



The Determinants of Good Shariah Corporate Governance in the Kuwaiti Financial Sector

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**Thesis Submitted in Fulfilment of The Requirements for the Degree of
Doctor of Philosophy in Business and Management at Nottingham
University Business School**

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22 August 2023

Acknowledgement

All praise belongs to Allah, the Almighty, who made everything possible, including this work. Thanking Allah would be incomplete without thanking everyone who has supported me throughout the course of my thesis. Their unwavering support, guidance, and encouragement have been instrumental in shaping my academic path and the successful completion of my thesis.

First and foremost, I extend my deepest appreciation to my supervisors, Professor Emmanuel Adegbite and Professor Jane Frecknall-Hughes. Your invaluable guidance, insightful feedback, and continuous encouragement have been pivotal in shaping the direction of my research and the quality of my work. Your dedication to my intellectual growth and your willingness to share your expertise have been a constant source of inspiration.

I would also like to extend my sincere thanks to my external examiner, Dr. Franklin Nakpodia, and my internal examiner, Professor Musa Mangena. Your thoughtful insights, rigorous evaluation, and constructive critiques have enriched my thesis and pushed me to reach new heights in my research. Your feedback has been instrumental in refining my ideas and enhancing the scholarly rigor of my work.

I want to take this opportunity to sincerely thank the Central Bank of Kuwait for their kind sponsorship, which allowed me to continue my PhD studies. Their steadfast support has been crucial to helping me advance in both my academic and professional endeavours.

I would like to thank my parents for their unconditional love and support throughout my life. I truly believe that the PhD process would not have been achievable without their prayers and constant encouragement.

I am forever indebted to my wife for her remarkable sacrifices during my PhD journey. My motivating force has been her unwavering support, innumerable

moments of understanding, and patience throughout the tough times. Her faith in me and her sacrifices have been the foundation of my success, and I am endlessly grateful to have her at my side on this extraordinary journey.

I'm grateful to my children (Deemah, Jana, Bader and Zaid) for your steadfast patience, which has been my rock during this journey. Your support means the world to me.

Finally, this journey would not have been possible without the combined efforts and support of these extraordinary people. Their contributions have had an indelible impact on my intellectual and personal development. I am grateful for the opportunity to work with such committed mentors, examiners, and loved ones. Thank you for being such an important part of this chapter in my life.

Abstract

Within the corporate governance domain in Islamic financial institutions, Shariah corporate governance has come under intense scrutiny from different jurisprudence for various reasons. For example, the increasing number of Islamic financial institutions has led to new challenges, including legal and Shariah related ones. In response, regulatory authorities issuing Shariah corporate governance regulations for Islamic financial institutions against the latter adopting their own policies and procedures, has further caused confusion in understanding the determinants of sound Shariah corporate governance. Despite diverse theoretical, policy and practical implications, these issues remain more serious and largely unaddressed in the prior extant literature. The current research thus addresses such shortcomings by ascertaining the determinants of good Shariah corporate governance in Kuwait, while investigating the appropriateness of regulatory approaches and the soundness of current arrangements in the Kuwaiti financial context.

Based on institutional theory and hence focusing on institutional effects (social/cultural, political and legal) at both macro and micro levels, this research relies on semi-structured interviews (36 in total) with participants from various sectors – financial, regulatory, academic, Shariah law and other Islamic finance stakeholders. To the best of the researcher's knowledge, this research is the first to deal intensively with Shariah corporate governance in Kuwaiti Islamic financial institutions, and it has done this in various ways. It finds that the relatively new Islamic financial industry, classified as an ‘infant industry’, requires judicious treatment regarding supervision and follow up by Islamic financial institutions. Also, regarding the supervisory approach (rule-based or principle-based supervision), a divergence of viewpoints prevails among the supervisory authorities in the Kuwaiti financial sector, which leads to regulatory multiplicity and conflict. Ultimately, this research contributes to the institutional theorising of Shariah corporate governance in the Kuwaiti context. It also serves as an evaluation tool for the practices of and legislation concerning Shariah corporate governance in Kuwait from the perspective of Islamic finance industry stakeholders (participant-based). Moreover, it provides valuable policy recommendations that can help the regulatory authorities resolve current issues and sustain good Shariah corporate governance in practice.

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List of Abbreviations

AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions
AGM	Annual General Meeting
BOD	Board(s) of directors
CBK	Central Bank of Kuwait
CEO	Chief Executive Officer
CMA	Capital Markets Authority
GCC	Gulf Cooperation Council
IFI	Islamic financial institution
IFSB	Islamic Financial Services Board
IRU	Insurance Regulatory Unit
NGO	Non-governmental Organisation
SSB	Shariah supervisory board
IA	Investment account

Chapter 1

Introduction

1.1 Overview

Corporate governance has attracted much and increasing attention over the past 30 years for various reasons, particularly the on-going tension between the two dominant corporate governance perspectives – shareholder-oriented and stakeholder-oriented (see Hasan, 2012) – and the consequences of this conflict. Moreover, in the wake of corporate governance failures, such as those of corporations in the United States of America (e.g., Enron and WorldCom) and Europe (e.g., Parmalat and Royal Ahold), resultant diverse definitions of corporate governance have brought a lack of consensus on this concept, especially as most definitions often tackle a specific perspective –political, social, economic or legal (Soltani, 2014) – so consequently lack an integrated approach.

According to Hasan (2012, p. 8), the word corporate relates to “a form of organisation that represents a group of people as a single entity for certain purposes”. Governance, however, concerns “the style or way an organisation, institution or corporation is guided, steered and controlled” (Hasan, 2012, p. 9). Hence, Hasan (2012, p. 9) defines corporate governance as “the entire network of formal and informal relations involving a large group of stakeholders in the firm, such as shareholders, management, employees, the community and the environment”. For the Organisation for Economic Co-operation and Development (OECD), corporate governance similarly involves “a set of relationships between a company’s management, its board, its shareholders and other stakeholders” (OECD, 2015, p. 9). Therefore, corporate governance concerns two vital aspects: how to manage different relationships well and how to control the firm transactions in a professional way in the best interests of different organisational stakeholders. More specifically, corporate governance in the realm of Islamic financial institutions (IFIs) – the entities that adhere to Islamic principles in the provision of products, operations or services within such financial contexts – involves an additional layer of governance, as these

bodies should consider both corporate governance generally and Shariah compliant corporate governance or put more simply, Shariah corporate governance specifically. However, despite the very extensive literature on corporate governance in developed economies, less is known about the determinants of good Shariah corporate governance in Islamic contexts such as Kuwait. This thesis addresses this gap through a case study of the Kuwaiti financial sector.

The rest of this chapter elaborates on this brief overview of important terminologies and addresses key aspects of this study's focus in the following way. This section discusses the most prominent corporate governance scandals that led to the focus on launching new corporate governance rules and principles in the United States of America and Europe (1.2). Section 1.3 touches on the importance of corporate governance in the banking sector broadly and the unique notion of corporate governance in IFIs particularly. It then explores and addresses the definition and the importance of corporate governance in IFIs (1.4). Next, it discusses the importance of Shariah corporate governance in IFIs and subsequently reviews this in relation to a specific IFI failure case (1.4.1). The ensuing section clarifies why the researcher chose Kuwait as this study's context (1.5), then discusses the macro (1.6) and micro (1.7) level determinants of Shariah corporate governance (SCG), before the term 'good' Shariah corporate governance is briefly discussed from different perspectives (1.8). After this, this chapter addresses the important aspect of why this research is vital, considering the dearth of Shariah corporate governance studies in the Kuwaiti context (1.9). The penultimate section of this opening chapter specifically addresses this work's research questions and objectives (1.10). The final section (1.11) presents the organisation of the thesis and an overview of each chapter.

1.2 Corporate Governance Scandals and Reform in Financial Systems

The Enron crisis, widely regarded as a highly notorious instance of corporate governance failure, transpired during the early 2000s. Enron, a prominent American energy corporation, was involved in deceptive accounting

methodologies and deliberate manipulation of its financial records in order to portray a misleading depiction of profitability and fiscal soundness. The controversy pertained to the manipulation of financial records through the utilisation of off-balance-sheet businesses and intricate transactions, with the simultaneous concealment of substantial liabilities. The lack of effective control by the company's board of directors and auditors, coupled with conflicts of interest among senior officials, facilitated the unchecked perpetuation of manipulation (Tricker, 2019). Enron's corporate governance suffered from a dearth of transparency, inadequate internal controls, and ethical breaches, ultimately resulting in its demise. This catastrophic event resulted in the substantial erosion of shareholder wealth and prompted substantial legislative measures aimed at enhancing corporate governance norms.

Moving from the United States of America to Europe, particularly to the Parmalat scandal (2003): the Parmalat case unfolded in 2003 was a significant corporate governance crisis that included major Italian dairy and food corporations. Bava and Devalle (2012) conducted a study on Parmalat, revealing a considerable consolidation of authority within an individual. Finanziaria held the chairman and chief executive officer (CEO). In addition, the management of Parmalat utilised special purpose entities (SPE) to conceal its financial deficits and fabricate a false financial state. The insufficiency of due diligence and independent verification conducted by the company's board of directors and auditors facilitated the ongoing occurrence of fraudulent activities. Though these examples are related to conventional institutions, its core issue relate to the same issue of IFIs (see section 1.4.1). Concerning this research, IFIs can suffer from the same corporate governance issues but from a Shariah compliance angle. Indeed, the crux of the issue relates to the inadequacy of the governance policies and procedures (Ferry et al., 2021).

In the wake of the scandals above, several nations developed extensive legal and regulatory measures on corporate governance. For instance, in the United States of America, the Sarbanes-Oxley law was passed in 2002 specifically to address corporate governance issues, while the New York Stock Exchange, the National

Association of Securities Dealers Automated Quotations and the American Stock Exchange also issued several regulations and directives. The major changes set by these laws and regulations regarding the board of directors (BOD) and audit committee include the naming of an independent director and at least one financial expert (in the sense of including independent directors and financial experts on the firms' boards of directors). Another change was that audit firms should separate the audit from non-audit services provided to the same client to avoid conflicts of interest and maintain a high-quality, trustworthy service.

In this regard, Agrawal and Chadha (2005) chose 318 businesses to examine: 159 US public companies that had restated their earnings and another 159 firms with non-restated earnings during the period from January 2000 to December 2001. Their sample includes restatements from well-known firms such as Enron and Tyco (see also Tricker, 2019).¹ The authors found no significant relationship between the independence of the BOD (the group responsible of maintaining corporate governance practice) and audit committee regarding misstatements, nor between auditors who provided non-audit and audit services simultaneously. In other words, an independent director would be less likely to support accounting malpractice in an effort to hide drawbacks. On the other hand, the probability of misstatements is higher in companies with a Chief Executive Officer (CEO) belonging to the founding family (Agrawal and Chadha, 2005). Nonetheless, the likelihood of restatements is less likely with companies that have an independent director or audit committee and financial expertise in their audit committee. Despite some of these findings seeming unusual on the surface, especially as regards non-significant relationships between the independent board director and audit committee, this does not mean that an independent director (as one of the main drivers of 'good' corporate governance) necessarily has a positive impact on monitoring managers and their misconduct (e.g., fraud). This may nevertheless be a potential area for future research using qualitative

¹ Tyco International Ltd is a conglomerate of US firms in four sectors (fire and security, electronics, engineering goods and services, and healthcare). In 2002, it collapsed, shortly after its former directors embezzled millions of dollars (Thanos, 2015).

methods (e.g., interviews or focus groups) to extend the authors' research (Agrawal and Chadha, 2005) to include Shariah corporate governance aspects such as Shariah audits and Shariah supervisory board (SSB) members' internal and external relationships that may affect their independence especially in the Kuwaiti context (see chapter 5).

1.3 The Importance of Corporate Governance to the Financial System

The former president of the World Bank, James Wolfensohn, noted the main purposes of corporate governance as fairness, transparency and accountability (Ahmed and Chapra, 2002), which are underlying ideals for Shariah corporate governance too. Also, corporate governance entails the procedures carried out by the financial institution internally ensuring a sound relationship between the various departments to limit the influence of one body over another (e.g., who implements and who monitors implementation should not be one and the same administrative body). In addition, corporate governance is a practice that a financial institution (particularly banks) performs in front of its stakeholders to maintain the confidence accorded to that financial institution.

Furthermore, Ginena (2014, p. 87) highlights corporate governance's vital role in "protecting depositors' funds, granting supervisors additional confidence to rely further on the internal processes of the bank [which] can be useful in times of financial distress". Moreover, an important dimension of corporate governance, particularly in the aftermath of the 2008 global financial crisis, is the increased concern about risk (Adegbite, 2012). In the supervision field, the regulatory authorities have become interested in adopting their supervisory instructions based on the degree of risk for each bank and financial institution in what is known as risk-based instructions. For example, the Central Bank of Kuwait issued corporate governance instructions in 2012 (updated in 2019) obligating banks to form an independent risk committee from among the board committees and establish a risk department affiliated with the bank's board of directors (Central Bank of Kuwait, 2012, 2019). Thus, risk governance and good management are considered essential banking reforms in the aftermath of the global financial crisis in 2008 to maintain the financial stability of the banking

sector. Overall, financial stability is one of the main benefits of having a good corporate governance infrastructure and an effective corporate governance implementation process (CBK, 2016; Ginena, 2014).²

1.4 Shariah Corporate Governance in Islamic Financial Institutions (IFIs) and its Importance

IFIs are unique because they adhere to Shariah (Islamic law) principles in financial transactions. As such, corporate governance in IFIs is unique. For example, in addition to their BOD, IFIs have another line of defence to support all stakeholders' interests: the Shariah supervisory board (SSB). The SSB is a "group of Shariah scholars who oversee and supervise operations, products and transactions of IFIs to ensure that they comply with Shariah principles" (Ahmed, 2011, p. 393). Such Shariah scholars are specialists in Islamic financial jurisprudence, or, in Arabic, *Fiqh Al-Mu'amalat*. Consequently, the most important aspect for attracting both investors and customers to IFIs is the assurance that all transactions, products and services provided comply with Shariah principles and align with the SSB's edicts, or, in Arabic, *fatwas*.

In this vein, Shariah corporate governance is the aspect that distinguishes IFIs from conventional institutions (those that give interest-based loans, for instance). Hasan (2012, p. 47) defines Shariah corporate governance as "the unique kind of governance in financial architecture as it is concerned with religious aspects of the overall activities of IFIs". Notably, the Shariah supervision process consists of two main stages – the ex-ante approval phase of the new product or service and the post-implementation phase. The SSB thus plays a pivotal role in assuring the conformity of IFIs' transactions with Shariah tenets. Basically, the sounder its SSB arrangements are then the closer each IFI is to fulfilling *Maqasid Al-Shariah* (Islamic law), and vice versa. Specifically,

² Dr Mohamad Al-Hashel, the former Governor of the Central Bank of Kuwait (CBK), mentioned this point in a press release (CBK, 2016, p. 1) after issuing the Shariah governance regulations for Islamic banks in December 2016: "[I]n particular, the growth of the Kuwaiti Islamic banking sector in terms of its size and quality of operations since the issuance of the previously mentioned instructions in June 2003 has increased the importance of the role of Shariah supervision governance in Islamic banks. Furthermore, the growth in Islamic banking in Kuwait has made this topic a vital component of financial stability."

SSB arrangements concern, but are not limited to, independence, competency (fit and proper criteria), confidentiality, consistency of judgement and disclosure of Shariah-related matters (Graiss and Pellegrini, 2006). These arrangements (micro level) in addition to Shariah corporate governance regulations (macro level) can help IFIs avoid poor Shariah corporate governance experiences, such as those that have happened with some IFIs in Egypt (1988)³ and that of the Ihlas Finance House in Turkey (2001) (the latter is covered in Section 1.4.1).

1.4.1 The Ihlas Finance House Case

An example of an Islamic bank failing because of weak governance and internal audit systems is the closure of the Ihlas Finance House in 2001. Although Islamic banks in Turkey worked as finance houses, and the percentage of Islamic banks' assets was small (3.3%), the Ihlas Finance House had the largest share of this percentage (Ali, 2007). Amid the economic crisis in Turkey in 2000 and early 2001, the banking system was adversely affected, and many conventional banks went bankrupt. As Ali (2007) notes, though, what is remarkable is that despite the presence of several Islamic banks or finance houses in Turkey, most proved resilient as only the Ihlas Finance House closed. Among its reasons for closing was the so-called control failure, "a failure in corporate governance and lack of internal checks and balances" (Ali, 2007, p. 24).

In this regard, the Ihlas Finance House's BOD, which supposedly exercised the/a supervisory role and served as stakeholders' first line of defence, was problematic in that it led/was integral to the bank's bankruptcy and closure. This BOD had a lax attitude towards governance and participated in what has been called 'rubber-stamping' (Ali, 2007), where members agreed to decisions without study or discussion. Even worse, some BOD members had a conflict of interest and had been granted financing facilities that did not comply with the bank's financing policies. Moreover, some BOD members were unfit and lacked

³ The failure of Islamic investment companies in Egypt in 1988 was due to, among other things, "improper regulatory frameworks and engagement in Shariah non-compliant activities" (Hasan, 2011, p. 41).

competence (Ali, 2007). Consequently, these problems caused various issues and led to the bank's eventual collapse.

Regulatory issues relating to the Central Bank of Turkey aggravated this dire situation. For instance, some destructive practices occurred in the Ihlis Finance House owing to lax regulation, such as management's use of the bank's resources to serve the special interests of some of its leaders. As a result, the Central Bank of Turkey took no early steps to correct the bank's (Ihlis Finance House) situation, which worsened until its license was revoked. Notably, Islamic banks (finance houses) have been allowed to operate in Turkey since 1983, implying that the Islamic financial industry is still in its infancy (the comparable Islamic financial industry in Kuwait started in 1977). So, the Turkish supervisory authority, when facing the economic crisis in 2000, took a hands-off approach to the new industry (distancing itself from dealing with industry matters). Ahmed (2011) and Hasan (2012) argued that most of the supervisory authorities in the Gulf countries have dealt with the hands-off or the minimalist method regarding Islamic financial institutions. The hands-off method may align with the general principle-based approach, not going into detail and leaving an interpretation of the supervisory principles to the financial institutions.

In this vein, two main supervisory approaches prevailing: the rules-based and the principles-based approach (see Chapter 2). Previous research (e.g., Saurwein, 2011; Nakpodia et al., 2018) suggested that supervisory authorities dealing with a new sector such as the Islamic financial industry require a rules-based approach rather than the principles-based approach used by the Turkish Central Bank in dealing with the crisis. This aspect (the suitability of regulatory approach) is one of the main ones researched and investigated in the context of Shariah corporate governance in Kuwait. In addition, in this Turkish case the investment accounts' resources were used to cover up the bank's internal financial problems, so Shariah supervision in the bank was absent. Thus, Shariah corporate governance can prevent bad practices from occurring proactively or correct some mistakes after they occur.

Another example of Shariah corporate governance disorder is what happened to the Investment Dar, a Kuwaiti investment company. Investment Dar had substantial Shariah compliance difficulties with its affiliate AlShamel Bank during the 2008 global financial crisis (Ginena and Hamid, 2015). Due to defaults on obligations, a liquidity crisis exposed non-compliant practises such speculative and high-risk investments, non-disclosure to investors, and failure to follow Islamic ethical standards. Non-compliance weakened Islamic investor trust and caused a bank run, worsening both institutions' financial problems. The crisis highlighted the necessity for strong Shariah governance structures and professional Shariah boards to regulate Islamic finance, emphasising transparency, disclosure, and Islamic principles. Compliance, governance, and legitimacy were needed to restore investor confidence and stability in the Islamic finance industry.

Based on the cases above, several important queries arise:

- To what extent are regulatory authorities aware of the nature of Islamic financial institutions?
- To what extent do regulatory authorities apply the appropriate supervisory approach (rules-based or principles-based)?
- On what basis is the suitability of one approach over another determined?
- To what extent do the IFIs' boards of directors have the knowledge of and experience regarding the nature of Islamic finance?
- Do Islamic financial institutions have a sound Shariah corporate governance system?

These queries feed into and complement this study's main research questions (see Section 1.9).

1.5 Why Kuwait?

Kuwait is a member of the Organization of Islamic Countries (57 countries) (OIC), the founder of the Gulf Cooperation Council (GCC), which consists of six countries – namely, Saudi Arabia, United Arab Emirates, Qatar, Bahrain, Oman and Kuwait – and considered a developing country. As banks make up

80% of its financial system, Kuwait has a bank-centric financial system, with the remaining 20% being shared by investment companies, foreign exchange companies and insurance companies (CBK Financial Stability Report, 2020).⁴ The Kuwaiti banking system consists of five conventional banks, five Islamic banks, one specialised (real estate) bank and 12 branches of foreign banks.

It is for several reasons that Kuwait is considered a leader in the Islamic finance industry field. First, Kuwait established the Kuwait Finance House in 1977 – the second commercial Islamic bank in the world (in terms of establishment) after the Dubai Islamic Bank in 1975. Second, the share of the total assets of Islamic banks within the Kuwaiti banking sector is approximately 45%, with five local Islamic banks alongside five local traditional banks, according to the CBK governor (CBK Financial Stability Report, 2020). Third, the Kuwaiti Islamic financial industry, especially Islamic banks, has systematically become an important sector. According to International Monetary Fund report (2017), if the market share of Islamic financial institutions' assets reaches 15% or more, the industry becomes important in terms of the level of the financial sector. For example, the market share of Islamic banks is 45% of the banking sector's assets as a whole, and therefore Islamic banks in Kuwait are an important sector (CBK's Financial stability report, 2020). Despite such aspects of the Kuwaiti Islamic financial industry, it nevertheless suffers from a dearth of academic studies on Shariah corporate governance aspects, on both a macro and a micro level. Hence, it is not only necessary to study this context/the characteristics of the Kuwaiti environment but it is also imperative to do so from the perspectives that have impacted on Shariah corporate governance in Kuwait – namely, the macro *and* the micro. This study can thus benefit these dual facets of Kuwait's banking and financial sector and hence the industry overall.

Employing institutional theory, which focuses on institutional effects (legal, political, and social), this research investigates the suitability of the regulatory

⁴ “A foreign exchange company is any company licensed to practice currency exchange business, e.g., buying and selling currencies, traveler cheques, drafts/remittances, trading in precious metals, cheque collection and transfers drawn on parties abroad” (CBK, 1984, p. 1).

approach relating to Shariah corporate governance in Kuwait, the soundness of current Shariah corporate governance arrangements in a specific context and whether it (Shariah corporate governance arrangements) fits the Kuwaiti environment. While covering much, it also digs deep in exploring and evaluating all the abovementioned aspects. In terms of evaluation, there is Shariah corporate governance regulation in Kuwait, yet no research has assessed the status of Shariah corporate governance and its soundness from both levels (macro and micro) – at least to the best of the researcher’s knowledge. Further, this research not only assesses the status of Shariah corporate governance but also explores the determinants of Shariah corporate governance that, according to interviewees’ perspectives, are appropriate for the Kuwaiti context. Thus, the study combines an assessment of this specific Shariah corporate governance status with insights into the development of the Kuwaiti Islamic financial industry’s sustainable growth. It hence contributes to the institutional theorising of Shariah corporate governance in the context of Kuwait, though this research also serves as an evaluation tool for the practices and legislations of Shariah corporate governance in Kuwait, considering Islamic finance industry stakeholders’ perspectives (participant-based). Moreover, this study provided valuable policy recommendations for helping the regulatory authorities to sustain Shariah corporate governance practice.

1.6 Macro-Level Determinants: The Kuwaiti Contextual Background

Socially, Kuwaiti society is one of the most highly interconnected societies in the GCC, with a particularly prominent manifestation of this interdependence being the *diwaniyya* – “a place where men can freely express their opinions and thoughts about matters of daily life both locally and globally, encompassing political, educational, social, economic, or sports issues” (Al-Sejari, 2018, p. 380). Similarly, In Kuwaiti society, it is normal for board chairs and directors of Islamic financial institutions to visit the Shariah supervisory board members in their *diwaniyyat*, which are typically personal spaces in people’s homes. The effect of frequent visits on the transfer of thoughts and ideas has been examined later. It is believed that the person being visited monitors the other person’s actions. Given the nature of Kuwaiti society, then, one might argue that this habit

could break the professionalism barrier between the administration and the SSB. A possible consequence of such customs concerns social embarrassment, where SSB members may 'tolerate' a transaction that does not comply with the Shariah principles to avoid the social embarrassment or because of the close relationship between the two parties. Accordingly, the researcher investigates these aspects (social, political, regulatory, and legal) as, to the best of his knowledge, they have not previously been addressed. An essential research contribution herein thus concerns these institutional aspects and their relevance to Shariah corporate governance in the Kuwaiti context through the institutional theory lens.

Demographically, the population of Kuwait is about 4,385 million (Kuwaitis constitute 34% of Kuwait population, 66% non-Kuwaiti). Kuwaiti Muslims comprise 99% of Kuwaitis (Central Statistical Bureau, 2021). It is noteworthy that Kuwait consists of six residential governorates, namely Al-Asimah, Hawalli, Mubarak Al-Kabeer, Al-Jahra, Al-Ahmadi, and Al-Farwaniyah. In the research conducted by Husaini et al. (1999), it was found that a quantifiable indicator of religiosity may be derived from the number of individuals attending prayers and engaging in religiously-sponsored activities. According to data from the Kuwaiti Central Statistical Bureau (2021), the overall count of mosques in Kuwait witnessed a notable increase from 1,353 in 2012 to 1,821 in 2021. This rise in the number of places of worship is an indicator for measuring religiosity.

Regarding religiously-sponsored activities, consider the circles dedicated to memorising the Holy Qur'an. These circles experienced a decline from 2334 for 2012/2013 to 2304 for 2021/2022. Furthermore, there has been a decline in the total number of male and female students enrolled in these circles, with a fall from 33,161 for 2012/2013 to 31,995 for 2021/2022. The increasing number of mosques in Kuwait, possibly attributed to the development of new residential areas, has not been accompanied by a commensurate growth in Quran memorising circles. Given that these circles are essential to people's religious devotion, there seems to be a drop in the extent of religiosity in Kuwaiti society. Therefore, this decline in value might be attributed to additional financial factors, such as engagement in activities that do not adhere to Shariah principles.

Politically, several factors impact on the political situation in Kuwait. Of course, the Kuwaiti constitution specifies three public authorities – the legislative authority (parliament),⁵ the executive authority (the government)⁶ and the judiciary authority (<https://www.constituteproject.org>).⁷ The Amir is the head of state and considered the father of these three authorities. There are also different political currents and parties (liberal, Arab nationalist, religious, Islamist, etc.) as well as public benefit associations that influence the political situation (the Kuwaiti Economic Association, the Kuwaiti Association for Protecting Public Funds, the Kuwait Alumni Association, etc.). The most prominent feature of political life in Kuwait is the National Assembly, elected through free general elections. Although the Kuwaiti parliamentary experience is unique at the level of the Arab Gulf states in particular and in all Arab countries more broadly, it faces many challenges.

A particularly prominent challenge of the Kuwaiti political system derives from its combination of presidential and parliamentary systems, for it is neither a fully presidential system in which the Amir (ruler) has complete authority in legislation and oversight nor a fully parliamentary system in which the parliamentary majority can form a government with a programme of work supported by the parliamentary majority. Consequently, the Kuwaiti democratic experience has been characterised by many parliamentary governmental conflicts that have led to political instability (the Amir has dissolved parliament several times, for instance – see Salama and Al-Sharrah, 2011). While this may not relate directly to the research topic, it indirectly relates to the slow process of enacting anti-corruption laws and laws relating to the Islamic financial industry, for example. Furthermore, just as there is a profound social interdependence in Kuwaiti society, political tendencies are also rooted in

⁵ Article number (51) of the Kuwait constitution states: “In conformity with the Constitution, legislative power shall be vested in the Amir and the National Assembly”.

⁶ Article number (52) states: “Executive power shall be vested in the Amir, the Cabinet and the Ministers in the manner specified in the Constitution”.

⁷ Article number (53) states: “Within the limits of the Constitution, judicial power shall be vested in the Courts in the Amir’s name”.

society. Consequently, they have repercussions, especially in employment within leadership and supervisory positions, including the SSBs in IFIs. Although it is crucial to study the extent to which political aspects affect Shariah corporate governance practices for a more accurate and fuller understanding of Shariah corporate governance, it has, to the researcher's knowledge, yet to be studied in this context.

The legal aspects of the Islamic financial industry, and Shariah corporate governance in particular, are the cornerstones for the growth and continuity of the industry. In Kuwait, Islamic banks and investment companies continued to operate without legal regulation until 2003 when the Islamic banking law was issued. This law is part of Law No. 32 from 1968 concerning currency, the Central Bank of Kuwait and the regulation of banking. These financial institutions (Islamic banks and investment companies) had been operating in accordance with the corporation law issued in 1980 and were not subject to a specific supervisory authority, such as the CBK, or certain requirements (e.g., they were not legally obligated to send periodic reports to the supervisory authority).

1.7 Micro-level Determinants: Internal Shariah Supervision Arrangements

The internal Shariah supervision arrangements for each IFI in this research includes the presence of a Shariah supervisory board (SSB) and addresses the extent of the board's independence and the SSB members' competency in addition to internal and external Shariah audits. In summary, the three elements of Shariah supervision from a micro-level perspective are the Shariah supervisory board, the internal Shariah audit and the external Shariah audit. Most previous literature has discussed these aspects only partially (i.e., the SSB size effect on the IFI's performance) or dealt with those aspects through agency theory or in another context. However, this research deals with the micro-level aspects mentioned above in a specific context (i.e., Kuwait) with, among others, Shariah specialists and Shariah corporate governance stakeholders, doing so through institutional theory. Moreover, this study suggests some legal

amendments that allow the participation in the decision-making process of investment account holders, who are the majority of depositors in Islamic banks.

Noting the historical development of Shariah governance regulations in the Kuwaiti financial sector also facilitates a fuller understanding. In 2003, the CBK issued the Instructions No. 2/RbA/100/2003 regarding the rules and conditions for the appointment and competencies of the SSB in Islamic Banks. These instructions dealt explicitly with the formation of the SSB, the number of its members, terms of membership and appointment, the report of the SSB and auditor responsibility. After that, the application of these instructions continued without any change until 2016, when the Central Bank issued comprehensive Instructions on the Shariah supervisory governance for Kuwaiti Islamic banks, which replaced former instructions in 2003. The latest instructions (2016) included the three main aspects of Shariah governance: SSB, the internal Shariah audit and the external Shariah audit. It also provided instructions on roles of the BOD, its committees and the executive management concerning Shariah supervision and ensuring the institution's commitment to Shariah provisions.

With that in consideration, however, Law No. (32) for the year 1968, mentioned above, does not deal with Islamic financial products such as *Mudarabah* (profit/loss sharing). Consequently, several disputes have been discussed in the Kuwaiti courts regarding Islamic financial products, especially the *Ijarah* (leasing) and *Murabaha* (cost-plus) products, owing to the lack of detailed laws and regulations that cover these products. Consequently, some court rulings have been issued that consider some of the Islamic financial institutions' tools to be illegal and note how some are used to circumvent Shariah-prohibited practices. This matter constitutes one of the most critical challenges for Islamic financial institutions as it affects their reputation and compromises the reason for their existence, which is compliance with Shariah provisions. Hence, this research has discussed the legal challenges raised above with participants and has come up with several practical recommendations.

