysia, Bahrain, Qatar and Pakistan.

Ali Abdullah Alnodel is an Associate Professor at the College of Business and Economics, Qassim University, Saudi Arabia. He is a Vice Dean of Postgraduate and Research of the College of Business and Economics, Qassim University. He holds PhD in Accounting and Auditing from the University of Manchester, UK (2004), a Master’s in accounting from the University of Miami, USA (1998). He is a member of international and national accounting associations such as Colorado Board of Accountants, Saudi Organization for Certified Public Accountants, Saudi Accounting Association, and American Accounting Association. His research focusses on corporate governance, auditing, accounting and financial disclosure. His papers have been published in local and international journals. He presented his papers in different conferences held all over the world, for example, Saudi Arabia, Australia, United Kingdom and United States.

Muhammad Azeem Qureshi is an Associate Professor of Finance at Oslo Business School, Oslo Metropolitan University, Norway. He holds PhD in System Dynamics from the University of Bergen, Norway (2008), MPhil in System Dynamics from the University of Bergen, Norway (2004) and MBA from Bahauddin Zakariya University Multan, Pakistan (1989). He started his career as an Investment
Banker in Pakistan. He also earned diploma in banking (DAIBP) during his over six years’ career as banker. Dr. Qureshi joined academia in Pakistan in 1997. In 2009, he moved to Norway at his current position where he teaches courses in corporate finance, international finance and managerial accounting to Norwegian as well as international students from across the globe. His research focusses on corporate finance, social economics, Islamic banking and finance. He has published several papers in international journals. He has also participated in several conferences held in the United States, Canada, Switzerland, the Netherlands, Spain, Italy, Norway, France, South Korea, Saudi Arabia, Qatar, Turkey, Malaysia and Pakistan.
Mohammad Abdullah is a Shari‘ah consultant based in Dubai. He earned his PhD and MA in Islamic Finance from the University of Gloucestershire, UK. Abdullah enjoys good academic interests in the fields of Islamic finance, Islamic microfinance and comparative studies of waqf (Islamic endowment) and English trust. He has published a number of academic papers in reputed international journals and has contributed few book chapters. Abdullah is a well-trained Shari‘ah Scholar and is a graduate of Darul Uloom Nadwatul Ulama, India.

Shafiu I. Abdullah works with Sule Lamido University Kafin-Hausa, Jigawa state Nigeria. He has previously worked with Media Trust Abuja Nigeria and Intercontinental Bank Nigeria PLC. He has a Bachelor’s in Economics and a Master’s in Business Administration and Economics. He has published articles in journals, newspapers, as book chapters and conference proceedings. His research interests are in Islamic economics and finance, advertising, consumer theory, risk management and corporate governance. He won a writing award from the Nigerian Stock Exchange in 2003.

Abu Umar Faruq Ahmad is an Associate Professor in Islamic Economic Institute (IEI) at King Abdulaziz University, Jeddah. Prior to joining IEI he worked as Associate Professor at Universiti Brunei Darussalam; Senior Researcher with International Shari‘ah Research Academy for Islamic Finance (ISRA); as Associate Professor at INCEIF, the Global University of Islamic Finance, Kuala Lumpur; and as Assistant Professor at Hamdan Bin Mohammad Smart University, Dubai; and. He holds LLM (Hons.); and PhD from Western Sydney University, Australia with High Distinction. He has several published books, chapters in edited books and refereed journal articles on Islamic economics and finance to his credit. He spoke at over 50 international conferences held in different parts of the globe. He is the Founding Chairman of the Shari‘ah Supervisory Board of Islamic Cooperative Finance Australia (ICFA), and Shari‘ah Audit Executive at Islamic Bank of Australia Project Sydney, Australia.

Tanveer Ahsan works as an Assistant Professor of Finance with Rennes School of Business, Rennes, France. He earned his PhD from School of Accounting, Dongbei University of Finance and Economics, Dalian, China. Earlier he earned his BBA (Hons.) and MBA in Finance from Institute of Management Sciences, Bahauddin Zakariya University, Multan, Pakistan. He served the same university for more than two years (2010–2012). His research interests are in corporate
financing policies and panel data techniques. He has published numerous articles. His research focuses on different aspects of corporate financing policy.

**Mohammad Nurul Alam** is a Retired Professor of Accounting. He obtained his Doctorate degree on ‘Small Business Finance by Islamic Banks’ from Lund University, Sweden. He served as an Associate Professor of Accounting at the Canadian University of Dubai and at Sultan Qaboos University. He has been teaching PhD students as a Visiting Professor in the Department of Islamic Economics and Finance (IEF) at Trisakti University, West Jakarta, Indonesia. He worked as a Coordinator of ‘Fresh Start Program’ involved in teaching women in the region of Peel, Brampton, Canada.

**Abdurrahman bin Abdulaziz Alaqil** is an Assistant Professor at College of Shari’ah and Islamic Studies, Qassim University, Saudi Arabia. His research interest is sunnah and hadith. He holds PhD from Islamic University of Madinah, Saudi Arabia. He has published a number of articles in the academic journals. He is a Member of different Shari’ah Committees.

