CORPORATE GOVERNANCE FROM WESTERN AND ISLAMIC PERSPECTIVES*

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ABSTRACT

Corporate governance is one of the essential elements of any corporation development as it plays roles to design and promote principles of fairness, accountability and transparency. Western concept of corporate governance either the Anglo-American model that promotes shareholder-value system or he European Model that upholds the stakeholder-value system has been subject of continuing debate for well over a century. It is observed however that there is not much discussion or literature on the issue of corporate governance from the Islamic perspective. It is strongly indicated that any Islamic corporation particularly Islamic financial institution needs to have a solid governance model and proper strategies that will promote the adoption of strong and effective corporate governance within the Islamic paradigm. This paper is intended to provide comparative overview on the concept, principles and model of corporate governance from both western and Islamic perspective focuses on the governance framework of Islamic financial institution.

Field of Research: Corporate governance of Islamic Financial Institution.

1.0 Introduction

Corporate governance in banking has been analyzed very extensively in the context of conventional banking markets. By contrast, little is written on corporate governance from Islamic perspective or *Islamic* corporate governance particularly the governance structures of Islamic finance sector, despite its rapid growth since the mid 1970s and their increasing presence on world financial markets[1] (Hamid, Y. (2007: 308).

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[1] The surveys of Siddiqi, M.N., (1981) and Haneef, M.A., (1995), on the contemporary literatures on Islamic economic thought prove that there are lack of references and discussion on the topic of corporate governance from Islamic perspective. In addition, Mannan, M.A. (1984) in his compilation of abstract of researches in Islamic economics also further shows the absence of specific research on Shari'ah corporate governance. Only in 2002, Chapra, M.U. and Ahmed, H, published their research entitled Corporate Governance in Islamic Financial Institution, an academic project sponsored by the Islamic Development Bank to study the corporate governance issues in the Islamic financial institution.

Undeniably, corporate governance is one of the vital elements of any corporation development and it is even bigger challenge to Islamic finance system due to its additional risk as compared to the conventional banking system. For instance the depositors would become exposed with various kind of risks when the Islamic banks started moving into the risk-sharing modes i.e. *mudharaba* and *musyaraka* (Chapra M. Umer, 2007: 338). Therefore, it is strongly indicated that any Islamic corporation particularly Islamic financial institution needs to have a proper governance framework to ensure its growth and success. This paper attempts to provide comparative study on the concept of corporate governance from western and Islamic perspectives. The initial study submits that Islam presents distinctive values and special characteristics of corporate governance with aim to uphold and maintain the principle of social justice not only to the shareholders of the firm but to the all stakeholders.

2.0 Conceptual Definition of Corporate Governance

2.1 Defining Corporation

Literally, the word corporation derives from the *latin* word "corpus" which means body, aggregate, or mass. *Corpus* might be used to mean a human body, or a body or group of laws. American Heritage Dictionary defines it as a body of persons granted a charter legally recognizing them as a separate entity having its own rights, privileges and liabilities distinct from those of its members.

Although the concept of partnership in the form of *musyarakah* or *mudharabah* is well known since in the early period of Islam, it is found that there is less discussion on a concept akin to the corporation[2]. In fact, Kuran, T., (2005) writes that the corporation was absent from the Middle East until the nineteenth century[3]. Muslim jurists have already accepted a concept of corporation known as *Shahsiyah I'tibariyah* based on principles of *qiyas* (analogy) and *istihsan* or *masalih mursalah* (public interest) (Ghazali, S., Omar, S. and Aidit, G., 2005:456). In fact, the existence of public treasury (*Bayt al-Mal*) and the endowment (*Waqf*) implies the recognition on the concept of corporation with separate legal entity. Nyazee, I.A.K., (2006: 297-301) clearly states that the earlier Muslim jurists were fully aware of the concept of corporate personality but they rejected it for the system they were dealing with. He further mentions that most of Muslims modern scholars claim that this concept was known to Islamic law and only some of the scholars are doubtful on this position. As the study focuses on the issue of corporate governance, the paper does not intend to

[2] There were discussions by Muslim jurists on the concept of *Syahsiyah I'tibariyah* or corporation in Islam since 6th century but only in 19th century the concept is materialized through the establishment of the first Muslim-owned corporation namely *Sirket Hariye..*

[3] Timur Kuran views that the Middle East have failed to develop efficient modern economic institution in the form of corporation. This is not because of Islam is inherently incompatible with economic growth, innovation or progress but because of unintended interactions among Islamic institutions derived from the *Shariah* (2004: 2).

discuss in depth the debates on the concept of corporation. It is submitted that the concept of artificial personality or a corpus with a separate legal entity is clearly accepted in Islam.

2.2 Defining Governance

The word governance derived from the *latin* word "*gubernare*" which means to steer or to govern (Cadbury, A, 2002: 1). The Oxford English Dictionary defines to govern as to guide, direct or steer society. According to Stoker (1998: 17), governance refers to the emergence of governing styles in which the boundaries between and within public and private sectors have blurred. These definitions present a very wide meaning of governance as it may cover area of politic, economy, social justice and public administration. The paper only attempts to discuss the issue of corporate governance.

