

# CORPORATE GOVERNANCE IN ISLAMIC FINANCIAL INSTITUTIONS: AN ETHICAL PERSPECTIVE\*

Dr. Zulkifli Hasan  
Faculty of Syariah and Law  
Islamic Science University of Malaysia  
E-mail: zul361977@yahoo.com  
Blog: <http://zulkiflihasan.wordpress.com>

## ABSTRACT

*Globalization is a phenomenon of a borderless world in which no boundaries in acquisition of information as well as in dealing with other people from the rest of the world. The impact of globalization affects number of key areas and this includes Islamic finance. While significant concerns have been invoked on the material aspects of Islamic finance such as financial growth and products sophistication, it is nevertheless observed that equal emphasizes have not been given on the issue of ethics. In view of scarcity literature on the subject and the essence of ethics in Islamic finance, this article aims at expanding the faith based moral horizon by advocating ethics as one of the foundational dimensions of corporate governance in Islamic Financial Institutions (IFIs). Unlike the western concept of corporate governance which is based on the western business morality that derived from "secular humanist", this article suggests that corporate governance in IFIs is founded on the epistemological aspect of Tawhid, Shari'ah and ethics. In the absence of extensive discourse on corporate governance and ethics, this article attempts to highlight several key ethical principles embedded in Islam that would offer some guidelines in guiding the future development of Islamic finance.*

*Keywords: Corporate Governance, Shari'ah, ethics and IFIs.*

## 1.0 Introduction

Islam is neither simply a religion nor a mere ideological vision. It is a practical system of life and balance between human bodily requirements, spirit and reason. Islam is a comprehensive religion and it covers *aqidah* (belief), *Shari'ah* and *akhlak* (ethics). In contemporary perspective, the ideal practice of Islamic finance tends to provide evidence about the comprehensiveness of Islam by invoking these three core elements.

Contrary to the ideal assumption that Islamic finance is about belief, *Shari'ah* and ethics, it is observed nevertheless that in actual practice, Islamic finance is more anxious on the legal and mechanistic aspect of *Shari'ah* compliant. At this point, Balz, (2010: 250) views that Islamic finance is now experiencing a "formalist

---

\* Paper presented at the Conference on the Future of Faith in the Era of Globalization, University of Sarajevo, Bosnia and Herzegovina, 19-20<sup>th</sup> September 2010.

deadlock” where the industry is more concerned with formal adherence to Islamic law instead of promoting Islamic ethical values. This is affirmed by El Gamal, (2006) when he severely criticized the practice of Islamic finance particularly by highlighting the issue of *Shari’ah* arbitrage. Significant criticisms by numerous scholars about the current practice of Islamic finance have led to series of questions as to the distinctiveness of Islamic finance with its conventional counterparts. Chapra, (2010) and Siddiqi (2007) for instance view that the practice of Islamic finance seems unable to attain its authenticity and share many common similarities with conventional finance. As a result, Islamic finance industry is also experiencing the impact of recent financial crisis such as in the case of closure of Ihlas Finance House in Turkey, the Islamic Bank of South Africa and Islamic Investment Companies of Egypt. These corporate failures raise an issue on the importance of ethics as the core element of Islamic finance.

There are numerous observations about major causes of corporate difficulties as experienced by several IFIs and one of them is weak of corporate governance<sup>1</sup>. The analysis of such corporate failures in the existing literature nevertheless is found to heavily emphasize on the aspect of regulatory failure, management failure and control failure in corporate governance structure. It is observed that there is lack of discourse on the issue of ethics or the ethical failure aspects in IFIs that lead to such corporate difficulties. In view of scarcity literature on this subject, this article aims at providing general overview and basic understanding on the ethical perspective of corporate governance in IFIs. This article adds the previous literature on ethics and corporate governance by highlighting the distinctiveness of Islamic ethical principles and possible mechanism to institutionalize it. The remainder of this article is structured as follows. The next section reviews western and Islamic literature on ethics and corporate governance and section 3 specifically explains conceptual framework of Islamic ethics and its underlying principles. Section 4 attempts to highlight possible approach to promote and implement ethics by advocating the institutionalization of ethics and finally, section 5 concludes the discussion.