**Mehmet Asutay** is a Professor of Middle Eastern and Islamic Political Economy and Finance at the Durham University Business School and Director of the Durham Centre in Islamic Economics and Finance (UK). Mehmet’s teaching, research, publication and supervision of research are in Islamic moral economy, Islamic finance and banking, Islamic political economy, Islamic governance and management and the Middle Eastern political economies. His articles on his research interests have been published in various international academic journals and professional magazines. He has also published and edited books on aspects of Islamic moral economy and Islamic finance, the latest of which are *Islamic Finance: Political Economy, Values and Innovation; Islamic Finance: Performance and Efficiency;* and *Islamic Finance: Risk, Stability and Growth* (three volumes; Gerlach Press, 2015–2016).

**Muhammad Ayub** is Director of Research at Riphah International University Islamabad, Pakistan and Editor of *Journal of Islamic Business and Management* (JIBM). He is Non-resident Editor of AAOIFI’s *Journal of Islamic Finance Accountancy* (JOIFA) as well. He is also a Jurisconsult at the Federal Shariat Court of Pakistan. His unique contributions include ‘Islamic Banking Certificate Course’ being offered by SBP/NIBAF since 2005, and the textbook *Understanding Islamic Finance* (Wiley, 2007), which has been translated into Arabic, Malay, Bhasa, Turkish, Urdu and other languages.

**Mohd Hairul Azrin Haji Besar** is a Lecturer at the School of Business and Economics, Universiti Brunei Darussalam with research interests in the fields of accounting, financial reporting, governance and Islamic finance. He is currently an Alternate Member in the Brunei Shari’ah Financial Supervisory Board (SFSB). Dr Besar graduated with first-class honors in accounting and holds an MBA, specialising in Islamic Banking and Finance, from the International Islamic University Malaysia. He has been awarded PhD in Accounting and Finance from the University of Glasgow, UK.
Umar Burki is currently working as an Associate Professor in School of Business and Faculty of Social Sciences, University College of Southeast Norway, and Program Coordinator for Master's in Innovation and Management. He holds two Master's degrees in industrial logistics and economics and a PhD in business logistics from Molde University College, Norway. He has been published in several international academic journals, and has contributed conference papers related to B2B relationships, green innovations, supply chain management and international marketing.

Masudul Alam Choudhury is Adjunct Professor and International Chair of the post-graduate program in Islamic Economics and Finance, Trisakti University, Jakarta, Indonesia. He served as a Professor of Economics in Cape Breton University, Canada. He also served as Professor of Economics in Sultan Qaboos University, Muscat, Oman. Choudhury’s specialisation in the field of economics and finance is analytical methodology derived from the Qur’an and sunnah in the socio-scientific field with special focus on Islamic economics and finance studied from the Qur’anic worldview of monotheism. He earned his Master’s of Economics and PhD (Political Economy) from University of Toronto, Canada. He is Editor-in-Chief of Humanomics: International Journal of Systems and Ethics.

Sherif El-Halaby is an Academic Visitor at the University of Portsmouth. He has participated in more than 15 international conferences such as AAA and BAFA. He is working as a full-time Lecturer at the October University for Modern Sciences and Arts. He is also a part-time Lecturer at the Arab Academy for Science, Technology and Maritime Transport, Ahram Canadian University, Open Arab University and East London University, UK.

Yaser Ahmed Fallatah is an Assistant Professor of Accounting at the College of Industrial Management, King Fahd University of Petroleum and Minerals, Dhahran, Saudi Arabia. He presented his papers in different international conferences. He is also a Member of the American Accounting Association.

Abul Hassan Farooqi is a Research Scientist II/Associate Professor of Finance in King Fahd University of Petroleum and Minerals, Dhahran, Saudi Arabia. Earlier, he taught at the Markfield Institute of Higher Education (UK), Staffordshire University (UK) and the University of Brunei, Darussalam. He has published more than 30 papers in the areas of Finance, Islamic Economics and Finance. Recently, one of his book as a co-author entitled Islamic Finance: Ethical Underpinnings, Products, and Institutions (Hurricane Risk) is published by Macmillan (2018).

Rihab Grassa is an Auditor and Lecturer at the Higher Colleges of Technology in UAE and an External Associate Researcher for the Laboratoire Interdisciplinaire de Gestion Université - Enterprise in the High Institute of Accounting and Business Administration, University of Manouba, Tunisia. She is also a Board Member of the Tunisian Association for Islamic Finance. She has worked as a researcher/analyst in KPMG Global Islamic Finance in Dubai, and as a manager.
for Islamic finance services in KPMG Tunisia. She is currently working on a number of projects that will promote the development of Islamic finance in Middle East and North African countries.

Murya Habbash is an Associate Professor of Accounting at Administrative and Financial Sciences School, King Khalid University, Abha, Saudi Arabia. He holds PhD from the Durham University, UK in 2010, which focused on corporate governance and earnings quality. His current research interests include corporate governance, audit quality, corporate social responsibility and earnings quality. He has published a book and a number of research papers in academic journals. He also holds CPA-Saudi and CME qualifications. He is also a Board Member and Audit Committee Chairman in a Saudi-listed company.

The late Professor Sofyan Harahap served as a full-time Professor of Accounting in the Faculty of Economics, Trisakti University, Jakarta, Indonesia. Along with Professor Masudul Alam Choudhury, Sofyan Harahap was a co-founder of the now 19-year-old postgraduate program in Islamic Economics and Finance, Faculty of Economics, Trisakti University, Jakarta, Indonesia.