Based on the previous two sections (1.6, 1.7), Kuwait holds considerable importance in the Islamic financial industry within the Gulf Cooperation Council (GCC) and the global economy. As a founder of the GCC, Kuwait plays a vital role in promoting Islamic banking and finance, contributing to regional economic integration and collaboration. The country's substantial oil production and reserves provide a solid foundation for Islamic financial institutions to engage in Shariah-compliant investment activities, bolstering the industry's growth. Kuwait's position as a regional financial hub and its expertise in Islamic finance attract investors and financial institutions seeking Shariah-compliant opportunities. The sole democratic state in the GCC and its strategic location makes it an attractive destination for Islamic finance, establishing economic ties and promoting Islamic financial products and services internationally. Thus, Kuwait's significance cannot be understated in the Islamic financial industry, and its contributions continue to shape the development and expansion of Islamic finance in the GCC and beyond.

1.8 What is 'Good' Shariah Corporate Governance?

In the realm of Shariah corporate governance, and to the best of the researcher's knowledge, there is no research that explicitly mentions the definition of or the drivers of 'good' Shariah corporate governance. However, more broadly Filatotchev et al. (2007, p. 1) defined 'good' corporate governance in their study as relating to "the rights and responsibilities of company stakeholders, and the wealth-creating and wealth-protecting functions of corporate governance within this context". In their study, the authors discussed the drivers of good corporate governance, such as policy-making and different perspectives on the organisational level (micro-level), whole industry level (Islamic financial industry) and so on.⁸ More pertinently but still not explicitly, Shariah corporate governance has been alluded to as harbouring an implicit meaning for good Shariah corporate governance being about having supportive laws/regulations or regulatory authority towards IFIs/Islamic Banks from a policy-making (macro-level) perspective (Ahmed, 2011). Furthermore, from a micro-level

⁸ See Appendix 1.

point of view several Shariah corporate governance determinants are mentioned implicitly in various studies such as the independence of SSB members, and whether they are fit and proper (Grais and Pellegrini, 2006; Ginena and Hamid, 2015). Another central objective of this research is thus to combine the dispersed determinants from different research and levels (macro and micro) into one study within the Kuwaiti context, as discussed in Chapter 4 and 5. The following section mentions the research questions and objectives.

1.9 Research Questions and Objectives

This study's main research questions are as follows:

- 1) What are the macro-level determinants of 'good' Shariah corporate governance in the Kuwaiti financial sector?
- 2) What are the micro-level determinants of 'good' Shariah corporate governance in the Kuwaiti financial sector?

In answering these, this research has the following research objectives:

- 1) To evaluate the Shariah corporate governance status of Islamic financial institutions in the Kuwaiti financial sector.
- 2) To explore the determinants of good Shariah corporate governance of Islamic financial institutions from a macro-level perspective (the state).
- 3) To explore the determinants of good Shariah corporate governance of IFIs from a micro-level perspective (Organisational).
- 4) Based on the previous objectives, to present a comprehensive study of Shariah governance in the financial sector in the State of Kuwait that addresses practical concerns by offering real-world solutions that help deliver good Shariah corporate governance and sustain the Islamic financial industry practice.

1.10 Significance of the Study

This research is vital for several reasons. First, the issue of Shariah corporate governance is topical in the Islamic financial industry. In fact, aside from a very small number of countries (e.g., Malaysia, Oman) in the previous decade, there were no Shariah corporate governance complete legislation in the states that IFIs operate in. Across various countries a central problem has been the incoherent guidelines on forming the SSB, resulting in some flawed practices (such as monopolising the membership of SSBs, as will be discussed later). Second, some supervisory authorities have been reactive towards Shariah-related aspects concerning IFIs, while others have not even introduced an IBs-specific law or part of banking law (hands-off approach) (Ahmed, 2011). Despite this, in the last ten years, various countries, particularly Kuwait, have started paying attention to the issue of Shariah corporate governance, especially after the size of their Islamic financial industry expanded, which is the third reason for this research being vital: the industry's size has become so significant, especially in Kuwait, that it has become difficult to sustain and there is a general recognition that this needs addressing accordingly and that it cannot be ignored or left to market forces. Consequently, things are changing at the macro-level as more countries nowadays have their own comprehensive Shariah corporate governance regulations, yet as already noted, problems persist and need addressing.

Fourth, new challenges have emerged because of this increased industry size, including legal issues (e.g., multiple cases before the courts) and Shariah compliance challenges (e.g., the scarcity of Shariah scholars who specialise in Islamic financial transactions). Clearly, this needs to be attended to if it aggravates the situation – and the additional issues plaguing the industry must be nimbly resolved and proactively dealt with. Fifth, many supervisory authorities (e.g., Malaysia and Oman) have instructed Shariah corporate governance to deal with these new challenges of the Islamic financial industry sector and the various issues within it. As such, it is vital to study the case of Shariah corporate governance from macro-level angles (the state's dealings with Shariah corporate governance and the efficacy of the instructions issued, and its

suitability for the environment and context of the state); and, micro-level aspects relating to IFIs (e.g., the independence of the Shariah supervisory board). Crucial in both of these, and indeed the industry as well as this work as a whole, is identifying, understanding and addressing accordingly (via practical suggestions and solutions) the determinants of ‘good’ Shariah corporate governance overall but specifically at these micro and macro-levels.

Sixth, IFIs heavily rely on customer confidence, and this largely derives from each institution’s commitment to abide by the principles and provisions of Shariah (Islamic law). The ‘bottom line’ is that the less risk of Shariah non-compliance (or inversely the greater likelihood of Shariah compliance), the better the IFI’s reputation becomes (i.e., more credible). For this, each IFI must have a good Shariah corporate governance arrangement to maintain its presence as, and even remain classified as, an ‘Islamic’ entity, all of which represents micro-level aspects. A seventh reason is that IFIs are more likely to maintain their credibility when appropriate macro and micro Shariah corporate governance practices are in place – that is, when they are committed to Shariah regulations, both in form and in substance: in the sense that an institution has procedures and institutional arrangements that ensure Shariah compliance, as opposed to merely using Islamic law as a marketing slogan to attract clients and investors.

Lastly, in the last decade, Shariah corporate governance has come under the scrutiny of the supervisory authorities, researchers and those interested in IFIs, and they all share the same quest for furthering understanding to devise suitable resolutions whereby actions can be implemented that address issues, make improvements and save this comparatively fledgling but currently problematic industry.

Prior literature typically addresses Shariah corporate governance in one of two ways: at the micro-level through internal arrangements (SSB members’ competence, disclosure of the Shariah supervisory board, etc.); and at the macro-level – for example when comparing the presence or absence of Shariah

corporate governance instruction orders among nations, and additionally, how much specific micro-level aspects of Shariah corporate governance are covered by the instructions (i.e., the independence of the SSB). Remarkably, the agency theory (principal-agent) framework has been used in most scholarly studies concerning corporate governance and Shariah corporate governance. Notwithstanding its significance, this theory offers a general framework for comprehending the conflicts of interest that exist between the executive management and the BOD on the one hand and between the executive management and the BOD and the SSB on the other. One of the projections of agency theory in the Islamic financial industry context when there is a conflict between economic consideration (profit) and Shariah (religious) concerns, is that the BOD, for instance, tends to prioritise economic considerations while the SSB, in contrast, prioritises Shariah considerations over financial ones. However, the principal-agent theory needs to address the institutional aspects affecting the applications of corporate governance and Shariah corporate governance, such as the legal, political or social aspects of each society. Therefore, one of this research study's motivations is to overcome this shortcoming by evaluating and exploring Shariah corporate governance determinants at the macro and micro-levels through the institutional theory lens.

1.11 Organisation of the Thesis

The remainder of this thesis is organised as follows.

Chapter 2: Review of previous literature

This chapter critically appraises pertinent prior literature on Shariah corporate governance. It also identifies research gaps in this literature, which along with other aspects served as the basis of this work's research questions and objectives. What it also conveys is how many studies do not address the assessment of Shariah corporate governance in the State of Kuwait through those concerned with Shariah corporate governance, and thus they do not consider such perspectives on either the macro or the micro aspects, never mind using a qualitative approach to explore, evaluate and analyse this phenomenon, though the current work does. The chapter concludes by addressing the research's

theoretical framework, the most prominent theories discussed in the context of Shariah corporate governance, and the theory that the researcher settled on in this research.

Chapter 3: Research methodology and methods

This chapter presents the methodology and research method, showing how this research is based on Saunders et al.'s (2019) research onion. The chapter begins with the research philosophy and interpretative methodology and conveys their importance to the research topic. It also shows the process of going through research methods and how what suits this research (the qualitative method) emerged, specifically semi-structured interviews, for collecting research data. The chapter then touches on the pros and cons of this method and explores its appropriateness for this study, and it particularly considers the dearth of qualitative studies against their importance in exploring phenomena in detail. It also notes the number of research interviewee and provides anonymous information about them. Further, it shares information about the interview process. Finally, this chapter ends with the selecting of thematic analysis as the method of data analysis, justifying its use and showing how it is employed herein.

Chapter 4: The macro-level determinants of good Shariah corporate governance in the Kuwaiti financial sector

This chapter addresses the first research sub-question: what are the macro-level determinants of good Shariah corporate governance in the Kuwaiti financial sector? For this, it investigates supervisory, social, political and legal aspects. The chapter also provides insights into whether the regulatory approach used concerning Shariah corporate governance is suitable based on the institutional effects of the Kuwaiti context, before it touches on how it is essential to have a comprehensive Islamic finance road map in each country.

Chapter 5: The micro-level determinants of good Shariah corporate governance in the Kuwaiti financial sector

This chapter addresses the second research sub-question: what are the micro-level determinants of good Shariah corporate governance in the Kuwaiti financial sector? It concerns two sub-levels: micro industry-level and micro firm-level. While the former discusses the current state of Shariah corporate governance and evaluates the status from the interviewee perspectives. The latter (firm-level) concerns the internal arrangement of each IFI's Shariah supervision, covering aspects such as SSB, SSB independence, SSB member's competence and Shariah-related matters disclosure, besides internal and external Shariah audits. Moreover, other Shariah corporate governance stakeholders, such as non-governmental organisations, international standard sitters relating to IFIs and educational bodies along with their role in sustaining the Islamic financial industry's growth are also presented.

Chapter 6: Research conclusion

This chapter concludes the research, present the research's practical and theoretical contributions, and provides the main limitations and potential future research aspects.

Chapter 2

Review of Prior Literature and Theoretical Framework

2.1 Introduction

Corporate governance is a multidimensional and developing notion understood as the structures, processes, and practises organisations use to lead, control, and operate themselves (OECD, 2015; Tricker, 2019). It (corporate governance) serves as a fundamental foundation for interactions and connections among numerous stakeholders, including shareholders, management, boards of directors, employees, consumers, suppliers, and society. Through accountability, transparency, and ethical values, it aligns the interests of shareholders, management, and stakeholders. In this vein (aligning various interests) includes robust board monitoring, transparent reporting, risk management, and ethical considerations. Thus, the fundamental objective of corporate governance is to ensure a company's responsible and transparent administration. Therefore, increasing its long-term value and protecting the interests of all stakeholders.

Specifically, Shariah corporate governance in Islamic financial institutions is a relatively new issue. Historically, Shariah corporate governance has been divided into two stages. From 2002 to 2012, the first phase was that of recognition and discussion among academics and practitioners in Islamic financial institutions (during which there were few Shariah corporate governance supervisory instructions issued by only a few countries). From 2012 to 2022, the second stage was the drafting and implementation of legislation and regulations to support Shariah corporate governance. The discussions revolved around how to strengthen the growth of Islamic financial institutions by strengthening corporate governance practices through its mechanisms (board of directors, executive management, shareholders, and depositors) and its tools (internal control system, risk management, transparency, Shariah and financial audit) (Chapra and Ahmed, 2002).

In addition, the debates spun around the most prominent challenges facing the Islamic financial industry (i.e., lack of Islamic finance degree and absence of Islamic financial transactions legislation) (Farook and Farooq, 2013; Grassa, 2013). Moreover, Islamic financial institutions' principles of Shariah corporate governance (Grais and Pellegrini, 2006; DeLorenzo, 2006; Abu-Tabanjeh, 2009). For example, Shariah auditing was not recognised and did not spread as a practice except in the second stage (mentioned above), where the culture of adherence to the principles of Islamic Shariah was limited to the presence of the Shariah Supervisory Board or a resident Shariah adviser in the Islamic financial institution (Hudaib and Haniffa, 2009). While in the second stage, and after the steady growth of Islamic financial institutions, scientific papers began to discuss the implications of this growth in terms of the scarcity of Shariah scholars specialising in Islamic financial transactions and the absence of Islamic finance higher study programmes in the universities (Ginena and Hamid, 2015; Abozaid, 2016), as well as some malpractices of Islamic financial institutions such as fatwa shopping (Oseni et al., 2016; Ullah et al., 2018).

In terms of regulation, there is a debate about the most appropriate regulatory methodology for monitoring corporate governance, whether rules-based or principles-based (Nakpodia et al., 2018). The characteristics of each monitoring methodology will be detailed separately (see section 2.2), likewise the necessary infrastructure to implement either of the two methodologies. However, to the researcher's knowledge, no study addresses this matter in the Shariah corporate governance field and what is appropriate or best for the Islamic financial industry. Several concepts have been addressed, however, such as regulatory unreasonableness, suggested by Boyum (1983), and its implications for the regulatory environment and the actual application of corporate governance. Besides, discussing the relevant practice concept suggested by (Andrews, 2012) rather than best practice considering each nation's specific context and peculiarities.

Based on the above, good Shariah corporate governance could be comprehended as the comprehensive framework, including the system, procedures, and

infrastructure that serve as the foundation for the Islamic financial industry, whether at a macro or micro level. This matter is further elaborated upon in sections 2.4 and 2.5. Comprehensive Shariah corporate governance moves beyond the internal arrangements of IFIs themselves (e.g., SSB arrangements) to broader dimensions. Indeed, in its comprehensive form, good Shariah corporate governance covers various factors contributing to its effectiveness. These factors include the political environment, legal underpinnings, social considerations, and educational infrastructure, non-governmental organisations related to the Islamic financial industry. Further, the international standards-setting bodies influence Shariah corporate governance practices.

The rest of this chapter is organised as follows. First, sections 2.2 and 2.3 discuss briefly corporate governance in Kuwait and Shariah corporate governance in the banking industry. Then, section 2.4 details the macro-level contextual factors affecting corporate governance arrangements. Next, section 2.4.1 discusses the regulatory aspect as the first contextual (macro-level) factor affecting corporate governance and Shariah corporate governance. Further sections (2.4.2, 2.4.3, 2.4.4) cover the Kuwaiti social, legal, and political aspects. Then, section 2.5 delves deep into the micro-level aspects relating to Shariah corporate governance arrangements, such as the Shariah supervisory board's independence, Shariah supervisory board members' competence, and Shariah-related matters transparency. The subsequent sections (from 2.5.1 to 2.5.7) address the following aspects: Shariah audit (2.5.1), the independence of Shariah auditors (2.5.2), Shariah audit quality (2.5.3), Shariah audit and advisory firms (2.5.4), national Shariah authority in regulatory bodies (2.5.5), master planning (2.5.6), and shareholder activism (2.5.7). Then, section 2.6 explains the research gaps, research questions, and research objectives. Next, section 2.7 discusses the theory and theoretical framework and why institutional theory is chosen. Lastly, Section 2.8 concludes the chapter.

2.2 Corporate Governance in Kuwait

Hardly any literature explores the Kuwaiti corporate governance and Shariah corporate governance context, with Al-Saidi and Al-Shammari's (2014) attempt

to investigate corporate governance from stakeholders' perspective in this country being an exception. The study found that the Kuwaiti legal system is not sufficiently developed to achieve corporate governance aims, and three major issues hinder high-quality corporate governance in Kuwait: the culture, the corruption and the lack of education. According to Al-Saidi and Al-Shammari (2014), two external aspects influence companies – namely, large shareholders (institutional investors, government investors and individual investors) and creditors. On the one hand, the latter represents a major source of funding for companies, and with debt and/or financial difficulties, risk comes to such firms. On the other hand, the shareholder types affect the firms' strategies and attitudes. Moreover, within companies two factors influence corporate governance: first, the board of director (BOD), which concerns issues such as the independence of directors, board diversity, board committees, board size and role duality; and second, disclosure and transparency (Al-Saidi and Al-Shammari, 2014). In addition, the rights of shareholders (i.e., minority shareholders) and stakeholders (Kuwaiti laws do not clearly specify stakeholders' role) are not protected adequately in Kuwait. Finally, their findings section discusses accountability, which simply means that managers and the board are accountable for decisions they take, and accountability inevitably increases the level of corporate governance, especially the protection of the rights of shareholders and stakeholders. The study contains several policy recommendations that may enhance the corporate governance environment and facilitate its proper implementation (e.g., enhancing board committees' roles), but it did not incorporate the cultural factor – specifically, how the culture of each society may influence people's behaviour (e.g., Nigerian habits of respecting elders) (Nakpodia et al., 2018). Future studies should thus address the cultural factor to construct a full picture of the status of corporate governance in Kuwait, and such research would benefit from comparing this factor with that in other GCC countries.

2.3 Shariah Corporate Governance in the Banking Industry

Shariah corporate governance is a system for and a group of procedures relating to the specific type of IFI known as Islamic banks and is fundamentally about

ensuring these banks provide their products and services under the umbrella of Shariah principles. If they do, this enhances public confidence in Islamic banks and hence the banking sector as a whole. From a regulatory perspective in the past decade, Shariah corporate governance has come under greater scrutiny owing to, among other things, its importance, especially regarding such specific, and wider public confidence (in Islamic banks and the banking system respectively). For instance, during this period many regulatory authorities in the GCC have issued Shariah corporate governance regulations and instructions, including the CBK (2016)⁹, the Central Bank of Bahrain (CBB) (2017)¹⁰ and the Saudi Arabia Monetary Authority (SAMA) (2020)¹¹ – the common element of these regulations being that all adopt the rule-based approach. As the next section will demonstrate, these pursue two regulatory approaches, either hard law (rule-based) or soft law (principle-based) (Cuomo et al., 2016).

2.4 Contextual (Macro-level) Factors Affecting Corporate Governance Arrangements

This section discusses the institutional contexts embedded in the state and society in Kuwait and includes five sections, namely: the regulatory context (2.4.1) with sub-section (2.4.1.1) concerning Shariah corporate governance from regulatory perspective, the social context (2.4.2), the legal context (2.4.3), and the political context (2.4.4). The following section discusses the regulatory context.

2.4.1 Regulatory Context

In this regard, Nakpodia et al. (2018) examine the suitability of regulatory approaches (rule-based and principle-based) for sub-Saharan African countries, as well as the determinants of implementing each approach and whether having a mixed or integrated approach is acceptable. Interestingly, Nakpodia et al. (2018) mention four types of corporate governance regulation states – namely, no regulation, self-regulation (principle-based), co-regulation and statutory

⁹ Shariah Supervisory Governance for Kuwaiti Islamic Banks (CBK, 2016).

¹⁰ Shariah Governance (CBB, 2017).

¹¹ Shariah Governance Framework (SAMA, 2020).

regulation (enacted by laws and being regulations or rule-based) (see also Just and Latzer, 2004; Kirkbride and Letza, 2004). An especially important point these authors make concerns how implementing a particular corporate governance regulatory approach (see Figure 2 below) requires prerequisite conditions or sound infrastructure such as a so-called conducive environment (i.e., law enforcement)¹² to produce positive effects on the corporate governance environment in general (Nakpodia et al., 2018).

Regarding the two regulatory approaches mentioned above, the idea of appropriateness is dominant; hence, there is no ‘right’ or ‘wrong’ as far as these regulatory approaches are concerned (Cuomo et al., 2016; Nakpodia et al., 2018). In other words, what is deemed suitable in one country may not be suitable in another. As Nakpodia et al. (2018) report, a principle-based approach might be appropriate in developed countries with high law enforcement strategies and low-level corruption besides other factors (i.e., active regulatory authorities). However, the rules-based approach could be more effective for developing countries, particularly those with specific characteristics such as a low literacy level, careless stakeholders and weak regulators. In this vein, Hommel and King (2013) indicate that applying an appropriate regulatory approach also relates to risks so, for them, a so-called risk-based regulation decision also needs considering. They conclude that, regarding such risk, a comprehensive (rules-based) approach is suitable for an industry that is still in its infancy, while a mature industry may be suited to a less comprehensive and less detailed approach – in other words, that of the principles-based approach.

In this context, many describe the industry’s or product’s life cycle, including Philip Drew. Drew (1987, cited in Klepper, 1997) indicated that an industry’s life cycle is represented in four stages: the embryonic stage, growth, maturity, and then aging (p. 147). Therefore, it is worth mentioning a description of these

¹² According to Aguilera (2018, p. 95), law enforcement concerns “the degree to which government monitoring is consistent and the severity of punishment for violating rules and laws is predictable.”

stages, especially the stages of growth and maturity, as it was mentioned by Drew (1987, cited in Klepper, 1997, pp. 147–148):

In growing markets, the number of participants reaches a peak, after which there is a shakeout. Before this happens, product lines proliferate, and buyers find the market bewildering. Growth rates exceed 10% per year and market shares are variable. Mature markets are established and predictable, like mature people (at least those who have not encountered their midlife crisis). Products are well-known to both buyers and suppliers; that is, buyers know what to look for and suppliers know what the market needs. Market shares are established, changing only slowly, and newcomers find it difficult to displace entrenched companies.

What is the Industry Life Cycle?

An industry life cycle depicts the various stages where businesses operate, progress, and slump within an industry. An industry life cycle typically consists of five stages — startup, growth, shakeout, maturity, and decline. These stages can last for different amounts of time – some can be months, some can be years.

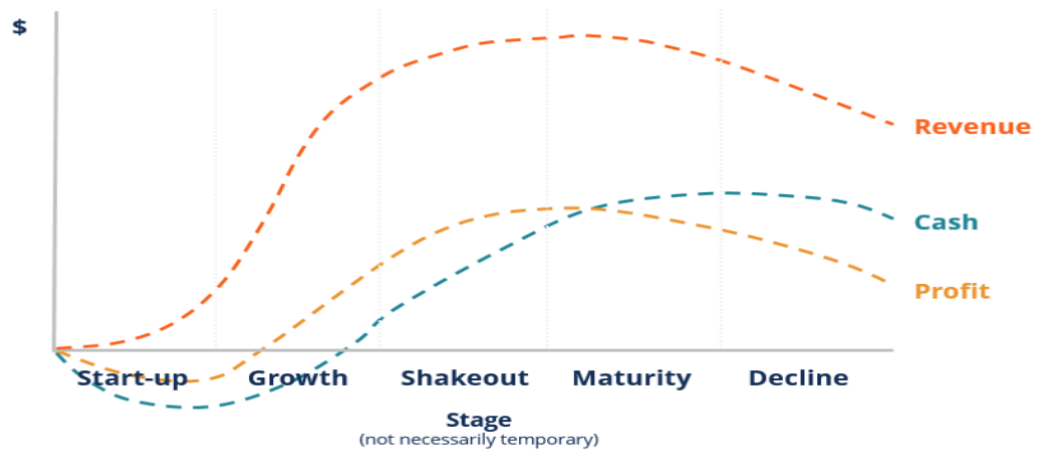


Figure 1: Industry Life Cycle (Corporate Finance Institute, 2022)

Peltoniemi (2011) suggests that IFIs in their early stage (see Figure 1) seek legitimacy in society and that this legitimacy can be achieved through several players, the most important being regulatory institutions, competitors and customers. Drawing on this, Nakpodia et al. (2018) propose that an integrated regulatory approach that combines both approaches can be very beneficial in the

implementation of corporate governance systems. This (integrated regulatory) approach consists of three stages. The first is the full rule-based approach (short-term), which addresses micro and macro corporate governance challenges such as low enforcement tools and low literacy level. The second stage consists of both approaches but with a predominance of the first regulatory framework (statutory regulation). The final stage consists of both approaches but with the predominance of the principle-based approach (co-regulation).

As far as the integrated regulatory approach is concerned, these authors state that the next phase cannot begin until the desired goals or results have been achieved for the preceding phase. Despite such an emphatic statement, one could still, nevertheless, consider this condition ambiguous as it lacks clear prerequisites for each phase. Furthermore, as their study focuses only on Nigerian Stock Exchange firms, it is shrouded in the issue of generalisability. Although it could be generalised theoretically as a single case or solo research method could be generalised for theoretical propositions when considering the difference between analytical and statistical generalisation (Kelliher, 2005). Further research may therefore dig deeper regarding the foregoing aspects in different regions (e.g., GCC) and sectors such as SMEs and state-owned companies.

Regarding the influences of the type of regulatory approach and extent of compliance on a firm's performance, Tariq and Abbas (2013) found a negative relationship between high compliance with the corporate governance code after its issuance by the Pakistani capital market and firm performance (the companies that made high commitments had poorer results). Another explanation for this, perhaps, exists though, as companies may be keen on 'textual' compliance with the supervisory instructions to obtain legitimacy without complying with the spirit of the instructions. Moreover, sometimes compliance is not for the public good but rather to avoid penalties imposed by regulatory authorities. Therefore, applying a corporate governance code that is imported from a different environment does not necessarily pay off, and that is what happened in Pakistan. As a result, Tariq and Abbas's (2013) conclusion that one size does not fit all is consistent with other studies, such as Nakpodia et al. (2018) and Aguilera et al.

(2018), which emphasise the importance of considering the social, legal, and political factors that are an integral part of any society and state.

Integrated approaches are not necessarily about applying both equally across all aspects though, especially as they are both similar yet also different. A study by Burgemeestre et al. (2009), for example, pointed out that even though rules differ from principles, both occupy the same spectrum but at different points.

	Dimension	Typical Principles	Typical Rules
1.	temporal	ex post	ex ante
2.	conceptual	general / universal / abstract	specific / particular / concrete
3.	functional	large discretionary power	little discretionary power
4.	representation	declarative (what)	procedural (how)
5.	knowledge needed	quite a lot	relatively little
6.	exception handling	allow for exceptions (defeasible)	all or nothing (strict)
7.	conflict resolution	by weight (trade off)	no conflicts possible

Figure 2: Characterisation of Rules and Principles by Dimensions (Burgemeestre et al., 2009)

Suppose a construction company wants to emphasise the safety of builders, for instance: it may put the principle of safety first or specify detailed requirements ‘rules’ for the type of helmet and clothing used while performing work. Here, both approaches (the principle and the rule) share the same goal but differ in their means of guidance for that end. This is thus an example of how the conceptual dimension, as shown in Figure 2 below, suggests that principles-based are general and abstract while rules-based is specific and concrete (Burgmeestre et al., 2009).

In the realm of a principles-based approach, Baldwin et al. (2012) suggest that four kinds of institutions exist. The first consists of well-mannered and highly capable institutions that easily and without issues conform to the principles-based regulation “with light encouragement” (Baldwin et al., 2012, p. 305). The

second consists of well-mannered but low-capacity institutions that have inadequate qualifications for comprehending and interpreting the principles. This produces implementation challenges because the nature of the principle-based methodology depends greatly on the qualifications and competence of people in charge of compliance management.

Institutions that are untrustworthy and have a small capacity make up the third type. These institutions will not be held accountable for the principles as they cannot apply them organisationally or interpret them correctly. This type is unquestionably more challenging than the second type in terms of compliance behaviour and principles-based regulation eligibility. The fourth category involves institutions with a high capacity and a bad attitude. These institutions “are predisposed to evade the relevant principles whenever this is to their advantages”, claim Baldwin et al. (2012, p. 305). In other words, they have a practical and self-serving mindset. All four aforementioned institutions indicate that a principles-based regulation method requires proper configuration in terms of compliance and governance culture, compliance organisational capabilities, availability of law enforcement tools and regulatory deterrence, and this could require time.

Indeed, Andrews (2012) argues that we cannot demand the adoption of ‘best practice’ as shown in developed nations (i.e., the United Kingdom) then replicate this in developing nations (i.e., Kuwait), as each state has its own unique context and environment. For this author, adopting ‘relevant practice’ is more practical and applicable than adopting ‘best practices’. One could argue that, although the relevant point in this instance is logical, it is unclear what factor(s) make such a practice relevant or suitable. Andrews (2012) indicates that two factors determine the applicability of best practice: first, the severity and nature of the problem facing the state; and second, the viability of these elements. According to Andrews (2012, p. 141), viability can be analysed via three questions:

- 1) Is the proposed solution ‘acceptable’ in light of the norms and/or values?
- 2) Considering the power structure, is the solution ‘authorised’?
- 3) Are the ‘capabilities’ to adopt and implement the solution current or foreseeable?

Each of these factors requires elaboration, but the primary focus here is the context or more specifically the uniqueness of each country’s environment (social, political, legal, etc.). Political acceptability and the availability of resources are the primary factors that led to the previous three questions (Andrews, 2012). Thus, it is vital to consider the three questions mentioned above, as guidance, to find out whether the actual or proposed practices fit within the country context (e.g., Kuwait) and what policymakers should be concerned about.

Furthermore, there is occasionally a cost associated with choosing tighter law enforcement to counter a specific undesirable phenomenon while attaining the desired level of product innovation (Banerjee, 2011). When drafting rules, regulatory authorities should consider this point and even make trade-offs between level of intensity of law enforcement and such innovation. There may even be an additional trade-off between normative foundations (human rights) and regulatory effectiveness (cost–benefits) (Samuels, 1978). Samuels (1978) indeed emphasised the necessity of taking normative values into account while developing rules and regulations as opposed to considering only economic aspect (Samuels, 1978). The regulatory authorities should thus maintain a balance between economic determinants and value determinants, especially given that the subject of this research is Islamic law. For instance, sometimes regulators treat conventional and Islamic banks equally, ignoring the value aspect of Islamic banks. Among the products Islamic banks offer, for example, are *Musharakah* and *Mudarabah*,¹³ which are riskier than debt-based financing

¹³ *Musharakah* “is used for contractual partnership in which all partners provide funds, not necessarily equally, and have the right to work for the joint venture” (Ayub, 2007, p. 308).

instruments (e.g., *Murabaha*).¹⁴ Here come the supervisory authorities, who impose high levels of collateral on the instruments of Islamic banks (*Musharakah* and *Mudarabah*) if used. Consequently, numerous Islamic banks concentrate on low-risk debt instruments (e.g., *Murabaha* and *Tawarruq*).¹⁵

How supervisory authorities handle matters is another factor to consider, especially as numerous supervisory instructions for the same research topic (Shariah corporate governance) can bring about the specific phenomenon of regulatory multiplicity. Osemeka and Adegbite (2016) point out that, although regulatory multiplicity for one subject (e.g., corporate governance) in one country has advantages, such as the different sizes of institutions being considered as one size does not fit all, this multiplicity can have several drawbacks. On the one hand, the regulatory multiplicity of regimes poses a challenge for financial institutions to move from being subject to a supervisory authority with strict governance instructions to being subject to a supervisory authority with less intensive instructions. Moreover, regulatory multiplicity can undermine financial institutions' confidence in the regulatory authorities' seriousness in implementing corporate governance. Consequently, the regulatory multiplicity of regimes would create an atmosphere of uncertainty. On the other hand, Osemeka and Adegbite (2016) found that the plurality of regulatory systems in Nigeria creates conflict and contributes to the fact that the financial institutions adhere to particular regulatory instructions and avoid complying with certain other regulatory instructions. Subsequently, these

Mudarabah "is a special kind Shirkah – partnership – in which an investor or a group of investors provides capital to an agent or manager who has to trade with it; the profit is shared according to the pre-agreed proportion, while the loss has to be borne exclusively by the investor" (Ayub, 2007, pp. 320–321).