## **2.0 Ethics in Western and Islamic Theory of Corporate Governance**

Becht and Barca, (2001) provide a literature review of a number of corporate governance models as possible solutions to solving the collective action problem among shareholders such as takeover model, block holder model, board models,

---

<sup>1</sup> The OECD, (2004: 11) defines corporate governance as “a set of relationship between company’s management, its board, its shareholders and other stakeholders, thereby plays essential function to provide the structure through which the company goals are set and the means of attaining those objectives and monitoring performance are determined”. The IFSB, (2006: 33) defines corporate governance “as a set of relationships between a company’s management, its BOD, its shareholders and other stakeholders which provides the structure through which the objectives of the company are set; and the means of attaining those objectives and monitoring performance are determined”.

executive compensation models and multi-constituency models. Another examination of the existing corporate governance theory can be found in Lewis, (1999: 33-66) where he examines the Anglo-Saxon model, the Germanic model, the Japanese model, the Latinic model, the Confucian model and the Islamic model. Generally, all of these corporate governance theories are either developed on the basis of agency theory or stakeholder theory orientation.

The Anglo-Saxon model of corporate governance which is also known as market-based systems or shareholder-value system or principle-agent model is considered as the most dominant academic view. Miller (2004:2) views that shareholders value orientation concerns on the sovereignty of individual where sole consideration is given to shareholders. Stakeholders' value model on the other hand focuses on a relationship-based model that emphasizes on maximizing the interests of a broader group of stakeholders (Adams, 2003: 4). Both these Western theories of corporate governance tend to focus on the mechanism of resolving the agency problems. These theories nevertheless have failed to certain extent to take into account the element of ethics as an essential component of corporate governance. Only after the incident of significant corporate failures and financial scandals due to lack of ethical consideration, there were suggestions to integrate ethics into corporate governance framework such as Drennan, (2004), Cladwell and Karri, (2005), Arjoon, (2005) and Sullivan and Shkolnikov, (2007)<sup>2</sup>.

The notion of integrating ethics as part of corporate governance system then raises an issue of philosophical foundation of ethics in conventional literature. Basically, the ethical dimension in western theory is built on the basis of utilitarianism, relativism and universalism (Beekun, 1996). The ethical principles that extracted from these theories are based on philosophical ethics which is constructed from social interaction. All of the universal ethical principles which are applicable to corporate governance such as accountability, transparency, fairness and responsibilities are socially constructed through human reason and experiences.

On the other hand, Islamic model of corporate governance advocates comprehensive approach by emphasizing the elements of ethics as propounded in *al Quran* and *al Sunnah*. Unlike ethics from western theory perspective, the Islamic ethical principles are divine and religious construct. Wilson, (2002: 53) states that the Islamic ethics as being enduring and based on holy revelation while the ethics in western theory derived from social values are more transitory in nature. *Al Quran* and *al Sunnah* provide guidelines and principles of ethics that can be universally applied including in the matter of corporate governance. The

---

<sup>2</sup> It is reported that the implementation of business ethics provides positive effects on firms' financial performance (Spiller, 2002: 150).

distinctiveness of corporate governance theories from Islamic and Western perspectives and its relationship with ethics can be summarized as follows: -