Zulkifli Hasan is an Associate Professor at the Faculty of Shari'ah and Law, Universiti Sains Islam Malaysia and also a Member of the Shari’ah Board of an Islamic bank in Malaysia. He has published numerous articles and books. He assisted the task force on corporate governance in Islamic financial institutions to develop corporate governance guidelines for IFIs in the Middle East and North Africa (MENA). He also assisted a task force on environmental, social and governance (ESG) to specifically introduce the S&P/Hawkamah Pan Arab ESG Index for listed companies in 11 MENA markets. His book entitled *Shari'ah Governance in Islamic Banks* is published by the Edinburgh University Press, UK (2012).

Mohammad Ziaul Hoque is a Retired Professor of Finance. He served as Assistant Professor of Finance at the Monash University Australia and the Sultan Qaboos University. He also served as an Operations Manager for Rahimafrooz Bangladesh Ltd., and a Manager at the Bangladesh Shilpa Bank. He earned his Master’s in Business Administration from the University of Sao Paolo/RMIT, Australia and PhD from the Victoria University, Melbourne, Australia. He is the Editor of *Journal of Business and Policy Research*. He has authored several books in Economics and Finance.

Khaled Hussainey is a Professor of Accounting and Financial Management at the Portsmouth University. He has been awarded the prestigious 2007 Best Paper Award of the *British Accounting Review* for his article ‘Loss Firms’ Annual Report Narratives and Share Price Anticipation of Earnings’, and the prestigious 2012 Best Paper Award of the *Journal of Risk Finance* for his article ‘Revisiting the Capital Structure Puzzle: UK Evidence’. He is currently a Co-editor-in-chief of *Journal of Financial Reporting and Accounting*; associate editor of *Journal of Applied Accounting Research* and *International Journal of Accounting, Auditing and Performance Evaluation*. 
Mohd Adib Ismail is a Senior Lecturer at the Faculty of Economics and Management, Universiti Kebangsaan Malaysia (UKM). He has published several peer-reviewed papers in indexed journals along with book chapters in publications by known publishers. He completed his doctoral study in Economics from the International Islamic University of Malaysia in 2009. Prior to that, he obtained his Bachelor’s degree in Islamic Studies with concentration on Shari’ah and Economics from the University of Malaya, and Master’s degree in Economics from UKM. At UKM, he teaches Macroeconomics, Islamic Economics and fiqh.

Abdul Ghafar Ismail is a Professor of Islamic financial economics at Johor Islamic Studies College. He has also served as the Head of the Research division, Islamic Research and Training Institute (IRTI), Islamic Development Bank (IDB) and as a Professor of Islamic Financial Economics at the Universiti Kebangsaan Malaysia. He has contributed many articles in scholarly journals and has published books as well as written individual chapters in several books.

Noor Suhaida Kasri is the Head of Islamic Capital Market Unit in International Shari’ah Research Academy for Islamic Finance (ISRA). She received her Doctor of Philosophy in Islamic Banking Finance and Management from the University of Gloucestershire (in collaboration with Markfield Institute of Higher Education), UK. Her Master’s in Law was from the King's College of London. Her research interests are in law, regulation, social and ethical finance. She has written a number of research papers, articles and textbook chapters, and presented in conferences globally.

Hasan Kiaee earned his PhD in 2013 and Master’s in 2009 from the University of Tehran, Iran. He is working as an Assistant Professor of Economics at the Imam Sadiq University, Iran. His research focusses on Islamic Economics and Finance. In addition to publications, he actively participates in the Islamic banking and finance conferences inside and outside of Iran. He is also working as an Advisor for a number of banks and financial institutions in Iran.

Muhammad Iman Sastra Mihajat holds a LLB (Shari’ah) from the Al Azhar University Cairo, Egypt, Master’s in Finance, and PhD in Islamic Banking and Finance (Institute of Islamic Banking and Finance, IIiBF) from the International Islamic University Malaysia (IIUM). He is the Head of Shari’ah, Al Yusr Islamic Banking – Oman Arab Bank. He is a Founder of iMan Institute of Islamic Finance (IIIF). He teaches in several well-known universities in Indonesia, such as Universitas Indonesia, Padjajaran University, Trisakti University, Islamic University of Syarif Hidayatullah, Al Azhar Indonesia University and Azzahra Islamic University.

Murniati Mukhlisin earned her Bachelor’s degree in Islamic Accounting from International Islamic University, Malaysia and PhD from the University of Glasgow, UK. She has taught at the University of Glasgow and Essex Business School, University of Essex, UK. Dr Mukhlisin works on critical perspective of research in the areas of financial reporting, Islamic accounting, Islamic banking and finance, and Islamic financial literacy. She is Rector at Tazkia University College of Islamic Economics, Bogor, Indonesia. Dr. Murniati

**Haitham Nakhleh** is an Assistant Professor of Business Administration at the College of Business and Economics, Qassim University, Saudi Arabia. He holds PhD in Business Management from the M.S. University, India, and Master’s in Commerce from the University of Mysore, India. Nakhleh’s research interests focus on various dimensions of business and technology, e-marketing, HRIS and different theories. His research papers have appeared in different national and international refereed journals.

**Leny Nofianti** earned her PhD from the Department of Accounting at University Padjadjaran in 2012. Currently, she is a Senior Lecturer in the Accounting Department and serves as Vice Dean of Finance and Administration in Economics and Social Science Faculty, State Islamic University Suska Riau, Indonesia. Her research focusses on governance, *shari’ah* governance, Islamic accounting and islamic banking and finance. She has carried out several research projects and published research papers in national and international publications.