2.3 Defining Corporate Governance

Generally, the definition of corporate governance can be divided into two senses. Firstly, in narrower sense corporate governance can be defined as a formal system of accountability of senior management to the shareholders[4]. Secondly, in expansive term, corporate governance includes the entire network of formal and informal relations involving the corporate sector and their consequences for society in general[5].

A concept of corporate governance from Islamic perspective does not differ much with the conventional definition as it refers to a system by which companies are directed and controlled with a purpose to meet the corporation's objective by protecting all the stakeholders' interest and right. Uniquely, in the context of corporate governance within the Islamic paradigm it presents distinct characteristics and features in comparison with the conventional system as it refers as a special case of a broader decision-making theory that uses the premise of Islamic socio-scientific epistemology which is premised on the divine oneness of God (Choudury, M,A. and Hoque, M. Z, 2004).

3.0 The Role of Corporate Governance

If we refer to early academic discussion on corporate governance in the case of United States, it is found that the function of corporate governance is focused on

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[4] Shleifer and Vishny (1997:737) states that it deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. Cadbury Report (1992) explains corporate governance as the system by which companies are directed and controlled.

[5] Mesnooh, Christopher J. (2002: 8) views it as a code aiming at greater managerial transparency, responsibility and shareholder equality. Another broad definition regards it as an institutional framework in which the integrity of the transaction is decided. It encompasses not only the internal structure of corporation but also external environment including capital and labor markets, bankruptcy systems and governmental competition policies (Salacuse, J.W. 2003:35).

the merits of conglomerate merger and the hostile takeover as mechanism for controlling agency costs[6] (Macey, JR., 2004: 580). It evolves into other areas of the role of institutional investors as corporate monitor and to control managerial shirking and more generally to maximize shareholder's value.

In the context of financial services sector, the apex objective of the corporate governance is to ensure fairness not only to shareholders but to stakeholders to be attained through greater transparency and accountability. This is in line with the statement made by Wolfensohn, J. (1999), former president of the Word bank where he views that corporate governance is about promoting corporate fairness, transparency and accountability. In narrower sense it refers to processes by which shareholders' attempt to maximize their profit and to minimize cost and in broader sense it covers almost all parties related with the corporation namely the stakeholders. On the other hand, Scott, K. (2003:527) explains the objective functions of corporate governance system. In modern corporations, with technological progress and economies especially large scale corporation requires heavy capital investment. The amounts of capital required can be raised through investors, who must rely on the managers to run the enterprise. Therefore, corporate governance system is a set of legal rules, incentives and behaviors that support the reliance by investors. The end goal of corporate governance then is to maximize the economic efficiency of the firm.

Choudhury (2004: 59) states the objective functions of corporate governance in Islam is to define and attain an objective criterion by means of understanding the relations between critical variables supported by policies, programs and strategic coalition. A clear and precise of the objective criterion leads to the determination of such policies, programs and strategies by means of institutional consensus and the exercise of proper instruments as required by the corporation. These objective functions put *maqasid Shari'ah*[7] as the ultimate goal of corporate governance.

The corporate governance in Islam and Western plays very essential roles in order to meet the specific goals and objectives of the corporation. In fact, Islam adds further value by insisting the element of *Maqasid Shari'ah* which can not be found in Western concept. Section 3 and 4 provide a comparative analysis on the differences of Western and Islamic concept of corporate governance. The study heavily relies on the two main western corporate governance models namely the Anglo-American and the European.

4.0 Western Concept of Corporate Governance

[6] The corporate governance is needed because of three its main features, i.e. the banks are more opaque which involve the agency problems; the banks are subjected to strict regulation and the prevalent government ownership of banks which raise specific governance problem (Archer, S. and Rifaat, A.A.K, 2007: 310).

[7] *Maqasid Shari'ah* means protection of the wellfare of the people, which lies in safeguarding their faith, life, intellect, posterity and wealth (Al-Ghazali, 1937: 139-140).

Becht. M and Barca. F (2001) provides a literature review of a number of corporate governance models as possible solutions to solving the collective action problem among dispersed shareholders. These models consist of the takeover model; block holder model; delegated monitoring and large creditors; board models; executive compensation models; and multi-constituency models. Collectively, these models can be construed as *quantitative* corporate governance. Beside all these models, the study focuses only the main two dominant corporate governance systems namely the Anglo-Saxon or "neo liberal" approach and the European models.

Corporate governance issues arise in the corporation in two situations namely whenever there is an agency problem or conflict of interest involving members of the organization such as board of directors, managers and shareholders and cost of business are such that agency problem can not be dealt with through a normal contract (Hart, O., 1995: 678)[8]. The rationale of the existing corporate governance systems of the Anglo-Saxon, the European and other models are undeniably due to these two issues that need to be dealt with effectively. Each system has its own features, represents different corporate structures and diverse aims of corporation. The differences amongst the corporate governance model of the financial system have been subject continuing debate for well over a century.