¹⁴ The value aspect of the *Musharakah* and *Mudarabah* tools is linked to the profit-loss sharing principle: that is, the financier and the investor both share the risks. For example, the financier may lose his money if the project does not achieve profits even if the investor (i.e., the Islamic bank) is not negligent. Moreover, the second aspect of the correlation of the *Musharakah* and *Mudarabah* with values is that they are linked to the real economy through projects such as building apartments, universities or hospitals.

¹⁵ *Murabaha* (mark-up financing) is "a credit sale (at a stated profit margin)" (Jatmiko, 2017, p. 29). Grais and Pellegrini (2006, p. 29) define it as follows: "the seller informs the buyer of his cost of acquiring or producing a specified product. The profit margin is then negotiated between them. The total cost is usually paid in instalments." *Tawarruq* is "a purchase of a commodity for a deferred payment and the buyer selling it for cash to a third party" (Ahmed and Mohammad, 2014, p. 5).

authors (Osemeka and Adegbite, 2016) advocate the necessity of harmonising corporate governance regulations and support the possibility of combining them to reduce conflict among them and ultimately to increase commitment to governance and the sustainability of companies' performance. Given there are three regulatory authorities that have issued Shariah corporate governance in the context of the current research – the Central Bank of Kuwait (CBK), Capital Markets Authority (CMA) and Insurance Regulatory Unit (IRU) – regulatory multiplicity may be occur as shown in Chapter 4.

Concerning Shariah corporate governance in Kuwait, several regulations have been issued by the leading supervisory authorities (CBK, CMA, IRU) on IFIs (banks, investment companies, real-estate companies and insurance companies). These regulations agree in some ways and differ in others, as future chapters will show. For example, forming an Shariah supervisory board (SSB) may be binding in the instructions of one body but optional according to the instructions of another supervisory body, and this may create a kind of uncertainty or a lack of seriousness in the application of Shariah corporate governance. In addition, regulatory multiplicity may pose several challenges to the regulated entities, as mentioned above. Notably, this aspect (regulatory multiplicity) has not been discussed in the previous literature on Shariah corporate governance in Kuwait or other GCC countries. The following section discusses in depth the various regulatory philosophies in dealing with Shariah corporate governance.

2.4.1.1 Shariah Corporate Governance from a Regulatory Perspective (Macro Level)

States deal with Shariah-related matters in different ways. Some favour distancing themselves from these, arguing that there is no need to intervene while SSBs exist in Islamic banks/IFIs, while others adopt a similar position to this but include a small degree of intervention via law or regulation, although this may be minimal. Alternatively, some adopt a proactive approach that does not let market forces control or direct Islamic finance practice; rather, their central banks take the initiative to lead the Islamic financial industry by having, for instance, their national Shariah authority issue detailed SSB regulations.

A leading Shariah corporate governance paper from the regulatory perspective (Ahmed, 2011) uses content analysis to divide Shariah corporate governance regimes into categories for evaluation and identifies four categories of Shariah corporate governance systems, by reference to their nature:

- 1) The existence of supportive/unsupportive laws and regulations (whether there are Islamic bank laws and regulations or only robust regulations).
- 2) Regulatory requirements for SSB issues and Shariah-related affairs (minimum number of SSB members, duties, qualifications, etc.). Also, the code of conduct may include a cap on the number of IFIs SSB members can serve.
- 3) Shariah supervision mechanisms at the state level by establishing an national Shariah authority.
- 4) Having SSB at an organisational level, where SSB regulatory requirements are absent, for instance, where an Islamic bank works in a country that has no specific SSB requirements, so the Islamic bank voluntarily established its own SSB.

In addition, Ahmed (2011) also noted four Shariah corporate governance regimes, in terms of legal and regulatory point of view:

- 1) Legally constructed (no SSB or national Shariah authority at either the organisational or institutional level, as existed in Iran).
- 2) Robust Shariah governance (with sound SSB arrangements at the organisational level and an national Shariah authority, as existing in Malaysia, Pakistan and Indonesia).

- 3) Passive Shariah governance (Shariah-related regulations and SSB at the organisational level only, as existing in the United Arab Emirates (UAE), Qatar and Kuwait).¹⁶
- 4) Market driven (similar to the first regime but without Islamic banking laws and regulations regarding SSB).

In light of the aforementioned Shariah corporate governance categories, Ahmed (2011) advises regulatory authorities (especially those in number three (passive Shariah corporate governance) and four (market driven) to intervene in Shariah-related affairs in IFIs, as regulatory intervention can protect other stakeholders' interests from toxic practices such as 'fatwa shopping', thereby minimising harm to the Islamic finance industry's credibility and maintaining independency as well as objectivity in SSB rulings and edicts. Another reason for national-level intervention is that Shariah compliance risks¹⁷(SCR) could lead to reputational risk, in the first instance, followed by a withdrawal risk, which may damage IFIs' credibility and consequently cause domino effects throughout the financial system. Moreover, the Islamic financial industry's extensive growth may result in various fatwas in the same aspects and jurisdictions. Consequently, the intervention of regulatory bodies is important for maintaining the credibility of edicts and preventing 'fatwa shopping', which can harm the industry's credibility.

Finally, Ahmed (2011) says two regulatory approaches for Shariah governance help overcome the abovementioned issues. The first involves strengthening Shariah governance at the bank (organisational) level via sound SG regulations that deal with all areas of concerns related to the SSB. These regulations should also address SSB members' qualifications (fit and proper criteria), the independence requirement, multi-membership of SSB members, etc. The second approach is to issue a complementary Shariah supervision mechanism at the

¹⁶ United Arab Emirates and Kuwait established their national Shariah authorities after Ahmed's (2011) study; therefore, they are no longer passive Shariah governance regimes.

¹⁷ Shariah compliance risk is "the possibility that a financial service or product is not or will not be in compliance with established Shariah principles and standards" (DeLorenzo, 2007, p. 397).

national level by having an national Shariah authority implement maximum Shariah objectives (beyond financial and social aspects) rather than minimising only Shariah non-compliance risks at the organisational level. Indeed, having an national Shariah authority in such a country has several advantages. Dealing and responding to all Shariah aspects at the macro level, which would affect and reflect on the micro level, is the first. The second is preventing the industry from controversial products such as *Tawarruq* (ex-ante), as mentioned earlier. Moreover, a national Shariah authority might provide the products that have met Islamic objectives (*Maqasid al-Shariah*).

Ahmed (2011) also evaluated Shariah corporate governance approaches, mentioning the pros and cons of each. There are several concerns regarding the fourth approach (SSB at Islamic bank only/ market driven), starting with or most immediately concerning the selection of SSB members who may be influenced by bank-owners' interests. Moreover, as the BOD and executive management choose and pay the SSB members, the latter's independence is questionable. Furthermore, this could create incentives for 'fatwa shopping' (Ahmed, 2011).

The second concern involves SSB members who tend to be more permissive towards Shariah requirements and thus will consequently more likely engage in a trade-off between economic factors and Shariah requirements, meaning that the laxer the Shariah governance regulatory framework is, the more trade-off there will be between *Maqasid Al-Shariah* and economic incentives. The probability of choosing diluted or controversial products would hence be high, even if there are other Shariah-based products available. In this regard, Kahf (2004, p. 27) states that "many of them – Shariah scholars – are now accused of being bankers' window dressing and over-stretching the rules of Shariah to provide easy fatwas for a new breed of bankers".

There are also concerns with the first legally constructed approach (neither central Shariah supervision at the national level nor SSB at the organisational level). As Ahmed's (2011) paper mentions, the entire Islamic finance industry relies on the details of Islamic commercial and banking law, so the degree of

creativity of Islamic banks and institutions' products and services might be limited as all requirements are stated clearly and emphatically in the law, leaving little room for interpretation. Furthermore, it may take longer to make changes in the law (matters need discussing and passing by the parliament).

Regarding the third approach (passive Shariah corporate governance), Ahmed (2011) argues that the regulatory authority distances itself from Shariah-related matters, even though, for instance, there is an explicit text (article 5)¹⁸ in UAE Federal Law No. 6 of 1985 regarding Islamic banks, financial institutions and investment companies about establishing a higher Shariah authority, nothing (e.g., an national Shariah authority) had been established between 1985 and 2018, and there are no detailed guidelines regarding SSBs at the organisational level.¹⁹ In Kuwait, Law No. 32 of 1968 concerning currency, the CBK and the organisation of banking business, article 93²⁰ stipulates that, in a conflict of opinion between SSB members and an Islamic bank, the latter's BOD may transfer the issue to the fatwa board in the Ministry of Endowments (*Awqaf*) and Islamic affairs. Moreover, article 93 requires each bank to have an SSB with at least three Shariah scholars.

The author concludes that the robust Shariah corporate governance approach is the ideal. Indeed, he argues that the Malaysian model of Shariah governance is the ideal for the Islamic financial industry, which mitigates Shariah-related risk at the macro level while simultaneously maintaining a suitable level of innovation at that level. However, the main gap is that Ahmed (2011) did not detail why the Malaysian regulatory Shariah governance regime is the best and the basis on which he chose this regime. In this vein, Farook and Farooq (2013) touch on some challenges facing the Islamic financial industry, the uniqueness of their paper being the solutions they provide regarding each challenge. They state that a main contemporary Islamic finance concern is the position of Islamic law in the transactions and products of IFIs – in other words, the extent to which

¹⁸ See Appendix 4.

¹⁹ See Appendix 4.

²⁰ See Appendix 4.

the benefits of IFI transactions and products are serving needy people or existing in rural areas (social aims). One could express a contrary opinion, however, and argue that this is not the business of IFIs. Instead, these institutions are financial intermediaries (making profit being their major aim) and not charity foundations. In addition, the scarcity of qualified Shariah scholars is another challenge the Islamic financial industry faces,²¹ Hence, Shariah non-compliance is a risk that threatens the industry's reputation if there are no serious solutions (short and long term) to deal with such challenges.

Farook and Farooq (2013) discuss three prominent Shariah corporate governance challenges in detail and offer pragmatic solutions for them:

- 1) The high cost of the Shariah compliance process and arrangements. For instance, the *sukuk*²² issuance documentation fee is between \$100,000 and \$250,000 per issuance. As mentioned in Farook and Farooq (2013, p. 140), Standard & Poor (S&P) confirmed that the *sukuk* issuance cost is relatively higher than the conventional bond. This could, in fact, hinder or at least slow the growth of the *sukuk* market. Therefore, the authors suggest distributing the cost of a broad range of transactions as one solution, with a second solution being to reduce the number of items that require fees (fees per transaction).

²¹ The reasons behind this aspect will be discussed later in this research.

²² *Sukuk* is an Arabic term; it is a plural of term *Sack* which means certificate. The term *Sukuk* is, broadly, translated as 'Islamic bonds' although the correct translation is "Islamic Investment Certificates" (Afshar, 2013, p. 45). The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) officially defined *Sukuk* as certificates of equal value representing undivided shares in ownership of tangible assets, usufruct, and services (AAOIFI, 2008) (El Mosaid and Boutti, 2014, p. 226).

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2) The conflicts of interest among Shariah scholars (SSs), BODs and executives. As SSs are usually nominated by an IFI/IB or a BOD and approved by the general assembly, this might affect their willingness to voice an objection on some proposed products. Furthermore, the existence of Shariah scholars in multiple SSBs in the same sector may cause conflicts of interest. As the authors say, the Secretary General of the Auditing Organization for Islamic Financial Institutions (AAOIFI),²³ Dr Nedal Alchaar, has publicly noted this concern, saying that “there is a potential case for conflict of interest, and a case of information leakage or perhaps competition impact” (El Baltaji and Anwar, 2010 cited in Farook and Farooq, 2013, p. 141). Abozaid (2016, p. 225) touches on this point and argues that a third party ought to intervene and “break the bond of interest between the aforementioned parts”. The rationale behind this is that Shariah scholars are not angels, and they are exposed to the inducements of monetary incentives and positions as well. Consequently, Farook and Farooq (2013) and Abozaid (2016) suggest that the most appropriate third party to deal with such an issue is the regulatory authority, meaning either the central banks or the capital market authorities. As a solution, they recommend establishing a central Shariah board to deal with compensation for Shariah scholars, their appointment and dismissal, and the identification of institutions they can serve (e.g., Pakistan and Malaysia have banned Shariah scholars from sitting in more than one SSB in one sector). However, the authors claim that governmental intervention through an national Shariah authority is fraught

²³ The AAOIFI was established in 1991 and is based in Bahrain (see earlier). It “is the leading international not-for-profit organisation primarily responsible for the development and issuance of standards for the global Islamic finance industry. It has issued a total of 100 standards in the areas of Shariah, accounting, auditing, ethics and governance for international Islamic finance” (AAOIFI, 2019).

with peril – for instance, there could be a kind of intervention into Shariah scholars duties, or some pressures put on them to pass a certain decision against their will (through fatwas). Nonetheless, the proposed solution (establishing an national Shariah authority) is better than leaving the industry having no guidelines (market driven).

- 3) SSBs’ multi-membership is a challenge that may arise with massive industry growth without a parallel growth of qualified Shariah scholars, which may be an even more significant issue considering that many of the regulatory authorities prefer to distance themselves from Shariah-related matters. Consequently, Shariah scholars have been appointed to several SSBs in the same sector and country. Interesting findings by Unal and Ley (2008, as cited in Grassa, 2013, p. 180) show that:

Three specific scholars are members of twenty-six percent of all Shariah Boards in the GCC. There are also differing levels of activity between scholars (from a total of 121 studied): approximately 56 scholars holding fewer board positions, whereas the top 10 scholars hold on average more than 25 board positions.

Furthermore, the governor of the CBK, Dr Mohammad Al-Hashel, has identified similar serious findings but with updated data (CBK, 2018)²⁴ – namely, of 1075 Shariah scholars sitting in 1,400 IFIs, eight scholars occupy over 30 board seats each. This scarcity (lack of sufficient knowledgeable Shariah scholars) is a challenge for the industry, but it does not stop here. In fact, it becomes much more serious when scrutinising other figures on IFIs SSB seat occupancy (three scholars having over 70 board seats each). One can thus imagine the astronomical income of the five star Shariah scholars, as the authors described

²⁴ Keynote speech, CBK-IFSB Islamic Financial Conference: Universal Value Proposition, 2nd May 2018.

them. The authors add that a scholar can earn up to \$150,000 for one project that may require only six weeks of work, at most. Nevertheless, the effort required to review all the documentation of new products (i.e., *sukuk*) or prepare themselves for regular SSB meetings is extensive. In this respect, the authors (Farook and Farooq, 2013) argue that a high-quality Shariah compliance process requires more time and effort spent on reviewing IFIs' products and transactions, though another solution is to employ more SSB members in the industry rather than have few occupy many seats, which arguably invites various issues such as undesired shortcuts. Indeed, the well-known Shariah scholars often read only the executive summaries of a junior scholar's documents or items that the Shariah auditor teams prepare. Another related sub-issue is that the renowned Shariah scholars are not extensively engaged in transferring their know-how to the new generation of Shariah scholars. Accordingly, the authors argue that these issues are a symptom of regulators failing to set a cap on the number of Shariah scholars serving in each IFI (as mentioned above).

A solution to this issue is to have regulatory boundaries such as those of the Malaysian²⁵, Pakistani²⁶ and Omani regulations regarding the multi-membership of Shariah scholars. For instance, the Islamic Banking Regulatory Framework in Oman banned SSB members from sitting on more than one SSB in one sector (i.e., the banking sector), but the Islamic Banking Regulatory Framework allows them to sit in more than one SSB in different sectors overall (i.e., banking, financial and insurance sectors), although no more than four simultaneous SSB memberships in Oman are permitted²⁷ (Central Bank of Oman, 2012). Such a limit may have several benefits. First, it can minimise the probability of conflicts of interest. Second, it might be a part of a succession plan – that is, opening the door for young Shariah scholars to learn from senior Shariah scholars and from their opinions. Third, it may solve the confidentiality issue relating to SSB multi-membership (i.e., leaking confidential information about one institution to a rival).

²⁵ See Appendix 4.

²⁶ See Appendix 4.

²⁷ See Appendix 4.

Farook and Farooq (2013) similarly touch on these and related challenges, including the dearth of educational Islamic economics and finance programmes at different academic levels (bachelor's, master's and doctoral), the issue with the Shariah scholars performing their due diligence while they are members of dozens of SSBs, and the importance of equipping young Shariah scholars and Shariah auditors with appropriate professional training regarding banking, finance, accounting and Shariah auditing procedures. On the last of these, the AAOIFI does have its own certificate to denote a certified Shariah adviser and auditor. Also, the CBK announced its own certified Shariah auditor from 3 March 2019 in collaboration with the Institute of Banking Studies (IBS)²⁸ (CBK, 2019).

Recently, AlQassar and Ahmed's (2022) comparative study of Shariah corporate governance (or Shariah governance regime – SGR) covered four countries (Malaysia, Pakistan, United Arab Emirates and Kuwait). Employing legitimacy theory, they studied the laws and regulations concerning Shariah corporate governance in light of the international guidelines and standards issued by standard-setter institutions within Islamic finance, namely, the AAOIFI and Islamic Financial Services Board (IFSB). Their research methodology was qualitative – content analysis using the leximetrics mechanism, with leximetrics being “the process of translating legal materials, principally texts of statutes, decrees and judgments, into a form which can be used in statistical analysis” (Adams et al., 2017, p. 7). The most important goal of AlQassar and Ahmed's (2022) paper concerned forming policies and recommendations for enhancing adherence to the provisions and purposes of Islamic law, and combatting fraud in transactions, through the presence of laws, regulations and supportive instructions from countries.

²⁸ Up until writing this thesis, Institute of Banking Studies (the programme administrator) has established four programmes for certified Shariah audits (each programme lasting for five weeks, with intensive content). At the end of the programme, each trainee must pass the exam to obtain this certificate.

Moreover, 15 Shariah corporate governance indicators have been investigated at the macro-level (regulatory framework) and micro-level (organisational – SSB).²⁹ These indicators are considered a practical tool for evaluating the strengths and weaknesses of any Shariah corporate governance system and developing them commensurately with each country's environment and international best practices. The results suggest that Malaysia has the most robust Shariah governance regime while UAE has the weakest legal and regulatory environment of Shariah governance. Furthermore, the AlQassar and Ahmed (2022) reveal that the regulatory framework in Pakistan for SSBs can be further improved at the organisational level while the Shariah governance regulatory framework in Kuwait can be further strengthened. It also shows the diversity in the qualitative nature of Shariah governance regime in terms of the laws and regulations used to establish Shariah governance regime in different countries. Although in Malaysia both laws and regulations are used for this, regulations determine Shariah governance regime in Pakistan and Kuwait, while laws are used for the same in UAE. Furthermore, in UAE the Higher Shariah Authority is responsible for determining various aspects of Shariah governance regime. From a regulatory perspective, hence, it is desirable to introduce international standards of Shariah governance to promote growth and ensure the stability of the Islamic finance sector.

Although the authors' paper offers a valid tool for assessing Shariah corporate governance regulations, there are caveats. First, it deals only with the published laws and regulations relating to Shariah corporate governance, which may not provide sufficient depth to study this phenomenon. Also, it does not address those countries' institutional aspects (social, legal and political) that influence the actual application of Shariah corporate governance. This significant gap in AlQassar and Ahmed's (2022) paper has inspired the current study to examine

²⁹ Shariah governance indicators-Regulatory framework: BOD responsibilities related to Shariah issues, BOD committees, internal Shariah audit, Shariah reporting and transparency, central Shariah board, standardisation of Shariah rulings.

Shariah governance indicators-SSB: SSB appointment, competence (fit and proper), independence, confidentiality, consistency, compensation and dismissal, cross-membership, assessment of SSB members (AlQassar and Ahmed, 2022).

the institutional aspects in the Kuwaiti context with respect to Shariah corporate governance.

In the realm of regulation and effective regulations, the ‘regulatory unreasonableness’ concept suggested by Boyum (1983, p. 752)) is crucial in understanding the probable reasons for regulatory failure and this term denotes how “regulatory requirements are unreasonable if compliance wouldn’t yield the intended benefits. Further, a regulatory requirement is unreasonable if compliance would entail costs that clearly exceed the resulting social benefits. Finally, unreasonableness means cost-ineffectiveness”. On this last point, Boyum (1983) noted two kinds of cost-ineffectiveness that lead to regulatory unreasonableness. The first is at the rule level and involves aggregate economic inefficiency. The second is at the site level and relates to the duality of the regulator and the regulated entities. More specifically, at site-level regulatory unreasonableness, sometimes a regulatory authority tries to unify its regulations irrespective of their size, importance and the regulated institutions’ resources. Such institutions are not always able to incorporate certain regulations, which Boyum (1983) termed as the ‘capacity to comply’. For instance, a small IFI with limited resources cannot appoint three SSB members and a designated Shariah audit department, as this could circumvent instructions (e.g., small IFI may appoint unqualified Shariah scholars). Furthermore, ‘over-inclusiveness’ of legal rules also leads to regulatory unreasonableness. To illustrate, regulators could think that they can perceive every kind of possible violation, but in reality, some of these would not exist.

In this vein, regulatory unreasonableness may be deemed part of regulatory failure when the regulations do not deliver their objectives. Windholz (2017) has discussed regulatory failure in detail and proposed reasons for it. Baldwin et al. (2012, p. 69) enumerated reasons for regulatory failure under a common overarching cause when stating that “the failings usually involve poor performance in discharging the core tasks of regulation: detecting undesirable behaviour; developing responses and intervention tools to deal with errant behaviour; enforcing those tools on the ground; and assessing and modifying regulatory

performance”. Saurwein (2011) suggested it would be beneficial to evaluate the current regulatory approach and use ‘enabling contextual factors’.³⁰ Some of these, as with the industry’s reputational sensitivity, may be appropriate for considering even though they are not necessarily applicable or relevant to the Kuwaiti setting. In fact, this aspect (reputational sensitivity) is useful in identifying the most appropriate regulatory approach because the Islamic financial industry is particularly sensitive to public trust and credibility, especially with an IFI’s Shariah non-compliance event.

Broadly speaking, there are unique characteristics within specific contexts for each country that determine the suitability and appropriateness of the regulatory approach of corporate governance and Shariah corporate governance. Based on institutional theory, Nakpodia and Adegbite (2018) investigate the role and effects on corporate governance practices of three different types of elites (political, cultural and religious) in Nigeria. They argue that the institutional voids in corporations may allow various kinds of elites to leverage their interests. The first category, cultural elites, includes three types of such leverages: social inequality, respect for age and submissiveness to authority. In short, this category indicates that corporate governance regulation may not be obeyed by influential executives because of some BOD members’ exaggerated respect for their elders. In such a case, the CG regulations would be merely ‘ink on the paper’.

The second category comprises religious elites. The data analysed in Nakpodia and Adegbite’s (2018) study reveals that, despite the positive relationship between religion and corporate governance (as religion encourages ethics and morality) there are indicators that some religious leaders use their position for

³⁰ Enabling contextual factors include: (1) the economic benefits for the industry; (2) the reputational sensitivity of the industry; (3) the intervention capacity of governmental actors; (4) the impact of regulatory failure and the need for uniform and binding minimum standards; (5) the required intensity of regulatory intervention; (6) the conflict between public and private interests; (7) the number of participants and market fragmentation; (8) the ability of organisations to assume regulatory tasks; (9) the intensity of competition; (10) the extent to which the existing industry culture supports the public policy objectives; and (11) the involvement of governmental actors (Saurwein, 2011, pp. 342–350).

their own benefit and not that of the company. The third category comprises political elites, who Nakpodia and Adegbite (2018) say are the most influential regarding corporate governance practices in Nigeria. Weak law enforcement tools lead to these people being deemed as superior to regulators in terms of power or influence. This means that this influential class (political elites) controls what is issued by the regulatory authorities so that it does not affect their interests. In addition, misunderstandings about people's rights and democracy may raise the possibility that corrupt elites will fill the institutional voids (Nakpodia and Adegbite, 2018).

Nakpodia and Adegbite (2018) nevertheless reveal that if the Nigerian authorities pay attention to the weaknesses of institutional voids and boost the rule of law, then they can minimise corruption. In other words, implementing law enforcement tools and driving awareness of their importance may reduce the impact corrupt elites have on corporate governance practices in Nigeria. These three aforementioned aspects partly address the influential role of macro determinants in corporate governance practices, but there are further aspects of corporate governance that cannot be overlooked, such as legislation and the regulations themselves. Also, the study by these authors focuses only on companies listed on the Nigerian Stock Exchange, and other types of firms could offer different insights into this topic (e.g., SMEs and state-owned companies). Also, this limitation motivated this research in assessing the influence of Kuwaiti elites in the context of Shariah corporate governance, as will be seen in Chapters 4 and 5. The subsequent sections explored the Kuwaiti social, legal, and political context, and how it influences Shariah corporate governance.

2.4.2 Social Context

A tradition and on-going custom of Kuwaiti society, which forms part of its clear features, is the so-called *diwaniyya*, which Alnajjar (2000) and Al-Kandari (2016) both call a socio-political institution in Kuwaiti society but the former more specifically sees it as “the traditional meeting area adjacent to a Kuwaiti home” (Alnajjar, 2000, p. 257). Even more comprehensively, Alhajeri (2010, p. 25) defines the *diwaniyya* as “an informal political, cultural, and social outlet

where common and elite people alike can meet to discuss the society's affairs". As such, the *diwaniyya* is an essential place wherein public opinion is formed, and, unsurprisingly, various segments of society are keen to visit it, including politicians, economists, Shariah scholars, National Assembly candidates and others.

In Kuwaiti history, the *diwaniyyas* played a significant role in expressing the rejection of the unconstitutional dissolution of the Kuwaiti National Assembly in 1986. In 1989, former parliamentarians and political figures and parties in Kuwaiti society were called on to gather every Monday of every week in the *diwaniyya* and deliver speeches rejecting the continued dissolution of parliament, the return to work on the country's constitution and the return of parliament in events that were consequently called 'Monday's *diwaniyyas*' (Alnajjar, 2000).

The *diwaniyya* is a primary reason for Kuwaiti society being seen as extremely socially connected, with social connectedness being "the sense of belonging based on the appraisal of having sufficient close social contacts" (Van Bel et al., 2008, p. 3132). The most suitable description with respect to the Kuwaiti context derives from Diemer and Regan's (2022) suggestions about how social connectedness is an informal network or a less structured channel which may unintentionally strengthen relationships or convey knowledge. Another perception of social connectedness relates to the ideas of belonging and intimacy (Rettie, 2003; cited in Visser et al., 2011), meaning belonging to a group of or numerous groups of family and/or friends. In summary, five dimensions describe the various types/extents of social connectedness:

- 1) *Relationship saliency* – the prominence of the relationship in one's mind, which is the outcome of thinking of another person or being aware of him/her.
- 2) *Closeness* – the experience of feeling close to another. This does not relate to physical proximity, but rather to the social presence in one's mind.

- 3) *Contact quality* – the perceived quality of social contact with another person.
- 4) *Knowing each other's experiences* – being aware of each other's experience, both in terms of subjective experiences (e.g., love, enjoyment, sadness) as well as awareness of things that happen in one's life.
- 5) *Shared understanding* – having a similar view on the world; having similar opinions and being on the same wavelength.

(Van Bel et al., 2008, p. 132)

At least one dimension (e.g., closeness) or more could perhaps influence the relationships among various Shariah corporate governance-concerned parties, and SSB members may change their opinion as an SSB member in some way or even merely dilute it because of social connectedness. However, Kuwaiti society has notably been built on visits and social courtesies, so a mere weekly or monthly visit by a board member of an IFI to an SSB member's *diwaniyya* may not pose a threat to the governance principles such as independence or create a conflict of interest. In the context of this research, it is natural for there to be synergy and communication between those concerned with Shariah corporate governance in Islamic financial institutions, including members of boards of directors, executive managers, Shariah scholars who sit on SSBs and Shariah auditors. There are evidently various possibilities regarding such influence, but these are currently mere speculation. Despite the importance of this possible effect, no studies have hitherto been conducted to explore whether there is a negative or positive impact of *diwaniyya* on the practices of Shariah corporate governance in Kuwait. In addition to the social aspect, the Kuwaiti legal context is essential as it has significant repercussions on the Islamic financial industry, especially Sharia governance, which the next section discusses.

2.4.3 Legal Context

Islamic financial institutions' legal and legislative aspects are essential in several respects. First and foremost, the law recognises the uniqueness of IFIs and thus their distinctness from their conventional counterparts. As such, the supervisory

institutions deal with IFIs in a manner appropriate to their nature. Second, the law allows IFIs to operate within a clear framework and defined terms of reference that do not accept different interpretations by a judge in case of a dispute. Third, the law provides IFIs with the necessary support from the supervisory institution. Fourthly, the law provides an appropriate means for those dealing with IFIs in the event of a dispute between parties to be resolved under the law regulating those institutions.

Based on the foregoing, an important legal challenge in this regard is the insufficiency of laws and regulations that deal with Islamic financial products. For example, there is what is called *Ijarah Muntahia Bittamleek*. The courts in the GCC (especially in Kuwait) consider this product a loan, but it is not. The danger of this challenge thus lies in the fact that the products of IFIs are not supported by legislation, and this may cause these institutions financial losses. In other words, such a challenge led to “the unenforceability of contracts” (Ginena, 2014, p. 91). Also, there is a reputational risk to the Islamic financial industry as a whole, because if these issues were to increase then customers’ perceptions of Islamic financial institutions would be negatively affected. The reason for this is that Islamic financial institutions do not offer products based on Islamic law but rather copy the products offered by conventional financial institutions with the addition of some Islamic labels.

Nadar (2009), Ginena (2014), and Labanieh et al. (2019) have all suggested a proposed method for dealing with this legal problem, in addition to the disputes that occur between the concerned parties of Islamic financial institutions, namely arbitration. For this research, arbitration is a dispute resolution mechanism that is also known as *tahkim* in Arabic (Labanieh et al., 2019). In the Kuwaiti context, arbitration in Islamic financial transactions cases, the suitability of this tool (arbitration) for Kuwait, and the Shariah corporate governance challenges in the Kuwaiti legal environment is scarcely mentioned in the literature. Hence, this research contributed in two aspects: assessing the legal status and discussing and proposing appropriate solutions to the challenges through those concerned with Islamic financial institutions (see Chapter 4). The

following section discusses the fourth macro institutional effect, the political context.