**Mohd Zakhiri Md Nor** is a Senior Lecturer at the School of Law, Universiti Utara Malaysia. Currently, he is a Chairman of *Shari’ah* Advisory Board of Mizuho Bank and used to be *Shari’ah* Committee Member of Agrobank. He is also a Visiting Professor at the Islamic University of Maldives, Associate Member of the Association of *Shari’ah* Advisors in Islamic Finance Malaysia (ASAS), a Member of the Chartered Institute of Islamic Finance Professionals (CIIFP) and a Research Fellow at the Legal & Justice as well as the Syariah and Business Law Research Centre of Universiti Utara Malaysia. He holds PhD in Islamic Finance from INCEIF – the Global University of Islamic Finance.

**Noor Aimi Mohamad Puad** is a Lecturer at the Faculty of Management and Muamalah, Kolej Universiti Islam Antarabangsa Selangor (KUIS). She holds Bachelor degree in Accounting and Master of Science in Finance (Islamic banking) from the International Islamic University Malaysia (IIUM). Currently, she is pursuing her PhD at Institute of Islamic banking and Finance (IIBF), IIUM. She has expertise in accounting, Islamic banking and finance.

**Shafiqur Rahman** is a Faculty Member at Kent Institute, Sydney. He is also the Vice President of Australian Academy of Business Leadership. He served the US Embassy in dhaka as an Economic Specialist as well as a trade Promotions Manager. He also served as an MBA Coordinator for two private universities in Bangladesh. He holds a Phd in Management from the Macquarie University, Australia. He also received a Graduate Certificate in Research from Western Sydney University, and an MBA from iBA, dhaka University. He has published more than 15 papers in international journals, and presented papers in 20 international conferences.

**Irum Saba** is an Assistant Professor in the Department of Economics and Finance and Program Director of MS Islamic Banking and Finance at Institute
of Business Administration (IBA), Karachi, Pakistan. She is also a Member of Grand Council of the Chartered Institute of Islamic Finance Professionals (CIIF), Malaysia. She is a Sub-editor of *Journal of Islamic Finance Accountancy (JOIFA)*, AAOIFI, Bahrain, and Vice President of Asia Pacific Applied Economics Association (APEA), Australia. She earned her PhD from INCEIF. Her areas of interest are political economy, management, *shari’ah*, wealth planning and management, Islamic microfinance, corporate governance and Islamic finance.

**Rose Ruziana Samad** is a PhD Candidate at GS-Muamalat, Faculty Economics and Muamalat, USIM. She earned her Diploma in Banking and a Bachelor’s degree in Finance with Honors from the University Teknologi MARA. She completed her Master’s in Economics from the National University of Malaysia. She also holds IFP and RFP from the IBFIM. She was formerly a Lecturer in UiTM Johor and then continued her service as a Senior Lecturer in Economics and Finance at INTI International University Nilai. Her interests are in governance issues of cooperatives and *shari’ah*-based cooperatives.

**Mohammad Saif Sarwar** is a well trained *Shari’ah* Scholar. He holds Master’s in Islamic Banking and Finance from the University of Gloucestershire, UK, and a PG Diploma in *Shari’ah* sciences from the Mahdul Fatah, Damascus. He has worked as a Project Manager with Al Maali Consulting Group, Dubai. Prior to this, Mohammad has experience of working with UK-based Islamic finance consultancy IFAAS. He has published few academic papers on critical *fiqhi* issues of Islamic finance in different journals and Islamic finance magazines.

**Muhammad Hakimi Mohd. Shafiai** is a Senior Lecturer at the Universiti Kebangsaan Malaysia. He received his PhD (Islamic Economics) from the Graduate School of Asian and African Area Studies, Kyoto University, Japan. He has written a book entitled *Islamic Finance for Agricultural Development*, and has published several scholarly articles related to Islamic economics.

**Zurina Shafii** is an Associate Professor, Faculty of Economics and Muamalat and Research Fellow in Islamic Finance and Wealth Management Institute, Universiti Sains Islam Malaysia. Durham University (UK) awarded her Master’s and PhD degrees in Islamic finance. She has authored four books on Islamic financial planning, *Shari’ah* audit and Islamic finance. She has served at Durham University, the Islamic Research Training Institute of Islamic Development Bank and the Global Islamic Finance Development Centre, a research centre for the World Bank at Istanbul, and also in ASAFAS, Kyoto University, Japan.

**Shahida Shahimi** is an Associate Professor at the School of Economics, Faculty of Economics and Management, National University of Malaysia. She earned her PhD in Law from the University of Aberdeen, UK. She is an Editor of *Journal Ekonomi Malaysia* (JEM) and *Malaysian Journal of Economics* (Scopus-Indexed). She is also an Associate Research Fellow at the International Research Centre of Islamic Economics and Finance (IRCIEF), International Islamic University College Selangor (KUIS). Her major interests are in the fields of Islamic
banking and finance, Islamic capital market, Islamic economics, social finance, waqf, sukuk and crowd-funding.