4.1 The Anglo-Saxon Model

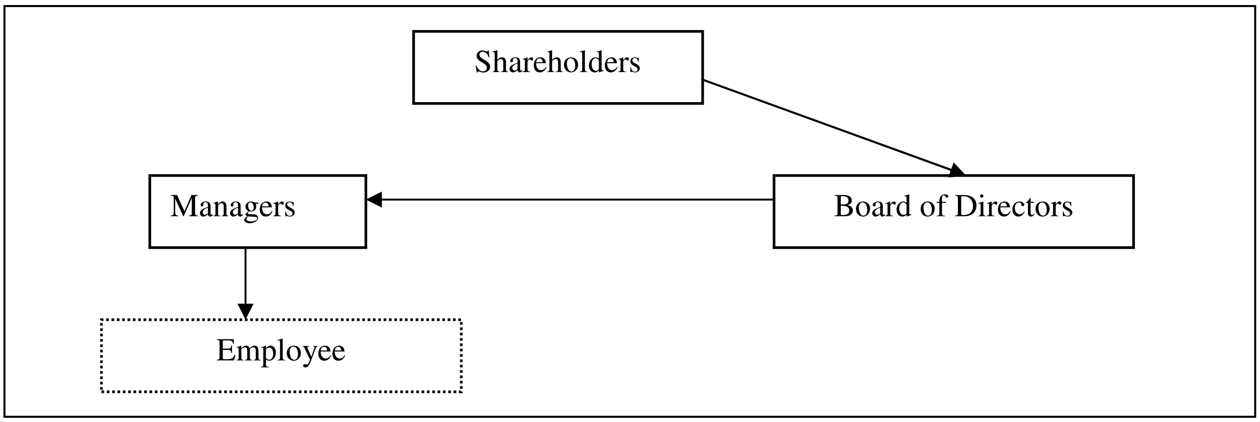
The Anglo-Saxon model of corporate governance which is also known as market-based systems or shareholder-value system or principle-agent or finance-model is considered as the most dominant theory championed by the United States and the United Kingdom. Market-based system of the United Kingdom and the United States are characterized by arm's length relationship between corporations and investors who are said to be concerned primarily about short-term returns (Frank. J and Mayer. C, 2004). It rests on the premises that market particularly the markets for capital, managerial labor and corporate control provide the most effective restraints on managerial discretion and that the residual voting rights of shareholders should ultimately commit corporate resources to value maximizing ends.

It is observed that the shareholders value system has been a dominant academic view of the corporation for many years. This is evidenced, beside the United States and the United Kingdom, by the practice of many corporations in other countries which uphold the shareholders system such as Australia, New Zealand,

[8] In the absence of agency problems, all members of the organization can be instructed to maximize profit or to minimize cost and they will be prepared to carry out the instructions. Effort and other kind of costs can be reimbursed directly and incentives are not required to motivate and therefore no governance structure is required to resolve disagreement. The issue of corporate governance model is not relevant in the absence of this agency problem (Hart, O., 1995:678).

Canada, South Africa and majority of South East Asia Countries for instance Malaysia, Philippines and Singapore including China.

Miller (2004:2) emphasizes that corporate governance concerns with shareholders value. In other word, the individual is sovereign and not the government, not the producers and not the merchants. The connection between customer sovereignty and corporate governance just not lies in the benefit customer derive s from the corporation's output but the shareholders, the investors, the owners are also customers and that what drives shareholders-value principles. Figure 1: The Anglo-Saxon Model of Corporate Governance (Cernat, L., 2004: 153).



The figure 1 appears to show that the Anglo-Saxon model based on the corporate concept of fiduciary relationship between the shareholders and the managers motivated by profit-oriented behavior. This conception is derived from the belief of market capitalism whereby the interest and the market can function in a self-regulating and balanced manner. Perhaps the most distinctive aspect of the Anglo-Saxon system is the structure of corporate ownership where the share ownership is widely dispersed and shareholders influence on management is weak. That is the reason why in the Anglo-Saxon system, the corporation really needs strong legal protection to protect the shareholders. In short, the central preoccupation of corporate governance in the Anglo-Saxon system is to protect the interest and rights of the shareholders.

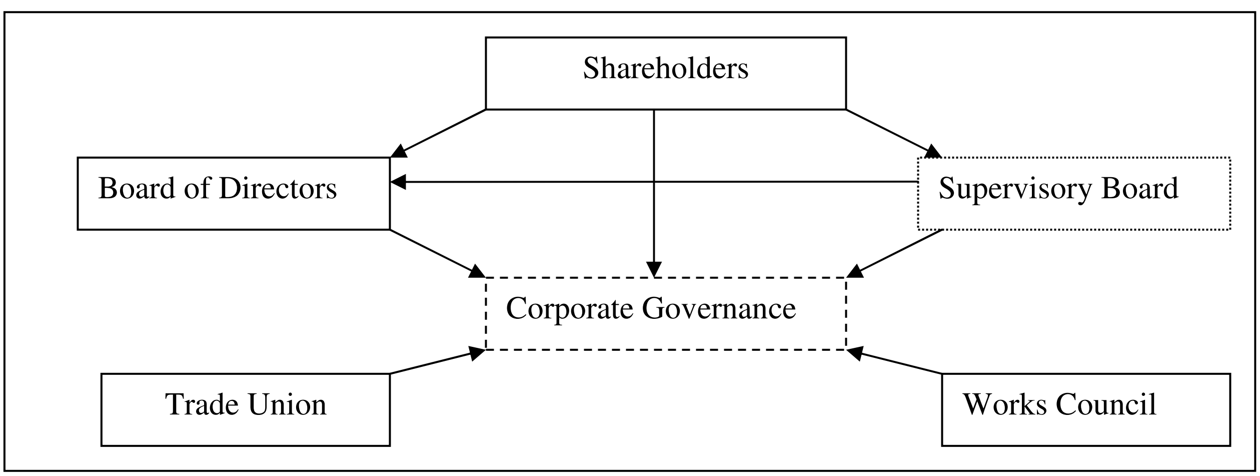
4.2 The European Model

Since the publication of Berle and Means (1932), many have believed that there are significant problem with the Anglo-American system of corporate governance. Another approach of corporate governance was introduced known as Stakeholders model[9]. In this system, companies raise most of their external finance from banks that have close, long term relationships with their corporate