2.4.4 Political Context

Considering what the researcher indicated in section (1.6) in the political context, starting with the three constitutional authorities, passing through the political and intellectual currents in Kuwait, and ending with the public benefits associations, the Islamic financial industry in Kuwait is closely linked to the political aspect, especially when establishing Islamic financial institutions.

Al-Kandari (2021) believes that Islamist intellectual activity led to the establishment of the Dubai Islamic Bank in 1975 in the UAE and the Kuwait Finance House in 1977 in Kuwait. A committee was formed to establish an Islamic banking institution as an alternative for those who do not wish to deal with conventional financial institutions (interest-based). This committee developed an integrated proposal for establishing an Islamic Shariah-compliant banking institution. It was presented to the government of Kuwait in the early 1970s. However, the proposal was rejected because it was deemed “incompatible with interest-based international banking systems” (Al-Kandari, 2021, p. 233). In addition, the Kuwaiti Parliament at the time (the beginning of the 1970s) was dominated by liberals, government officials, and independents who opposed the establishment of an Islamic bank. Therefore, it was likely that the Kuwaiti National Assembly would not approve a law establishing an Islamic banking company, as there were insufficient advocates for the concept. In 1976, during the five-year dissolution of the Kuwaiti National Assembly (1976 to 1981), the first Islamic financial institution, the Kuwait Finance House, was established. This was done by Decree-Law No. 72 of 1977 to establish the Kuwait Finance House. The Kuwaiti government owns 49% of the bank’s (Kuwait Finance House) shares, while the public owns the rest (51%) through public subscription (Al-Kandari, 2021).

Suppose we consider the political background to the conditions for the emergence of Islamic financial institutions with the nature of the interconnected Kuwaiti society (especially through the *diwaniyya*, see section 2.4.2). It could

be an intellectual and political influence on Shariah governance. In this context, as previously noted, Kuwaiti society is socially connected, most notably through the *diwaniyya*, where politics and public affairs dominate the conversations. As Alhajeri (2010, p. 29) explains, it is similarly significant in Kuwaiti's history:

Economic growth, with its accompanying cultural and social changes, drove the Kuwaiti *diwaniyya* to play a leading role in fostering participation in public affairs at a time when no political organizations or parties existed. Gradually, the *diwaniyya* changed from a place of casual discussion and social interaction into a platform for all Kuwaitis to discuss crucial financial, social, and cultural issues.

Additionally, Alnajjar (2000) believes that *diwaniyya* has gone beyond being only social and has also become political. He says (p. 257):

They [*diwaniyyas*] are considered social institutions; however, their political role far exceeds the seemingly purely social function for which the institution seems designed. Almost all elections and important political meetings prior to the 1950s were held in *diwaniyyas*, which put the institution in the forefront of political progress. It has been the place from which election campaigns of the post-independence era have been launched. No candidate can win without meeting with the major *diwaniyyas* of his constituency.

Based on the preceding comments, *diwaniyyas* have a significant social and political impact in Kuwait. However, there has been no research into the impact of these *diwaniyyas*, as they have evolved into socio-political institutions, on those concerned with Shariah supervision (Shariah supervisory board members; Shariah auditors) in terms of independence and professionalism. Hence, this research has contributed to bridging this gap, as it has examined the extent of the impact of political aspects on the professionalism of those involved in

Shariah supervision in Islamic financial institutions. The next section addresses the micro-level contextual effects of Shariah corporate governance in Kuwait.

2.5 Shariah Corporate Governance in Islamic Financial Institutions (Micro Level)

People's well-being and the prosperity of humanity are generally deemed the main objectives of Islamic law, or *Maqasid al-Shariah*. As Shariah compliance is the main objective of Shariah corporate governance, various research studies have addressed Shariah corporate governance from regulatory and organisational perspectives (Abozaid, 2016; Ginena and Hamid, 2015; Grassa, 2013). For instance, Grais and Pellegrini (2006) address the SSB's internal arrangement and discuss the complementary or external approach but also evaluate existing approaches (corporate governance in IFIs). For these authors, the meaning of adhering to Islamic principles includes the following:

- 1) Not engaging in activities harmful to individuals and societies (e.g., selling and buying alcohol, gambling).
- 2) Not engaging in interest-based transactions (usury loans).
- 3) Not dealing with products that are separate from the real economy (financial derivatives).

An IFI's internal arrangements include establishing an autonomous body that specialises in Shariah aspects and which is composed of various Shariah scholars. According to AlKhalifi (2003; cited in Alkamees, 2012), SSB independence allows it to perform independently. Indeed, SSB members should not be influenced by any form of pressure (e.g., from IFIs' management teams or shareholders) that could negatively impact on their decisions but also any other member functions, which Grais and Pellegrini (2006) say total five: (1) approve products and transactions (*ex-ante*) by issuing edicts (fatwas); (2) review the application of edicts after launching the products (*ex-post*); (3) advise

the BOD and the executives on Shariah matters; (4) calculate *Zakat*³¹ on behalf of shareholders; (5) and decide on where to donate earnings that are not Shariah compliant. All these functions have specific core aims but are overall about ensuring conformity with Shariah principles within all transactions and with all products IFIs provide. They are hence also a means of maintaining the reputation of the Islamic finance industry – the cornerstone of their business. Having proper SSB arrangements and Shariah corporate governance thus facilitates financial stability within the banking and financial system.

Regarding SSB members, Grais and Pellegrini (2006) mention various conditions for an SSB's sound supervisory role, such as independency of jurists (Shariah scholars). SSB members are independent in theory as BODs nominate them and shareholders (the general assembly) appoint them. Practically, though, some pressures are exerted from management when jurists try to issue an objective opinion regarding a product or service. Sometimes managers use their leverage to direct or influence the edicts, so they are more lenient; in other words, they dilute Shariah principles (Ahmed and Chapra, 2002). This results in what is commonly called 'fatwa shopping',³² or "the act of looking around for a friendly ruling on the compliance of a particular finance product" (Oseni et al., 2016, p. 121). Ullah et al. (2018) also mention a certain form of pressure from IFIs' management teams or BODs on SSB members as being the threat of not renewing for the next session, which is concerns management coercion. As Ullah et al. (2018, p. 908) say:

They – IFIs BODs – even threaten our jobs! Once the bank asked me to consider a structure, which I found repugnant to Shariah, and I rejected it. Then I got a phone call from the president saying, 'I need you to approve the structure. I will call you after 5 min and I need a positive answer, otherwise I will take my action'. I told him, 'What

³¹ *Zakat* is one of the five pillars of Islam, and it can be briefly described as a tax on wealth (Grais and Pellegrini, 2006, p. 7).

³² Ullah et al., (2018, p. 896) called it 'fatwa repositioning' and defined it as "the covert skirmish for adjusting the level of Shariah compliance by Shariah scholars and managers in order to achieve their respective objectives".

action are you taking after 5 min? You can take that action now because my answer will be the same after 5 min.'

In this vein, there exists a view (Abdel Karim, 1990) not only that the Shariah supervisory boards' independence is equivalent to auditors' independence but also that those appointed by the (general assembly) are themselves the auditors. If this is so, why criticise the method of appointment for Shariah supervisory boards and not that for appointing auditors? Perhaps first we should consider whether these two do indeed share similarities, and Abdel Karim (1990) suggests several between them. First, they both ensure that management conducts required operations. Secondly, both issue a report at the end of the financial year (the SSB's report aims to confirm the extent of the institution's commitment to the principles and provisions of Islamic law in its operations; the external auditor's report is about confirming that the financial statements the institution issued were made in accordance with the approved accounting standards). As with intention of these reports, there are several differences between the SSB and the external auditor, especially how the former depends primarily on moral and religious responsibility in detecting violations of Islamic Shariah principles while the latter depends mainly on economic and monetary motives in the audit and review process. In this regard (the economic aspect), Moizer (1986, cited in Abdel Karim, 1990, p. 6) notes the following:

- 1) The value of the auditor's economic interest that will be lost if the auditor upsets company management.
- 2) The probability that the client will dispense with the auditor's services should he or she disclose a breach by management.
- 3) The loss of future net revenues that will occur as a result of the loss of reputation suffered by the auditor when misconduct is made public.

Abdel Karim (1990) argued that these points are not applicable to the SSB member or the religious auditor as their standpoints are religious and ethical, and it is inconceivable that their economic preferences take precedence over

religious and moral goals. This is nevertheless debatable and has been the subject of investigation for those interviewed in this research.

Alkhamees (2012) believes that the independence of the Shariah Supervisory Board has five considerations that may yield negative influence: appointment method, high remuneration, providing loans to SSB members, ownership of shares in the IFIs where the member of the SSB works, and serving as an executive in the IFI. On the appointment aspect, one opinion suggests that the appointment of the SSB through an IFI's AGM is one of the best practices and brings much independence, while the opposing view believes that, while ostensibly being independent, the IFI's BOD will not nominate members who have an intellectual disagreement with them or are known for not favouring the opinion of board members in a particular product or service. Also, sometimes BOD members threaten the members of the authority not to renew their contracts for the next term to pressure them into agreeing to a particular product or service, which leans towards the second opinion (hence the independence of SSB members is at stake).

If this is an issue, Alkhamees (2012) pointed out two ways of increasing objectivity in SSB member selections. The first is to submit the nominated SSB members beforehand to the regulatory body (central bank or capital market authority) to approve them before appointing them through the general assembly. The second is to assess the nominated SSB members' competence (whether they are 'fit and proper') through an international Shariah body that comprises renowned Shariah scholars. Indeed, the first suggestion is already applied in several countries such as UAE and Malaysia, according to Alkhamees (2012), while the second may not be applicable for a couple of reasons. On the one hand, the proposed international Shariah body may not be recognised locally and thus its decisions and recommendations become for reference only so are not legally binding locally. On the other hand, it is practically difficult to ensure that an international institution should have the final say in a local matter. Notwithstanding the foregoing, the second proposal (international Shariah body)

is worth researching. Hence, the current research considered this aspect (SSB independence) from interviewees' perspectives in the Kuwaiti context.

A further requirement is confidentiality, as SSB members should keep secret their discussions in particular institutions, though in some cases the multi-membership of jurists within several IFIs in the same country may affect such compartmentalised confidentiality. As Nawaz et al. (2021, p. 15) note, although having prominent scholars on an Islamic bank's SSB increases profitability, it can also "reduce market value possibly due to the market perceiving them as less independent and too busy to actually perform their role effectively". Accordingly, some jurisdictions have prohibited jurists' multi-membership within the same sector – as has happened with, for example, the Central Bank of Malaysia (Bank Negara Malaysia) whereby a scholar who sits on a bank SSB cannot sit on another bank's SSB. Although this may help minimise the confidentiality issue, it could simultaneously create another challenge regarding lack of knowledge and shortage of qualified scholars.

Contrasting studies that link the membership multiplicity of Shariah scholars in SSBs to a lack of time and effort spent on Shariah supervision (e.g., Ullah et al., 2018; Abd Razak, 2019) found that membership multiplicity, from a Shariah perspective, is neither negative nor positive, but there are three opinions about this matter. The first sees membership multiplicity as obligatory to increase Shariah scholars' horizons and their practical experience via their exposure to different situations and peoples. The second makes membership multiplicity permissible – not forbidden or recommended – because the Shariah scholar possesses the qualifications and can conduct his responsibilities without negligence. The third deems membership multiplicity as impermissible, especially if it causes the Shariah scholar's failure to fulfil the responsibilities entrusted to him by an IFI's shareholders and this endangers their interests. While the issue of multiple memberships evidently elicits different viewpoints, it is also subject to the context in which Islamic financial institutions operate, so as with aforementioned aspects, a one-size-fits-all principle cannot be applied.

Although numerous studies, for example Ferris et al. (2003), mention that multi-directorships may serve as a proxy for reputational capital, with such individuals seen as high-quality directors (especially, as noted, because serving on many boards can equip them with diverse experience), multi-membership proponents still encounter strong opposition from certain organisations (e.g., some regulators). Ferris et al.'s (2003) findings do not, however, support such calls from professional bodies such as the International Council for Institutional Investors and Corporate Governance to limit directors' memberships to one. Indeed, the authors suggest that there is no clear evidence to support the 'busyness hypothesis'³³ that implies multiple board memberships may reduce executive directors' oversight or the company's value. Equally, though, there is also no evidence to support the hypothesis that the fewer a member's membership in board committees, the more productive or effective he is. Furthermore, no solid statistical evidence exists to support the hypothesis that companies with multi-memberships members are vulnerable to embezzlement and fraud. Although this study (Ferris et al., 2003) is not in the context of the Shariah corporate governance of IFIs, it supports the claim that the 'busyness hypothesis' for SSB members may reduce performance of their supervisory responsibilities. In other words, multi-membership could threaten Shariah supervision.

However, Nomran et al.'s (2018) study of Malaysian Islamic banks deems cross-memberships for SSB members as positively impacting on the SSBs' performance, as members expand their knowledge, gain other experiences, interact with different people, discuss a more significant number of other scholars' views and hear more questions (and answers). As their horizons and perceptions expand, they may not only gain further understanding of Islamic financial products and services but also their challenges.

³³ According to Ferris et al. (2003, p. 1088), the "busyness hypothesis of corporate directorships postulates that serving on multiple boards overcommits an individual. As a consequence, such individuals shirk their responsibilities as directors".

A third Shariah corporate governance requirement in the micro-level mentioned by Grais and Pelligrini (2006) is competence (i.e., an individual being deemed fit and proper), meaning that SSB jurists should be knowledgeable and well qualified. Knowledgeable means the Shariah scholar has at least a bachelor's degree in Shariah *Usul al-Fiqh* (the origin of Islamic law), especially in commercial and accounting practices (*Fiqh al-Muamalat*). The Shariah scholar should also be familiar with the basics of economics, banking and commerce so as to be able to deal with business situations. Nowadays, for instance, some regulatory authorities (e.g., the CBK) have developed a specialised certificate concerning Islamic finance and banking and Shariah audits. Such initiatives would provide the market with qualified human resources to deal with sophisticated financial products from the Shariah perspective.

Haridan et al. (2018) have investigated the influence of SSBs' governance role on preserving Shariah compliance and the issues such as competence, independence and effectiveness in light of the Malaysian Shariah governance framework. They point out that, despite Shariah governance framework's positive impact on Islamic banks in general, several issues need considering such as SSB members' lack of knowledge of banking and finance aspects and the internal Shariah audit's heavy reliance on SSB members perhaps affecting the SSB. Accordingly, Haridan et al. (2018) recommend segregating the review function of the SSB to external Shariah audit and preserving the advisory role of the SSB.

The fourth Shariah corporate governance requirement in the micro-level mentioned by Grais and Pelligrini (2006) is consistency. This means the consistency regarding fatwas requires fatwas of similar products in different Islamic banks /IFIs to be in accord. The real issue, in fact, is that different edicts for the same product within the same jurisdiction would put confidence in the industry at risk, potentially hindering the Islamic financial industry's growth.

A fifth requirement includes the disclosure of Shariah-related aspects, specifically, disclosing information such as SSB fatwas, SSB members'

attendance rate at meetings and their remuneration, and SSB competences and compositions should enhance IFI transparency (Grassa, 2013). Consequently, this step would enhance an IFI's credibility, which is the cornerstone of the Islamic financial industry and the broader banking system's financial stability. Although the presence of SSB positively correlates with banks' risk disclosure level (Elamer et al., 2019), it is supposed to be more rooted according to Islamic law principles in the IFIs (Abu-Tapanjeh, 2009). Moreover, Albassam and Ntim's (2017, p. 185) study on Saudi listed companies indicates how "[c]orporations that depict greater commitment towards incorporating Islamic values into their operations [i.e., with the presence of SSB] through high Islamic values disclosure index score engage in higher voluntary corporate governance disclosures than those that are not".

Grais and Pellegrini (2006), however, say that IFIs' transparency is poor as few disclose Shariah compliance information in their annual reports. At p. 12, the authors also note the following about seven out of the 13 Islamic banks investigated:

They did not provide detailed information on the professional background of SSB members. Moreover, only two banks disclosed the fatwas authorising the provision of financial services and products. Only one disclosed a provision for decision-making and interaction with other bodies of the firm. Finally, only one institution disclosed on its website the duties and obligations of the SSB.

Furthermore, Alkhamees (2012) indicated a lack of sufficient transparency and disclosure in IFIs regarding Shariah corporate governance and related aspects, including SSB members' remunerations, the publication of the SSBs' fatwas, SSB members' academic and professional qualifications, the Shariah violations committed during the financial year, and the banks' percentage-to-total profits and how to deal with them. Notably, Alkhamees's (2012) work was not contextually limited to one country as it studied and compared the annual reports of Islamic banks in both the Kingdom of Saudi Arabia (KSA) and the UK

regarding their disclosure practices concerning Shariah governance. They found that, in general, the disclosure culture is better in the UK than in the KSA, perhaps because of the former's democratic political system and the greater transparency this requires. There was nevertheless a reluctance in both countries' Islamic banks to disclose the financial rewards SSB members received. Indeed, despite the importance of publishing the SSB's fatwas for raising public awareness about Islamic finance, few Islamic banks publish their SSB's fatwas. Thus, lack of transparency does not help raise awareness of Islamic finance and banking.

Overall, these SSBs' reports themselves are essential concerns here, as Alkhamees (2012) indicated that these reports, prepared per AAOIFI standards, are nevertheless superficial and stereotypical as they are without meaningful data and disclosures. Similarly, Aribi et al.'s (2019) study of GCC and Malaysian SSB reports evaluated them using five criteria: report form, SSB members' background, audit process, Shariah violations and *Zakat*. It reveals that the level of IFIs' disclosures is relatively low compared with the Shariah reporting index's measurement of stakeholder expectations. Consequently, the transparency of IFIs' Shariah compliance is slightly weak; hence, the practice and culture of disclosure needs strengthening. The following sections discuss other micro-level factors affecting Shariah corporate governance in Kuwait begins with Shariah audit (2.5.1).

2.5.1 Shariah Audit

Besides the internal arrangements for Shariah compliance addressed above, there is the so-called Shariah audit– “a comprehensive assessment and examination of all products, services, contracts, agreements, policies, procedures, transactions, financial statements, circulars and other matters which may arise and form part of the IFI's operations, either directly or indirectly, in their business transactions” (Hussan et al. 2013, p. 4).

Bank Negara Malaysia, the Central Bank of Malaysia, defines Shariah audit as “a function that provides an independent assessment on the quality and

effectiveness of the IFI's internal control, risk management systems, governance processes as well as the overall compliance of the IFI's operations, business, affairs and activities with Shariah" (Bank Negara Malaysia, 2019). The Shariah auditors are somewhat akin to being assistants of the SSB. Just as the financial audit has an internal audit and an external audit, the Shariah audit has two such parts too – the internal Shariah audit and the external Shariah audit. The former reviews the IFI's day-to-day activities in terms of compliance with the SSB's decisions and fatwas, while the latter is appointed by the IFI's general assembly and provides an independent assessment at the end of each fiscal year of the extent of the IFI's commitment to the principles of Islamic law (detailed later).

Nevertheless, for Shariah auditors to perform their duties professionally they ought to be granted full power and access to all required documents and information. Also, they must be separated from executive management and its duties. Similarly, vital for enhancing the credibility and integrity of the external auditor's reports in general is a high level of independence, which will shield auditors from any bias that contradicts their objective judgement.

There is, for some Shariah corporate governance stakeholders, little difference between internal and external Shariah audits, or at least an overlap perceived in their tasks. Grais and Pellegrini (2006, p. 21) nevertheless point out that the "internal audit by the SSB would have an independent appraisal function, including the review of Shariah verification systems and controls, while external Shariah auditors would have a statutory responsibility to express an independent opinion on Shariah compliance". Despite clear differences existing between both types of Shariah audit, it is recommended that management carefully consider this aspect. The next section discusses the independence of Shariah auditor.

2.5.2 The Independence of the Shariah Auditor

A practical dimension of an auditor's independence, Uddin et al. (2013) argue, is that auditor independence involves three elements:

- 1) Clear definition of internal auditor responsibilities.
- 2) The position of the internal auditor within the organisational structure of the institution.
- 3) The reporting lines.

For the authors, then, if the internal auditor has clearly defined responsibilities but his position is under the CEO or chief financial officer, the internal auditor's independence is at stake. Another kind of lack of independence occurs when numbers one and two in the above are applied but number three is inconsistent with the previous two dimensions – an example being if the reporting line of the internal audit report involves a solid line for the IFI's CEO and a dotted line to the BOD audit committee.³⁴ This opposes independency best practice (i.e., a dotted line for the IFI's chief Executive Officer and a solid line to the BOD audit committee). In this research context, Basiruddin and Ahmed (2020) assert that the BOD ought to play a major role in maintaining the high quality of Shariah audit (as the Shariah audit belongs to the BOD). The Shariah audit must therefore be highly independent, even from the SSB, to perform their duties with the highest degree of independence. Maintaining the above practical three dimensions of independence is thus essential.

Concerning auditor independence within the KSA, Hudaib and Haniffa (2009), using interviews and observations of two auditing firms (one local and the other international but operating in Saudi Arabia), found that the concept of independence differs at macro (the state), meso (organisational) and micro (personal) levels. It is noteworthy that there is a clear negative impact of political (one family ruler), religious (lack of independence of official Shariah scholars) and social (effect of favouritism and nepotism) on the independence of auditing in Saudi Arabia. Also, each organisation's culture influences auditor independence. For instance, while religious values (i.e., fear of God) are considered an essential foundation for the auditor's independence in an audit

³⁴ The solid line means the authority which controls and decides the Shariah audit affairs, while the dotted line means the authority that is only being informed without any control about the Shariah audit.

firm, the ‘liberal’ economic foundation influences the independence of auditors of other companies, meaning there are Shariah auditors whose motive for independence is religious and those whose motive is economical only (monetary returns). Hence, it is crucial to consider these aspects when studying a phenomenon and preparing a proposal for supervisory instructions.

More broadly, Moore et al. (2006) discuss auditor independence from the inner human perspective, or what they call the internal dynamics of moral seduction. Indeed, when the auditor is subjected to pressure, he may not feel inclined to alter his conclusions in favour of the client but may do at the expense of the technical standards of auditing or the principles of Islamic law, as in the context of this study. As Moore et al. (2006, p. 11) note: “[p]utting the most Machiavellian fringes of professional communities aside, we suggest that the majority of professionals are unaware of the gradual accumulation of pressures on them to slant their conclusions – a process we characterise as moral seduction”. In addition, political and societal factors undoubtedly influence the auditor’s decision-making and conclusions (Moore et al., 2006), consistent with this research's basic idea (the effects of institutional factors), as addressed in subsequent chapters. On auditor independence, Moore et al. (2006) report three main issues that potentially threaten this.

The first is managers’ ability to hire and fire auditors. When managers can choose from the auditors who serve their objectives, independence is at stake. An unprofessional practice in this field is what is known as ‘low-balling’, which according to Moore et al. (2006, p. 15) involves “offering a discounted price for audit services in order to build a relationship that could become profitable later, either by increasing audit fees or by cross-selling services”. The risk associated with this is that the auditor might be lenient or abandon the professional application of auditing standards in order to gain the client’s satisfaction and thereby renew the audit contract for subsequent years.

The second is auditors taking jobs with clients. Suppose the preceding practice was hazardous; consequently, the auditor-client relationship is more precarious.

Specifically, psychological factors such as admiration or personal inclination can cause the auditor either to overlook the client's errors or interpret them in a way that is not valid and is not conducive to professional standards (Thomson, 1995, cited in Moore et al., 2006). One manifestation of the auditor-client relationship is the periodic rotation between auditor and client. A deep relationship can consequently form between the two parties, which increases the likelihood of corruption and lack of independence.

The third involves auditors providing non-audit services, meaning one auditor (e.g., EY) is responsible for providing financial audits and consultation services (i.e., expansion plan) for the same client (e.g., Amazon). In this vein, several studies have suggested that the more non-audit services the auditor offers then the more biased and lenient the auditor will be likely to be (Frankel et al., 2002), which can yield issues concerning lack of auditor independence. Therefore, several supervisory instructions can prevent the auditor from providing audit and advisory services to the same client in the same fiscal year. Based on the foregoing, the following section examines the Shariah audit quality dimensions.

2.5.3 Shariah Audit Quality

Besides the practical aspect of Shariah auditor independence, several researchers have discussed audit effectiveness and auditors' interpersonal traits (Khalid and Sarea, 2021; AlBawwat et al., 2021; Samagaio and Felicio, 2022) and human biases (Moore et al., 2006) on internal audit quality. Internal Shariah audit effectiveness concerns "the ability of internal Shariah auditors to achieve established objectives within IFIs" (Khalid and Sarea, 2021, p. 335). A possible key trait of auditors that influences audit quality is 'professional scepticism' – "an attitude that includes thoughts that constantly question and critically evaluate audit evidence" (Christina and Brahmana, 2019; cited in Samagaio and Felicio, 2022, p. 795). In other words, auditors ought to assess audit evidence critically before making their judgements. Hurtt (2010, cited in Samagaio and Felicio, 2022) lists the six traits of professional scepticism for auditors: a questioning mind, a suspension of judgement, a search for knowledge, interpersonal understanding, self-esteem and autonomy.

In this vein, AlBawwat et al.'s (2021) study deems emotional stability a trait (part of discipline personality traits)³⁵ that generates self-confidence, which in turn leads to highly persuasive audit messages or reports to concerned customers and ultimately internal audit effectiveness. Contributing to this (personality) is the Shariah auditor's knowledge and skills. Moreover, the personality traits of internal auditors positively influence the effectiveness of internal audit functions, which can positively influence the quality of financial reporting.³⁶ Samagaio and Felicio's (2022) study, which adopted the five personality dimensions model³⁷ and noted its impact on the three audit quality standards (professional scepticism, reduced audit quality practices³⁸ and material judgement of the auditor) confirmed the relationship between certain auditor traits and audit quality. Specifically, agreeableness, conscientiousness and openness positively correlate with auditors' professional scepticism, whereas conscientiousness and neuroticism negatively influence reduced audit quality practices. As such, enhancing a Shariah auditor's personal traits accordingly should yield greater audit quality.

All this also relates to the competency model suggested by Mohd Ali et al. (2020), which is based on four building blocks: the knowledge required; core/technical skills; other characteristics; professional conduct and ethics (see Figure 3 below). Other characteristics include positive attitude, willingness to

³⁵ Emotional stability traits are self-confidence, stress sensitivity and frustration resistance (AlBawwat et al., 2021). The other three personality sub-characteristics are as follows: 1) openness to experience (innovation-orientation, intellectual versus action orientation, self-reflection, openness to change); 2) conscientiousness (systematic approach, self-discipline, motivation); and 3) extraversion (enthusiasm, sociability, energy, assertiveness) (AlBawwat et al., 2021, p. 803).

³⁶ The effectiveness of internal audit functions relates to the following aspects: value added to company; compliance with professional standards and codes; independence; objectivity; organisational status; and applying a systematic approach. Financial reporting quality concerns the following aspects: relevance; faithful representation; comparability; verifiability; timeliness; and understandability (AlBawwat et al., 2021, p. 803).

³⁷ The big five model suggested by McCrae and Costa (1997, cited in Samagaio and Felicio, 2022) consists of the following traits: extraversion; agreeableness; conscientiousness; neuroticism; and openness to experience (p. 796) (for details see Appendix 2).

³⁸ According to Samagaio and Felicio (2022, p. 796), reduced audit quality practices relate to "the possibility of failure of some of the audit steps by the auditor, which can lead to an inappropriate reduction of the effectiveness of evidence gathering".

Type of internal auditors	Building blocks			Professional Conduct and Ethics		
	Knowledge	Core/Technical Skills	Other Characteristics			
Shari'ah auditors in Islamic banking business	Internal auditors in banking institutions	General internal auditors	<ul style="list-style-type: none"> • Auditing • Identification of non-compliance activities • Fraud awareness • Report writing • Coordinating resources and audit activities • Communication • Negotiation skill • Analytical thinking • Basic IT audit • Risk mapping • Negotiation skill 	<ul style="list-style-type: none"> • Positive attitude • Willingness to learn • Committed • Dedicated • Passion • Interest • Teamwork and collaboration • Management skill • Strong vision • Judgement • Leadership 	<ul style="list-style-type: none"> • Objectivity • Confidentiality • Due professional care • Integrity • Independence • Technical standards 	
			<ul style="list-style-type: none"> • Banking business operation • Regulation and guidelines pertaining to conventional banking such as FSA 2013 or BAFIA 1989 			<ul style="list-style-type: none"> • Auditing banking operation and products • Identification of non-compliance banking activities
			<ul style="list-style-type: none"> • Fundamental shari'ah on Islamic banking product • Fiqh Muamalat • Shari'ah governance • Shari'ah Committee resolution • Regulation, acts or standards pertaining to Islamic banking business such as IFSA 2013 and SGF 			<ul style="list-style-type: none"> • Auditing Islamic banking business operation and products • Identification of shari'ah non-compliance activities

Figure 3: Proposed Competency Model of Shariah Auditor (Mohd Ali et al., 2020, p. 394)

learn, teamwork and collaboration, and judgement. These competencies and other elements (e.g., knowledge, technical skills) can help Shariah auditors deliver Shariah audit engagement accordingly and lead to continual improvement in Islamic financial institutions (Mohd Ali et al., 2020). One of the main findings of Mohd Ali et al.'s (2020) research revealed in Malaysian IFIs a lack of talented Shariah auditors (in terms of auditing understanding and techniques) who are well versed in required knowledge. Fundamentally, it is rare to find a Shariah auditor who meets all the above criteria (the four building blocks). As such, regulatory and educational authorities must contribute to preparing the market with trained cadres who are both knowledgeable and technically competent.

Islam and Bhuiyan (2021) also stressed the importance of shariah audit quality by giving auditors full freedom to execute their task, especially from SSB members' control. In this vein, Shariah advisory firms emerged to conduct Shariah supervision services, and that is discussed in the next section.

2.5.4 Shariah Audit and Advisory Firms

In recent years, the so-called Shariah advisory firms have taken charge of providing Shariah-related services for IFIs, including SSB functions, internal

Shariah audit, external Shariah audits and Shariah consultancy. According to guiding principles on Shariah governance systems for institutions offering Islamic financial services issued by Islamic financial services board, a Shariah advisory firm is: “[a]n entity that, depending on its size and capacity, provides Shariah advisory services, including Shariah audit reviews, as well as advice on Shariah-compliant product development, as part of its professional services.” (Rashid and Ghazi, 2009, p. 22). These advisory firms are one step towards strengthening Shariah compliance. Rashid and Ghazi (2021) suggested four factors to assess the Shariah audit quality of the Shariah advisory and audit firms. These factors are the audit fee, the reputation of the advisory firm, audit firm tenure, and audit firm size.

Several studies indicated that the longer the auditor’s work period in one company/bank (audit tenure), the greater the likelihood of unprofessional practices occurring owing to the auditor-client relationship (Deis and Giroux, 1992; Moore et al., 2006). For example, one of the reasons for the Enron scandal in 2002 was that there was a close relationship between the auditor (Arthur Andersen) and the Enron company, which led to the auditor covering up Enron’s financial shortcomings so as to continue providing auditing services to them (Moore et al., 2006). Additionally, large and financially sound businesses are more likely to exert pressure on auditors to perform substandard work, lest the client choose a different auditor (Deis and Giroux, 1992).