**Table 1: The Distinctiveness of Corporate Governance Theories from Islamic and Western Perspectives**

Aspects	Shareholder Model	Stakeholder Model	Islamic Model
<b>Episteme</b>	Rationalism and Rationality Ethics is social construct	Rationalism and Rationality Ethics is social construct	Faith-based rationalism: <i>Aqidah, Shari'ah</i> and <i>Akhlaq</i> <i>Ethics is holy revelation</i>
<b>Rights and Interest</b>	To protect the interest and rights of the shareholders.	The right of community in relation of the corporation.	To protect the interest and rights of all stakeholders but subject to the rules of <i>Shari'ah</i> and ethics.
<b>Corporate goal</b>	Shareholders profit	Stakeholders and Social welfare	<i>Maqasid Shari'ah</i> <sup>3</sup> : <i>Ethics is part and parcel of maqasid Shari'ah</i>
<b>Nature of Management</b>	Management dominated	Controlling shareholder dominated	Concept of <i>Khalifah</i> (vicegerency), <i>Shura</i> (consultation) and subject to <i>Shari'ah</i> and ethics
<b>Management Boards</b>	One-tier board No specific committee on ethical issues	Two-tier boards; Executive and supervisory Board/ No specific committee on ethical issues	<i>Shari'ah</i> board or any institution that responsible on the <i>Shari'ah</i> and ethical issues.
<b>Nature of Business</b>	No specific restriction on any kind of business	less prioritized No specific restriction on any kind of business	Only <i>Shari'ah</i> and ethical permissible activities are allowed.

Table 1 illustrates the diversity of Islamic model of corporate governance with its conventional counterparts in six main areas i.e. the episteme, right and interest, corporate goal, nature of management, management board and nature of business. Unlike the shareholder value system and the stakeholder value orientation, the Islamic model of corporate governance puts *aqidah, Shari'ah* and ethics as the main component of its framework<sup>4</sup>. At this point, Chapra, (1992),

<sup>3</sup> *Maqasid Shari'ah* means protection of the welfare of the people, which lies in safeguarding their faith, life, intellect, posterity and wealth (Al-Ghazali, 1937: 139-140).

<sup>4</sup> This is in line with the IFSB, (2006: 33) where it explains corporate governance in the context of IFIs to encompass "a set of organizational arrangements whereby the actions of the management of IIFS are aligned, as far as possible, with the interests of its stakeholders; provision of proper incentives for the organs of governance such as the BOD, *Shari'ah* Board and management to pursue objectives that are in the interests

views that the underlying Islamic ethical principle acts as a moral filter for socio economic justice. In this regard, a set of values and ethical principles as defined by divine revelation through *al Quran* and *al Sunnah* provides clear guidelines as to the ethical consideration that relevant to corporate governance particularly in setting the standard code of behavior of all stakeholders and guiding the daily and business activities of the firm.

### 3.0 Ethical Dimension of Corporate Governance from Islamic Perspective

#### 3.1 Conceptual Framework of Ethics

The word *ethics* is derived from the Greek word *ethos*, which means character or custom (Solomon, 1984: 3). It represents a wide meaning of character, behavior or code of conducts. In Islam, the word ethic is synonym with the term *adab* and *khuluq* (Siddiqui, 1997: 423). These two terms denote good behavior or a standard of conduct to be observed in social interactions (Saedon and Kamal, 1992: 51-62) or the set of moral principles that distinguish right and wrong (Beekun, 1996: 2). In the holy *al-Quran* the term *khuluq* can be found in *Surah al-Qalam* verse 4 as Allah says: “*And surely you (Prophet Muhammad) have the best form of morals,*” and in *surah al-Shu’ara* verse 137: “*There is no other than khuluq of the ancient*”. Apart from these, the Prophetic *hadith* had also made reference to ethics and morality where Aishah reported that that “*the Khuluq (Morals) of the Prophet was based upon the Qur’an*” and the Prophet says that “*I have come to complete the code of moral conduct*” (Muslim).

In deconstructing the Islamic ethical principles within the realm of economic, Naqvi, (1981: 45-57) advocates four important axioms that specifically reflect its relevancy in determining the rules of economic behavior in a society. The axioms of unity, equilibrium, free will and responsibility are the basis for deriving a set of ethical system and principles that would be appropriate to nurture and guide the economic behavior from Islamic point of view<sup>5</sup>. These divine formulated axioms provide very useful guidelines in identifying and recognizing legitimate ethical principles in economic.

---

of the stakeholders and facilitate effective monitoring, thereby encouraging IFIs to use resources more efficiently; and compliance with Islamic *Shari’ah* rules and principles”.