[9] Some authors use different terminology on the European model of corporate governance such as stakeholder model, stakeholder theory, stakeholder management and stakeholder society.

customers. The European model is focused on a relationship-based model that emphasizes the maximization of the interests of a broader group of shareholders (Ismail Adams, 2003: 4). The stakeholders' model of corporate governance is practiced by majority of the European countries such as German, France, Italy, Spain and Greece where many large firms are part of social and economic structure. In addition, Scott, K., (2003: 533) writes that the proposal for reform in the South Korean corporate governance system also suggest the introduction of the European model of supervisory board or two-tier system and allowing banks to own greater equity shares in the corporation. This development mirrors the trend towards the stakeholders' value system by a few of Asian countries beside Japan.

The European model or stakeholder theory rejects the three main propositions of the American model namely all stakeholders have a right to participate in corporate decisions that affect them, manager's fiduciary duty to protect the interest of all stakeholder and the corporation's objective to promote the interest of stakeholder and not only shareholders (Iqbal, Z and Mirakhor, A, 2004: 46). The term stakeholders refer to groups of constituent who have legitimate claim on the corporation (Freeman, 1984: 46) or a person who contributes directly or indirectly to the firms. Lepineu classifies the stakeholders into shareholders, internal stakeholders (employees and labor union), the operational partners (customers, suppliers, creditors and contractors) and the social community (state authorities, trade union, non-governmental organization and civil society). Special attribute of the European model of corporate governance system is the practice of the two-tier system as in Germany or the French known as "*conseil de surveillance*", comprising a supervisory board of outside directors and a separate management board of executive directors, in which structure the two boards meet separately. (Yvon Pesqueux and Salma, D, 2005:7). The figure 2 provides the corporate governance style of the European model. (Cernat, L., 2004: 153).



In Germany, corporate governance framework mainly concerns on a few hundred large firms with more than 2000 employees and listed on the stock exchanges and operating on the two-tier system i.e. supervisory and management board system. The legal system does not play much role in German corporate governance. A two-tiered system consists of management board and supervisory board which have the power to elect the management board. The supervisory boards however do not have much decision-making responsibility and codetermination undermines its monitoring effectiveness. For shareholders to sue management in case of negligent or tort, it would take a majority or 10% at a general meeting to file a court petition (Scott, K., 2003: 529-530). The same conception is also being practiced in France where the board of directors and the managers hold duties not only to the company itself but to employees, the trade union, the works council and to the public at large (Snyder, L, 2007: 238-239).

5.0 Corporate Governance Model from Islamic Perspective

Generally, it is observed that the main objective of the corporation including the so called Islamic corporation is to maximize the shareholder's value of wealth. This implies that in actual practice, many Islamic corporations adopt the Anglo-Saxon model of corporate governance[10]. The proponents of the Anglo-Saxon continuously attempt to defense their model and the opponents strongly criticize them especially in the aspect of principle-agent relationship or the agency problems. In the context of Islamic corporate governance, there are a few studies have been carried out particularly Islamic financial institutions to come up with alternative models of corporate governance.

The studies seem to suggest that Islamic corporation may adopt a totally different model of corporate governance or a modified version of the Stakeholder-oriented model as an alternative for its corporate governance framework. The former refers to the corporate governance model based on the principle of consultation where all stakeholders share the same goal of *Tawhid* or the oneness of Allah (Choudury, M,A. and Hoque, M. Z, 2004) and the latter concerns on adopting the stakeholders' value system with some modifications (Iqbal, Z, and Mirakhor, A., 2004) and (Chapra, M.U. and Ahmed, H, 2002). Effective corporate governance within Islamic framework is the epicenter of Islamic financial business so as to protect the stakeholders' interest as a whole. In the Islamic context, the interest of stakeholders is beyond the financial return or profit maximization; it covers the element of ethic, Shari'ah or Islamic law and principle of *Tawhid* i.e. the oneness of Allah.

5.1 *Tawhid* and *Shura* Based Approach

[10] For instance a study conducted by Lim, P.K. (2007: 737-738) on the corporate governance reform in Malaysia found that majority of the companies prefer to adopt the Anglo-Saxon model of corporate governance as a benchmark against the best system in the world as practiced by the United Kingdom and United States. Malaysia is considered as one of the world leading players in Islamic finance.

Although all the Islamic economists or Muslim jurists agree on the concept of *Tawhid* as one of the philosophical pillars of Islamic economic[11], it is observed that little is written or discussed on the *Tawhid* epistemological methodology to the issue of corporate governance. Fortunately, Choudhury, M,A. and Hoque, M. Z, (2004) discuss the fundamental Islamic epistemology of reference of Tawhid on their corporate governance model[12].

