

An Investigation on Sharia Governance in Islamic Banking A Case of Islamic Banks in Oman

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ABSTRACT

The concept of Sharia governance in Islamic banks in Oman was highlighted by presenting the conceptual framework for Sharia governance and regulating the Islamic banks through Sharia governance. Finally, the study explains the role of Sharia governance in raising the efficiency of Islamic banks. As this research paper concluded that Sharia governance has a major role in Islamic banks, through the existence of a Sharia supervisory body on all transactions that take place inside these banks, which prevents the occurrence of any activities that violate the provisions of Islamic law, as happens in other banks. The Sharia Supervisory Board for Muzn is the highest authority in the bank with regard to all matters related to Islamic law. It ensures that the commission's decisions are strictly followed. The Sharia Supervisory Board reviews product papers, structures, policies, and legal documents and all other tasks. The board also provides decisions based on Sharia in all matters and related banking issues, including opinion on all aspects of the bank's commitment to Islamic law. The findings indicated that Sharia governance laws must be applied by Islamic banks and they need to make updates through the SSB and AAOIFI boards. Sharia was found to be a regulatory and supervisory component that Islamic banks must operate under to ensure the religion has been applied within the establishment of the banks.

Keywords: Sharia governance, Islamic banking, Sharia council, Sharia governance in Islamic banking

INTRODUCTION

Islamic religion is spread across many countries in the world and the application of Sharia governance structure is the mode of showing direction in the religious ways of doing business. The establishment of Islamic banking institutions was to help regulate and help Muslims in obtaining lending services and find ways of saving their finances with the banking institutions that can follow religion and assure of governance. The Sharia governance is a way of performing corporate governance but from a religious perspective which has been researched and studied by various authors (Ahmed 2017). The different sources that can be deemed to better fit the research will be reviewed in this chapter and the main points or the findings from the studies used in coming up with the way the current research has to be carried out. The studies will be used as guidance materials which will offer direction on how and where the research must

capture the information related to Islamic bans to establish an understanding of the application of Sharia governance within Islamic banks.