<sup>5</sup> The concept of unity refers to vertical dimension of Islam whereby man’s life on earth in its entirety relates eternally to God (Naqvi, 1981: 48). While unity depicts the vertical dimension, equilibrium denotes the horizontal dimension of Islam by which it is a binding moral commitment of every individual, institution, corporation or any kind of entities to uphold a delicate balance in all aspects of lives (Naqvi, 1981: 51). The axiom of free will then propagates the concept of natural freedom within certain limitation whereby it emphasizes on the element of balancing between the ‘individual freedom’ and ‘collective freedom’ (Naqvi, 1981: 52). Finally, the concept of ‘*amanah*’ or responsibility complements the Islamic ethical axioms in which the natural freedom that derived from the free will axiom must be exercised with full responsibility as a vicegerent and trustee of God (Naqvi, 1981: 54).

Another construct of ethics to legitimize the ideal Islamic economic behavior refers to the principle of *adl* (justice), *amanah* (trust) and *ihsan* (benevolence). Based on the ethical axioms of unity, equilibrium, free will and responsibility, Islamic ethics must at least have three important characteristics namely the criterion of *adl* (justice), *amanah* (trust) and *ihsan* (benevolence) (Beekun and Badawi, 2005: 134-135). The first feature of ethics in Islam requires all individual to behave justly to all<sup>6</sup>. The managers for instance shall treat equally the employees without discrimination. The concept of *amanah* then further characterizes Islamic ethics by considering individual as a vicegerent of God and he is accountable to Him<sup>7</sup> in which requires him to be responsible in whatever he does. Finally, the concept of *Ihsan* represents the core and most important element of Islamic ethics. Unlike justice which is mandatory, *Ihsan* denotes what is above and beyond mandatory (Al Qurtubi, 1966)<sup>8</sup>. In this regard, *Ihsan* requires extra caution, effort and good intention where the individual performs good deeds with the realization that Allah is watching him at all times<sup>9</sup>. The criterion of *ihsan* then expects all stakeholders in IFIs regardless of shareholders, managers, board of directors (BOD) and employees to observe the set of Islamic ethical principles which is divinely revealed and clearly stipulated in *al Quran* and *al Sunnah*.

### 3.2 Ethical Principles

In discussing ethics in the context of corporate governance in IFIs, this article highlights several Islamic ethical principles that relevant to key stakeholders and these include prohibition of *riba*, *maysir* and *gharar*, to observe good behavior and conduct with candor, courtesy and fairness, to acquire knowledge, diligence and competence, to uphold interest of all stakeholders, fair competition, transparency, confidentiality and fair price and wages. All of these ethical principles are extracted and derived from the Islamic ethical axioms of unity, equilibrium, free will and responsibility as well as the criterion of *adl*, *amanah* and *ihsan*. It is worth noting that this list is non-exhaustive.

#### Table 2: Islamic Ethical Principles

---

<sup>6</sup> Allah says in *al Quran* "Allah commands justice, the doing of good and liberality to kith and kin, and HE forbids all shameful deeds and injustice and rebellion: He instructs you, that ye may receive admonition" (*Al Quran*, 16: 90).

<sup>7</sup> In *al Quran*, (8: 27) Allah says "Ye that believe! Betray not that trust of Allah and the Messenger, nor misappropriate knowingly things entrusted to you".

<sup>8</sup> *Adl* refers to the person's inner intentions and feelings that should be consistent with the declared words and actions, while *Ihsan* goes beyond that where it requires words, actions and intention of certain good deeds sincerely realizing he is accountable to Allah (Al-Qurtubi (1966, 10: 165, as cited in Beekun and Badawi, 2005: 134).

<sup>9</sup> In *hadith* narrated by Umar, the Prophet explained *ihsan* as the act of worshipping Allah as though you are seeing Him, and while you see Him not yet truly He sees you (Al Nawawi, 2001).