As the foundation of Islamic faith is *Tawhid*, the basis for the corporate governance framework also emanates from this concept. Allah says in *al-Quran* "*Men who celebrate the praises of Allah standing, sitting, and lying down on their sides, and contemplate the wonders of creation in the heavens and the earth, (with the thought): "Our Lord! Not for naught Hast thou created all this! Glory to Thee! Give us Salvation from the penalty of the Fire*" (3: 191). This verse provides fundamental principle of governance where everything created by Allah has a purpose and human being is created to be the world's vicegerent. By putting a trust to mankind as a vicegerent, Allah plays actively roles to monitor and involve in every affairs of human being and He is aware and knowing everything all the times (Chapra, M.U., 1992: 202). Allah says al-Quran "*O my son! If it be (anything) equal to the weight of a grain of mustard seed, and though it be in a rock, or in the heavens or on the earth, Allah will bring it forth. Verily, Allah is Subtle, Well-Aware"* (31:16)[13]. As Allah knows everything and all mankind is answerable to Him, the principle of Tawhid shall be the foundation of the corporate governance model in Islam.

According to Choudhury, an Islamic corporation is a legal entity where the principle and proportionate of the firm's shares owned by the shareholders based on equity participation and profit sharing ratios. Meanwhile, governance of corporation deals with legal and organizational structures that control the internal governance of a firm with an objective to define and attain an objective criterion by way of understanding the relations between variables supported by policies, programs and strategic coalition (Choudury, M,A. and Hoque, M. Z, 2004: 58 and 83). As an Islamic corporation, it has to have a distinct corporate governance values that enable to differentiate it with the western concept of corporate governance.

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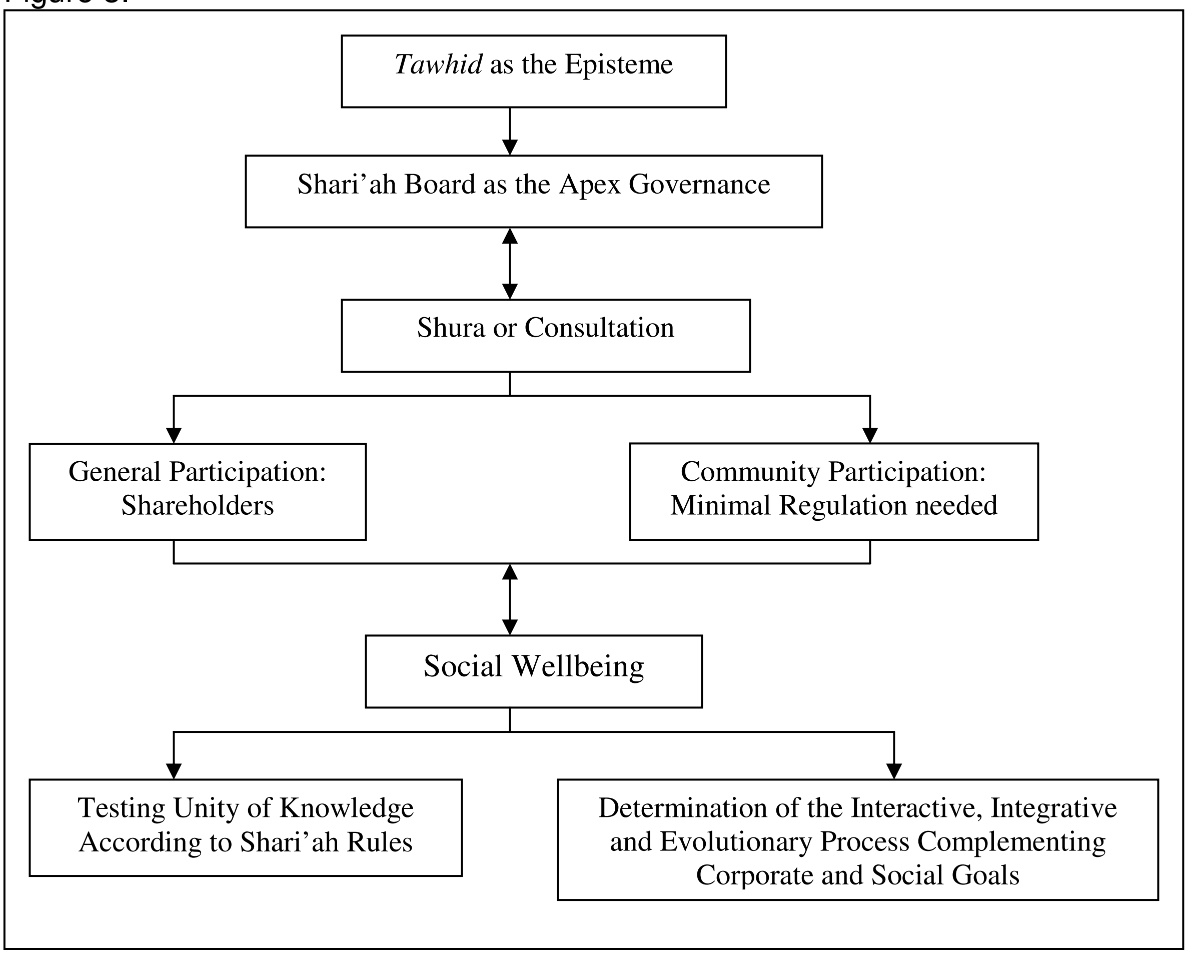
[11] See Mannan, M.A. (1970), Siddiqi, M.N. (1978), Kahf, M. (1978), Ahmad, K. (1980), Naqvi, S.N.H., (1981), Taleghani, S.M., (1982), Al-Sadr, M.B., (1982) and Choudhury, M.A. and Malik, U.A. (1992).