Salman Ahmed Shaikh is an Assistant Professor of Management Sciences at the SZABIST Karachi, Pakistan. He holds PhD in Economics from the National University of Malaysia. He has published several papers and book chapters on Islamic economics and finance. He has presented papers in international conferences in Turkey, Indonesia, Malaysia, Brunei and Pakistan. Over the years, he has worked from both the mainstream and the Islamic perspective on macroeconomics, development economics, public finance, corporate finance, investments and asset pricing.

Salah Al Shalhoob is an Assistant Professor and Director of the Centre of Research Excellence for Islamic Banking and Finance, King Fahd University of Petroleum and Minerals, Dhahran, Saudi Arabia. He earned his PhD in Islamic Finance and Law from the University of Edinburgh, UK. He is a well-renowned scholar of Islamic finance in Saudi Arabia.

Nadeem Ahmed Sheikh is an Associate Professor of Finance at the Institute of Management Sciences, Bahauddin Zakariya University, Multan, Pakistan. He earned his PhD (Business Administration) from the School of Management, Huazhong University of Science and Technology, Wuhan, China. He has published articles in national and international journals. One of his articles published in International Journal of Commerce and Management, ‘The Impact of Capital Structure on Performance: An Empirical Study of Non-Financial Listed Firms in Pakistan’ won a Highly Commended Paper Award in 2014. His research interests include capital structure, corporate governance, dividend policy, intellectual capital and working capital management.

Mohammad Soleimani received his MA degree in Islamic Studies and Economics from the Imam Sadiq University, Iran, and PhD in Economics from the Tarbiat Modares University, Tehran, Iran. He is an Assistant Professor in Islamic Science and Economics, in the Imam Sadiq University. His current research interests include financial economics and development economics. He has published articles in the areas of social capital, financial crisis and income distributions. He is the Author of policy papers in the Islamic Parliament Research Center of Iran in the area of Islamic Finance.

Rochania Ayu Yunanda is working as a Lecturer at the Sekolah Tinggi Ekonomi Islam Tazkia Bogor Indonesia since 2008. She has been a member of ISO team as Internal Auditor conducting monthly review and periodical audit on ISO compliance, and internal audit before surveillance audit by SAI Global. She earned her Master’s degree from International Islamic University Malaysia. She is now pursuing her PhD at the Universiti Sains Islam Malaysia. She has done some research on Islamic non-profit institutions and governance in waqf, particularly in waqf performance and waqf accounting and auditing.
Governance issues are of particular concern to Islamic financial institutions as it is crucial that they have appropriate governance structures to assure their clients and other stakeholders that their operations are shari'ah compliant. In this context the present study is a welcome addition to the growing literature on shari'ah governance, indeed it is the most comprehensive study to date, covering both structural and modelling issues, as well as presenting interesting country studies of shari'ah governance in Malaysia, Indonesia, Saudi Arabia, Oman, Bangladesh, Pakistan and Iran. These experiences are especially valuable as they provide a comparative perspective on the implementation of the best practices in Islamic corporate governance.

The relationship between the shari'ah board and the board of directors of Islamic financial institutions is a key issue, and much has been learnt from working practices in this area during the last four decades. Practical matters covered include policies for the appointment and retention of shari'ah board members. Although this was originally dealt within an informal manner, countries such as Malaysia have introduced detailed legislation to ensure that the best practices have legal foundations. Islamic law, of course, provides a framework for corporate and shari'ah governance, but as litigation involving Islamic financial institutions is dealt with under national law, it is helpful if law makers address the challenges that arise in applying commercial law to Islamic financial institutions. The book should be an essential reading for shari'ah scholars and those working for law firms dealing with Islamic financial institutions.

A whole part of the work deals with corporate governance from an Islamic audit and accounting perspective. The six chapters covering financial reporting standards for Islamic banks, takaful providers and other Islamic financial institutions are of particular value. There is a growing literature on Islamic accounting and auditing but this study, for the first time, has been focussed on corporate governance. Comprehensive financial reporting and detailed data analysis are crucial to ensure that Islamic financial institutions are sound with appropriate transparency for the benefit of shareholders and clients. As a matter of good practice, it is suggested that senior management remuneration should be in the public domain. Voluntary disclosure should be encouraged as a moral imperative and where provision for compulsory disclosure is absent because of inadequate commercial legal provisions.

A major strength of the book is that theory and practice are brought together. Questions that arise include whether Islamic corporate governance
is driven by Islamic teaching, or rather if good practice is evidence based. In other words, there is a debate over whether the approach should be deductive, drawing on Islamic scholarship or inductive, by studying the behaviour of Islamic financial institutions. In reality, the two approaches are not exclusive; indeed, it can be argued they complement each other. The merit of this book is that the approach is multifaceted, with a comprehensive treatment of Islamic corporate governance issues.

Rodney Wilson
Emeritus Professor, Durham University, UK
Chapter 1

Islamic *Shari’ah* and the Principles of Corporate Governance: An Introduction

*Abdurrahman bin Abdulaziz Alaql*

Financial crises, administrative corruption, and the ensuing economic collapses in most societies have demonstrated the need for a system providing three basic pillars: justice, accountability, and transparency, through which controls and means of control are put into place, ensuring good governance and safeguarding the rights and interests of all parties involved in the firms. It would also limit the uncontrolled behavior of the executive management, and align the role of the board of directors with the objectives of the parties associated with these firms. This system is later known as the “corporate governance.”