Ethical Principles	Sources
<b>Prohibition of Riba (Interest)</b>	<i>"O you who have attained faith! Remain conscious of God, and give up all outstanding gains from Usury, if you are (truly) believers" (Al Quran, 2: 278)<sup>10</sup>.</i>
<b>Prohibition of Maysir (Gambling)</b>	<i>"O you who believe! Intoxicants and gambling, (dedication of) stones and (divination by) arrows, are an abomination of Satans handwork: Abstain from such (abomination), that you may prosper. Satans plan is (but) to excite enmity and hatred between you with intoxicants and gambling, and hinder you from the remembrance of Allah, and from prayer: Will you not then abstain?" (Al Quran, 5: 90-91).</i>
<b>Prohibition of Gharar (Uncertainties)</b>	Hadith narrated by Muslim, Ahmad, 'Abu Dawud, Al Tirmidhi, Al Nasa'i, Al Darami and Ibn Majah on the authority of Abu Hurayra where the Prophet prohibited the pebble sale and the <i>gharar</i> sale.
<b>Good Character and Behavior<sup>11</sup></b>	<p>Abd Allah ibn 'Amr said, the Prophet used to say: <i>"The best of you are those who have the most excellent morals"</i> (Bukhari, 61: 23).</p> <p>Hadith narrated by Abu Hurairah, the Messenger of Allah said: <i>"The most perfect of the believers in faith is the best of them in moral excellence, and the best of you are the kindest of you to their wives"</i> (Al Tirmidzi, 10: 11).</p> <p>Muadh Ibn Jabal reported that the Prophet said: <i>Fear Allah wheresoever you may be, follow up an evil deed by a good one which will wipe (the former) out and behave good-naturedly to people"</i> (Al Nawawi, 2001: 35).</p>
<b>Generosity in Doing Business<sup>12</sup></b>	<p>Uthman bin Affan reported that the Prophet said: <i>"Allah will admit to the Paradise a man who is lenient as a seller and a buyer."</i> (Ibn Majah, 3: 2202)</p> <p>Jabir bin Abdullah reported that Allah's Messenger said: <i>"May Allah have mercy on the bondsman who is kind when he sells, kind when he buys and lenient when he demands (his debt)"</i> (Ibn Majah, 3: 2202)</p>
<b>Diligence and Competence<sup>13</sup></b>	<p>The Prophet said: <i>"Allah loves to see one's job done at the level of itqan or wisdom"</i> (Cited in Al Dimasqi, 2006: 385-388).</p> <p>Saidatina Aishah reported that the Rasulullah said: <i>"The deeds most loved by Allah (are those) done regularly, even if</i></p>

<sup>10</sup> See also *al Quran*, (2: 275, 3: 140, 4: 161 and 30: 39).

<sup>11</sup> Islam insists on obligation to observe good character and behavior as the Prophet himself is sent to us for purpose of perfecting the best of character.

<sup>12</sup> Generosity in doing business refers to willingness and kindness in giving away either rights or property or times for the benefit of others.

	<i>they are small"</i> (Bukhari and Muslim).
<b>To Uphold Interest of All Stakeholders</b>	<p>Ibnu Umar reported that the Messenger of Allah said: "A Muslim is the brother of a Muslim; he does him no injustice, nor does he leave him alone (to be the victim of another's injustice); and whoever does the needful for his brother, Allah does the needful for him; and whoever removes the distress of a Muslim, Allah removes from him a distress out of the distresses of the day of resurrection; and whoever covers (the fault of) a Muslim, Allah will cover his sins on the day of resurrection" (Bukhari, 46: 3)</p> <p>Anas reported that the Prophet said: "Help thy brother whether he is the doer of wrong or wrong is done to him." They (his companions) said, O Messenger of Allāh! We can help a man to whom wrong is done, but how could we help him when he is the doer of wrong? He said: "Take hold of his hands from doing wrong." (Bukhari, 46: 4).</p>
<b>Fair Competition<sup>14</sup></b>	<p>The Messenger of Allah said: "Do not hate one another and do not be jealous of one another and do not boycott one another, and be servants of Allah (as) brethren; and it is not lawful for a Muslim that he should sever his relations with his brother for more than three days" (Bukhari, 78: 57).</p> <p>The Prophet declared that: <i>He who monopolizes is not but a wrongdoer</i>" (Al-Tirmidhi, 6: 23).</p>
<b>Transparency<sup>15</sup></b>	<p>"And if you are traveling and cannot find a scribe, then there be mortgage taken.....and do not conceal not evidence for whoever hides it, surely his heart is tainted with sin and Allah is knower of what yo dou do." (Al-Quran, 2: 283).</p> <p>Abdallah reported that the Prophet said: "Truthfulness leads to righteousness, and righteousness leads to Paradise. And a man keeps on telling the truth until he becomes a truthful person. Falsehood leads to Al-Fajur (i.e. wickedness, evil-doing), and Al-Fajur (wickedness) leads to the (Hell) Fire, and a man may keep on telling lies till he is written before Allah, a liar" (Bukhari, 8: 116).</p>
<b>Confidentiality<sup>16</sup></b>	Hadith reported by Abu Hurairah, the Prophet said:

<sup>13</sup> Islam also concerns on the quality of works where individual is required to improve their working standards to the utmost and it should be maintained constantly so as to avoid any occurrence of negligence which could harm the interest of others.

<sup>14</sup> It is universally affirmed that unfair competition is an act that against human right, dictum and principle of morality and ethic. The basic premise of ethics on competition is to promote fair trade, healthy competition and ultimately consumer welfare in the market.

<sup>15</sup> Transparency is of utmost importance as *al Quran* specifically forbids concealing of evidence.

<sup>16</sup> Every individual has also duty to keep secret of all communications which is classified as private and confidential unless it is against the public interest and justice.

	<p><i>"Whosoever relieves from a believer some grief pertaining to this world, Allah will relieve from him some grief pertaining to the Hereafter. Whosoever alleviates the difficulties of a needy person who cannot pay his debt, Allah will alleviate his difficulties in both this world and the Hereafter. Whosoever conceals the faults of a Muslim, Allah will conceal his faults in this world and the Hereafter. Allah will aid a servant (of His) so long as the servant aids his brother. Whosoever follows a path to seek knowledge therein, Allah will make easy for him a path to Paradise. No people gather together in one of the houses of Allah, reciting the Book of Allah and studying it among themselves, except that tranquility descends upon them, mercy covers them, the angels surround them, and Allah makes mention of them amongst those who are in His presence. Whosoever is slowed down by his deeds will not be hastened forward by his lineage"</i> (Cited in Al Asin, 1970: 14-15).</p>
<p><b>Fair Wages and Price<sup>17</sup></b></p>	<p><i>"Withhold not things justly due to others"</i> (Al Quran, 26: 18).</p> <p>Hakim bin Hizam reported that the Prophet Muhammad said: <i>"The seller and the buyer have the right to keep or return the goods so long as they have not parted or till they part; and if both the parties spoke the truth and described the defects and qualities (of the goods), then they would be blessed in their transaction and if they told lies or hide something, then the blessings of their transaction would be lost "</i> (Bukhari, 3: 293).</p>

The command to avoid *riba*, *maysir* and *gharar* is considered as main characteristics of Islamic ethical principles. The prohibition of *riba*, *maysir* and *gharar* is clearly mentioned in *al Quran* and *al Sunnah*. Unlike the western ethical code which is based on social interaction in which *riba*, *maysir* and *gharar* are tolerable, Islam vividly declares these three elements to be unethical and can not be compromised at all times. The remainder of the underlying Islamic ethical principles however may share some common similarities with the western ethical code.

#### **4.0 Institutionalization of Ethics in IFIs**

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

---

<sup>17</sup> Any practice of excessive price is against the Islamic ethical principle. Fair policy such as fair remuneration and equal employment opportunities is actually part of ethical consideration.

establishing permanent board-level committee that responsible to set the policy on ethics<sup>18</sup>, issuance of code of ethics, organizing ethics training, reinforcing the employee's organizational commitment, and encouraging an ethically-oriented organizational culture (Sim, 1991). 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. Their responsibilities to promote, to implement, to practice and to enforce ethics are summarized in table 3.