[12] Although Choudhury, M.A. and Malik, U.A. (1992) discussed the principle of *Tawhid* and human solidarity in Islamic political economy, they do not provide any specific model for corporate governance.

[13] See also al-Quran 99: 7-8 where Allah says "*So, whosoever does good equal to the weight of a speck of dust shall see it. And whosoever does evil equal to the weight of a speck of dust shall see it*". The verse reminds the human being that Allah knows everything even to things that were to be hidden inside a solid rock, not even the weight of a speck of dust in the heavens or on the earth.

There are four principles and instruments governing Islamic governance i.e. extension of Tawhid unity of knowledge via interactive, integrative and evolutionary process to the interacting environing factors, the principle of justice, the principle of productive engagement of resources in social and the principle of economic activities and recursive intention amongst the above stages. All of these principles are the main premises of the Islamic corporate governance where the Shari'ah rules embedded in *al-Quran* and *al-Sunnah* make the Islamic corporation market driven and at the same time uphold the principle of social justice (Choudury, M,A. and Hoque, M. Z, 2004: 57-83). The concept of corporate governance in Islamic perspective is summarized by Choudhury in Figure 3.



The figure 3 shows that the Islamic corporate governance approach is premised on the *Tawhid* epistemological model whereby the functional roles of corporation are working via the *Shari'ah* rules. The principle of Tawhid derives important concept of vicegerency (*khilafah),* and justice or equilibrium (*al-adl wal Ihsan*[14]). The stakeholders as vicegerent of Allah have fiduciary duty to uphold the

[14] Naqvi, S.N.H. (1994: 27-28) defines *al-adl wal ihsan* as a state of social equilibrium. The principle of social equilibrium in the context of economy provides a best configuration of the production, consumption and distribution activities where the needs of all members in the society constitute the first priority over the individual.

principle of distributive justice via the *Shuratic* process. Chapra, M.U., (1992:234) mentions that the practice of Shura is not an option but it is rather an obligation. The constituent of Shura provides widest possible participation of the stakeholders in the affairs of the state including corporation either directly or via representatives.

There are two main institution involved in the above process of corporate governance namely the *Shari'ah* board and the constituent of shura's groups of participants i.e. all the stakeholders. In determining the scope of *Shari'ah*, the institution of *Shari'ah* board comes into a picture and it plays crucial role to ensure that all corporation activities are in line with the *Shari'ah* principles. In addition, the shareholders also play a big role as active participants and conscious stakeholders in the process of decision making and policy framework by considering the interest of all direct and indirect stakeholders rather than maximize their profit alone. The other stakeholders including community should also play their roles to provide mutual cooperation to protect the interest as a whole and to stimulate the social wellbeing function for social welfare. All of these processes are centered on toward fulfilling the ultimate objective of Islamic corporate governance of complementing the private and social goals via upholding the principle distributive justice (Choudury, M,A. and Hoque, M. Z, 2004: 85-88).

5.2 Stakeholders Based Approach

Chapra, M.U. and Ahmed, H, (2002: 13-20) in their research on corporate governance of Islamic financial institution emphasize on the notion of equitably protecting the rights of all stakeholders irrespective of whether they hold equity or not. This seems to support the model proposed by Iqbal, Z, and Mirakhor, A, where they view that the corporate governance model in Islamic economic system is a stakeholder-centered model in which the governance style and structures protect the interest and rights of all stakeholders rather than the shareholders per se [15](Iqbal, Z, and Mirakhor, A, 2004: 43, 48). Their main arguments are based on two fundamental concepts of Islamic law namely principle of property rights and commitment to explicit and implicit contractual agreements that govern the economic and social behavior of individuals, society and state. These two principles provide strong justification for the notion of classifying Islamic corporate governance as a stakeholder-oriented model. In addition, Nienhaus, V., (2003: 290) states that Islamic corporate governance

[15] Archer, S. and Rifaat, A.A.K. (2007) impliedly view that the corporate governance of Islamic financial institution is inclined toward the stakeholders value based model. This is because the nature of corporation particularly of the directors and the management owe fiduciary duties of care and loyalty to the shareholders and also other stakeholders including especially the investment account holders. Wajdi, A.D. (2008: 391-413) further supports the notion of stakeholder oriented model in Islamic financial sector where he provides the pyramid of *maslahah* as a devise or mechanism to protect rights and interests of various stakeholders.

should be based on value oriented and promote the principle of fairness and justice with respect to all stakeholders[16].