In light of this situation, intensive studies in different economies and countries have sought to measure the impact of governance principles and applications in achieving the objectives for which the firm was established, and the extent to which the interests of different parties in firms are taken into account. It observes that good governance practices improve performance and productivity of firms, reduce administrative corruption, and thus enhance economic growth and welfare of the society. A number of studies have considered the issue of corporate governance in Islamic societies, but these were largely preoccupied with the practical aspects and did not link governance system with the values and principles of the early stages of Islamic societies that play a fundamental role in determining its primary objectives.

The economic collapses, financial crises, economic decline, and administrative corruption witnessed by most of the Muslim communities despite their endowments of huge physical and human resources led to the idea of compiling this volume. It aims at surveying the sources of Islamic legislation to examine the extent of the suitability of the contemporary governance applications for Islamic communities as well as their authenticity from the *shari’ah* perspective. This is very important for the Islamic communities because of the vital role Islamic legislations play in shaping the behavior of Muslims which makes these legislations a very influential factor in the proper application of corporate governance.
1.1. The Islamic Perspective of Governance

1.1.1. Human Nature

The basic inclination of humans is dominated by injustice and ignorance. Allah (swt) says:

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Truly, We did offer Al-Amanah (the trust or moral responsibility or honesty and all the duties which Allah has ordained) to the heavens and the earth, and the mountains, but they declined to bear it and were afraid of it (i.e. afraid of Allah’s Torment). But man bore it. Verily, he was unjust (to himself) and ignorant (of its results). (33:72)
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This means that the majority of people lack knowledge, and fairness; however, the believer is complemented by learning and justice, which are the origins of virtue, while others remain at the original position of ignorance and injustice. The human being was also described with miserliness and niggardliness.¹ The Prophet (PBUH) says: “Thou could not be a believer until thou love for your brother what thou love for yourself” (Sahih Al-Bukhari). Humans were also natured toward despotism.² This despotism becomes more evil with the gaining of more possessions. Shari‘ah has set rules and regulations that govern human behavior and determine the bases for rights to realize justice among the people.

1.1.2. The Individual and the Group

A group is, in essence, a number of individuals who are tied together by common interests and objectives. Individuals cannot isolate themselves from their communities and live all alone. Rather, by their very nature, they are destined for participation and communication.³ The Islamic view toward the individual and the group is a comprehensive and balanced one. It pays attention to the group and individuals in the same way. It neither completely ignores the group as done in capitalism nor does it give importance to the group at the expense of individual as in socialism. Thus, each individual and group has their rights in Islam without any infringement on either party’s rights.

1.1.3. Sensing Social Responsibility

Islam bestows several responsibilities to the individual within the community. Among these are one’s responsibility toward oneself, one’s family, the community,

¹Al-Qur‘an (70:21–19).
²Al-Qur‘an (96: 6.7).
³Al-Qur‘an (49:13).
and the universe as a whole. The individual is responsible as prescribed by the Islamic *shari’ah*. As the Prophet (PBUH) says:

Surely! everyone of you is a guardian and is responsible for his charges: The Imam (ruler) of the people is a guardian and is responsible for his subjects; a man is the guardian of his family (household) and is responsible for his subjects; a woman is the guardian of her husband’s home and of his children and is responsible for them; and the slave of a man is a guardian of his master’s property and is responsible for it. Surely, every one of you is a guardian and responsible for his charges. (Sahih Bukhari Vol. 9, Book 89, No. 252)

This responsibility is a great source of benefits in this world and in the hereafter. The responsibility of the community toward individual and the responsibility of the individual toward community are intertwined. Indeed, in this system there is a strong bond among believers, as the Prophet (PBUH) says: “Truly the faithful are to one another like components of a building – each part supports the other” (Muslim and Bukhari); and “the faithful are like a single body: If his eye suffers, then his constitution will suffer; and if he has headache, then his whole system will suffer” (Muslim).

### 1.1.4. Keeping the Rights of All Parties

The Islamic *shari’ah* seeks to preserve all rights that underlie the worldly and religious aspects of people’s lives. Thus, one of the *shari’ah*’s objectives is to maintain the five necessities, which are: religion, life, mind, offspring, and property. Legislations were made to maintain these five necessities, since life cannot be sustained without any one of them.

A basic tenet of the Islamic *shari’ah* is the sanctity of Muslim’s wealth. Allah (swt) says:

O you who believe! Eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent. And do not kill yourselves (nor kill one another). Surely, Allah is the Most Merciful to you. (4:29)

The Prophet (PBUH) said: “Your blood and money are impermissible to you.”

### 1.1.5. Conflict of Interest

Without divine guidance, human being is self-centered and would infringe on other people’s rights and might even take over other people’s wealth through illegal ways. This leads to injustice and corruption in the society which would threaten the whole underlying system of the society. Hence, the Islamic *shari’ah* laid down the foundations and regulations which would govern people’s relations
and transactions with the target of justice. The Islamic shari’ah strives to protect simultaneously public and private interests. However, if there is a conflict between them, then priority goes to the public interest.

1.1.6. Efficiency and Work Perfection

Islam urges for the perfection and articulation of work. The Prophet (PBUH) says: “Allah loves when one of you is doing something that he does it in the most excellent manner” (Al-Qaradawi, 1995); and Allah (swt) says: “And spend in the cause of Allah (i.e., jihad of all kinds, etc.) and do not throw yourselves into destruction (by not spending your wealth in the cause of Allah), and do good. Truly, Allah (swt) loves Al-Muhsinun (the good-doers)” (2:195).