CONCEPTUAL FRAMEWORK

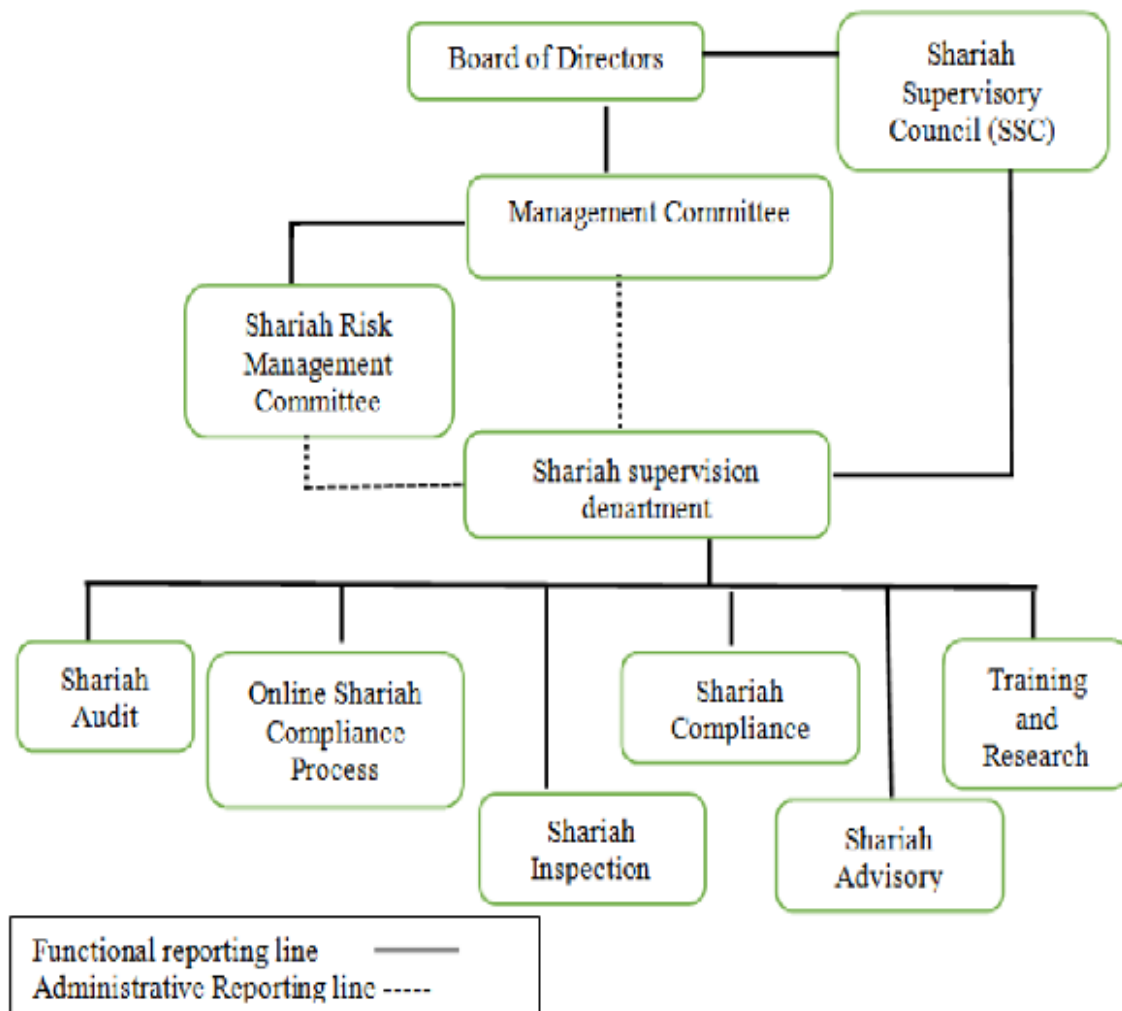


Figure 2 1: Sharia Governance Framework in Islamic Banks (Neifar et al. (2020))

Within the banks, there is a Board of Directors that is comprised of a Sharia Supervisory Council (SSC) and a management Committee. The Management Committee and the SSC take the initiative of handling the application of Sharia in terms of risk management and supervision. In the supervision of Sharia application within Islamic banks, the tasks of auditing, checking on compliance process, inspecting Sharia application, Sharia advisory, and the training & research invested on Sharia. The above figure indicates how the processes or steps take place in a systematic way.

IMPORTANCE AND ROLE OF GOVERNANCE IN ISLAMIC BANKS

The research focus on the concept of sharia governance in Islamic banking in Oman, by presenting the conceptual framework for Sharia governance, and highlighting the role of sharia governance in raising the efficiency of Islamic banking in Oman. As this investigation research paper presumed that Sharia administration has a significant job in Islamic banking, through the

presence of a Sharia administrative body on all exchanges that occur inside these banks, which forestalls the event of any exercises that disregard the arrangements of Islamic law, as occurs in different banks. Many researchers agree on the importance of corporate governance and financial institutions, including Islamic banking in Oman, in pushing forward development, raising performance and reducing the risk of financial and administrative corruption at the level of companies and countries alike. Islamic banking in Oman are considered like other Islamic financial institutions that have sought to apply the principles of governance in order to ensure their financial performance, through the financial dimension of achieving profitability in a way that does not conflict with the provisions of Islamic law and the moral dimension of the imposition of the Sharia Supervisory Authority. Its mission is to monitor all banking operations carried out within these banks, always in accordance with the provisions of Islamic law.

Generally, there are a number of studies and researches have been done on Sharia governance in Islamic Banking. A research conducting by Khuram et al. (2013) the purpose of the research is to know the importance of corporate governance management being practiced in Pakistani Islamic banking context. One of the most important dimensions affecting Sharia governance in Islamic banks are BOD and SSB, The study also indicates that there is a big difference between Islamic banks and Islamic banking windows regard to BOD and SSB and no difference in the other factors. The concern of customers increases in terms of Islamic banking windows and decreases in the case of Islamic banks because the managements of Islamic banks comply with Sharia governance accurately and there is significant interest by customers and shareholders in implementing Sharia governance in Islamic banking.

Another study carried out by the International Journal of Islamic and Middle Eastern Finance and Management in 2020 and the aim of the study is to know the role of knowledge diffusion in development the principles of sharia governance in Islamic banking. "Knowledge of sharia governance may help Islamic banking workers in how to manage Islamic, banking services. Encouraging interaction between sharia scholars and management constitutes a great understanding, reduces conflicts and misunderstanding, thus enhancing the productive capacity of banks and increasing compliance with the sharia governance, In general, the process of disseminating knowledge contributes to the development of sharia governance in Islamic banks" (Adnan et al. 2020)

According to Ginena (2014) "Failure to comply with Sharia governance poses a great risk to Islamic banks and their stakeholders, and this risk leads to bank failure, lack of liquidity, Industry smearing and financial instability. There is a connection between corporate administration and the monetary strength of Islamic banks in Malaysia, the degree of steadiness in banks is measured by using the Z-Score indicator, stability, the SBS and size of the board of directors does not affect financial stability" (Mongi 2016). This literature review examines the Sharia Governance in Islamic banking. Additionally it shows the relation of sharia governance by financial stability in the Islamic banks and what the challenges faced by sharia governance.