Since Shariah advisory and Shariah auditing firms are relatively new to the Islamic financial industry, they are not immune to bad practices that may be committed against them or by them, as was the case with well-established auditors in financial auditing (i.e., Arthur Andersen with Enron in 2002). Thus, this study was able to fill a vacuum in the Shariah corporate governance literature, which lacked a discussion of Shariah auditing and Shariah advisory firms in the Kuwaiti setting.

Furthermore, Grais and Pellegrini (2006) mention others, such as how relying on merely the public and/or private sector for Shariah corporate governance is

not enough, so civil society associations should play a role, especially as they can shed light on some Shariah corporate governance shortcomings of IFIs. For the authors, this step would increase society (as an IFI stakeholder) awareness of the importance of how institutions manage their operations professionally, especially in implementing Shariah principles of financial instruments. In short, Grais and Pellegrini (2006) suggest that governing and maintaining Shariah compliance in IFIs accordingly involves internal (SSB and internal Shariah audit) and external arrangements, personnel and procedures (standard-setters, external Shariah audit, Shariah advisory firm and reputable agents).

2.5.5 National Shariah Authority in Regulatory Bodies

Along with the internal arrangements Grais and Pellegrini (2006) suggested, external arrangements for Shariah corporate governance and Shariah compliance also exist – a main one being having a national Shariah authority in central banks or capital market authorities. Countries such as Sudan, Malaysia, Indonesia and Bahrain have established an NSA, and the main aims of an NSA are harmonising edicts and enhancing Shariah compliance (Grais and Pellegrini, 2006; Hasan, 2012, Alam et al., 2019; Alam et al., 2022)). Moreover, to tackle certain Shariah corporate governance issues noted above, such as SSB independence and SSB members' competency, establishing an NSA in regulatory authorities could help. Unlike SSBs at the institutional level, NSA rulings have broad impacts on IFIs at the national level.

Hasan (2012) notes how NSAs undertake several functions: (1) being the final referee for IFIs in cases of differences in interpretations of Shariah-related matters (courts could rely on its rulings in case of disputes); (2) approving nominations for SSB members in IFIs; (3) issuing circulars and guidelines pertaining to IBs to boost Shariah corporate governance and mitigating 'Shariah risk' (the risk of transactions, services and products of IBs being Shariah non-compliant). An NSA might also serve as the main standardisation body for IFIs' dominant products (e.g., *Murabaha*), therefore potentially mitigating the legal risk IFIs face. Notably, the above mentioned harmonisation of edicts reflects the consistent and ideal model of Islamic banking and financial institutions

presented to a non-Muslim world. For this purpose, Ayub (2018) called for countries in which IFIs operate to adopt the standards issued by standard-setting bodies such as AAOIFI to attain such harmonisation of IFI practices, thereby paving the way for these institutions' products to be standardised and easy to apply globally. Other authors (Graiss and Pelligrini, 2006; Hasan, 2012; Ullah et al., 2018) have nevertheless claimed that NSAs are subject to government intervention, so with them the independency of Shariah scholars is questionable. In other words, NSA decisions are likely to be politicised according to the inclinations of government officials, and decisions may lack objectivity.

Other options for dealing with Shariah corporate governance challenges include establishing a specialised Islamic banking division in the regulatory authority (i.e., in CBK, CMA, IRU). Ullah et al. (2018) point out that several countries have indeed established such a division in their regulatory institutions, the aim of which is to study the status of Islamic banking from a holistic point of view. By way of illustration, the central bank studies the spread of a particular product (i.e., *Murabaha*) and the effect of this on increasing consumer behaviour, and it may intervene by placing a cap on a particular product (e.g., *Murabaha*). More specifically, the central bank, for instance, may set 40% for using the mentioned product to urge Islamic banks to use other Islamic financial products such as *Istisna'a* (order to manufacture) and *Musharakah* (partnership).³⁹

Another important point regarding establishing a dedicated Islamic banking division in the regulatory authority concerns specialisation and proactive work in developing Islamic banking on solid and sustainable foundations. However, what may hinder this goal is the lack of conviction from leadership and senior management in central banks on such divisions, especially with any change in administration and resultant different priorities. The state thus needs a comprehensive plan regarding Islamic finance to avoid being significantly affected by the arrival or departure of people who believe or do not believe in Islamic finance. On the contrary, IFIs' work is indeed not seriously affected by

³⁹ *Istisna'a* (order to manufacture) "is a special kind of Bai – sale – where the sale of a commodity is transacted before the commodity comes into existence" (Ayub, 2007, p. 263)

leadership changes because such a comprehensive plan exists, and the new leader should complete its implementation. Of course, it is possible to develop certain ideas and address shortcomings in this, if any exist, but it should not be cancelled as it is the state's comprehensive medium- and long-term plan.

2.5.6 Master Planning

Rudnyckyj (2014) discussed how Malaysia transformed from a country without an Islamic financial system to a country considered one of the most influential international centres of Islamic finance. This achievement happened not by chance but through Malaysia's comprehensive development plan (Rudnyckyj, 2014) – a strategy of making Malaysia an international centre for Islamic finance. Malaysia's infrastructure was prepared accordingly, and its Steering Committee on Islamic banking was established in 1981. In addition to Malaysia, Turkey and Kazakhstan have developed strategic plans for the Islamic financial industry in their countries. For example, the Participation Banks Association of Turkey has developed a 10-year strategic plan (2015-2025) to achieve a market share of Islamic banks in Turkey to reach 15% of the Turkish banking sector (Yanikkaya and Pabuçcu, 2017). Further, Kazakhstan has developed a five-year strategic plan (2020-2025) for the Islamic financial industry sector (Islamic finance master plan for the republic of Kazakhstan, 2020).

Adegbite (2015) addresses the micro dimension of corporate governance in sub-Saharan Africa, especially Nigeria, as a case study, and asks the following main research question (ibid., p. 3): “How can firms promote good corporate governance (and prevent corporation corruption) in weak institutional settings?”. By using different qualitative methods, the author's research (Adegbite, 2015) triangulates in-depth interviews, focus-group discussions and case studies. While the most dominant corporate governance theory is agency theory, this author's work employs institutional theory, which broadly analyses socio-cultural aspects not tackled in its counterpart's approach. Furthermore, agency theory does not deal with the differences between countries in terms of environmental and legal facets (Adegbite, 2015). The author clearly underlines the importance of investigating how and what drives companies to act based on

'best' corporate governance practice in weak institutional (contextual) arrangements generally, such as a high level of corruption, low level of law enforcement, reactive regulatory bodies and limited transparency.

Specifically, Adegbite (2015) summarised four manifestations of a weak corporate governance environment in Nigeria: (1) weak board governance (reactiveness and laziness); (2) weak monitoring by and accountability of executives; (3) corporate corruption (private sector); and (4) public-private corruption (when regulators facilitate the corruption for some corporations). Drawing on these, Adegbite (2015) listed the antecedents of and propositions⁴⁰ for 'good' CG:

- 1) Board independence
- 2) Board heterogeneity
- 3) Board reputation
- 4) Board evaluation
- 5) Active and independent Audit Board committee
- 6) Foreign institutional investors
- 7) Performance-related executives' compensation
- 8) Full and transparent information disclosure
- 9) Effective shareholder activism

Adegbite (2015) concludes his paper by discussing several limitations, starting with the research's inability to quantify or test empirically the relationship between the nine proposed interdependent corporate governance factors and actual corporate governance improvements at the firm level. Another concerns its generalisation, which relates to the qualitative research method, though the author alludes to an aspect that goes beyond the generalisation issue. For the study, in fact, provides insights into the international corporations working in a weak corporate governance environment (i.e., Nigeria), and this research could indeed be applied in GCC countries such as Kuwait, which has a low rating of

⁴⁰ See Appendix 3.

the role of law and weak corporate governance institutional arrangements according to the World Bank governance index (World Bank, 2020). As Yin (2003, as cited in Kelliher, 2005) distinguishes between analytical and statistical generalisation, the researcher could generalise the findings for developing theoretical propositions. So, based on the above mentioned nine corporate governance propositions, this qualitative study could be applied in Kuwait's context as well.

2.5.7 Shareholder Activism

As Adebite (2015) and other researchers (Adebite et al., 2012; Gillan and Starks, 2000; Goranova and Ryan, 2014; Li et al., 2015) have pointed out, shareholder activism can be a valuable corporate governance tool or mechanism, as it involves “actions taken by shareholders with the explicit intention of influencing corporations’ policies and practices, rather than as latent intentions implicit in ownership stakes or trading behaviour” (Goranova and Ryan, 2014, p. 1232). An essential benefit of shareholder activism, sometimes called investor activism (Li et al., 2015) or shareholder engagement (Goranova and Ryan, 2014), is as a tool for shareholders/investors to hold the company’s management accountable, hence improving its performance. As Johed and Catasús (2015, p. 105) say, “[d]uring AGMs, Swedish Shareholders Association representatives ask management and members of the boards to account for their efforts. The questions reflect the Swedish Shareholders Association’s goal to protect the interests of shareholders with minor holdings”. In contrast, some researchers and practitioners, especially corporate management, argue that this is time-consuming and sometimes costly, particularly because it requires financial and human resources that may not be available (Goranova and Ryan, 2014).

Shareholder activism nevertheless varies from country to country, depending on the legal infrastructure, political environment and the nature of society. The legal environment concerns whether laws regulate social activity and whether there are clear provisions for minority protection. The political environment is about the extent of government and parliamentary support for shareholder activism but also the corruption of the political class (government and parliamentarians) and

their links to company owners or managers, which can hinder the functioning of shareholder activism. The nature of society concerns social connectedness between members of society (as there largely is in Kuwait), as this relates to aspects such as how social embarrassment may negatively affect a shareholders' activism and willingness to voice criticism in AGMs (Almutairi, 2021).

Almutairi (2021) studied the lack of shareholder activism in the Kuwaiti context and listed the reasons behind that. Legally, the reasons are the ownership concentration of major shareholders, unfair voting system, weak monitoring instruments, and insufficient minority shareholders protection (see Almutairi, 2021). Socially, the shareholder apathy culture is discussed in detail by Almutairi (2021) as one of the prominent manifestations of the shareholders' reality in Kuwait. In this regard, shareholder apathy culture is caused by several reasons, which are as follows: "long litigation proceedings, absence of shareholder institutions and free-riding, retail investors as speculators, and Kuwait is a small country where everyone knows everyone" (Almutairi, 2021, pp. 48–52). Based on this, social embarrassment and nepotism in Kuwait are influencing factors for the weak accounting culture of shareholders. In other words, it is hard to challenge, object to, or even hold someone with whom one is socially connected accountable. Thus, based on Almutairi's paper (2021), this research has added two aspects: the context of Shariah corporate governance in Islamic financial institutions and a deeper analysis through semi-structured interviews (see Chapter 3).

2.6. Research Gap and Questions

Based on the preceding analysis, this study fills in the gaps in the Shariah corporate governance literature regarding the following aspects. According to the researcher's knowledge, Shariah corporate governance in the GCC requires additional investigations and research. Someone may assert that there are comparative studies on Shariah corporate governance in the GCC undertaken by multiple researchers, such as Hasan (2012) and Grassa (2013). It is noted, however, that these studies are out of date and cannot be relied upon, given the considerable and impactful changes in Shariah corporate governance

legislation/regulations in various countries over the past decade. On the other hand, other studies examine only one facet of Shariah corporate governance (e.g., Alam et al., 2019; Al-Qassar and Ahmed, 2022). Broader contemporary considerations (macro and micro), as addressed in this research, can stimulate broad understandings of specific concerns within specific contexts. This study investigated both and contributed a lot of novel knowledge. Regarding Shariah corporate governance from the macro institutional dimensions (regulatory, social, political and legal) that directly and indirectly effect on Shariah corporate governance practises. To the best of the researcher's knowledge, this is the first study that examines at the impact of *diwaniyya* and social connection on Shariah corporate governance practises. This suggests an indirect detrimental effect of frequent contacts between SSB members and CEOs or members of the board of directors of Islamic financial institutions (see Chapter 4).

Second, notwithstanding the paucity of such research, quantitative methods dominated it (see Chapter 3). Although studies such as (Alam et al., 2022) dealt with Shariah governance employing a qualitative method (semi-structured interviews), the scope of the study was different. The study was conducted in Bangladesh, where Bangladesh's legal, social, and political contexts are vastly different from those in Kuwait. Consequently, a research gap remains related to the scarcity of qualitative studies dealing with the Kuwaiti context. Third, the majority of Shariah corporate governance studies and Shariah supervision utilised agency theory as a lens. Despite its significance (agency theory), its scope is narrow, it cannot explain certain actions, and it does not address the social, political, and legal components of each country and culture, in the same way that institutional theory does (Nakpodia et al., 2020). The agency theory does not consider the changes in society and its classes that could negatively affect governance practices, as indicated by the researcher in Section (4.4) or the influence of the politically and commercially influential. There are so-called institutional voids, as called by Nakpodia et al. (2018), which are gaps through which corrupt practices infiltrate, which differ from country to country and from continent to continent. Thus, institutional theory provides a broader scope for

explaining some phenomena and practices by considering institutional aspects (social, legal, and political) (Alam et al., 2022).

Based on the foregoing, this study's main research questions are as follows:

- 1) What are the macro-level determinants of 'good' Shariah corporate governance in the Kuwaiti financial sector?
- 2) What are the micro-level determinants of 'good' Shariah corporate governance in the Kuwaiti financial sector?

In answering these, this research has the following research objectives:

- 1) To evaluate Shariah corporate governance status of Islamic financial institutions in the Kuwaiti financial sector.
- 2) To explore the determinants of 'good' Shariah corporate governance of Islamic financial institutions from a macro-level perspective (the state).
- 3) To explore the determinants of 'good' Shariah corporate governance of Islamic financial institutions from a micro-level perspective (industry and firm levels).
- 4) Based on the previous objectives, to present a comprehensive study of Shariah corporate governance in the financial sector in Kuwait that address practical concerns by offering real-world solutions that help deliver 'good' Shariah corporate governance and sustain the Islamic financial industry practice.

The following section discusses the theoretical underpinning of this research.

2.7 Theory and Theoretical Framework

In this section, the thesis explores a suitable theoretical framing to address the aforementioned research questions and objectives. Shariah corporate governance falls under the broader concept of corporate governance, so studies concerning these two often have overlaps. They also obviously have differences, especially in how the latter (corporate governance) applies to conventional and Islamic financial institutions while the former (Shariah corporate governance)

applies to Islamic financial institutions only. Pande and Ansari (2014), Obid and Naysarys (2014) and Cuomo et al. (2016) all worked through these topics using various theories on corporate governance and Shariah corporate governance too. They started with agency theory, passed through stakeholder and stewardship theories, and ended with institutional theory. Unlike agency theory, stakeholder theory focuses on improving work and organising financial results in the interests of all stakeholders (employees, clients, society) and not at the expense of one party over another. In contrast with agency theory, stewardship theory assumes that when managers seek to maximise a company's profits and achieve its goals, they ultimately fill their own self-esteem needs, but managers should not prioritise these personal interests over the company's goals and objectives (Obid and Naysarys, 2014). From such and other research, the main two theories that have emerged are agency theory (principle-agent) and institutional theory.

2.7.1 Between Agency and Institutional Theories

Agency theory, with its focus on how to maximise shareholder value, or maximise profits (Pande and Ansari, 2014), dominates the corporate governance realm and that of Shariah corporate governance too. The idea behind it stems from the information asymmetry between owners (principals) and management (agents). Indeed, managers usually have more information than owners and with this they try to maximise their profits at the expense of shareholders' rights, and this leads to agency cost. Hence, agency theory is concerned with two basics issues:

- 1- The agency problem that arises when a) the desires or goals of the principal and agent conflict; and b) it is difficult or expensive for the principal to verify what the agent is actually doing.
- 2- The problem of risk sharing that arises when the principal and agent have different attitudes toward risk.

(Eisenhardt, 1989, p. 58)

In the Islamic financial industry context, agency theory is applied in various ways. An essential principle of Islamic finance is profit and -loss-sharing (Obid and Naysarys, 2014) whereby the customer and the institution share any profit (agreed on in advance) but also, in a negative financial outcome, they share the loss (the customer loses his money and the bank loses its effort and time).⁴¹ What we care about here is when the bank out-performs the customer regarding information availability, resulting in an information asymmetry problem between the two parties – as happens with Islamic financial institutions. As Safieddine (2009, p. 144) states:

While agency problems in conventional companies arise when managers deviate from their duty to maximize shareholders' wealth, any divergence by managers of Islamic financial institutions from placing all supplied funds in Shariah-compliant investments creates an additional source of agency problems.

In contrast, institutional theory “views organisations as operating within a social framework of norms, values, and taken-for-granted assumptions about what constitutes appropriate or acceptable economic behaviour” (Oliver, 1997, p. 699). Here, then, institutions reflect community values and the external environment (Scott, 1987). Notably, corporate governance is a social phenomenon –and institutional theory focuses strongly on social and cultural aspects.⁴² It also considers the implications of other contextual effects, such as legal and political facets embedded in each society. These effects, according to Adegbite (2015), include the role of the state and the degree of effectiveness of regulatory initiatives and authorities. This theory could therefore provide the depth necessary to understand and evaluate Shariah corporate governance

⁴¹ Though the customer would not lose his money if there were misconduct or negligence by the IFI's management.

⁴² According to Carnegie and Napier (2002, p. 699), culture means “the values, beliefs, and practices that are shared by a defined group, underpinning the group's collective ‘world-view’. The group may be the members of a particular organisation, a social class or a religious, ethnic or national population, so long as there is a core of common attitude shared by all members of the group”.

practices and environments based on distinct features but also social differences among nations, which are what shape each society's behaviour and beliefs.

2.7.2 Institutional Theory: The Main Idea

Institutional theory is based on institutions being a product or reflection of society and its values (Scott, 1987). Something is institutionalised when it takes root through its implantation through several factors (detailed later). According to Scott (1987, p. 495), institutionalisation is “the process by which actions become repeated over time and are assigned similar meanings by self and others”. Institutional theorists argue that institutionalism's root is conformity, which is motivated by an institution's desire to attain legitimacy. In other words, institutions are keen to ensure that their practices are isomorphic and in line with state laws and market standards. Through such factors, institutions also seek to meet community expectations and align with community values (Greenwood et al., 2017). Given this, many share similarities as they all usually seek not only to increase their economic efficiency but also align with society's values and what is expected of them. Sometimes, institutions nevertheless pursue so-called ‘decoupling’, which means that “organisations abide only superficially by institutional pressure and adopt a new structure without necessarily implementing the related practices” (Greenwood et al., 2017, p. 80). This situation involves form over substance to convey a clear message to the market and to customers, too, about their commitment to social values, even if these are not necessarily fulfilled to the extent presented. Regarding Shariah corporate governance, sometimes IFIs announce through the board of directors or senior management that they are fully committed to strict Shariah supervision and have appointed prominent Shariah scholars and Shariah auditors. However, in reality this can differ from detailed and proper procedures and policies for Shariah supervision. Consequently, the threat of dismissal or non-renewal for Shariah auditors ultimately lurks and this can exert much pressure on them (Shariah auditors) if they report Shariah violations.

As noted, the over-arching motivation for institutionalisation is legitimacy but it is also a permeating facet of it, which is understandably so, given that “legitimacy is critical for survival” (Mayer and Rowan, 1977, cited in Gümüşay,

2020, p. 861). Deephouse et al. (2017, cited in Greenwood et al., 2017, p. 34) explain that legitimacy is crucial because “many stakeholders will only engage with legitimate organisations”. Indeed, then, institutions will likely fail without it, and they pursue it by responding to several isomorphism pressures: coercive, mimetic and normative. Coercive isomorphism concerns the laws and regulations or even sanctions with which institutions must comply (mandatory). Mimetic isomorphism happens when institutions mimic ideal practice, or what Cohen et al. (2008, p. 186) call “follow the leader” – irrespective of this practice being suitable or not. Normative pressure is where institutions feel compelled to follow certain norms, though these are not mandatory. For instance, the market may not consider the accountant as professional if he does not have a certified public accountant qualification. In the coercive case, then, as the state is directing it, the institutional pressure is vertical; however, in the mimetic and normative cases the pressure is horizontal (Greenwood et al., 2017).

Regarding the current research context, IFIs are keen to preserve their reputation by adhering to Shariah provisions in all their transactions, thereby maintaining their legitimacy. Hence, for such legitimacy purposes they are keen to appoint renowned Shariah scholars to SSBs, though an implication of institutional theory is that IFIs may appoint homogeneous individuals (i.e., friends or those with the same intellectual background) to SSB membership. In these cases, such SSB members would be less likely to criticise or challenge management or they may be more lenient with them (Cohen et al., 2008), suggesting these SSB roles are ceremonial rather than real and beneficial: “in essence, institutional theory emphasizes how governance mechanism fulfil ritualistic roles that help legitimise the interactions among the various actors within the corporate governance mosaic” (Cohen et al., 2008, p. 187).

Furthermore, institutional theory tempts what is called regulatory multiplicity (Osemeke and Adegbite, 2016), where two or more regulatory authorities diverge in their regulations about the same subject (e.g., Shariah corporate governance). Scott (2005) discusses such multiplicity of institutional arrangements between different fields and within certain ones, saying it produces a trade-off between the bodies affiliated with the regulatory institutions

and the body the supervisory instructions of which are more lenient. As Scott (2005, p. 12) puts it: “[c]learly, competing rules or schema open up possibilities for choice and bargaining among subordinate actors”. For instance, in the Kuwaiti Shariah corporate governance context, the CBK’s Shariah corporate governance regulations make it mandatory for Islamic banks to establish an SSB. Simultaneously, however, establishing an SSB is optional based on the CMA’s Shariah corporate governance regulations. In this work regulatory multiplicity and its implications are explicitly discussed by the interviewees, as Chapter 4 shows.

2.7.3 Institutional Theory and Organisational Field

The so-called organisational field is an idea that arose and evolved through institutional theory and concerns “a community of organisations that partakes of a common meaning system and whose participants interact more frequently and fatefully with one another than with actors outside the field” (Greenwood et al., 2017, p. 56). For example, an IFI’s organisational field can include other IFIs, regulatory authorities, an IFI’s Chief Executive Officers (CEOs) and board of directors, SSB members, and Shariah audit firms and auditors. Institutions seek to legitimise their existence by identifying with various personnel and organisations but also with diffused practices and procedures within their organisational field. An indication of institutional theory relating to Shariah corporate governance is therefore how IFIs sometimes pay large sums of money to appoint eminent Shariah scholars. Although these scholars have many memberships in other Islamic financial institutions and this may ostensibly seem a negative. Nevertheless, the reason behind this practice is not necessarily about gaining benefits from the efforts of scholars but is instead for marketing purposes and legitimising the institution’s existence. In this regard, the various memberships can be useful. As Wooten and Hoffman (2017 cited in Greenwood et al., 2017, p. 57) say, these “experts are hired not for advice but to signal legitimacy”. Hence, ritualistic conformity becomes dominant in response to isomorphic pressures.

2.7.4 Religion and Religiosity within Institutional Theory

According to Abdelsalam et al. (2021, p. 3), religiosity is “the extent of adhering to prevailing religious beliefs, codes, values, practices and promulgations”. Gümüşay (2020) reviews the journey of religion in developed western countries, noting how it was once considered a sublime value that was considered within various economic and commercial activities. After that, religion moved from being an independent sublime value to becoming a part of culture and on the sidelines of life (secularism). In fact, it was replaced by rationalism – that is, people relying on what is tangible, calculated and material instead of on sublime values such as religion – values that are intangible and immaterial. Polanyi (2001, cited in Gümüşay, 2020, p. 858) called this shift in religion a “great transformation of social order”, where, as he puts it, “economic activity is not anymore embedded nor constrained by normative obligations from other societal spheres such as family, religion, and politics, but rather independent and focused on obtaining profit”.

The reason for mentioning religion here in the theoretical framework is that this work’s research topic, Shariah corporate governance, is based on religious commitment (see also section 1.6). Although institutional theory focuses more on religion’s cognitive rather than the normative aspects (standards), religiosity has received little attention in research on Shariah corporate governance through the institutional theory lens even though religiosity is essential for customers to put their money in an Islamic financial institution. Moreover, religiosity encourages managers to refrain from exerting their leverage to benefit themselves at the expense of other stakeholders, especially in countries where religion is considered part of national identity (Abdelsalam et al., 2021). Also, religiosity – at least in theory – generally makes SSB members prefer religious considerations over monetary and financial incentives if they conflict.

The inclusion of religiosity is justified since it is regarded as an autonomous motivator in Islamic belief (Azid and Asutay, 2007) and is not part of social norms or customs (Abdelsalam et al., 2021). While social norms are not as absolute as religion, they are still ignored or debated. Since religion is a belief,

individuals' religiosity inhibits selfish behaviour or reckless practises by management or SSB members. Although the study did not specifically attempt to examine the impact of religiosity on Shariah corporate governance practises, religiosity is viewed as an independent component that can be investigated further as an influencing factor in the future. Therefore, the current research thus adds the dimension of religiosity to the aforementioned others (coercive, mimetic, normative) to give even more contextual depth. Institutional theory therefore seems the most appropriate theory for interpreting and explaining the social, political, legal and cultural effects of developing countries such as Kuwait.

2.7.5 Theoretical Framing

As indicated in previous sections, institutional theory covers the social, political, and legal aspects embedded in every society that agency theory does not tackle. In this regard, the organisational field referred to by institutional theorists (Scott, 1995; Greenwood et al., 2017) is a significant concept and framework that explains the Shariah corporate governance phenomenon, as indicated by section 2.7.3. The Shariah corporate governance phenomenon and its practices can also be explained through the concept of isomorphism, as it has three main types: coercive, mimetic, and normative. The main objective of institutions seeking to be isomorphic in a particular economic sector is to obtain legitimacy. In other words, institutions, especially Islamic financial institutions, seek to obtain societal legitimacy by adhering to what is recognised as best practices (normative or imitation) and to the law or regulatory instructions (coercive).

Interestingly, organisations sometimes practice what is known as decoupling, which is a commitment in a non-substantive form, or as Cohen et al. (2008) called it, ritualistic commitment. In addition, the religion and religiosity of Islamic financial institutions are considered at the heart of their work and addressing them through institutional theory adds an essential dimension to understanding the phenomenon of Shariah corporate governance (2.7.4). Hence, this study has enriched the study of institutional theory in new contexts that are rarely addressed through the lens of this theory, which is the Shariah corporate

governance of Islamic financial institutions in Kuwaiti financial sector. In contrast, agency theory does not discuss decoupling, organisational field, isomorphism (coercive, mimetic and normative), conformity and legitimacy. Indeed, these concepts are crucial to interpret and explain Shariah corporate governance phenomenon, as discussed above. Thus, institutional theory is more appropriate for this research as it offers more room and broad horizons, especially when discussing institutional Kuwaiti aspects (see Chapter 4).

2.8 Conclusion

This chapter deals with the prior literature that discussed this research topic, where it began with an overview of Shariah corporate governance in the banking sector and why this topic attracted the supervisory authorities' attention in many Islamic countries. Then it discussed in detail the regulatory approaches that dealt with corporate governance in general and Shariah corporate governance in particular, represented in reference to a regulatory approach based on rules and also on principles. In this context, the chapter explains each approach's features and characteristics and how each approach may be appropriate for Shariah corporate governance in the Kuwaiti context. In addition, it discusses the bases and considerations on which the regulatory approach is chosen. According to the researcher's knowledge, the prior literature does not deal with the issue of Sharia governance in this context (regulatory approaches).

Likewise, this chapter has discussed the literature that dealt with the institutional aspects: social, political, and legal. For example, it dealt with a social aspect that characterises Kuwaiti society, called *diwaniya*, and the extent of its impact on the Shariah corporate governance practices. In other words, the prior literature indicates that there is a possibility of transmitting ideas and opinions between people who meet continuously or periodically, expressed by social connectedness. In light of this, this research discussed the extent of the impact of visits by those concerned with Sharia governance, that is, SSB members, executives, or BOD members. Nevertheless, according to the researcher's assessment, the prior literature did not address the issue of *diwaniya* as a

prominent social feature of Kuwaiti society or its impact on Shariah corporate governance practices.

Furthermore, this research deals with the legal aspects related to the Islamic financial industry and the extent of its impact on Shariah corporate governance practices in Kuwait. For example, there is a clear research gap regarding the appropriateness of legislation for Islamic financial products offered by Islamic financial institutions and identification of the legal problems (e.g., the lack of specialised courts and judges specialised in Islamic finance) and the extent of their impact on Shariah corporate governance practices in Kuwait. In addition, there was a clear research gap in the prior literature in reference to the study of the political aspect as one of the influencing institutional aspects concerning Shariah corporate governance.

This research opened new horizons at the level of Islamic financial institutions (micro) and their arrangements for Shariah supervision (the SSB independence, the competency of its members, transparency and disclosure of Shariah-related matters). It was discovered that there is a shortcoming in prior researchers' handling and evaluation of these aspects, especially after development in the preceding decade. Therefore, the researcher has studied the Kuwaiti *diwaniya* and qualitatively assessed the arrangements mentioned above and others, which is generally not considered in studies dealing with Shariah corporate governance in Kuwait.

Chapter 3

Research Methodology and Methods

3.1 Introduction

This chapter outlines the research methodology and methods based on Saunders et al.'s (2019) 'research onion' (see Figure 4). The diagram proposed by Saunders et al. (2019) offers a step-by-step framework for the research methodology and method(s) used. It begins with the research philosophy and approaches to theory development (the two larger circles of the onion), continues with the selection of research methodologies and strategies, and concludes with the research time horizon and data collection and analysis techniques and procedures. The distinguishing characteristic of the research onion proposed by Saunders et al. (2019) is that it frames the researcher's mindset with a scientific methodology that assists him in organising his ideas and research steps. In addition, it allows the reader to follow the researcher's writing in a logical and smooth sequence, ensuring that the research approach is conveyed to the reader. Section 3.2 discusses the research methodology (research ontology and epistemology) and differentiates between research methodology and research methods.

As this research employs a qualitative method (semi-structured interviews), Section 3.3 elaborates on the merits and shortcomings of this research approach in general, while Section 3.4 explains the specific research design and the theory building done for this research. Section 3.5 initially covers/addresses methodological choice, specifically the mono method qualitative, then considers in depth the qualitative interviews conducted herein, including their types. Section 3.6 explains the appropriate research strategy and the next section, 3.7, concerns the research time horizon. Next, Section 3.8 touches on the research techniques and procedures, which involves showing why the researcher uses semi-structured interviews, then 3.8.1 briefly conveys the interview settings and 3.8.2 clarifies data analysis techniques used in qualitative research and the researcher's selection of thematic analysis. Section 3.9 explores ethical considerations and issues related to qualitative research methods – importantly

sharing how the researcher deals with these. Lastly, Section 3.10 concludes the chapter.