1.1.7. Agent and Client

Cooperation among members of Islamic society is another teaching of Islam. Allah (swt) says: “Cooperate in righteousness and piety, and do not cooperate in sin and aggression. And fear Allah, indeed Allah is severe in penalty.” One aspect of this legitimate cooperation is called agency arrangement. The agency arrangement involves one person authorising another to accomplish a legitimate work for him. Allah (swt) decreed the agent–client law, whereby He allowed the human being to authorize someone to do things on his behalf. Both client and agent must be adult, sensible, and rationale one.

1.1.8. Concentration of Wealth/Power

In most countries, we observe concentration of wealth in the hands of a few rich families. In that way, due to the pressure of family, incompetent family members become managers, or following the status quo governance is deteriorating (Morck & Steier, 2005). However, Islam discourages the concentration of wealth in few hands. The Qur’an says:

> Whatever spoils from the dwellers of the township Allah has bestowed on His messenger, shall belong to Allah, His messenger, messenger’s relatives, and to the orphans, the needy and the travelers in need; so that it may not become the property of the rich among you. Whatever Allah’s messenger gives you, take it and from whatever he forbids you, refrain from it. Fear Allah, for Allah is stern in retribution.” (59:7)

1.2. Islamic Principles of Governance

As discussed above, Muslims are required to protect and look after their property. To do this, the Islamic jurisprudence provides a framework of financial system based on the core principles of transparency, accountability, and justice. The Islamic jurisprudence also explains the issues related to partnership, contract, and agency that outline corporate governance.
1.2.1. Justice

1.2.1.1. Justice (Adala) in Islam. Adala is derived from al adal, which means “straightness”\(^4\); straightness is contrary to injustice and despotism. Another term related to justice is fairness (al qist), which in Arabic means straightness. It means there is no discrimination among the shareholders/investors regarding the position they have in the corporation and the nationality they belong to, and they have the right to question about the dividends and other matters. There is a consensus among the shari’ah scholars that without justice the whole system will be spoiled and corrupted. The famous Muslim social scientist Ibn Khaldun says that if people have no trust in the existing system and they assumed that whatever they are earning is not being protected by the existing system, so they will leave their hope and will not participate in the economic activities. In his opinion, this will have a negative impact on the growth and welfare of the economy and consequently there would be big economic and financial chaos in the economy. On the other hand, if they believe that their property and their earnings are protected by the system, then they will strive more for the earnings. This can only be done if justice prevails in the economy.

Allah (swt) says in the Qur’an: “Indeed, Allah orders justice and good conduct and giving to relatives and forbids immorality and bad conduct and oppression. He admonishes you that perhaps you will be reminded” (16:90); also, the Qur’an says:

So to that [religion of Allah] invite, [O Muhammad], and remain on a right course as you are commanded and do not follow their inclinations but say, “I have believed in what Allah has revealed of the Qur’an, and I have been commanded to do justice among you.”

Allah is our Lord and your Lord. For us are our deeds, and for you your deeds. There is no [need for] argument between us and you. Allah will bring us together, and to Him is the [final] destination. (42:15)

And

Indeed, Allah commands you to render trusts to whom they are due and when you judge between people to judge with justice. Excellent is that which Allah instructs you. Indeed, Allah is ever Hearing and Seeing. (4:58)

In the above verses, Allah (swt) ordered that his servants have to play the fair game and hold the justice whatever be the situation. Justice is the main ingredient of governance.\(^5\) There should be no discrimination between friends and

\(^4\)“adaltuhu hatta i’tidal,” which means “I straightened it out and till it became straight and flattened out.”

\(^5\)Al Qur’an (4:135), (5:8), (2:282), and (6:52).
enemies, native and foreigners, etc., and similarly it should be prevailed in all the dimensions of life, either it is social, economic, financial, or political. And all the contracts should be based on justice, fairness, and transparency. The Prophet (PBUH) said: “Oh My servants! I forbade on Myself injustice and oppression and I made them forbidden for you, so don’t be unjust towards each other” (Muslim). And Suwaid-bin-Qais reported:

I and the slave Makhrafah brought cloth from Hajr and came there-with to Makkah. Then the Messenger of Allah came to us walking. He bargained with us for cloth and we sold to him. A man there was measuring with weight up. The holy Prophet (PBUH) said to him: Measure and weigh down. (Ahmad, Abu Daud, Tirmizi)

1.2.1.2. Responsibility of Doing Justice. From the shari’ah point of view, justice is an obligatory duty of all the segments of the society irrespective of individual or group, ruler or subject, master or slave, etc. Everyone is accountable to Allah (swt) and He knows the intentions and actions of every one. This is the duty of the community to cooperate with each other in the good deeds and maintaining the justice among the different agents of the community. Simultaneously, this is the duty of state to train all the agents about justice and righteousness.

1.2.1.3. The Characteristics of Justice in the Islamic Shari’ah. Under the umbrella of Islam, justice should be without any discrimination or biasness, that is, either someone is Muslim or non-Muslim, male or female, young or old, rich or poor, relative/loves one or not, and enemy or friend. For a judge, parents and kids have no priority. As Allah (swt) says:

O you who have believed, be persistently standing firm in justice, witnesses for Allah, even if it be against yourselves or parents and relatives. Whether one is rich or poor, Allah is more worthy of both. So follow not [personal] inclination, lest you not be just. And if you distort [your testimony] or refuse [to give it], then indeed Allah is ever, with what you do, Acquainted. (4:135)

The Prophet (PBUH) says: “By Allah, if Fatima, the daughter of Muhammad committed theft, Muhammad will cut off her hand!” (Bukhari). In the Islamic context, justice is free of space and time. Thus, he who oppresses in this world and violates, justice will not only be held accountable in this world alone but will also be held accountable hereafter.