THE MODERATING ROLE OF SHARIA SUPERVISORY BOARD ON THE RELATIONSHIP BETWEEN BOARD EFFECTIVENESS, OPERATIONAL RISK TRANSPARENCY AND BANK PERFORMANCE

Neifar et al. (2020) did a research about the role of Sharia in the supervision of the Islamic banks board and its effectiveness on the operational risk performance. Boards are effective and face various risks associated with the governance of Sharia which comes with regulations and restrictions on operations or activities within the performance of the banks. The ethical principles and religious beliefs that are associated with the governance. The research was done by collecting information from the financial reports of 25 Islamic banks operating within the Gulf Cooperation Council between the period of 2008 and 2017 Neifar et al. (2020). The source material is a great resource to the study because it focused on Islamic banks and based on their governance structures under Sharia principles and religious beliefs. The board quality and board effectiveness were found to be the major contributors or facilitators in the application of governance within the Islamic banks.

Fatmawati et al. (2020) conducted research in 11 countries where only Islamic banks were focused. The study specifically focused on how Sharia governance structure was applied in the Islamic banks and its comparison among the international and local Sharia governance codes. The application within the 11 different countries was carried out by obtaining the banks' financial or annual reports of the major stand-alone Islamic banks from every country among the eleven chosen countries. It was evident that the difference in ways of applying Sharia governance among the various countries was not very different. A majority of the codes were applied in a similar way due to the sharing of religion which focused on same principles and regulations as issued by the religion Fatmawati et al. (2020). Despite having some differences, the Sharia governance was found to be applied evenly. The same is assumed to be found similar in the current research which makes the source material important and significant in the current research.

Alam et al. (2019) in their research about the Sharia governance framework in Islamic banks in Bangladesh was to find out on the applied practices, problems faced, and the recommendations available to streamline and correct any deficiencies in the governance structure. The Islamic financial institutions apply Shariah governance within their operations with strict measures and compliance to abide as per the requirements of the religion and ways it is supposed to conduct financial services. The resource material is important as it focused on the governance are of Sharia among the Islamic institutions Alam et al. (2019). Corporate governance applies in a similar way but Sharia has much of religion involved in its operations than the legal framework of any governance. It requires an understanding of the Islamic religion.

CORPORATE GOVERNANCE AND FINANCIAL STABILITY IN ISLAMIC BANKING

Lassoued (2018) in his research was dealing with the examination of how corporate governance relate with the financial stability of Islamic banking institutions in Malaysia. As much as the Islamic banks operate in various parts of the world, much is not known by the people on how they are governed and the ways of managing to stay financially stable besides offering some services without charging interest. For example, Islamic banks are majorly known to offer lending services but not lending of loans. Loans attract interest to borrowers but lending is given and the principal amount is what is refunded. The ways that such banks operate and get governed is a riddle to understand in the research. The measure of Islamic

banks stability was measured using Z-score indicators from the collected data regarding the banks' financial stability Lassoued (2018). A major concern in the research was the size of the Sharia board within the Islamic banks which was used in offering regulations and guidelines on how the governance has to be applied and within which sectors. Every institution governs its operations under a criteria that they are registered in or within the industry they operate so that they can have a guideline on the manner of doing operations.

In the study carried out by Bourakba and Zerargui (2015) it was to help create an understanding of the relationship among the variables of credit risk, financial stability, and corporate governance in Islamic banks. The variable of corporate governance was mainly focused because of the applicability and ways of controlling the credit risk and enabling of the financial stability within the banks. It was discovered to have a two-fold kind of governance which was the Islamic Governance System and the Anglo-Saxon governance system. The main focus of the research by Bourakba and Zerargui (2015) was to establish a measure of the influence of corporate governance in terms of credit risk using an empirical evidence collected from a selected number of Islamic banks within the period of 2005 and 2012. A negative relationship was discovered within the non-performing loans ratio and the composition of the board of directors had compromises. Other variables were detected to have an influence on the governance of Islamic banks were the size of the board of directors, ownership concentration, and the Sharia supervisory board. However, a positive relationship was detected between the non-performing loans ratio and the banks' size. The supervisory authorities of the Islamic banks can obtain a great insight and information from the study where a lot of information was obtained from the study. Many factors were considered and their relationships categorized on how they affected the Sharia governance within the Islamic banking institutions.