As noted, this research process follows Saunders et al.'s (2019) research onion, which is portrayed below (Figure 4).

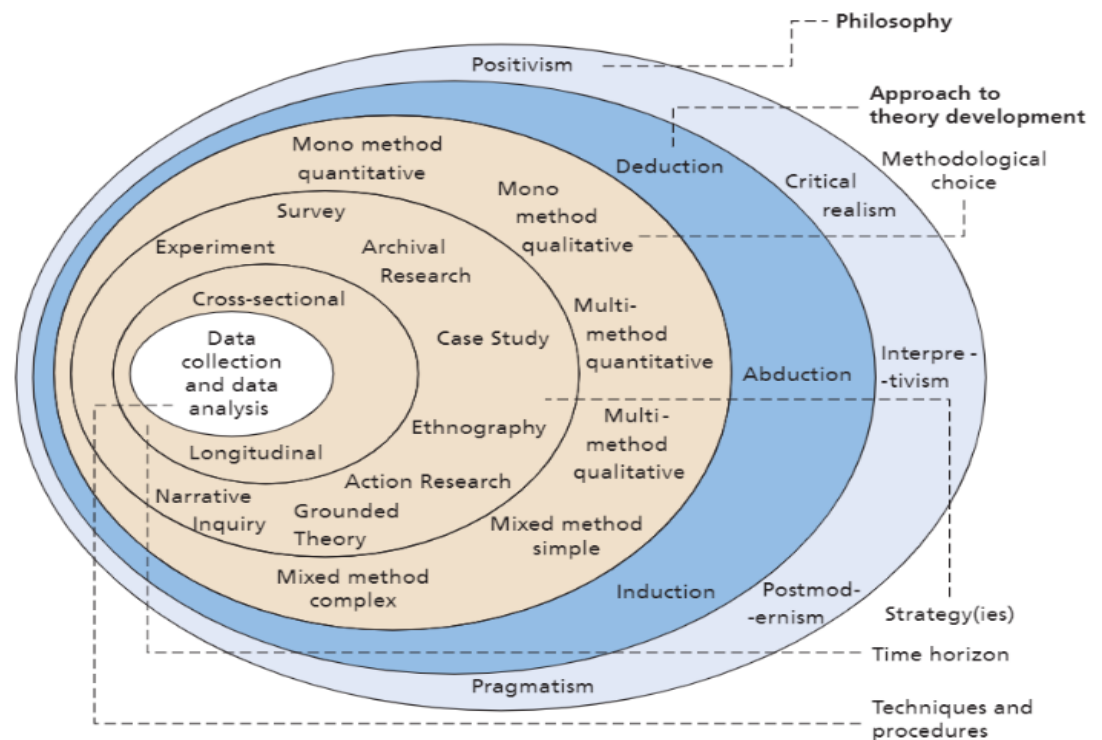


Figure 4: Research Onion (Saunders et al., 2019, p. 130)

3.2 Research Methodology and Methods

Research methodology and methods differ. The former concerns the philosophical stance or position of the research and the researcher, referred to as the ontology, epistemology and axiology, while the latter (methods) concerns how researchers design their research, including the collection and analysis of data, through qualitative or quantitative methods, or a combination of both (Matthews and Ross, 2010; Saunders et al., 2019). Next sections discuss the aforementioned aspects in detail.

3.2.1 Research Methodology

Research philosophy, ontology and epistemology help researchers conduct a coherent and credible study (Johnson and Duberley, 2000; Saunders et al., 2019), specifically by helping them organise their thoughts and consequently anticipate an appropriate analytical approach that gives the research a strong foundation. According to Saunders et al. (2019, p. 130), research philosophy refers to “a system of beliefs and assumptions about the development of knowledge”; in other words, it refers to the researcher’s perception (either objective or subjective) of reality. Furthermore, the existence of natural and social phenomena is the essence of ontological assumptions (Johnson and Duberley, 2000). In relation to management studies, five key philosophies prevail: positivism, postmodernism, critical realism, interpretivism and pragmatism (Saunders et al., 2019). The next three sections delve into the ontology, epistemology and axiology used for this research.

3.2.1.1 Ontological Stance

Accordingly, and taking the research questions into account, a constructivist ontological position, which for Johnson and Duberley (2000) is a main position in postmodernist philosophy, provides the most appropriate approach for this research as “the social phenomena making up our social world are only real in the sense that they are constructed ideas which are continually being reviewed and reworked by those involved in them (the social actors) through social interactions and reflection” (Matthews and Ross, 2010, p. 25). Such a position determines certain meanings that are uncovered by interpreting people’s perceptions and language – the main determinants of meaning construction. This is contrary to identifying facts based on a positivist philosophical position. For instance, corporate governance as a social phenomenon is both complex and interdisciplinary. Specifically, corporate governance is associated with the cultural, political and legal aspects that are heavily connected with people’s interactions, language and interpretations (Johnson and Duberley, 2000; Matthews and Ross, 2010).

To demonstrate further, a research study on assessing student performance may take a quantitative approach (positivism) that focuses on students' marks for each module or their exam scores. Conversely, a qualitative study applying a constructivist position might focus in detail on different aspects concerning student performance, such as classroom environment, teaching style or related factors (e.g., how the class members are addressed, how the teacher deals with their mistakes or the influence of home life) (Rahman, 2017). These factors give the researcher broader insights into the topic being investigated. A main advantage of constructivism is thus a deep understanding of the context (Peters et al., 2013). It also aligns with how and helps us realise that "the only way to understand reality is as a social construction, articulated as the result of human sense making and is thus interpretive in nature" (Peters et al., 2013, p. 338). While people are considered actors within the constructivist position, positivism and critical realism consider people to be information processors (Johnson and Duberley, 2000; Peters et al., 2013).

The researchers' ontology directs their approach to the research in terms of their research question(s), theoretical position and methodology, and constructivism is a position that constructs the meaning of social phenomena based on social actors' perspectives in a process that can bring deep understanding. It is hence about understanding these key participants in social life and what is being studied. As Matthews and Ross (2010, p. 28) noted, constructivists are thus about "standing in another's shoes". Accordingly, constructivism is the most appropriate position for this research, given its focus on social phenomena such as corporate governance and Shariah corporate governance.

3.2.1.2 Epistemological Stance

The second important feature of research philosophy is epistemology. Before defining the term, it is worth exploring this word's origins. According to Johnson and Duberley (2000), the term epistemology originates from the Greek words 'episteme', which means knowledge, and 'logos', which has several meanings such as knowledge, information and theory. Epistemology thus concerns "assumptions about knowledge" (Saunders et al., 2019, p. 133),

knowledge acquisition and the type of knowledge that is justified, acceptable and achievable. As mentioned above (3.2.1), five possible philosophical positions shape research philosophy: positivism, postmodernism, critical realism, interpretivism and pragmatism (Saunders et al., 2019). A researcher can choose any of these positions to undertake research as there is no single ‘correct’ way to approach a subject, as long as it is properly justified and articulated. Shankman (1984 cited in Roth and Mehta, 2002) clearly stated his belief that complete objectivity is impossible, but this does not mean abandoning the search for objective knowledge or conceding that all versions of reality are equally true. What is necessary, according to the interpretivist Rosaldo (1982, p. 198, cited in Roth and Mehta, 2002, p. 7), is an approach wherein the researcher engages in “ways of moving back and forth between an actor’s subjective interpretation and set of objective determinants”.

For the current research, which is based on constructivism as an ontological assumption, the most appropriate epistemological position is interpretivism – a philosophical approach that focuses on the meaning of people’s language, interactions and reflections (Kelliher, 2005). The interpretivist researcher places people in a specific context, at a specific time and in specific circumstances because reality (which is socially constructed) has a different meaning in different contexts. A main advantage of this position is that it enables various points of view to be recognised (Matthews and Ross, 2010). Similarly, it focuses on social phenomena (i.e., corporate governance aspects) from people’s perspectives (different stakeholders), in detail, and can help the researcher gain a profound understanding from which to comprehend precisely the issues being researched. Moreover, the interpretivist researcher thereby being value-driven facilitates understanding of the participants from their point of view or their social perspective, which can nevertheless be challenging (Saunders et al., 2019), while developing a deep understanding of each participant gives the research greater reliability in its results. Accordingly, the most appropriate approach based on this position is a qualitative approach, and the interpretivist researcher can use one or more of the following qualitative methods: interviews (structured or semi-structured), participant observations, focus groups,

documentary study and narrative study (Johnson and Duberley, 2000; Matthews and Ross, 2010).

Despite such positives, there are criticisms of the interpretivist position in particular and qualitative research in general, with Kelliher (2005) positing three main disadvantages of these – namely, reliability, validity and generalisability. First, reliability refers to the extent the method used in such research can be considered reliable. Second, validity is “an interpretive understanding of the meaning of truth” (Kelliher, 2005, p. 123), as qualitative research data rely greatly on transparent description to help the reader get easily to the main points of the study. Third, the generalisation issue is the extent to which the research results can be generalised beyond the research itself, meaning the ability to apply the results to a wider population or in different contexts.

In this context, the researcher has taken several steps to deal with the shortcomings of the interpretivist position. First, the researcher described the interviewees in detail (see Table 1) regarding their work sectors and their experiences. In addition, Table 2 below deals with the backgrounds, employment conditions, and positions of the participants, which reflect their diversity, whether within one sector or in different sectors. Secondly, the researcher provided a research overview and question guide for the participant to prepare and to enrich the interview. Third, the researcher followed the method of clarifying and probing questions in all interviews to address any unclear matters and make the interviews more in-depth in understanding the research topic and its dimensions. Fourth, research confidence among participants was increased by confirming, prior to each interview, that the researcher was not wearing any ‘hat’ other than that of a scientific researcher eager to understand the research topic and its dimensions. Furthermore, the researcher had no prior position on the issues that would be discussed. In addition, the researcher did not express his opinion, endorse, or disapprove of the participants’ viewpoints.

Kelliher (2005) suggests that to strengthen the reliability of qualitative research the researcher may apply ‘triangulation’, which combines more than one

research method (e.g., interviews with focus groups or participant observations). When the research draws a common conclusion from diverse methods, the research results will be more reliable (Kelliher, 2005). Similarly, the interpretivist researcher may develop a ‘thick (detailed) description’ of the research data and provide reasonable evidence to support the validity of the results. In turn, as long as the research setting (data collection conditions and/or circumstances) is described and the researcher reflects on it, then the research would be more ‘transferable’, meaning the extent to which the research design can be transferred externally (Saunders et al., 2019). Despite this, a single case or sole research method can be generalised for theoretical propositions considering the difference between analytical and statistical generalisation (Kelliher, 2005). Moreover, triangulation does not necessarily have to include only qualitative research methods; rather, it could be achieved using a combination of qualitative and quantitative methods, or applying subjective and objective perceptions of reality, as demonstrated by Roth and Mehta (2002), who used both positivist and interpretivist approaches to triangulate their research results.

Rahman (2017) suggests that the interpretivist position, which relies strongly on qualitative research methods, such as interviews or focus groups, can be a time-consuming option. During this time, the researcher could use the time to publish his/her findings, especially if applying a quantitative research method. In addition, the interpretivist approach could lead to the acquisition of excess data, which may be of little use, a phenomenon called ‘saturation’. According to Glaser and Strauss (1967 cited in Nakpodia et al., 2018, p. 395), “[s]aturation is achieved when the collection of new data does not shed any further light on the object being studied”. Generally, there are some issues related to both qualitative and quantitative research in terms of both philosophy and methodology. However, most important is how the researcher manages and minimises these issues by applying different strategies. In this study, the position is subjectively constructed within a specific context. Being a self-validated study, it requires ‘thick description’ (the researcher reflects deeply on the data collection, that is, interviewee information and interview settings) of the investigated case and

warranted evidence (Roth and Mehta, 2002). Thus, interpretivism offers a useful position that gives qualitative research an added value.

This section has set out the interpretivist position as the most appropriate for the current research and addresses particular criticisms such as reliability, validity and generalisability of findings beyond the research sample and context, and the time-consuming nature of such an approach (Peters et al., 2013). It has been argued that it is not a matter of the issues that may affect the qualitative or quantitative methodology but the way such issues are addressed that is of importance, as shown in Section 3.8. Next section discusses the axiological stance.

3.2.1.3 Axiological Stance

The third feature of research philosophy is axiology. For this research, axiology is described as “the role of values and ethics” (Saunders et al., 2019, p. 134). In other words, the concept of axiology in research pertains to the researcher's underlying views, ideals, and moral considerations that influence the research process and the knowledge they aim to generate. According to Saunders et al. (2019), this study is value-bound since the researcher cannot be separated from what is being researched and is thus subjective. In this vein, the researcher believes that the authenticity of the Islamic financial industry is essential (commitment to the provisions of Islamic law in form and substance). Therefore, his choice for this research aligned with the values he believes in (i.e., authenticity and integrity).

On the other hand, these values of the researcher did not constitute any challenge or obstacle to completing his research objectively and impartially. Instead, the researcher's values increased his eagerness to present the results objectively and away from confirmation bias (presenting only wished findings). Also, the researcher was keen on the diversity of the segment of those interviewed, as shown in section (3.7.1), thus presenting different viewpoints. Furthermore, the researcher diligently adhered to the ethical principles of scientific research, such as ensuring participant anonymity and obtaining informed consent, as outlined

in sections (3.7.1, 3.7.2, 3.8). Next section discusses the merits and drawbacks of a qualitative approach.

3.2.2 The Merits and Shortcomings of a Qualitative Approach

Various advantages and drawbacks are inherent in a qualitative approach. The first shortcoming concern's reliability. According to Kelliher (2005, p. 123), reliability is “the stability of measure” via which the research can be replicated in other contexts. Although this is usually in quantitative research, in qualitative research reliability parallels ‘dependability’, where the researcher reflects on and explains the research details and settings to enable others to evaluate the study or transfer it into another context (Saunders et al., 2019). Second, on validity, or an “interpretive understanding of truth” (Angen, 2000; cited in Kelliher, 2005, p. 123), qualitative research should include a ‘thick description’ of the research data and an explanation of how data were obtained (Kelliher, 2005; Roth and Mehta, 2002). The third concern is generalisation, which is “the extent to which the findings of the enquiry are more generally applicable outside the specifics of the situation studied” (Kelliher, 2005, p. 123). Again, several researchers in different fields (Kelliher, 2005; Roth and Mehta, 2002; Saunders et al., 2019) stress the importance of offering a clear description of the research phases, starting from the research question(s) through to data collection, analysis and finally the conclusions (including limitations). The aim is to increase the opportunity for other researchers to replicate or transfer the study into a similar setting or a different context, thereby minimising the negative effect of generalisation issues pertaining to the qualitative research method (Saunders et al., 2019).

Contrastingly, the qualitative research approach has several advantages, especially when focusing on the social phenomenon of Shariah corporate governance and its issues. First, it provides depth⁴³ in understanding about a specific phenomenon. Notably, Thomas and Magilvy (2011, p. 151) compared

⁴³ Depth refers to “the ability or need to gain a deep understanding of a specific phenomenon/experience with a limited number of participants” (Thomas and Magilvy, 2011, pp. 151–152).

a quantitative researcher (a fox) with a qualitative researcher (a hedgehog) and noted how “the fox knows many things, but the hedgehog knows one big thing”. In this regard (ibid., p. 152), “[h]edgehogs are interested in a holistic, close-up view of many features (variables in quantitative terms) of a single phenomenon. The perspective of qualitative research and analysis is like that of the hedgehog, staying focused on a single spot (phenomenon/experience)”. In contrast, the fox’s perspective or the quantitative researchers is wider, as they study the phenomenon horizontally (exploring the relationship/effects of independent factors on a dependent factor).

Second, qualitative research gives the reader a ‘thick description’ of actors’ understandings, feelings and body language (Rahman, 2017) because reality is socially constructed and people are its cornerstone. Third, it provides a good way of understanding people’s experiences regarding a specific subject (e.g., SSB independence) in a specific context. Fourth, according to Rahman (2017, p. 104) “interpretivist research is regarded as ‘ideographic’ research, the study of individual cases or events (Kelin and Myers, 1999); and it has abilities to understand different people’s voices, meanings and events”. This approach relies heavily on the meaning of human language and words in a particular context. For instance, in the context of independency of SSB members and the entity responsible for appointing them, the meaning of the same question asked for the same participant (Shariah scholars sitting in multiple SSBs) might be different in a different country owing to the contexts, especially if the research were conducted in two specifically different countries – one in the West with non-Shariah-based legislation and the other in a Muslim country with fully Shariah-based legislation. The fifth advantage concerns flexibility in designing the research strategy (Rahman, 2017). For example, semi-structured and unstructured interviews offer flexibility for interviewees, providing space to discuss their narrative within the frame of the research topic. Further, this approach gives the researcher opportunities to build a rapport with participants that can also facilitate exploring or explaining more post-interview, which is not the case with other research techniques such as surveys, where the researcher deals with anonymous participants.

Methodologically, most corporate governance and Shariah corporate governance studies in the Middle East or the Gulf Cooperation Council are dominated by the use of quantitative methods. On the other hand, qualitative studies conducted to discuss Shariah corporate governance are scarce. For example, based on semi-structured interviews, Bindabel et al. (2017) discuss the extent of compliance with Shariah governance rules among Islamic firms in three Gulf countries, namely Saudi Arabia, Kuwait, and the UAE. In addition to the extent of the impact of compliance with the rules of Shariah governance on acquisitions and mergers that take place internationally compared to Western companies, Khalid et al. (2018) dealt with the issue of Shariah auditors, their independence and eligibility, and the influence of Shariah supervisory board members on Shariah audit based on case studies and research interviews in the Kingdom of Bahrain. Although both studies discussed aspects that differ from this research or specific parts of it, the reader can see the depth of understanding of the studied phenomenon. Therefore, this research has contributed methodologically and theoretically to fill the research gap (as the researcher indicated in the second chapter) for this topic in Kuwait and to provide a deeper understanding of the research topic. Overall, then, the qualitative approach offers much, and its shortcomings can be mitigated.

3.3 Research Design and Theory Building

The second circle of the research onion is the approach to theory development. Notably, the current research design is based on research questions.⁴⁴ Based on this, and the research aim of studying and investigating the determinants of Shariah corporate governance in the Kuwaiti context, the research design combines exploratory and evaluative study. An exploratory study is “a valuable means to ask open questions to discover what is happening and to gain insights about a topic of interest” (Saunders et al., 2019, p. 186). As this research applied an interpretivist approach, it focused on the context, meanings and perceptions

⁴⁴ The research questions are as follows: 1) What are the macro-determinants of ‘good’ Shariah corporate governance in the Kuwaiti financial sector?; 2) What are the micro-determinants of ‘good’ Shariah corporate governance in the Kuwaiti financial sector?

of each participant through specific questions about the research topic. These questions, according to Saunders et al. (2019), usually begin with ‘what’ and/or ‘how’. Regarding the evaluative study aspect, Saunders et al. (2019, p. 188) say its aim is “to find out how something works well”. For example, if a country (e.g., Kuwait) issues a specific law, regulation or by-law regarding corporate governance, the researcher could try to assess the soundness and suitability of it according to experts and practitioners, and the extent to which it is fit for a specific country based on the legal, social and political environment.

Regarding theory development, quantitative research design is usually associated with a deductive approach, where “data are collected and analysed to test theory” (Saunders et al., 2019, p. 153). A qualitative research design, however, is commonly associated with an inductive approach to theory development and usually occurs when “your research starts by collecting data to explore phenomenon and you generate or build theory” (Saunders et al., 2019, p. 153). As the same authors note, while in the deductive approach the data follow the theory, in the inductive approach theory follows data. Thus, the current research, through its inductive approach, endeavours to add breadth and depth to institutional theory in the Kuwaiti context. In this context, the researcher analysed his data electronically using NVivo software. NVivo is a software designed for qualitative data analysis. Furthermore, as there is little research concerning Shariah corporate governance based on institutional theory, this research added new horizons and insights for policy-makers, regulators, practitioners, and IF researchers and customers.

3.4 Qualitative Data Collection (Methodological Choice)

Based on Saunders et al.’s (2019) research onion, the methodological choices can be quantitative, qualitative or mixed-method research designs – with the first two being either mono (one method alone) or multi-method (more than one qualitative or more than one quantitative). For instance, a researcher may conduct interviews and do ethnography, so the methodological choice here would be a multi-method qualitative study, according to Saunders et al.’s (2019) criteria. There can be various types of qualitative methods used in such research, and

Matthews and Ross (2010, p. 147) categorise these as follows: a) structured, semi-structured or unstructured interviews; b) focus groups; c) gathering documents; d) narrative,⁴⁵ and e) participant and non-participant observation.

3.4.1 Qualitative Interviews

The research interview is a main method of data collection that is widely used in qualitative research, which Matthews and Ross (2010, p. 219) define as a

data collection method which usually facilitates direct communication between two people, either face-to-face or at a distance via telephone or Internet. It enables the interviewer to elicit information, feelings, and opinions from the interviewee using questions and interactive dialogue.

Saunders et al. (2019, p. 434) describe the research interview as “a purposeful conversation between two or more people, during which the interviewer asks concise and unambiguous questions and listens to the interviewee talking”. As these definitions indicate, the research interview consists of the following components:

- 1) Having a clear purpose for interviewing participants (interviewees), which pertains to the research beforehand.
- 2) Occurring between two or among more people.
- 3) Being based on communication through conversation or dialogue with clear and direct question themes, and subject frame prepared beforehand.

Interviews are about exploring certain concepts, dimensions or subjects to explain more about a specific topic, to evaluate a particular experience and/or to rectify incorrect perceptions regarding specific aspects of research topics (Saunders et al., 2019). However, these aims cannot be achieved by researchers

⁴⁵ Narrative methods involve “gathering people’s stories to analyse how the story is told” (Matthews and Ross, 2010, p. 147).

without their having ‘journalistic’ interviewing skills, as Saunders et al. (2019, p. 435) describe them, subsequently summarising these skills into three points. First, a clear interview purpose is required (as mentioned) and good delivery of the first question. Indeed, the first question directs the course of the interview, resulting in a direction that acquires the required information or possibly in continuing the interview with useless information. Second, questions should be asked in a friendly and simple manner rather than using complicated terms or jargon. Third, the researcher should avoid asking ‘killer’ questions, which, according to Saunders et al. (2019), elicit only a very short response at best (‘yes’ or ‘no’). Indeed, asking ‘closed’ questions is likely to force the interviewee to avoid responding openly or even cause them to evade answering at all.

Matthews and Ross (2010) and Saunders et al. (2019), among many others, identify three types of interviews:

- Structured interviews, which are basically based on a questionnaire the interviewer prepares beforehand, with questions being asked in the same way, tone and sequence for each participant (to reduce bias). This kind is classified under “quantitative research interviews” (Saunders et al., 2019, p. 437) and is like a questionnaire wherein the questions are arranged in a fixed order and the interviewer does not interact with the participants or has very limited interaction.

- Unstructured interviews (in-depth interviews), which are usually informal and commence without significant interviewer preparation except for a generalised overview of the researcher’s thoughts about the research topic. The aim is to explore new ways of understanding a topic, event or phenomenon. Usually, the researcher leads the discussion in structured and semi-structured interviews, though during an unstructured interview the researcher reacts to the information the interviewee provides. This interview type is thus a dialogue – a sub-type of unstructured interview in which the researcher engages in an open discussion with the participant. For Saunders et al. (2019), a dialogic interview is more appropriate for interpretivist research as it enables more reflexive and flexible

interactions with participants in which the latter can tell their stories and experiences freely.

- Semi-structured interviews are the third main type, which, for Matthews and Ross (2010, p. 221):

are used to collect data in a wide variety of research designs. They are most typically associated with the collection of qualitative data when the researcher is interested in people's experience and understanding of the social world in this way.

3.4.1.1 Semi-Structured Interviews and Research Design

In a semi-structured interview, the researcher focuses on two factors: (i) the content and context of the interviewee; and (ii) the way opinions, feelings and facial expressions are presented. While structured interviews commence with predetermined questions, this type of interview commences with predetermined themes. Semi-structured interviews are used in three ways. The first is in exploratory research, where little research has been conducted on the topic in question and where the researcher may wish to know more about participants' opinions and perspectives on a specific aspect, or how they use language with respect to it. This approach can also be used in pilot testing, which is defined as follows:

A trial run or an opportunity to try out a data collection method on a small sample of cases before the main research data gathering takes place; to test question wording, so that research participant understanding and data collection procedures can all be tried out and amended, if necessary, before the main research stage.

(Matthews and Ross, 2010, p. 222)

Concerning pilot test or interview, the researcher conducted two pilot interviews with two Kuwaiti academics, one in finance (a former employee in the CBK and an IFI) and the other in law, who is currently working with the capital market

authority as a consultant. The second use of semi-structured interviews is in explanatory research, which focuses on why people behave or respond to a specific subject (e.g., why an SSB member might respond in a certain way to regulations that oblige him/her to disclose the rewards). By gathering explanations in interviewees' own words, the researcher can understand participants' perspectives. The third is in evaluation research, such as how semi-structured interviews allow the researcher to investigate participants' opinions regarding new regulations or policies that have been already implemented. From these, interviewers can determine whether participants believe policies have achieved their objectives (and why).

One could argue that semi-structured interviews without prepared questions might lead the researcher towards useless or unbeneficial interview data, but alternatively semi-structured interviews can serve as an 'interview guide'.⁴⁶ This guide does not consist of prepared questions; rather, it is "an agenda for an interviewer with additional notes and features to aid the researcher" (Matthews and Ross, 2010, p. 227). The same authors (*ibid.*) listed numerous benefits of an interview guide. It

- Helps the interviewer remember points to cover;
- Suggests ways of approaching topics;
- Reminds the interviewer about probes and ways of asking questions;
- Includes an introduction and a way of ending the interview;
- Ensures that the interviewer covers all the topics;
- Gives a possible order of topics; and
- Helps the interviewer enable people to talk in their own way and as fully as possible.

⁴⁶ See Appendix 5.

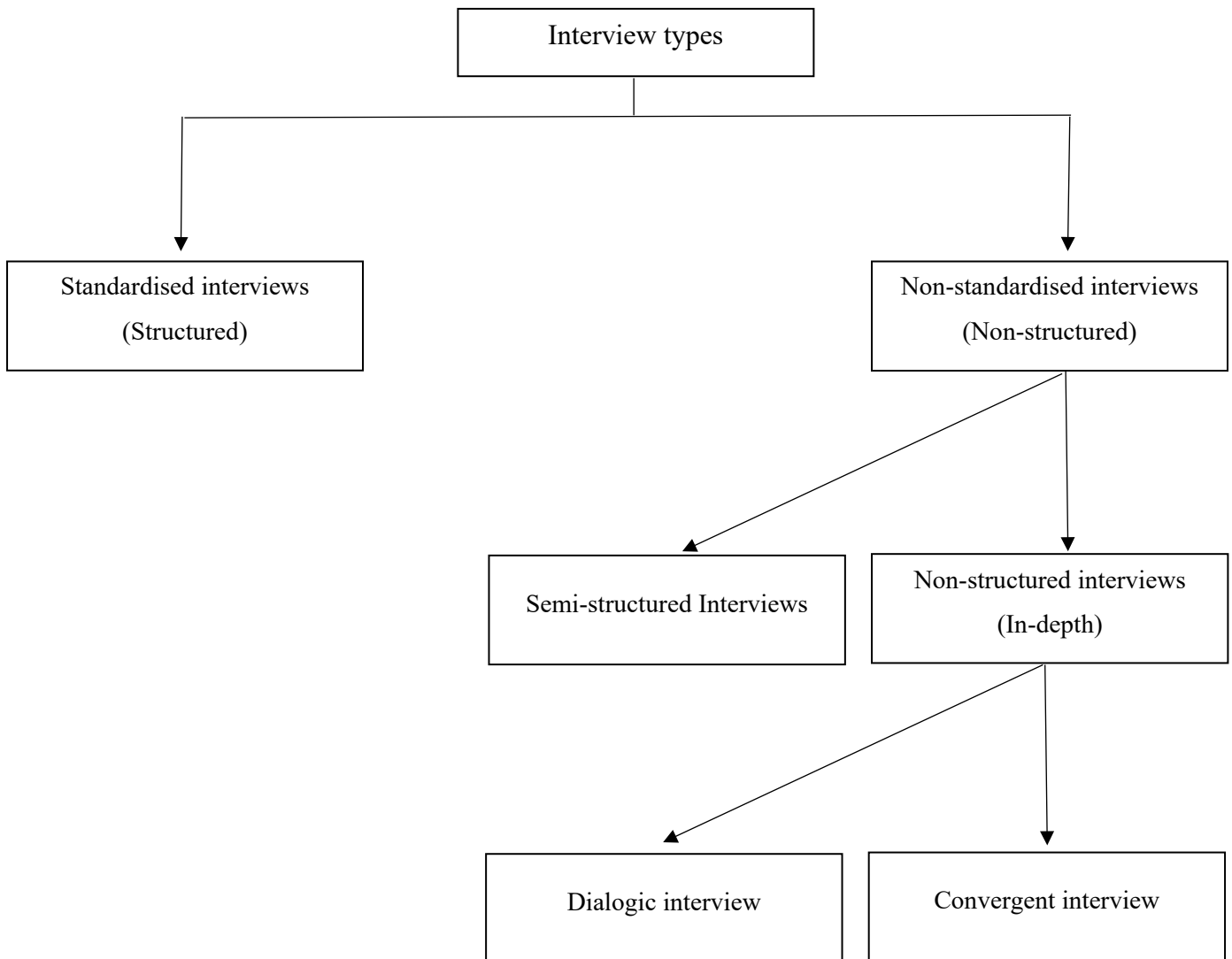


Figure 5: Interview Types (Saunders et al., 2019, p. 437)

Interviews can also vary in number of participants, (see Saunders et al., 2019, p. 479)

Recognising four types of research purposes (exploratory, descriptive, explanatory and evaluative), Saunders et al. (2019) also suggest that research interviews should be differentiated based on these and matched with particular interview purposes and even types:

- Semi-structured interviews are helpful in exploratory research, especially in providing appropriate background on topics in question. Moreover, semi-structured interviews are suitable for explanatory research that aims to understand the relationship between variables and whether the research topic is affected. Generally, this type of interview is associated with an inductive approach.
- Structured interviews are suitable for descriptive research that aims to provide a general pattern in seeking a good understanding of the research subject. They can also be used in explanatory research with statistical analysis. Usually, this type of interview is associated with a deductive approach.
- Unstructured interviews (in depth) are also used in exploratory research. According to Saunders et al. (2019, p. 443), the aim is to “find out what is happening and to understand the context”.

3.5 Research Strategy

Saunders et al. (2019, p. 189) define research strategy as “a plan of how a researcher will go about answering her or his research question”. Research strategies concerning qualitative methods range from ethnography, action research and grounded theory to narrative inquiry (Saunders et al., 2019). Based on the research questions, purposes, and research objectives (see Section 1.10), narrative inquiry is employed herein as a research strategy, with the narrative being “any text or discourse, or it might be text used within the context of a mode of inquiry in qualitative research” (Chase, 2005, cited in Creswell et al., 2007, p. 240). For Saunders et al. (2019, p. 209) “the narrative can be applied generally to describe the nature or outcome of a qualitative interview.”