**Table 3: Agent of Ethics in IFIs**

Agent of Ethics	Functional Roles
Regulatory Authority	To set regulatory framework for sound and proper code of ethics - Code of ethics on corporate governance for general usage
Supervisory Authority	To supervise, monitor and enforce the implementation of code of ethics - Enforcement of the code of ethics
Shareholders	To ensure that all investments and business activities are <i>Shari'ah</i> and ethically permissible - Incentive for ethical achievement
<i>Shari'ah</i> Board	To ensure <i>Shari'ah</i> and ethical compliance - Assist the BOD to come out with Code of Ethics - Emphasize on ethics in the process of issuing <i>Shari'ah</i> rulings
BOD	To set the IFIs direction and policies on ethics - Code of Ethics for internal usage - Ethics as a basis of decision making
Management	To implement set of ethical policies set by the BOD - Organizing ethics training - Module for ethics programme - Enforcement of ethics
Employees	To practice and comply with the code of ethics - Ethics as a culture

<sup>18</sup> Certain companies initiate the establishment of ethical committee known as "Defalcation Committee" to resolve cases related with ethical issues. This committee is an avenue within the internal structure of corporate governance in the firm to resolve disputes and cases involving violation of code of ethics (Othman and Abd Rahman, 2009: 380).

The regulatory authorities play a key role in promulgating a set of law or code of ethics on corporate governance. To complement this function, the supervisory authorities have duty to supervise and monitor the implementation of this code of ethics effectiveness of corporate governance system and to check its. Shareholders have responsibilities to ensure that all business transactions and investment activities are conducted in ethical way. The BOD has responsibility to specify the code of conduct and standard of appropriate behavior for internal usage. Unlike the BOD, the management has fiduciary duty to implement the ethical policies and strategies set by the BOD while the employees, to practice and observe every aspect of ethics as stipulated in the code of ethics.

The most essential agent of ethics in IFIs is *Shari'ah* board. Basically, the functions of *Shari'ah* board are two-folds i.e. advisory and supervisory and these include advising IFIs in its operation, to analyze and evaluate *Shari'ah* and ethical aspects of any banking and financing activities and to monitor and supervise the extent of *Shari'ah* compliance. Considering to their expertise and knowledge on *Shari'ah* and the state of its independence, *Shari'ah* board shall play an active role to promote Islamic ethics and values within the organization. The existence of *Shari'ah* board within the internal corporate governance structure shall be the advantage for IFIs to further promote the implementation of ethics in daily business activities, decision making process, management style, financial products and services and etc.

## 5.0 Concluding Remarks

In spite of its similarities and some common principles with the western theory of corporate governance, Islam adds additional value to the existing governance framework whereby it emphasizes on the element of faith, *Shari'ah* and ethics. The foregoing discussion on the ethical dimension in Islam further validates the need for inserting ethics as part of corporate governance framework in IFIs. Islam highly insists stakeholders of IFIs particularly shareholders, BOD, managers, employees and *Shari'ah* board to preserve standard of conducts, to observe good ethics, conscience and piousness. Since this article is theoretical in nature, further study is really needed in order to explore the extent of ethical practice in IFIs. This triggers the call for future research to complement the existing theoretical studies on ethics with appropriate empirical data and information.

## REFERENCES

Al-Asqalani, Ahmad Ibn, Ali, Ibn Hajar. (2000). *Fathu al-Bari Syarh Sahih Bukhari*". Volume 10. Damsyik: Dar al-Faiha'.

Al-Asin, Musa, Syahin. (1970). *"Fath al-Mun'im, Syarh Sahih Muslim"*. Volume 10. Cairo: Maktabah al-Jamiat al-Azhariyah.

Al-Ghazali, Abu Hamid Muhammad. (1937). *Al-Mustashfa*. Vol.1. Cairo: Al-Maktabah Al-Tijariyyah Al-Kubra.

Al-Nawawi, Yahya ibn Sharaf. (2001). *Text, Translation and Notes: Imam Nawawi's Collection of Forty Hadith*. Kuala Lumpur: Islamic Book Trust.

Arjoon, Surendra. (2005). Corporate Governance: An Ethical Perspective. *Journal of Business Ethics*, 61 (4), 343-352.

Becht, M and Barca, F. (2001). *The Control of Corporate Europe*. Oxford: Oxford University Press.