CENTRALIZATION OF CORPORATE GOVERNANCE FRAMEWORK FOR ISLAMIC FINANCIAL INSTITUTIONS: IS IT A WORTHY CAUSE?

In the research carried out by Ahmed (2017) it was aiming at coming up with proven evidence on the impact of corporate governance performance among the financial institutions within the UAE Islamic banks. A survey form key individuals within the institutions was carried out and they included the management team, shareholders, Sharia board of the banks, and the board of directors. Six Islamic banks were chosen working within the UAE. A formulation of three hypotheses was done and testified by an application of statistical tests and measures to find out how the variables correlate and also regression analysis was conducted. The measure of the Sharia governance structure among the Islamic banks was estimated or measured using the earnings per share (EPS), return on assets (ROA), return on equity (ROE), and the state of corporate governance. The results indicated a positive and straight forward relationship between the Islamic banks' financial performance and corporate governance index. Governance is a measure done and its results indicated on the outcome of the financial activities done within an institution. For the results indicated on the analysis of the financial activities such as the ROE, ROA, and EPS indicate on how the Islamic banks are under the influence of Sharia governance and the effect on the overall performance.

Farag et al. (2018) conducted a study that was investigating on the influence of having a dual board structure within financial institutions in the Islamic setting. Here was an agency relationship that was established and discovered to exist among the sampled 90 Islamic banks within 13 countries. The collected data was for the period of 2006 to 2014. It was discovered

that when the Islamic banks had a larger Sharia supervisory board (SSB) they performed better in terms of financial stability, performance, and offered a reinforcement to the institutions' fundamental roles. However, there was a discovery of a higher degree of operations that were coming up and required intervention from the various SSB members who could offer guidance and direction in complex areas or issues within the banks Farag et al. (2018). As opposed to other forms of management boards, having a larger SSB within the Islamic banks was discovered to have a lower agency costs. When the sizes of contracts were unrestricted, they could attract high agency costs. Therefore, the strategy applied by the Islamic banks is to have a larger SSB so that the agency costs can be reduced and save money through the reduction of cost by having an advisory team which can handle Islamic related governance matters about Sharia and the running of financial activities.

REGULATORY AND PRACTICAL FRAMEWORK OF SHARIA GOVERNANCE IN ISLAMIC BANKING

The regulatory and practical framework for Sharia governance in the Islamic financial world is the lifeblood of Islamic banks and their stakeholders. A study carried out by the International Journal of Islamic and Middle Eastern Finance and Management in 2013, the purpose of the study is to know the Sharia board in Islamic banks and its importance, which is a basic element in the practical and regulatory framework of Sharia governance. The study was based on two models of Sharia governance frameworks: the decentralized framework in the GCC and the central framework in Malaysia. The independence of the Sharia Board is essential in the structure and framework of Sharia governance, in addition to the centrality of sharia governance, and these two factors support the effectiveness and credibility for Islamic banks. "The centrality of the Sharia Board enhances and strengthens its position in decision-making and transparency, and enhances the strength of Sharia governance in general" (Hichem 2013). This study contributed to providing information about Sharia governance and the practical and regulatory framework by focusing on the Gulf region and Malaysia in terms of central frameworks and decentralization of governance in Islamic banks in both regions.

Another study conducted by Al-Malkawi and Pillai (2018), the aim of the study is to integrate corporate governance mechanisms into the framework of Islamic banks, to examine its impact on the Islamic banking framework. The study used 22 samples of international companies that have been operating in the GCC for 11 years. "To keep competition in the practical framework, the values of Islam must be taken into consideration and applied in corporate governance" (Al-Malkawi and Pillai 2018). The highlighting was on the corporate governance mechanisms involved in the financial performance of Islamic banks in the GCC countries.

Research carried out by Alexakis and Tsikouras (2009) and aims to provide a general picture of the regulatory framework for regulatory institutions and industrial complexes in Islamic finance. "Islamic finance may be affected by several factors, including: Increased participation of Western regulators in Islamic finance, as well as credit rating agencies; existence of sound accounting procedures; increased protection of stakeholders of Islamic Financial Institutions" (Alexakis and Tsikouras 2009). The research offers useful information on the current regulatory framework in Islamic finance and factors affecting Islamic finance.