The principle of property rights in Islam clearly provides a comprehensive framework to identify, recognize, respect and protects interest and rights of every individual, community, the state and corporation. In fact, rights of ownership, acquisition, usage and disposition of the property itself are considered as property (*al-mal*) which has beneficial use and value. In term of the rights of ownership, Islam declares that Allah is the sole owner of property and human being is just a trustee and custodian in which it implies the recognition to use and manage the properties in accordance with Shari'ah rules (Iqbal, Z, and Mirakhor, A, (2004: 50). There are various verses of al-Quran mentioned the principle of property rights and one of them is in surah 57:7 Allah says: *Believe in Allah and His Messenger and spend of that whereof He made you trustee"*[17]. The implied meaning of this verse lays down the principle of property's ownership where the mankind is only regarded as a trustee of God.

Beside, Islam recognizes private and society or state ownership. This implies the recognition of individual ownership in corporation as shareholders and at the same time Shari'ah rules provide guidelines to the individual, corporation and the state on how to deal with the property ownership. In short, the concept of property rights in Islam is based on these fundamental principles i.e. the rights on the property is subjected to Shari'ah, the enjoyment of rights to property is balanced with the rights of society and the state, every individual, society and the state is stakeholders and the recognition of rights of stakeholders by Islamic law (Iqbal, Z, and Mirakhor, A, (2004: 54).

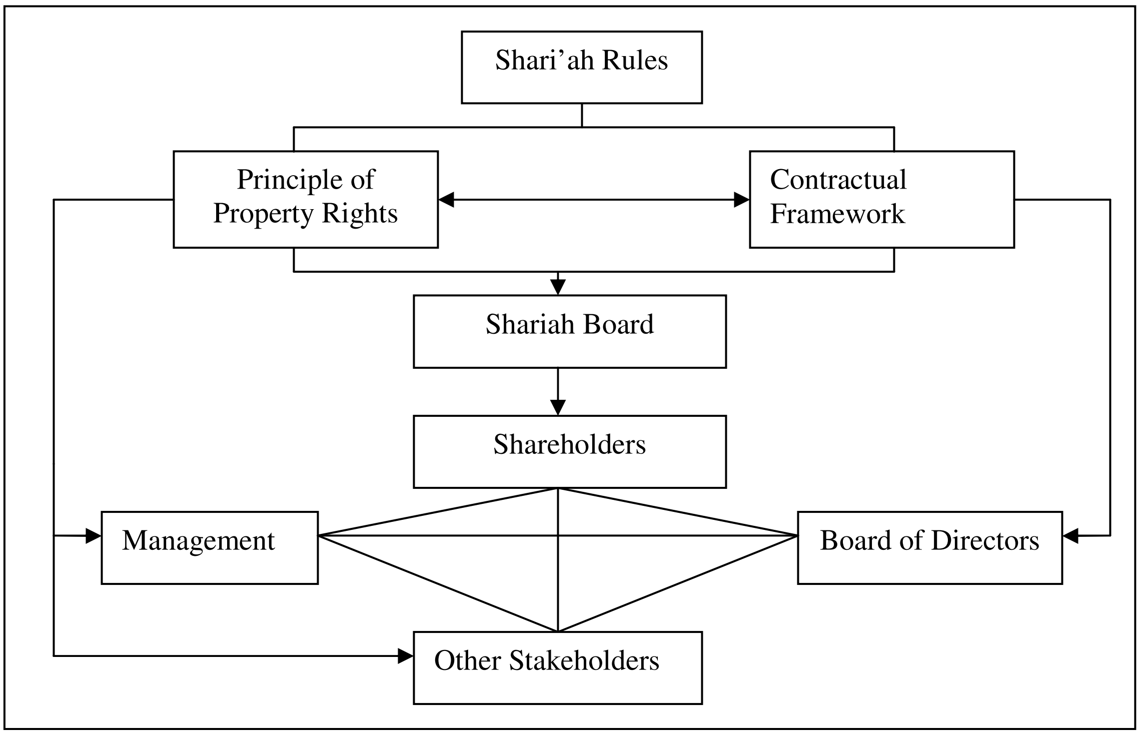
Contractual framework is also very unique in Islam. In *al-Quran surah* 5:1 Allah clearly reminds the Muslims on the principle of fulfilling each of their contractual obligations where He says: "*O you who believe, fulfill contracts*". This verse presents a basic foundation the notion of contract that every individual, society, corporation and the state are bound by their contracts which defines the rights and obligations of the parties. In relation with the issue on corporate governance, each stakeholder has duty to perform his contractual obligations in accordance with the term stipulated in the contract directly or indirectly. For example, the shareholders has duty to provide business capital, the management to manage and run the business, the employees to perform their respective duties and the state to ensure enforceability of the contracts in case of violation by any party. All of these duties arise through contractual framework and they are subjected to

[16] Interestingly, Nienhaus, V. (2006: 298-301) puts an issue whether the depositors of Islamic banks need for representative in boards for more efficient corporate governance supervision as in some corporation in Germany. He concludes however that the said notion will not be effective in the case of Islamic banks are exposed to competition. This strongly implies that the corporate governance of Islamic financial institution is more toward the stakeholders' value model.

[17] In another verses Allah says "*He it is who has created for you all that is on earth*" (2: 29) and " *Do not give your resources that Allah has made you its preservers on to the foolish"* (4:5).

the rules of Shari'ah. In short, the principle of contract in Islam establishes guideline to identify and qualify who is a rightful stakeholder.