Beekun, Rafeek. I. and Badawi, Jamal. A. (2005). Balancing Ethical Responsibility Among Multiple Organizational Stakeholder. *Journal of Business Ethics*, 60, 131-135.

Beekun, Rafik, I. (1996). *Islamic Business Ethics*. Herndon, Virginia: IIIT.

Caldwell, C. and Karri, R. (2005). Organizational Governance and Ethical System: A Covenantal Approach to Building Trust. *Journal of Business Ethics*, 58, 249-255.  
Chapra, Muhammad, Umer. (1992). *Islam and the Economic Challenge*. Herndon, Virginia: IIIT.

Chapra, Muhammad, Umer. (2010). Innovation and Authenticity in Islamic Finance in Ali, Syed, Nazim, *Islamic Finance, Innovation and Authenticity*, (pp. 31-64). Cambridge, Massachusetts: Harvard University.

Drennan, L. (2004). Ethics, Governance and Risk Management: Lesson From Mirror Group Newsarticles and Barings. *Journal of Business Ethics*, 52 (3), 257-266.

El-Gamal, M. (2006). *Islamic Finance, Law, Economic and Practice*. New York: Cambridge University Press.

IFSB. (2006a). *Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds*. Kuala Lumpur: IFSB.

Lewis, M.K. (1999). "Corporate Governance and Corporate Financing in Different Cultures", in Zeljko Sevic (Ed.), *Banking Reform in South East European Transitional Economies* (pp. 33-36). London: University of Greenwich Business School, Balkan Center for Public Policy and Related Studies Humanities Research Centre.

Naqvi, S. N. H. (1981). *Ethics and Economics, an Islamic Synthesis*. Leicester: The Islamic Foundation.

OECD. (2004). *OECD Principles of Corporate Governance (Revised)*. Paris: OECD. Available at: <http://www.oecd.org/dataoecd/32/18/31557724.pdf>. Access Date: 25th July 2010.

Othman, Zaleha and Abd Rahman, Rashidah. (2009). Recognizing Value Approach in Corporate Governance: Institutionalization of Ethics. *International Review of Business Research*, 5 (4), 374-387.

Saedon, Mahmud and Kamal, Nik Ahmad. (1992). Adab al-Qadhi in Daily Activities of a Qadhi. *IU Law Journal*, 2 (1), 51.

Siddiqui, Ataullah. (1997). Ethics in Islam: Key Concepts and Contemporary Challenges. *Journal of Moral Education*, 26 (4), 423- 431.

Siddiqui, Muhammad, Nejatullah, (2006). *What Went Wrong?* Keynote Address at the Roundtable on Islamic Economics: Current State of Knowledge and Development of Discipline held at Jeddah, Saudi Arabia on 26-27 May 2004 under joint auspices of the Islamic Research and Training Institute, Jeddah; and the Arab Planning Institute, Kuwait. Available at: [http://www.siddiqui.com/mns/Keynote\\_May2004\\_Jeddah.html](http://www.siddiqui.com/mns/Keynote_May2004_Jeddah.html), Access Date: 13<sup>th</sup> August 2010.

Sim, R. L. (1991). The Institutionalization of Organization Ethics. *Journal of Business Ethics*, 10 (7), 493-506.

Solomon, Robert. C. (1984). *Morality and the Good Life*. New York: McGraw-Hill.

Spiller, Rodger. (2000). Ethical Business and Investment: A Model for Business and Society. *Journal of Business Ethics*, 27 (1/2), 149-160.

Sullivan, J. and Shkolnikov, A. (2007). Business ethics: the key role of corporate governance'. *The Corporate Board*, January / February.

Vitell, S. and Hildago, E. (2006). The Impact of Corporate Ethical Value and Enforcement of Ethical Codes on the Perceived Importance of Ethics In Business: A Comparison of US and Spanish Managers. *Journal of Business Ethics*, 64, 31-43.

Wilson, Rodney. (2002). Parallels between Islamic and Ethical Banking. *Review of Islamic Economics*, 11, 51-62.