A study carried out by ISRA International Journal of Islamic Finance In 2017. The purpose the examine is studying the principles of Sharia in Islamic banking and the idea of the central

framework for the governance of Islamic financial institutions and the roles of the Central Sharia board in financial issues and its characteristics. The study was based on the provisions of the Qur'an and the Sunnah, as well as the sayings and opinions of scholars. "The centrality of the Sharia board in Islamic banks is necessary to regulate Islamic banking independently and to provide best banking practices and solutions the issues besides integrity and transparency" (Hakim and Razak 2017). In general the study may help in evaluation the advantages and disadvantages for the full concept of central sharia board.

SHARIA GOVERNANCE, ITS PRINCIPLES, AND ASSOCIATION WITH ISLAMIC INSTITUTIONS

Sharia governance is linked to Sharia principles and Islamic instructions, and one of these things is transparency and integrity in disclosure. Which is linked to honesty, which is one of the instructions of Islam. International Journal of Ethics and Systems in (2018) offered research about Determinants of Sharia governance disclosure in financial institutions: Evidence from Saudi Arabia. The aim of this paper to know the factors affecting Sharia governance disclosure in Islamic banks. 46 annual reports of deferent banks published in 2015 were investigated, the results show that the average level of voluntary disclosure of Sharia governance in Saudi financial institutions is 11.7 per cent, which is lower than expectations. "Financial institutions are adhere to the instructions of Sharia in their operational and banking strategy in compliance with government orders and to avoid community criticism". (Azid and Alnodel 2018). This research may expand in the scope of sharia governance disclosure investigation into the Islamic banking sector in a country that adheres to Islamic principles.

A study carried out by Nora (2019) the study is about trust, responsibility, and client information and explaining social responsibilities and connecting them to repurchasing goals. The aim of the study is to know the effects of customer confidence and the extent of their religious commitment, especially in Sharia banks in Indonesia and the study was conducted in Sharia banks in Indonesia in Jakarta and covered all bank clients in September 2017. "The commitment in sharia principles enhances customer's confidence in Sharia banks. The Religious commitment enhance the customer's relationship with banks, and high customer intimacy is also able to encourage repurchase as the knowledge is not sufficient to encourage the relationship of customers with sharia banks" (Nora 2019). The testing of adherence to the principles of Islam has become the originality of this study. The commitment of banks to Sharia governance and the principles of Islam enhances the customer's confidence in the bank and strengthens the intention of repurchase.

Another study carried out by Gökberk (2019) the study was about emphasize that Sharia principles stipulate that companies must abide by the Sharia, not just the law. The study also aims to reveal the strength of the impact of adherence to Sharia on the quality of financial reports. The sample was taken from 15 Muslims and non-Muslims countries and 2,300 companies for the period between 2005 and 2017, and the quality of the reports was measured through the estimated benefits and strength of auditing. "There is a variation in the quality of financial reports between companies that adhere to Sharia and companies that do not adhere to Sharia. Therefore, the quality of financial reports increases when the reduced the estimated benefits and increase the strength of auditing" (Gökberk 2019). The study adds to the bookkeeping writing by giving an understanding on the utilization of Islamic monetary

instruments. The outcomes likewise show that the utilization of international financial reporting standards (IFRS) strengthens the quality of financial reports.

Journal of Financial Crime in (2010) offered research about the financial crimes: Prohibition in Islam and prevention by the SBB of Islamic financial institutions. The research aims to ensure that financial crimes are unlawful (haram) in Islam, and that the Sharia Supervisory Board must prevent the occurrence of financial crimes. The research shows an analogy (qiyas) of the instructions in the Qur'an and Sunna. "The responsibilities of the Sharia Board in Islamic Banks must be in accordance with Islamic Sharia" (Faridah 2010). The paper gives extra measurement to Sharia's administration structure for the Islamic monetary administrations industry.

REMEDIES TO THE PROBLEMS FACED BY SHARIA GOVERNANCE IN ISLAMIC BANKING INDUSTRY

Abdullah (2019) published a book entitled *Research in Corporate and Sharia Governance in the Muslim World: Theory and Practice* and the book takes the Risk Management and Corporate Governance: An Islamic Perspective. The book explains how to manage financial risks and mismanagement, which is one of the challenges and obstacles facing Sharia governance. It also offers solutions to get rid of mismanagement and financial disasters and these solutions are the compatibility with the law of Allah and the applying of Islamic law.