1.2.2. Transparency in Islam

1.2.2.1. The concept of Transparency. In Arabic, the following words are used for transparency: for example, the word Al shaff refers to a curtain which reveals what is behind it. The word shaffa means a cloth which is so light and thin that it reveals the body. Whereas al ifs’ah is disclosing and revealing and al wa’duh is appearing and becoming clear.
1.2.2.2. Transparency as a Terminology. Transparency in the language of economics and business is used as follows:

Giving all those concerned an adequate opportunity to become acquainted with and obtain all the relevant information and decisions why the decisions were taken and who are the parties responsible for them and what results followed therefrom.

It is also characterized as the delivery of true, clear, and adequate information to all interested parties in order to give it a chance to analyze corporate operations.

1.2.2.3. Shari’ah and Transparency Principle. The principle of transparency, disclosure, and clarity is strongly acknowledged by shari’ah, while their opposites, concealment, deception, and misinformation are strictly prohibited. The principle of transparency is the essence of straightness and fairness as we have narrated in verse 135 of chapter Al Nisa. The principle of transparency prevailed everywhere in the system of Islam. For example, in administrative or financial matters it has the following points:

1. Full disclosure in making financial reports. (2:282)
2. Credibility in preparing financial reports. (2:283)

The Prophet’s (PBUH) sayings also explain in detail the concept of transparency and indicate the importance of transparency in commercial and financial matters.

The above-mentioned verses and sayings of the Prophet (PBUH) show that transparency means clarity, truthfulness, integrity, and comprehensiveness in the information presented by corporate sector to those who are entitled to access the related information. One of the most important tools that enhance the principle of transparency is “financial covenant declaration,” which is a prime factor in making information available to the monitoring authorities that check and uphold accountability for transparency.

As explained by Morck and Steier (2005), if investors have trust in the management of the corporations, then they are ready to buy the securities of those

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6Abu Huraira narrates that the Prophet (PBUH) passed by a food tray and on dipping his hand into it, he found the food was wet underneath. So he said “Oh! food owner what is this?” The food owner said, “It was rained onto, messenger of Allah.” The Prophet said, “Couldn’t you put it on top of the food so that people could see it, whoever cheats is not a part of me.” The Prophet (PBUH) said, “Three would not be addressed by Allah in the hereafter, nor would he look at them or commend them and they would receive a painful torture: the one whose garment reaches below his heels, the one who keeps reminding people of this good deeds to them and the one who sells his merchandize by constantly swearing that they are worthwhile.”
corporations. They also get the assurance that the company will run honestly, keeping the transparency with the full scale of efficiency. This is the state where corporate governance becomes critical. The corporate governance of large corporations depends on CEOs and other managers. Shareholders are always trying to monitor the level of the governance of these firms.

This would lead to the protection of property, prevent conflict of interest, and limit job exploitation, thus establishing the principle of transparency and clarity on which governance is based.

1.2.3. Accountability in Islam

1.2.3.1. The Concept of Accountability. In Arabic, the word mas’ilia (accountability) derived from (su’al), or question or sa’ltuhu, means information which is asked; generally, it is the question about the deeds.

1.2.3.2. Accountability in Islamic Shari’ah. Accountability is a necessary element of all the deeds and actions. If any action has no accountability, it means that action has no negative or positive value. Shari’ah has clearly mentioned about the accountability and its procedure. According to shari’ah, accountability is twofold.

1.2.3.3. Ex Ante Accountability. There is a clear-cut warning against dishonesty, extravagancy, and waste of money, urging for conservation of expenditure. Allah (swt) says: “And give to the kindred his due and to the poor and to the wayfarer. But spend not wastefully (your wealth) in the manner of a spendthrift.” (9:60)

1.2.3.4. Ex Post Accountability. An example of this is what was narrated by Abu Humaid Alsaidi, who said the following:

The Prophet (PBUH) appointed a man called Ibn Allutaiba and put him in charge of the charities (sadaqat) of Banu Saleem. When he came to settle accounts, he said (to the Prophet), “This is what is due to you and this is a present (to me).” The Prophet said: “Would you sit in the home of your father and mother until your present comes over to you if you are truthful.” Then he made a speech to us and after thanking Allah and praising him, he said: “I would appoint a man from among you to do some of the work that Allah has placed under my authority.” Then he comes along and says, “This is what is due to you and this is a present that was given to me. Why wouldn’t he sit in the home of his father and mother so that his present reaches him? In the name of Allah, if any of you takes something unrighteously, he will meet Allah carrying it in the Day of Judgment. I would recognize one of you who met Allah carrying a camel that keeps grunting or a cow that keeps bellowing or a goat that keeps bleating.” Then he raised his hand up high and said: “Oh Allah, have I delivered (the message), my eye saw (it) and my ear heard (it).” (Sahih Bukhari Vol. 9, Book 89, No. 305)

7 Also see Al Qur’an (7:31), (25:67), and (17:26–27, 29)