3.6 Research Time Horizon

The time horizon of such research is fundamentally based on the research questions, a researcher’s time availability, and data collection access to conduct the study. According to Saunders et al. (2019), the time horizon is either cross-sectional or longitudinal study. While the latter is relaxed in time regarding data

collection and analysis, cross-sectional studies involve “the study of a particular phenomenon (or phenomena) at a particular time” (Saunders et al., 2019, p. 212). In light of this, the current research is a ‘snapshot’ time horizon, as Saunders et al. (2019) term it.

3.7 Research Techniques and Procedures

This section covers data collection and data analysis.

3.7.1 Data Collection

This research applies a qualitative method of in-depth semi-structured interviews for data collection. The researcher prepared general questions beforehand (interview guide) to shape the dialogue and subsequently ensured that interviewees had the freedom of talking without frequent interviewer intervention/interference, which normally typifies structured interviews. The interviews were conducted with officials (ministers, junior ministers, Under-Secretary of Finance and Trade), regulators (central bank, capital market authority, regulatory insurance unit), boards of directors (BODs)/chief executive officers (CEOs) of IFIs, SSB scholars, Shariah auditors, Shariah Audit Syndicate, IFI practitioners, academic experts, legal experts, IFIs’ customers and a politician, as Table 1 below shows. The data was collected between March and October 2021.

Table 1: Interviewee Information

	Interviewee	Sector	Experience	Notes
1	SSE1	Shariah Expert Supervision	More than 25 years in the Shariah supervision field	Assistant professor in Islamic law – private university
2	SSE2	Shariah Expert Supervision	More than 35 years in the Shariah supervision field	Ex-dean of Shariah and Islamic studies college – Kuwait University
3	SSE3	Shariah Expert Supervision	More than 25 years in the Shariah supervision field	An academic + SSB member in several IFIs
4	SSE4	Shariah Expert Supervision	More than 35 years in the Shariah supervision field	Ex-academic in Shariah and Islamic studies college – Kuwait University
5	ACA1	Assistant professor – law	More than 15 years in the field of law	–
6	ACA2	Associate Professor – finance	More than 5 years in academia	–
7	ACA3	Assistant Professor – law	More than 5 years in academia	Arbitration specialist
8	SAM1	Shariah Audit Manager – IB	More than 15 years in the Shariah supervision field	–
9	SAM2	Shariah Audit Manager – IB	More than 15 years in the Shariah supervision field	–
10	SAM3	Shariah Audit Manager – IB	More than 15 years in Shariah supervision field	–
11	SAM4	Shariah Audit Manager	More than 25 years in accounting and financial auditing	Shariah audit firm
12	SSA	Shariah Auditing Association	More than 15 years in the Shariah supervision field	Non-governmental Organisation
13	SAE1	Shariah Audit Expert	More than 20 years in the Shariah auditing field	Shariah auditing firms – an academic and specialist in Shariah corporate governance
14	SAE2	Shariah Audit Expert	More than 10 years in the Shariah auditing field	Shariah auditing firms – an academic and specialist in Shariah auditing

15	SAE3	Shariah Audit Expert	More than 20 years in Shariah auditing field	Shariah auditing firm
16	SAE4	Shariah Audit Expert	More than 20 years in Shariah auditing field	Shariah auditing firms and IBs – an academic and specialist in Shariah auditing
17	BCH	BOD Chairman – IB	More than 35 years in Islamic banking and the IFIs field	–
18	INVCH1	BOD Chairman – Islamic Investment companies	More than 35 years in the IFIs field	One of the founders of IFIs in Kuwait
19	BODM	BOD Member – public and private companies	More than 35 years in IFIs and the accounting field	An academic in accounting – Kuwait University
20	BCEO	Chief Executive Officer (CEO) – Kuwaiti IB	More than 10 years in Islamic banking and more than 30 years in the banking field	–
21	EXE	Ex-CEO Kuwaiti IB	More than 5 years in Islamic banking and more than 25 years in the banking field	–
22	EXSSM	Ex-SSB Member – IB	An academic and specialist in Islamic financial transactions for more than 20 years	An academic in Shariah and Islamic studies – Kuwait University
23	SSM	SSB Member – IB	More than 20 years in SSB	An academic in Shariah and Islamic studies – Kuwait University
24	HSSA	Head of Shariah Supervisory Authority – Regulatory Authority	An academic and specialist in Islamic financial transactions for more than 20 years	An academic in Shariah and Islamic studies – Kuwait University
25	EXREG1	Ex-Regulator – Investment sector	More than 15 years' experience in regulatory authorities and legal consultants	Lawyer
26	EXREG2	Ex-Regulator – Banking sector	More than 25 years in regulatory authority (10	–

			years of these in the position of Vice President of the Authority)	
27	EXREG3	Ex-Regulator – Investment sector	More than 25 years in legal advice and commercial arbitration	An academic in law and a lawyer
28	INVREG1	Investment Regulator	More than 10 years in a senior position in a regulatory authority	–
	INVREG2	Investment Regulator	More than 20 years' experience in a regulatory authority	–
29	INVREG3	Investment Regulator – high leadership position	More than 30 years of legal and investment experience	An academic and ex-law college dean – Kuwait University
30	BREG1	Banking Regulator	More than 15 years in regulatory authority (5 of them in senior role)	–
31	BREG2	Banking Regulator – Senior executive position	More than 13 years in regulatory authority (senior role) and 25 years in the banking sector	–
32	IREG	Insurance Regulator	More than 15 years in the commercial and insurance field	–
33	BLC	Banking Legal Consultant – IB	More than 20 years' experience of legal and banking advice	An academic in law – Kuwait University
34	EXBLC	Ex-Banking Legal Consultant – IB	More than 25 years' experience of Islamic banking legal advice	An academic in law – Kuwait University
35	POL	Politician – Ex-parliament member	More than 25 years' experience of legal consultant and social activist	Lawyer and specialist in governmental governance
36	IFC	Islamic Finance Customer	More than 20 years' experience in Investment companies	An academic in management

The research sample was selected using purposive and snowball sampling. While purposive sampling depends heavily on researcher judgement in selecting appropriate participants to answer the research question(s), snowball sampling

– as Robson and McCartan (2016, p. 167) note – is “where interviewees recommend other interviewees [and thereby] increase the number of respondents and possibly their openness”. For example, on concluding the interviews the researcher may ask each interviewee about who else could participate in the research based on their own knowledge and experience in the field. As Myers (2020) says, this technique (snowball) enables the researcher to conduct another interview and gain access by virtue of the interviewee.

3.7.1.1 Interview Setting

The researcher used the Microsoft Teams program to conduct his research interviews, as most of his interviews were (only two were via Zoom due to a technical issue with the guests' Teams). The reason that prompted the researcher to conduct his interviews online is that the data collection period was during Covid-19 when there were restrictions on travel and meeting with people. Therefore, online interviews were the most appropriate method for that period. Despite the drawbacks of online interviews, such as the possibility of a weak network or lack of interaction between the researcher and the interviewee (such as body language), its merits outweighed its drawbacks. One of the essential advantages of online interviews, especially during Covid-19, is that it is the most used method for most people, and therefore no one cannot use it. Online interviews also have recording, conversation and time control features and the possibility of conducting more than one interview in one day.

Each interview lasted between one to two hours and was audio recorded (with participants' consent). This length of interview is widely used by academics and qualitative researchers as it is neither too short (the researcher cannot benefit because of lack of time) nor too long (it may disrupt or exhaust interviewee commitment). Although gaining access is considered a key challenge for some qualitative researchers, this is not the case here. With the researcher's work in the CBK over 15 years, during which many relationships were built with various Islamic finance industry stakeholders (SSB scholars, Shariah audit managers, academic experts, etc), and with Kuwaiti society being small and interconnected,

the researcher had previously built many relevant social relations that facilitated this process (though this meant attending to resultant possible bias – see 3.7.2).

On interviewing procedures, the interviewer first communicated with participants by phone to obtain an initial agreement regarding their interview then agreed on a suitable date to conduct it. Next, an e-mail with the consent form and participant information sheet attached was sent to participants. Consent was obtained by participants either signing the form or responding with approval via email. All interviews were conducted online since they took place during the COVID-19 period (travel restrictions). The researcher emailed each interviewee a link to an electronic interview. After each interview and before transcribing, the researcher recorded his observations and the most significant topics addressed by the interviewee most significant topics.

Furthermore, most interviews were conducted in Arabic language (only 2 interviews were in English). In terms of translation, each interview was translated from the Arabic language to English by researcher and Google translate. Then the researcher ensure that every terminology is accurate and if there is a mistake, the researcher correct it directly before moving to the next part of interview or the next interview. For example, the term such as Shariah translated legitimate in Google translate. Here, the researcher corrects the term before proceeding to the next part. The interviews were securely saved on OneDrive, with exclusive use limited solely to the researcher. Furthermore, the interviews files were appropriately identified and preserved in their original state, ensuring their readiness for transcribing. A written description providing facts such as the time, date, and name of each interview was provided alongside every video file. Regarding the process of transcribing, it is worth noting that the interviews were transcribed by freelancers who possess a high level in transcription skills.

3.7.2 Minimising Potential Bias

As the researcher chose the interviewees and given the background aspects noted in Section 3.8.1.1, selection bias was a risk. To counteract this, the researcher

purposely chose a diverse sample from different segments, even within one segment (as shown in the above table), without prioritising closer personal contacts. The selection thus includes Shariah scholars who are currently members of SSBs in Islamic banks and IFIs besides former SSB members. At the BODs and executive members levels, among the sample was a former CEO of an Islamic bank and a current CEO of another Islamic bank. Table 2 below shows this.

Table 2: Interviewee Backgrounds and/or Positions

Academic	Legal consultant at IFI		Regulators		Shariah scholars at SSB		Board of directors' members and Executives at IFI		Others (Shariah audit experts, customer, politician)
	Current	Former	Current	Former	Current	Former	Current	Former	
5	1	1	7	2	3	2	5	2	8

Source: Researcher

Another issue with qualitative methodologies is a possible lack of trust between the researcher and interviewees, perhaps owing to the interviewee's knowledge of the researcher's position. Consequently, the interviewee might need to be conservative in expressing meaningful information or a genuine opinion. In this context, the researcher clarified beforehand that his role here was as a researcher and that he was open to all opinions. In addition, the researcher signed a form about not publishing the interview, emphasising that it is for research purposes only and that those interviewed will remain anonymous. For instance, the researcher, as in Table 1 above, referred to the academic as ACA, the Shariah audit managers as SAM, the supervisors as REG, and so on.

3.7.3 Data Analysis

The most important issue after conducting interviews (or using other qualitative methods) is data analysis and interpretation – the crucial 'so what' of data gathering. Examples of qualitative data analysis include quasi-statistical approaches, which Robson and McCartan (2016, p. 461) say "uses word or

phrase frequencies and inter-correlations as key methods of determining the relative importance of terms and concepts, typified by content analysis”, thematic coding analysis and the grounded theory approach. A very clear and insightful definition of thematic analysis derives from Grbich (2007, cited in Matthews and Ross, 2010, p. 373), who sees it as “a process of segmentation, categorisation, and relinking of aspects of the data prior to final interpretation”. Based on the dimensions of the research questions (which focus on the macro and micro levels of Shariah corporate governance), this approach may be appropriate as various aspects (themes) related to these dimensions and the general research topic may arise and hence justify its use.

Robson and McCartan (2016) describe the phases of thematic analysis as follows:

- 1) Familiarising yourself with the data: “transcribing data (if necessary), reading and re-reading the data, noting down the initial ideas” (p. 469). This means the researcher listens to or reads the data more than once, trying to understand and to be familiar with what has been collected.
- 2) Generating initial codes: “extracts from the data are given codes in a systematic fashion across the entire data set, with similar extracts being given the same code” (p. 469). Codes are “the most basic segment, or element, of the raw data or information that can be assessed in meaningful way regarding the phenomenon” (Robson and McCartan, 2016, p. 471).
- 3) Identifying themes: as Matthews and Ross (2010) argue, in this phase the researcher begins to delve into the data to interpret them and to extract the meanings that have been classified into different themes. During this phase, it is recommended that the researcher revises themes and checks the relationship of the themes with the codes (Robson and McCartan, 2016) (see Table 3).
- 4) Constructing thematic networks and making comparisons: this is described as “developing a thematic ‘map’ of the analysis” (Robson and McCartan, 2016, p. 469).

- 5) Integration and interpretation: Robson and McCartan (2016, p. 469) say this involves “making comparisons between different aspects of the data using display techniques such as tables and networks, exploring, describing, summarising, and interpreting the patterns.”

In this context, the researcher analysed his data electronically using NVivo software. NVivo is a software designed for qualitative data analysis. Moreover, NVivo facilitates the researcher's engagement with extensive qualitative data (interviews). The software enables efficient data organisation, categorisation, and analysis (see Table 3). Based on Robson and McCartan (2016), the researcher started the analysis process by reading the transcriptions and listening to the interviews to familiarise himself with the data. Then, the researcher extracts the initial codes from the data. For example, SSB independence, Shariah audit, and political tendencies were extracted as an initial code. Then they were included within the Shariah supervision arrangement and Kuwait institutional context, respectively, as shown in Table 3 below. Consequently, the researcher blended all themes by interpreting what the interviewees mentioned and drawing an integrated picture of the research results, as shown in Chapters 4 and 5, and that was the final stage of analysis. Consequently, the researcher combined the various themes by analysing what the interviewees suggested and constructing a cohesive picture of the study findings, as presented in Chapters 4 and 5. This marked the concluding phase of the analysis process (see Table 3).

Table 3: Research Themes

Themes	Codes
Kuwait institutional context: <ul style="list-style-type: none"> • Legal aspects • Political aspects • Social aspects 	<ul style="list-style-type: none"> • Islamic financial transactions' laws and regulations, courts and judicial institutions and Shariah corporate governance. • The impact of the political tendencies of individuals; the National Assembly and its members on Shariah corporate governance. • The impact of <i>diwaniyya</i> and social connectedness of Kuwaiti society on Shariah corporate governance.

Shariah supervision arrangements	<ul style="list-style-type: none"> • SSB (SSB members' competency, SSB independence, Shariah-related matters disclosure, SSB members' multi-membership). • Shariah audit (internal and external, Shariah audit and Shariah advisory firms).
Kuwait Shariah corporate governance status	<ul style="list-style-type: none"> • Laws and regulations concerning Shariah corporate governance. • Regulatory authorities (CBK, CMA, and IRU) and the Shariah corporate governance, Islamic finance master/comprehensive plan.
IFI stakeholders	<ul style="list-style-type: none"> • Higher educational institutions. • Non-governmental organisation (i.e., Shariah audit syndication). • Standard-setting institutions (AAOIFI, IFSB).

3.8 Ethical Considerations⁴⁷

Saunders et al. (2019, pp. 252–253) define research ethics as “the standards that guide your conduct in relation to the rights of those who become the subject of your work or affected by it”. Particular ethical issues relate to academic research, whether qualitative or quantitative in nature, including having (the researcher) integrity, fairness and open-mindedness; respecting others and the privacy of those taking part in the research; ensuring data confidentiality and maintaining participant anonymity; and showing responsibility in analysing data and reporting findings (see Saunders et al., 2019, pp. 257–259). There are some ethical caveats associated with qualitative research, such as deception, lack of informed consent, and invasion of privacy (Diener & Crandall, 1980). This section and section (3.7.1.1) show the arrangements taken by the researcher to deal with these ethical caveats. As this research brings the researcher directly into contact with the participants, this involves certain ethical considerations. For instance, the participants' anonymity is a main aspect of research ethics, as it reflects the care of the researcher in maintaining confidentiality and anonymising collected data (Saunders et al., 2019). In this work, these aspects,

⁴⁷ Ethical approval has been obtained from the NUBS ethical committee for this research (see Appendix 6).

especially data confidentiality and participants' anonymity, are explicitly mentioned in the consent form, and all participants interviewed were asked to read and to sign the form if they agreed to participate voluntarily under the noted circumstances. In addition, the researcher covered these topics again at the beginning of each interview and proceeded only with participants' consent.

Furthermore, researchers should not hide or alter research findings or results that are not in line with his/her preference, which is referred to as responsibility in the analysis of data and reporting of findings (see Saunders et al., 2019). Nonetheless, unexpected results could be considered a new subtheme and contribute a new dimension to the study, thereby enhancing comprehension of the phenomenon from multiple perspectives and demonstrating the researcher's honesty and objectivity.

3.9 Conclusion

This chapter has outlined this work's research methodology and methods, which are based on Saunders et al.'s (2019) research onion. It started from research philosophy and ontological and epistemological stance, then moved to the appropriate philosophy for this research. It next discussed the approach of theory development before explaining the merits and shortcomings of this research approach then clarifying the research design and theory building. Following that, it explained the methodological choice, which was a mono method qualitative. Thereafter, it touched on the research strategy. This was followed by the research time horizon and the study's detailed research techniques and procedures, starting from interviews as one of the most frequently used data collection tools in qualitative research. Subsequently, the chapter explained the reason behind choosing semi-structured interviews as a data collection method (mono method) and followed this by considering the interview setting. Further, thematic analysis was explained as this work's data analysis technique. The main ethical issues and considerations were discussed, which showed how this research solved certain issues it faced, before the conclusion completed the chapter.

The following chapters present and discuss the findings from this study, supported with anonymised data from the interview respondents (see Table 1). Chapter 4 examines the macro determinants of good Shariah corporate governance, while Chapter 5 examines the micro determinants from two levels: industry-level and firm-level.

Chapter 4

Macro-Level Determinants of Good Shariah Corporate Governance in the Kuwaiti Financial Sector: Research Findings and Discussion

4.1 Introduction

This chapter addresses the first research question: what are the macro-determinants of ‘good’ Shariah corporate governance in the Kuwaiti financial sector? It discusses the institutional or macro-level determinants of ‘good’ Shariah corporate governance in Kuwait, including the regulatory, social, political and legal factors influencing Shariah corporate governance in this context. For example, the regulatory aspect considers whether and why a regulatory approach that is principle-based, rule-based or both is most suitable for the Kuwaiti environment. As Adegbite (2015) argues, studying institutional effects such as social, political and legal aspects enable researchers to identify appropriate Shariah corporate governance mechanisms (including regulatory) and/or approaches that fit a particular environment. Further, it discusses Shariah corporate governance stakeholders’ role, challenges, and the solutions with regard to the Islamic financial industry.

The chapter thus proceeds as follows. It initially presents the study findings about the regulatory approaches, whether rules-based, principles-based, or hybrid (4.2), in addition to the appropriateness of the supervisory approaches to Shariah corporate governance in the Kuwaiti context. Second, it discusses Kuwaiti society’s social connectedness and the extent of the impact of what is called *diwaniyya* (4.3) on the Shariah corporate governance practices. Then, it discusses the political aspects, such as parliamentarians, political parties, and intellectual groups in the Kuwaiti context (4.4), for instance, whether the political aspects harm Shariah corporate governance practices and those concerned with them (i.e., Islamic financial institutions’ Shariah Supervisory Board members and boards of directors). Fourth, it discusses the various aspects of the existence or absence of legislation regulating Islamic financial institutions (IFIs) (4.5). Further, it deals with the study results regarding legal challenges for IFIs, such as the absence of a particular law concerning Islamic financial

products offered by these institutions. Fifthly, it moves to the Shariah corporate governance stakeholders concerned with IFIs and the extent of their influence on the reality and practices of Shariah corporate governance (4.6), for example, educational institutions, especially universities, and the extent to which educational curricula exist for Islamic finance and economics. In addition, this section deals with non-governmental organisations concerned with Shariah supervision and standard-setting institutions for IFIs and the extent of the comprehensive plan's impact for Islamic finance in the country. Next, it presents the macro-level determinants of good Shariah corporate governance in the Kuwaiti financial sector (4.7). Finally, Section 4.8 concludes the chapter.

4.2 Regulatory Approach

A rule-based regulation approach currently regulates Islamic banks (IBs) in Kuwait, particularly regarding Shariah corporate governance, while its counterpart of a principle-based regulation regulates Islamic investment companies, although with a touch of rules-based regulations. An objective of this research is thus to consider the literature and participants' perspectives to assess the suitability and relevance of Kuwait's existing approach and determine whether there are any prerequisite steps for adopting a specific regulatory approach (Nakpodia et al., 2018). According to Burgemeestre et al. (2009), many regulatory regimes do not have a clear approach, perhaps because many are mixed in differing degrees (e.g., one clearly dominant or the two both having much input). As an example, a regime may be considered rule-based but with principle-based characteristics if it contains exceptions and qualifications, or vice versa. From different angles the following sections discuss rules-based regulations and principles-based regulations and, at times, both concurrently.

4.2.1 Between Rule-Based and Principle-Based Regulation

Respondent opinions vary as to whether the most appropriate regulatory approach for Shariah corporate governance is rule-based, principle-based or both. Most regulators incline towards a principle-based approach or a combination of both, while others (non-regulators) prefer a rule-based regulatory approach. Several interviewees indicate that while the Islamic

financial industry is still young, supervisory instructions should be specific and clear. BREG1 explains:

If we come from the instructions of Shariah governance, then the instructions are in their beginnings and more details must be put in place to work according to them until the experience is stable and becomes a natural practice.

Nakpodia et al. (2018) and Burgemeestre et al. (2009) say a main advantage of a rule-based approach is reducing ambiguity and the need to guess people's thoughts. POL stated the following:

I am one of the people who adopt the detailed rules process, which I see [as] more practical and more effective, and I see that human minds will differ if principles are set without defining the clear mechanisms and the consequences of violating these specific and clear mechanisms.

For example, the instructions for the Shariah governance of Kuwaiti Islamic banks issued in 2016 do not address the number of Shariah scholars who serve on SSBs in each sector. They address only the number of memberships in the banking sector (i.e., a maximum of three memberships), and this results in a limited number of Shariah scholars who serve across many sectors thus reducing their ability to execute their duties in every SSB. Also, the instructions cause confusion among the institutions subject to the regulatory authorities, so the institutions may make undesirable decisions based on ambiguous instructions. Considering this issue (not covering some important details), SSE1 stated:

I choose the rule-based approach. The methodological things are beautiful. It is true that it, rule-based, hurts sometimes, but people adhere to it after that. As for the other method, principle-based, and what is in it [with] dilution, it does not work.

SSM explained it differently:

If we come to the laws, they are issued in brief. Then, after that, the explanatory memorandum for these laws is issued, and then there must be a chapter in every law for penalties for violating these laws,

meaning that there is no law that says 'implement', and if you do not implement, there are no penalties. There is no one who will implement it because he considers it a complementary thing.

It became clear from what was mentioned by SSE1 and SSM that when the supervisory authorities leave out some critical points (such as the number of SSBs that a member can occupy in each sector), in such a case, the IFIs will act according to their own interest and not necessarily according to the public interest. Therefore, some individuals prefer to resolve matters based on the rules, not because this approach will not overlook a specific aspect, which is possible, but because it deals with the details and does not leave matters to the parties' discretion. SSM also provided an example of when regulations are not mandatory but based on an institution's discretion:

For example, today we are the Capital Markets Authority, which unfortunately made the Shariah supervisory board not binding on companies. Today companies say: 'The Shariah Board is not obligated to us, so why do I pay the extra costs of appointing the SSB? So, what are the consequences for it [appointing SSB]?' The Capital Markets Authority says to companies that you must have a Shariah auditor. You are obliged to have the Shariah auditor but not the Shariah Board. If there is a new issue, a new investment or a new structure, the companies present them to whom? You do not have SSB because you did not obligate it, and it is supposed to be presented to the Shariah observer until he shows that it is in accordance with the provisions of Islamic Shariah or not in accordance with the provisions of Islamic Shariah.

There are, as noted, two contrasting approaches that are nevertheless not always employed exclusively. With principles-based regulation, deemed self-regulation, the regulatory authority assumes that regulated institutions do not need detailed rules or instructions. Instead, a regulator issues general guidelines and principles for consideration (Baldwin et al., 2012). Here, the task of determining the way of controlling and mitigating the risks each institution faces is delegated to these regulated institutions (Baldwin et al., 2012). Baldwin et al. (2012) also note four types of institutions usually suited to the principle-based approach. The first are well-disposed and highly capable institutions that comply with PBR smoothly and without any difficulties via "gentle encouragement"

(Baldwin et al., 2012, p. 305). The second is well-disposed but low-capacity institutions. That is, the principle-based methodology notably depends largely on the qualifications and competencies of those in charge of compliance management. However, poor resources affect these institutions' understanding and interpretation of the principles and can cause implementation issues.

The third type involves ill-disposed and low-capacity institutions, which will not be bound by the principles as they cannot properly interpret them, nor do they have the organisational capacity to apply them. This type is thus more problematic than the second type in terms of compliance behaviour and eligibility for principles-based regulation. The fourth type, ill-disposed and high-capacity institutions, "are predisposed to circumvent the relevant principles whenever this is to their advantages" (Baldwin et al., 2012, p. 305) and are thus pragmatic and self-interested. Overall, a principles-based regulation approach needs appropriate configuration in terms of compliance and governance culture, compliance organisational skills, availability of law enforcement means and regulatory deterrence, which takes time.

Regulatory enforcement concerns "the degree to which government monitoring is consistent and the severity of punishment for violating rules and laws is predictable" (Aguilera et al., 2018, p. 95). This relates to not only limited law enforcement but also the nature of the state's legal system and its governance practices (Aguilera et al., 2018). There are three regulatory enforcement logics in this regard: 1) hard laws – strict regulatory enforcement; 2) soft laws – flexible regulatory enforcement; 3) and limited laws – lax regulatory enforcement (Aguilera et al., 2018). As there is sometimes a price to be paid if decision-makers opt for a stricter law enforcement to try to combat a particular negative phenomenon and a degree of product innovation (Banerjee, 2011), when drawing up regulations regulatory authorities should consider trade-offs between the level of intensity of law enforcement and innovation, though the trade-off may be between regulatory efficiency (cost–benefits) and normative premises (human rights) (Samuels, 1978). Samuels (1978), in fact, strongly

advocates considering normative values when drawing up policies/regulations and not merely the economic side. As ACA1 stated during an interview:

The thing is, what I hope happens is the role of the Central Bank as the supervisor, to protect the interest of people dealing with the Islamic banks by ensuring Shariah compliance and not just to leave it completely to the Shariah Supervisory Board. But also, on the other hand, if they strengthen the Shariah Supervisory Board's independence, this will also give a better credibility to Islamic banks, so that's the enforcement. We have rules, but we don't know if they're really enforced in practice or not.

In contrast to the principles-based regulation approach, which relies on indirect influence for changing organisations' behaviour and/or practices through a 'soft' code, the rules-based regulation relies on direct influence through a command-and-control strategy (Saurwein, 2011), a main merit of which is the clarity of instructions. Such clarity can reduce misinterpretation and consequent violations of instructions because of misunderstanding, hence increasing compliance with regulations and instructions. A rules-based regulation approach thus saves time and effort for supervising institutions in interpreting and clarifying instructions, which often happens with principles-based regulation.

Despite such positive features, rules-based regulation has several drawbacks. First, it is impossible to anticipate every kind of violation and govern it in advance, which would attempt 'regulatory unreasonableness' (Boyum, 1983). A "regulatory requirement is unreasonable if compliance would not yield the intended benefits. Further, a regulatory requirement is unreasonable if compliance would entail costs that clearly exceed the resulting social benefit" (Boyum, 1983, p. 752). In this regard, sometimes regulatory authorities do not consider different capacities for compliance among institutions. Furthermore, certain regulators think they can perceive every kind of rules' violation so impose very detailed rules, thereby imposing an "over-inclusiveness of legal rules" (Boyum, 1983, p. 753). Notably, the Kuwaiti Capital Market Authority (CMA) has itself experienced regulatory unreasonableness when issuing corporate governance regulations that were very detailed and unrealistic, causing many institutions not to implement them. As EXREG2 puts it:

It is not wise to come up with everything that is stated in governance. This is my opinion of the governance system established by the authority in 2014. Everyone is bored of instructions and companies are fussed, and the person who worked on preparing the instructions used to say, 'I came to you with the best rules of governance in the world', but I said that this is a legislative error and whoever did not study legislation does not understand. This matters, because the goal today is not to come up with the best rules in America, no, and because the market in America is not like the market in Kuwait.

In line with EXREG2's comment, Andrews (2012) says we cannot adopt 'best practice' in developed countries (e.g., United Kingdom) and copy and paste this into developing countries (e.g., Kuwait) as each has its own context and environment. Andrews (2012) instead suggests the more practical and applicable adoption of 'relevant' rather than 'best' practice, adding that two factors determine relevant practice: first, the degree and type of problem the state is facing; and second, the viability of such factors. In this vein, EXREG2 puts it:

We – the Kuwait Stock Exchange –have just been classified as an emerging market,⁴⁸ so it is not permissible to come up with rules suitable for the American market and the best rules for the American market and apply them to Kuwait. This is a mistake.

With regard to the viability point suggested by Andrews (2012), it can be measured based using three questions:

- 1) Is the solution 'acceptable' given the norms and/or values?
- 2) Can the solution be 'authorised' given the power structure?
- 3) Is the solution within the current or foreseeable 'abilities' to adopt and implement it?

Although each calls for elaboration, the main point here is the context or uniqueness of each country's environment (social, political, legal, etc.), though political acceptability and resource availability are the main measures for these

⁴⁸ Morgan Stanley Capital International (MSCI) reclassified the Kuwait Stock Exchange (KSE) from frontier to emerging market from May 2020 (https://www.msci.com/documents/1296102/1330218/KW_QandA_apr2020.pdf/8b2e2b1e-a513-9b5f-bd15-64f3a366cb7d?t=1586379991420).

questions (Andrews, 2012). Specific concerns are whether the actual or proposed practices fit the country's context or not and what factors policy makers should consider. A risk is that rules-based regulation pushes some institutions into circumventing instructions and making formal commitments without content (Baldwin et al., 2012; Nakpodia et al., 2018). Indeed, such 'creative compliance', or "the process whereby those regulated avoid having to break the rules and do so by circumventing the scope of a rule while still breaching the spirit of the rule" (Baldwin et al., 2012, p. 232) is counterproductive. As EXREG2 states:

You will not reach everything that is hoped for through the regulations, as the regulations in all countries of the world are in a race, so how do the regulations change in general? It changes for two reasons: First, crises occur, and these crises are examined, and the causes of their origin are studied, and this results in lessons learned. These lessons are reflected in the development of regulations, including Basel instructions, and some of them have become global (Basel 1, 2, 3).⁴⁹ Second reason, through local regulations, and because the quality and skill of the banking and financial sector calibre are often more profound and complex than regulators', for reasons including qualifications or/and better salaries, etc., they are trying to find a way to manoeuvre around the regulations. Here is what is called financial innovation, and it is actually getting around the regulations.

Therefore, principles-based, rules-based or a hybrid approach depends on various factors and circumstances. As BREG1 says:

There are situations that need strictness, or there are things that can be set with general principles, and there are things that need to set more clear detailed rules that depend on the maturity of the subject, the extent to which these institutions absorb it, and their previous experiences towards it – many things so to speak. It is the environment in which you work.