Beseiso (2014) published a book entitled "The Developing Role of Islamic Banking and Finance: From Local to Global Perspectives" and the book talks about the Central Banks' Role in Shaping the Future of Islamic Banking." Energy and helpful difficult work and responsibility from all players, including the controllers of Islamic banks upheld by open arrangements, worldwide and multilateral foundations and individuals from the Islamic financial family is believed to be the fundamental deciding variable for changing the Islamic financial family into one that will make the Islamic public and all humankind – through the worldwide monetary framework – live with greater soundness, government assistance and bliss. "Islamic banks are less stable than traditional banks, and regulatory capital is the main factor that reinforces the soundness of banking systems. The stability of Islamic banks depends on many factors such as the macroeconomic, as well as corruption, which has a negative role in the stability of banks" (Korbi and Bougatef 2017).

The International Journal of Ethics and Systems, (2019) published a research entitled the moderating role of Sharia supervisory board on the relationship between board effectiveness, operational risk transparency and bank performance. "The purpose of research is to know the effect of the Sharia Board of Directors on disclosure of financial performance and operational risks, and knowing the quality of the Sharia Board's commitment to Islamic principles" (Neifar et al. 2019). Annual financial reports were collected for 25 Islamic banks in the GCC, and then the level of transparency of the disclosure was measured. The final result was positive, and there was a high level of disclosure of financial performance, and stakeholders were informed about the real situation of the bank.

CONCLUSION

In recent years, the Islamic financial industry has witnessed a growth in the volume of assets and a growth in the number of Islamic banks, bonds issuances and Islamic investment funds. There are many financial institutions that have wanted to work on the basis of Islamic sharia,

and the methods of Sharia supervision are the main determinant of the general framework of organizational plans. "Towards a framework for the governance of Sharia supervision in Islamic banks: There are currently several different models for the work of Sharia supervisory bodies and the practice of Sharia advisory activities that are applied in regions with different authorities" (Elasrag 2014).

"Disclosure standards must be uniform throughout the world, which must be implemented to ensure a uniform level of disclosure in Islamic banks and in accordance with Islamic Sharia" (Arabi et al. 2019). Sufficient liquidity and huge capital in Islamic banks is one of the solutions that enhance the applying of Islamic governance and convince stakeholders to deposit more liquidity in banks. "The activities of Islamic banks are characterized by profit and loss sharing, which is likely to involve specificities in the bank liquidity issue and the capital adequacy ratio has significant and positive association with bank liquidity, as a strong capital ratio helps to strengthen the liquidity control" (Ben Jedidia 2020)

One of the recommendations to ensure an organized and successful Sharia governance framework is that the concept of Takaful should be applied in Islamic banking. "The concept of Takaful has a long history. It is linked with the era of Prophet Muhammad 1,400 years ago. The globalization and development of socio-economic systems have made business activities more complex in response to emerging human needs and requirements. Similarly, Takaful insurance has fully commercialized and become an important indicator of the international financial market" (Hassan 2020).

SUMMARY

The literature review has offered an understanding and findings from various sources on the effect of Sharia governance in Islamic banking institutions. Its effect and outcomes when the SSB board is maintained in a large size. A majority of the results found out have given direction on the current research and how the data collection exercise form the Islamic banks in Oman will be carried out. All the literature reviewed has a connection with Sharia governance within Islamic banking institutions and operations. The law has a way of handling matters based on Islamic settings and its guidance is a better way towards achieving and moderating the ways of learning the kind of data to collect. The past findings can be related to the current situations at the Islamic banks and aid in directing the current research towards achieving objectives.

The literature review has offered a conceptual framework that illustrates on how Sharia governance is applied in Islamic banks. The framework helps in the development of variables for data collection. The importance and role of governance in Islamic banks has also been highlighted so that its benefits can be discovered. When applying Sharia in the Islamic banks, they must understand the role of Sharia Supervisory Board (SSB) and its operations. The need for corporate governance and financial stability has also been reviewed within the chapter. While governance can be in many ways, its centralization has been focused and how important it can be to centralize governance among Islamic banks in the application of Sharia governance. The application of its regulations within Islamic banks. There are principles governing Sharia application and the chapter reviewed them so that the researcher can understand on what to expect the banks to be doing while applying or using Sharia governance within their operations. There are always challenges to the application of Sharia governance among Islamic banks. The experienced challenges need solutions. The literature review has discussed on

possible remedies to the challenges faced by the application of Sharia governance within Islamic banks.

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