Figure 4 summarized the Islamic corporate governance based on stakeholders-oriented model. It presents an overview on the stakeholders' model for Islamic corporate governance which is preoccupied by two fundamental concepts of Shari'ah principles of property rights and contractual frameworks. The governance of any corporation in Islam is ruled by Shari'ah where all the stakeholders including the shareholders, the management, other stakeholders such as the employees, the suppliers, the depositors and the community.



The Shari'ah board plays a role to advise and supervise the operation of the corporation so as to ensure that it complies with the Shari'ah principles. The board of directors acting on behalf of the shareholders has duty to monitor and oversee overall business activities and the managers have fiduciary duty to manage the firm as a trust for all the stakeholders and not for the shareholders alone. The other stakeholders such as employees, depositors, customers have duty to perform all of their contractual obligations. In addition, the state as a stakeholder will be the external institution to provide regulatory framework and its enforcement. The definition of stakeholders does not necessary refer to the shareholders per se or to those who have active participation in the decision making process but it includes non-investor or non-owner stakeholders i.e. any party who has direct or indirect participation in the corporation.

Based on the preceding discussion, it is observed that the notion of classifying Islamic corporate governance as stakeholders-oriented model is premised on two fundamental concepts namely the principle of property rights and the principle of contractual obligations. Hence, there are two tests to determine any individual to qualify as a stakeholder, firstly, whether the individual or group has any explicit and implicit contractual obligations and secondly, whether the one whose property rights are at risk due to business exposure of the corporation[18] (Iqbal, Z, and Mirakhor, A, (2004: 58).

6.0 Conclusion

The design of corporate governance model in Islam has its own unique features and presents distinctive characteristics in comparison with the western concept of the Anglo-Saxon and the European model. The study summarizes the diversities of these three models and classifies them into four aspects namely the episteme, the corporate objective, the nature of management, the management board and the capital-related ownership structure.

Aspects	**The Anglo-Saxon Model**	**The European Model**	**Shari'ah Model**
Episteme	Rationalism and Rationality	Rationalism and Rationality	*Tawhid*
Objective			
Rights and Interest	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 shari'ah.
Corporate goal	Shareholders controlling managers for purpose of shareholders profit	Society controlling corporation for purpose of social welfare	Shari'ah objective or *Maqasid Shari'ah*
Nature of Management	Management dominated	Controlling shareholder dominated	Concept of vicegerency*, Shura* and Interactive, Integrated and Evolutionary Process
Management Boards	One-tier board	Two-tier boards; executive and supervisory	Shari'ah board as the ultimate governance

[18] This is in line with the saying of Prophet: "*A Muslim is the one from whose hand others are safe"* (Sahih Bukhari, Volume 1, Book 2, Number 10).

		responsibility separate	
Capital-related and Ownership structure	Widely dispersed ownership; dividends prioritized	Banks and other corporations are major shareholders; dividends less prioritized	Shareholders and depositors or investment account holders

The above simplified version of the differences of Shari'ah and western concept of corporate governance provides an overview of the different approaches of corporate governance style and structure. In the aspect of epistemological method, Islam rejects the rationality and rationalism as the episteme of Shari'ah corporate governance and replaces it with the episteme of *Tawhid* or oneness of Allah. While the Anglo-Saxon model prioritizes the shareholders' value alone and the European model protects all the stakeholder's interest and rights, the Shari'ah corporate governance objective puts *maqasid Shari'ah*[19] as the ultimate goal and this entails the notion of protecting the interest and rights of all stakeholders within the *Shari'ah* rules. The nature of management of Islamic corporate governance model is premised on two fundamental principles of *shura* and interactive, integrated and evolutionary process and the apex level of management is the Shari'ah board that is responsible to supervise and oversee the overall corporate activities so as to comply with the *Shari'ah* principles. In contrast to the western concept, the nature of ownership structure in Islamic corporate governance considers the shareholders and the investment account holders as the rightful owners rather than the shareholders alone. The distinct features and characteristics of Islamic corporate governance combines the element of *Tawhid, Shura*, Interactive, Integrated and Evolutionary Process, *Shari'ah* rules or Islamic law and maintains the private goal without ignoring the duty of social welfare.

The model of corporate governance system in Western perspective raises an issue of the design of an efficient corporate governance structure of the Islamic financial institution within an Islamic paradigm. As an observation, the initial study finds that the corporate governance model in Islamic economic system is premised on the epistemological of *Tawhid*. In addition, the nature of corporate governance's goal is inclined toward the stakeholder value model where its governance style aims at protecting the stakeholders as a whole. In considering an Islamic view of the definition of the stakeholders, it enhances the interpretation beyond to those participate in governance of the corporation to the religion of Islam itself. Therefore, the corporate governance model from *Shari'ah* perspective considers Islam as the supreme stakeholders beside the other stakeholders' entity. The concept of Islam as the sovereign stakeholder affects the structure of the corporate governance system where it puts the *Shari'ah* as the governing law of all affairs of the corporation in which leads to the

[19] *Maqasid Shari'ah* means protection of the wellfare of the people, which lies in safeguarding their faith, life, intellect, posterity and wealth (Al-Ghazali, 1937: 139-140).

establishment of the *Shari'ah* Board as part of the corporate governance institutions.

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