⁴⁹ The Basel Committee on Banking Supervision (BCBS) is the primary global standard setter for the prudential regulation of banks, and it provides a forum for regular cooperation on banking supervisory matters. Its 45 members comprise central banks and bank supervisors from 28 jurisdictions (Bank for International Settlement, 2022).

4.2.2 The Institutional Context of Shariah Corporate Governance Regulation in Kuwait

Chapter 2's literature review alluded to there being no over-arching right or wrong way to choose the most appropriate regulatory approach because the choice depends on several factors that vary from environment to environment and country to country (Nakpodia et al., 2018; Saurwein, 2011). In this vein, several interviewees mentioned how a combined rule-based and principle-based approaches can be an option for regulators. SAM3 stated:

Normally, your two approaches would be a set of directives if they were principles, and it would be a set of rules if they were rules. Imagine the area you want to address in terms of governance that defines the approach, i.e., in the areas that are at high risk, the approach is more tiered, so there is a degree of deterrence because you are in front of high risks. In both cases, we can say that they are a type of controls. That is to say, to transfer governance works in the area where internal control and risk management are in place, and this is in traditional management and not legitimacy.

This participant suggests that deterrence-based regulation is suitable for managing the high-risk aspects of Shariah, such as the Shariah non-compliance risk,⁵⁰ but conversely, interpretation-based regulation is suitable for addressing Shariah's low-risk aspects (Hommel and King, 2013). Another respondent suggests using these regulatory approaches in accordance with cooperation from Kuwait's main regulatory authorities – the CBK, CMA, and IRU. As SAE2 states:

But I think that there must be a combination of rules and principles until we reach a conclusion. More accurate work on the governance of Islamic financial institutions [is needed], and this is at the heart of my work now. I say [with] the fatwa and Shariah supervision bodies appointed [by] the Central Bank and the Shariah supervisory board in the Capital Markets Authority, there must be cooperative work between the two sides to organise this issue [mixing rules and principles]

⁵⁰ DeLorenzo (2007, p. 397) defines the Shariah compliance risk as “the possibility that a financial service or product is not or will not be in compliance with established Shariah principles and standards”.

Indeed, most regulatory respondents believe that the principle-based approach is more appropriate for Shariah corporate governance. In BREG1's words:

The supervisory bodies are not Shariah bodies, but they are bodies that establish the work principles, and hence, the application could be referred by the body to AAOIFI,⁵¹ Shariah, accounting or any other standards. However, I don't think that there should be procedural frameworks imposed by the supervisory bodies in the context of their role other than Shariah financial and accounting aspects. Supervisory bodies do not interfere in detailing the financial standards or in application details, but the whole matter is governed by the accounting conventions and international standards since, if it takes such orientation, it will be placed out of its competence [specialisation] because they are mere Shariah aspects.

Another view notes how supervisory authorities issuing instructions on many details concerning social and political aspects would be costly and affect institutions' efficiency, which could even limit their innovation and creativity.

As EXREG1 puts it:

There is a trade-off between efficiency and regulations. You can put regulation and reduce bank risks to zero, but you will have a very inefficient financial intermediation. Similarly, you can make thousands of pages of instructions related to governance, but there is a cost for that; there is a cost in terms of implementation and the efficiency. As a supervisory authority you have to strike a balance between the level of regulatory instructions and between efficiency [...] you cannot go to the furthest details, you can monitor it on the basis of commitment and not on the basis of risk, and it will be costly to all parties. So, I say that these matters (nepotism, favouritism, etc.) will be greatly mitigated if the issue of efficiency and appropriateness is applied – to those who handle institutions and Shariah scholars as well.

What BREG1 and EXREG1 indicate parallels Samuels' (1978) suggestion for regulators to consider the cost–benefit analysis or the regulation efficiency first. In this vein, prior to issuing the comprehensive 2016 Shariah corporate governance instructions, the CBK addressed Shariah-related matters by distancing itself from them as it prefers not to interfere except when needed (a

⁵¹ AAOIFI is the acronym for the Accounting and Auditing Organization for Islamic Financial Institutions.

‘hands-off’ approach). BREG1 also stated:

Subsequently, I think that Shariah governance should continue in the context of principles without preventing interferences whenever there’s a need to correct some particular errors because the supervisory body is solely able to take the control and intervene when needed every now and then. However, this approach is not supposed to continue, and the industry will reach maturity. Hence, the supervisory body exercises its usual role.

As Saurwein (2011) suggests, using ‘enabling contextual factors’ to assess the existing regulatory approach and related factors may be helpful.⁵² Not all are necessarily applicable or even relevant to the Kuwaiti context, though some may be – for example, the Islamic financial industry’s reputational sensitivity. Indeed, because this industry is highly sensitive to public trust and credibility, especially regarding an IFI’s Shariah non-compliance, this can help determine the most suitable regulatory approach. Some participants said a new methodology should be devised but did so without elaboration, which nevertheless fits Nakpodia et al.’s (2018) point about involving many stakeholders in the regulatory instructions to be issued – not in a ‘top-down’ manner but rather in a horizontal manner.

Specifically, Nakpodia et al. (2018) argue that the dual – state (regulatory) and business (here IFI) – rules-based approach may not be the most appropriate. They instead suggest a third one – so-called co-regulation or multi-stakeholder regulation, which addresses oversights regarding certain interests and perspectives being absent from public policy decision-making besides the process for issuing regulatory instructions. Indeed, the main aim of multi-stakeholder regulation is to encompass via dialogue the interests and views of various stakeholders rather than merely business and government (e.g., the

⁵² Enabling contextual factors include: (1) the economic benefits for the industry; (2) the reputational sensitivity of the industry; (3) the intervention capacity of governmental actors; (4) the impact of regulatory failure and the need for uniform and binding minimum standards; (5) the required intensity of regulatory intervention; (6) the conflict between public and private interests; (7) the number of participants and market fragmentation; (8) the ability of organisations to assume regulatory tasks; (9) the intensity of competition; (10) the extent to which the existing industry culture supports the public policy objectives; and (11) the involvement of governmental actors (Saurwein, 2011).

public and employees). Those affected by the instructions thus participate and become engaged, and the assumption is that much compliance with the implementation subsequently occurs because the instructions were issued in consultation with all concerned parties. Nakpodia et al. (2018) call such regulation both negotiated and collaborative governance.⁵³ In SAE2's words:

I say there must be a cooperative work between the appointed Higher Committee of Shariah Supervision in the Central Bank and the advisory council for Shariah Supervision in the Capital Markets Authority to organise the issue of the new innovative [approach] by incorporating the rules and principles and bringing out something new, modern and different from what is applied.

Apparently, some (as SAE2 here) call for an innovative regulatory approach, as suggested by Nakbodia et al. (2018), in order to obtain the best regulatory approach for Shariah corporate governance that is suitable for the Kuwaiti environment. Another angle in determining an appropriate regulatory approach concerns the six world governance indicators issued by the World Bank every year (voice and accountability; political stability and absence of violence/terrorism; government effectiveness; regulatory quality; rule of law; and control of corruption).⁵⁴ Figure 6 below shows Kuwait's position through the previously mentioned six governance indicators issued by the World Bank.

⁵³ Collaboration is "the intervention by Government to use the social energy created by the tension between two or more social groupings habitually working in opposition to one another to achieve a policy objective" (Kirkbride and Letza, 2004, p. 89).

⁵⁴ See Appendix 7.

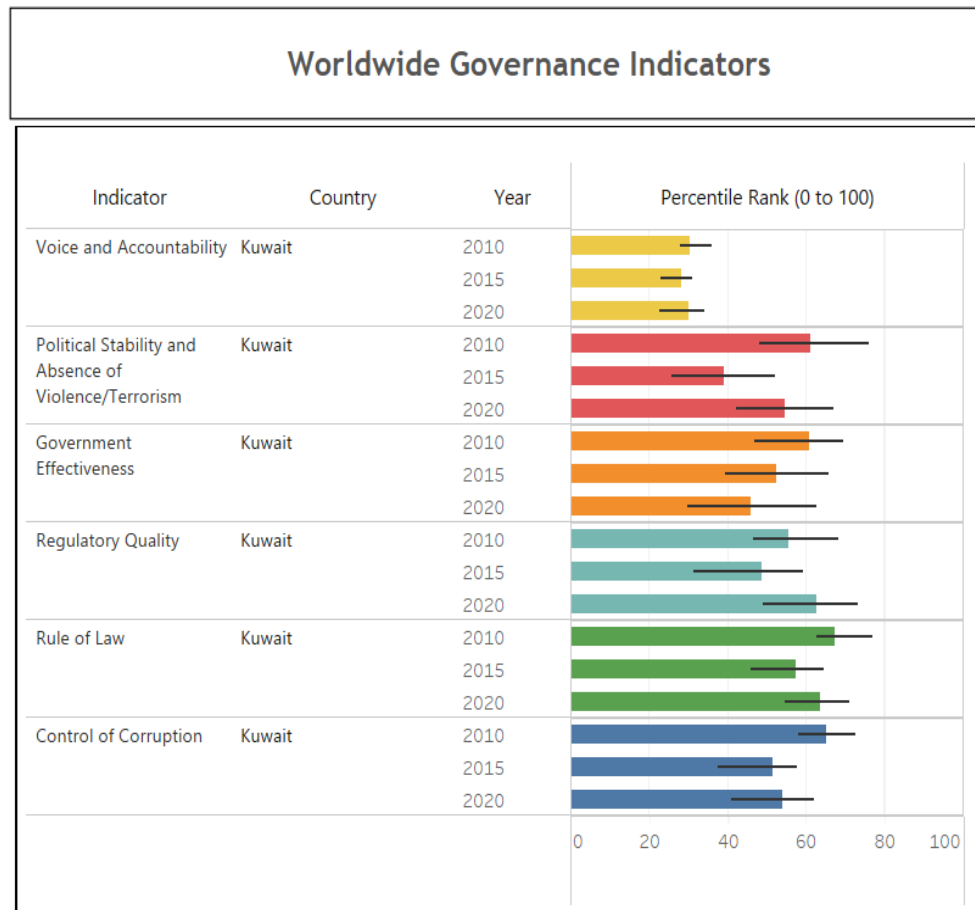


Figure 6: Kuwait's Governance Indicators – World Bank

The higher the score in these indicators (ranging from 1 to 100), the better the state's governance performance. However, Kuwait's scores mostly do not exceed 65, including on regulatory quality – as reflected in financial institutions' commitment (including Islamic ones) to laws and regulatory instructions. In such an environment, a principles-based approach that relies heavily on financial institutions' interpretation of supervisory principles may not be appropriate, as pointed out by Nakpodia et al. (2018). For these authors, if the legal environment (e.g., for Shariah corporate governance) is unfavourable (regarding legal deterrence or specialised courts), the principles-based regulation may not be best suited. In these circumstances, Nakpodia et al. (2018) instead suggest that appropriate regulatory approach should use both approaches across three stages. In the first stage the methodology is based on the rules, but this stage should not be prolonged as adherence to such a methodology is sometimes formal and

involves ‘box-ticking’. During this first stage, the above mentioned defects or weaknesses (e.g., low enforcement) are addressed before moving to the next transitional stage, where the two approaches (principles-based and rules-based) are combined, perhaps, with 60%⁵⁵ rules and 40% principles. At this stage, the principle-based approach is gradually introduced until it is established as a culture and as a flexible method based on the organisation’s self-monitoring, considering the means of law enforcement and deterrence the rules-based methodology provides (Baldwin et al., 2012). In the third stage, Nakpodia et al. (2018) say the principle-based approach prevails while the rules-based approach continues but at a lower intensity, let it be 30%, against the principle-based method’s 70%. The supervisory authority thus assumes that the institutions (i.e., IFIs) have reached the level of efficiency and responsibility that qualifies them to identify the risks they face – rather than the supervisory authorities doing this – and to take appropriate measures regarding them.

Another aspect suggested by EXSSM that is considered as one of the factors determining the appropriate regulatory approach for Shariah corporate governance is the extent to which those in charge of Islamic financial institutions adhere to the principles on which they were founded (i.e., providing an alternative to usurious transactions): in other words, how the Islamic financial industry has deviated from its original foundations in the 1970s, which EXSSM attributed to the domination of conventional IBs owners. He puts it:

The deviation occurred due to the predominance of the owners of economic thought that we call the conventional; they are the ones who controlled the situation in Islamic banks, and unfortunately, Islamic banks deviated from their course, and the Shariah supervision was affected because the choice came by this category [IB owners] that have the authority and power.

In addition, HSSA attributed the deviation issue indirectly to the lack of a culture of commitment to Shariah principles. He puts it:

⁵⁵ The percentages mentioned are from the researcher, not suggested by Nakpodia et al. (2018).

If we give the board of directors, the regulatory bodies, and the technical and practical bodies a Shariah financial culture in the field in which they work, I think many problems will be far away.

However, commitment (to Shariah principles) could also come through deterrence to such deviation via strict and clear laws and instructions. Moreover, many members of IFIs' boards of directors are only owners of capital and not possessed of a high cultural and financial awareness that enables them to follow up and monitor the institution with discipline and objectivity, so the rules-based approach may be more appropriate for the Kuwaiti financial sector because the Islamic financial industry is now in the hands of the second generation (most of whom are former leaders in conventional banks). Hence, leaving Shariah corporate governance to market forces and each IFI's interpretations through the principles-based approach may not help preserve the Islamic financial industry's authenticity (form and substance). As INVREG3 says:

Regarding the Shariah corporate governance aspect, the rules are applied to them – IFIs. That is, I cannot bind [anyone] to a principle or a goal, and he can manipulate me or the goal/principle, and this makes it mature. We have not reached it, especially since those who hold the membership of the board of directors in Kuwait are not at the high level of the intellectual, cultural and financial aspects. They are merely capital owners who have established companies. They do not have the scientific aspect and the experience that would enable them to understand the principle or the goal in order to apply it in the right way. The aspect of deviation and judgemental-based estimation in Kuwait is great.

Another angle some mentioned concerns how the Islamic financial industry is still young so it is very dangerous to do what some participants (see below) call 'phases burning' or 'shortening the stages' – that is, the regulatory authorities dealing with it as a mature industry that has completed all necessary steps, which may actually delay its natural growth. As BREG1 puts it:

If we suppose that the industry is in its infancy, then there are mistakes. By extension, there should be acceptance and strategic correction, not through interventions. Assuming there's a supervisory body intervened by appointment, in this case, who bears the ultimate responsibility for achieving the Shariah aspect? It's the

SSB because it appointed and relieved the Board of Directors and shareholders from responsibility. Is the purpose to make the supervisory body responsible for everything? I think this might lead to abortion of experience [Islamic financial industry]. Surely, time has a role. Intervention should be made only in case of serious violations.

Much more succinctly, EXREG2 says that ‘shortening the phases burns the project’.

A heavy responsibility is therefore on the supervisory authorities to deal with the Islamic financial industry appropriately and hence prudently – considering the latter’s early stage of development, so it does not encounter excessively strict supervisory regulations that do not suit its present situation, and thus avoids hindering it. If the circumstances require leniency and do not tolerate positions that require decisiveness.

4.3 Kuwait Social Connectedness: *Diwaniyya*

Kuwaiti society has a small but closely connected population, as previously noted (1.6, 2.4.2). Some scholars, such as Al-Kandari (2016), say that *diwaniyya* strengthens relationships, especially social ones, but also influences the intellectual inclinations of personalities. For example, Shariah corporate governance practice may be influenced if an SSB member of an Islamic financial institution attends the *diwaniyya* of that institution’s CEO or if a board chairman attended the *diwaniyya* of the Shariah audit director. This is a particularly significant social aspect that interviewees discussed. Since *diwaniyya* helps strengthen social relations, they see it as crucial for addressing the issue of social connectedness and a significant factor of Shariah corporate governance. According to Diemer and Regan (2022), social connectedness is an informal network or a less structured channel which may unintentionally strengthen relationships or convey knowledge. Another perception of social connectedness relates to belonging and intimacy (Rettie, 2003, cited in Visser et al., 2011). Similarly, Van Bel et al. (2008, p. 132) specifically identified five dimensions of social connectedness:

- 1) Relationship saliency – the prominence of the relationship in one’s mind, which is the outcome of thinking of another person or being aware of him/her.
- 2) Closeness – the experience of feeling close to another. This does not relate to physical proximity, but rather to the social presence in one’s mind.
- 3) Contact quality – the perceived quality of social contact with another person.
- 4) Knowing each other’s experiences – being aware of each other’s experience, both in terms of subjective experiences (e.g., love, enjoyment, sadness) as well as awareness of things that happen in one’s life.
- 5) Shared understanding – having a similar view on the world; having similar opinions and being on the same wavelength.

As such, relationships among SSB members and their institutions’ executives and directors need considering, including how these possibly negatively affect SSB members (e.g., changing their decisions unduly or leading them to be inappropriately lenient). Interviewees’ opinions varied on this topic. Most, however, say that social relationships do not negatively affect SSB members’ opinions, but some indicate that they do. Specifically for SAA:

Obviously, it [relationships affecting SSB members] exists a lot. I will give you an example. In one of the general assemblies of an organisation, and this incident happened recently, they wanted a person for a governance position, so from within the technical staff he said that we nominated a number of people and the owner of this institution said: ‘I do not want so-and-so with us’. The technicians said, ‘Do not agree with this person’. The owner said: ‘If you do not agree with him, I will vote for him in the general assembly (and I will take him and appoint him) according to my strong relationship’.

It is evident from the foregoing that *diwaniyya* has an impact on those concerned with Shariah corporate governance, either directly or indirectly. For instance, a member of the Board of Directors *diwaniyya* may request an SSB member in the same IFI to approve a financial product with doubts about it meeting Shariah

requirements. The indirect form occurs through frequent visits by a member of the Board of Directors to an SSB member in the same institution, and thus, Diemer and Regan (2022) argue, there will be an influence, albeit unconsciously (such as the inclination to his opinion). Therefore, *diwaniyya's* impact, as a Kuwaiti social feature, may indirectly impact the Shariah corporate governance practices. For instance, a possible unconscious inclination by SSB members to the opinion or desire of the board of directors or the executive management towards a product and service that does not comply with the provisions of Islamic Shariah). In this context, the social embeddedness in the Kuwaiti context, as stressed by the institutional theory, constitute an aspect that deserves consideration, especially by public policymakers. Hence, this study broadens the horizons of thinking about the influences that may affect Shariah corporate governance practices, including *diwaniyya*.

4.3.1 The Independence of Shariah Supervisory Board Members: The Judges' Lens

An unwritten custom among judges in Kuwait discourages them from interacting with people or frequently visiting their *diwaniyyas*, so as to maintain their own independence and neutrality. SSE3 stated:

One of my fellow judges in Kuwait, I always called him to [get] us all [to] go out. He told me: 'Muhammad, you are a dear friend of mine, but by virtue of our profession we [cannot] mix with many people'. And I know he says it humbly and not arrogantly, but he says it professionally as he is liable to meet those who have been judged or who cannot be judged in the future or those who accuse them later. Senior judges and [I] do not go out often and mix with people because you judge them, whether you like it or not.

SSE3 further /explained:

There is a psychological tendency to[wards] those you mix with, especially on a daily or weekly basis.

When considering SSB members and applying the judges' custom of avoiding frequent interactions with people, SSE3 alluded to a caveat:

Our Islamic history is that these people [Shariah scholars] used to mix with people and [did] not stay away from them. Take the example of the jurists. For them, communication with people was one of the sources of understanding of the jurisprudence that they research and study.

Interacting with people increases SSB members' awareness and understanding of market developments while additionally informing them of things occurring behind the scenes (Abd Razak, 2020). ACA3 explained that relationships among SSB members and BODs' members/executives are merely professional and not social because the latter are especially busy and have little time to socialise:

By virtue of my simple view of the field of Islamic finance, I find that most of the members of the Shariah supervisory boards, not all of them, because there are distinguished people, but most of them have many broad relationships. But these relationships are professional and functional relationships and not social relationships because it is their field and specialisation and devotion to time and research. And for the record, it actually makes them stay away from social fields as much as possible.

As ACA2 said about interacting with people: "Of course, it differed a lot and had a negative impact." For SSE3, "Companionship drops costs," which means that frequent visits between SSB members and IFIs' directors and executives 'break the ice', though may eventually lead them "having similar opinions and being on the same wavelength" (Van Bel et al., 2008, p. 132). Basically, it is akin to a merging of minds on certain points, and this detracts from SSB members' independence. As Diemer and Regan (2022) and Van Bel et al. (2008) suggest, social connectedness and the accompanying strengthening of relationships bring smooth but unintended sharing of ideas, but this is consistent with ACA2 and SSE3. Hence, regulatory authorities must consider the possibility of *diwaniyya*'s negative impact on SSB members' opinions when proposing instructions to deal with this matter to preserve SSBs' independence.

Some interviewees noted a culture among certain Islamic bank owners of Shariah scholars, or sheikhs, being under owners' command. As such, the

owners demand hearing only what they want to hear from the Shariah scholars. One interviewee (BCH) criticised a specific incident with one IB in Kuwait. Here, the sheikh (Shariah scholar) was asked to leave because he expressed an opinion against that of the bank's new owner:

You came up with the topic of dismissal, and you mentioned it to me. And when you speak frankly and have general positions towards public issues, you are human, so why do you punish me because I have a certain statement or position towards a certain issue? This scholar considered a reference today and has international and local scientific reputation, and because I have a special opinion, I asked and spoke. You come and tell me that you do not represent the owners, whether the owners are individuals or institutions as a state. You appointed me and wanted my opinion, but you do not own me.

Notably, the circle of eminent SSB members wields significant influence (see Table 4 below), especially as all new Shariah scholars who want to serve in an IB's SSBs must enter through this circle. As ACA2 said:

But today no one from the SSBs dares to say that the compliant companies are in dispute. Otherwise, he [Shariah scholar] will not enter the SSB in the banks or investment companies. And today there is a culture that exists that it is not necessary for me to express all my opinions and to save what can be saved. And he does what he is asked, and this culture exists from a Shariah point of view.

ACA2's argument aligns with the vested interest theory (Moe, 2015) in the realm of institutional theory.⁵⁶ In the current case, members who are in most Islamic bank SSBs have the vested interests.

⁵⁶ "Vested interests benefit from the status quo, and thus they are disinclined to seek radical changes in the established order – while pressure for radical change typically comes from reformers who do not like the established order and make proposals that are threatening to those who do" (Moe, 2015, p. 291).

Table 4: Memberships number of Shariah scholars in Kuwaiti IBs

Shariah scholars	Number of memberships in Kuwaiti IBs ⁵⁷
Dr Ali Al-Rashed	3
Dr Essam Al-Enezi	3
Dr Abdulaziz AlQassar	3
Dr Khalid Al-Mathkour	2
Dr Mohammad Al-Fuzaie	2
Dr Sayyid Mohammad Al-Tabtaba'e	1
Dr Mubarak Al-Harbi	1
Dr Anwar Abdulsalam	1
Dr Khaled Al-Otaibi	1
Dr Esam Abdulrahim Al-Ghareeb	1
Sheikh. Ali Al-Jady	1

Therefore, there are two points of view regarding the relationships between those concerned with Shariah corporate governance. While some see that these relationships, especially the social ones through visiting the *diwaniyyas*, directly or indirectly affected the Shariah corporate governance practice, others consider that relationships are part of society's culture and do not go beyond the professional aspect. Therefore, it does not negatively affect Shariah corporate governance practices. In a nutshell, *diwaniyya* is an integral part of the culture of Kuwaiti society. Accordingly, its negative impact on Shariah corporate governance practices cannot be ascertained. However, it is necessary to consider it as one of the aspects that should be dealt with wisely, so that the professionalism of the relationships is preserved.

⁵⁷ Based on IBs' 2021 annual reports.

4.4 The Political Context of Kuwaiti Shariah Corporate Governance

While this work has previously focused on the social aspects of Shariah corporate governance, it also examines Kuwaiti politics and their impact on Shariah corporate governance (see section 2.4.4). Some interviewees say that politics influence Shariah corporate governance in certain ways, particularly regarding SSB members' independence, but most say that politics do not influence Shariah corporate governance, as politicians, especially parliamentarians, follow the popular desire for a sound Islamic financial industry and favour a passive *diwaniyya* role for parliamentarians.

Accordingly, ACA2 says that parliamentarians are not very enthusiastic about passing legislation that supports the Islamic financial industry, particularly Shariah corporate governance. This is especially true for those parliamentarians who are considered Islamist and who are supposed to support legislation related to IFIs more than any other political parties – an observation consistent with Nakpodia et al. (2018). As ACA2 says:

The issue [Islamic financial product legislation] is not a political priority, even among Islamic currents. When you talk about this issue with all the currents, you imagine that you talk to them in another language. For example, you tell them that Zakat law is wrong because it is not in the priorities at all. Of course, those non-Islamic currents have another place, and part of the disruption of laws is that it is not a priority for them. Because culture does not exist in society, there is no political pressure on these people. Even Islamists have not embraced this issue.

In addition, HSSA indicates that a Shariah compliance culture for board members is vital because many are ultimately interested in the annual bonuses they receive and not whether these profits result from a lenient or incorrect Shariah *fatwa*, which Nakpodia et al. (2018) describe as stakeholders' apathy towards Shariah compliance. Actually, this apathy led to the resignation of the SSB in an Islamic financial institution as an objection to the BOD's behaviour regarding compliance with Shariah law provisions. For HSSA:

It is a very simple issue, but a big one, which is the Shariah compliance culture. If we give the board of directors, the regulators, the technical and practical bodies, a Shariah and financial culture in the field in which they are working, I imagine many problems will be [resolved].

HSSA provided a practical example to support his argument:

In this regard, I mention to you one of the Islamic companies. The chairman of the board of directors would come to us as SSB and tell us: 'Oh, people, record the violations that [are] in your Shariah report, and I personally will respond to the shareholders in the general assembly and not against you as a body because I do not speak of religion'. So, we always used to tell him: 'These are Shariah issues, and when this company [was] established, it was not established on this system unless you are keen on your religion. And it is not reasonable for you to come at the time of execution and say 'leave the religion and give me the profits and the Shariah matter is over'. However, we tried [to convince the BOD] in this company for three to four years and we could not, so we submitted our resignation and left.

Some participants argued that broader society culture is an important factor that politicians and parliamentarians also mirror. Nonetheless, BODM stated the following:

I lived through the issue [politics' effect on Shariah corporate governance]. In fact, I did not find it. We were the board of directors at X Investment company and at other investment companies. We were presented with the names of the Shariah supervisory board members, and I did not find that one of the members had reservations about a specific name. Rather, we respect the nomination that comes, but we [ensure] the competence of these members and then they go to the general assembly for their approval. I did not find it [politics effect on Shariah corporate governance]. Of course, you cannot say the process is 100% clear.

Unlike what is mentioned above, another interviewee pointed out that political parties and intellectual groups influence Shariah corporate governance. SAE4 describes the situation as follows:

Governance practices are difficult, as the choice of types of Shariah auditors is [to have those who are] affiliated with either political

groupings or certain ideological groups, so that the financial institution is an institution affiliated with a particular school of thought or politics. So, it chooses Shariah auditors of the same thought. So, it is as if it is a group of Shariah auditors, meaning Shariah auditors in the form of parties that mean these, are from such a group. I mean the issue of appointment will [be difficult] in any institution.

This means that the company whose managers or owners are from political thought or group X will choose SSB members or Shariah auditors from the same political thought or group. On the other hand, a company whose owners or managers share the same belief or political group will choose SSB members or Shariah auditors from the same belief or group. As a result, the appointment is made based on who is closest intellectually or politically to the person in question. As a result, Shariah corporate governance practices in Kuwait suffer as a result.

Another effect of politics on Shariah corporate governance practice is the social and political impacts of the ineffectiveness of shareholders in expressing their opinions in the general assemblies. This observation is consistent with research by Adegbite et al. (2012) and the people they identified as passive shareholders. EXREG1 stated the following:

Historically, the general assemblies, and until now, with great regret, which are supposed to have an important role in [the checks] and balance[s] in all institutions and in all sectors, do not play their role properly, and here come issues of social dimensions perhaps. You know the oversight work is greatly affected at the level of economic development and the value aspects of society, relationships, etc.

Another point of view suggested by IFC which is the change in Kuwaiti social classes is another dimension to consider – especially in the middle class, where most leaders of ministries, government and private institutions are neither rich nor poor. It is therefore difficult to corrupt these people, but this class has started to decline, and newly rich people have been appointed to leadership positions in government and private institutions, which may allow people to exert influence on this new class. To illustrate this, influencing this new class is possible because

the newly rich are embarrassed by those credited with appointing them to these positions. As a result, the new class of rich people tolerates desires or agrees to transactions that are not necessarily legal or Shariah compliant. As IFC stated:

The middle class in Kuwaiti society has receded in the past 20 years. The middle class has mostly been agents of ministries and holding [these] positions, they are neither rich nor poor, [and they] are not easily bought. Now, with the demographic change in Kuwait, this class [has receded], so today the owner of the money says: 'I appointed him as an under-secretary of the ministry, and I appointed a member of SSB (with a confident smile). This is mine'. [This indicates] that I can influence him by giving you a fatwa. Today, there are people who call me, and they ask me to intercede for them to become SSB members with the company, and I move for [them] to become a member of the body. Now, whoever appointed him may use the method of pressure.

Most interviewees say governance is primarily an ethical and cultural issue and that laws and regulations cannot eliminate poor governance. They may reduce it as a short-term fix or via 'tick-box compliance', but the culture of governance as the bulwark against corrupt practices such as nepotism is a long-term endeavour (Windholz, 2017). This can bring change, as SSE3 explains:

I and others participated in the training in this title: 'Business Ethics and Moral Values for Islamic Financial Institutions'. It is necessary that the supervisory authorities must demand the training for all institutions and companies. Laws cannot impose anything on social customs, but discipline is part of spreading positive ethics in society.

Business culture, which includes governance, is vital for determining the relationships among different stakeholders. According to Tricker (2019, p. 233), all "organisations develop their own culture, determined by their context, significant events that have affected them, and the influence of dominant individuals in the organisation". When the institution explicitly or implicitly establishes its own culture, employee behaviour reflects it but so does that of those who deal with the institution, especially the SSB members and the Shariah auditors, as this research indicates. A most important expression of an organisation's culture is its code of conduct – those "statements that [address] the relationships between the company, its staff, and the firm stakeholders,

including the customers, suppliers, and other business partners, shareholders and other sources of finance, local communities, society, and the state” (Tricker, 2019, p. 234).

One interviewee (SAM1) suggests another possible solution to Shariah corporate governance malpractice, whereby people sign pledges before commencing their governance duties to acknowledge their moral obligations. If individuals breach this, they should be punished with necessary penalties. In SAM1’s words,

I think it is possible to set controls for it, that in the event of leaking information, penalties or pledges are signed, [but] these are not available to us. For example, I personally have not [signed anything] on the confidentiality of information. It is possible to place pledges or before the job there will be an oath, and if a piece of information is leaked you will be held accountable. And if it is applied to more than one case, it will be well known in the market.

In light of what was mentioned above that governance is ultimately a culture, and that culture cannot be quickly instilled through laws and regulatory instructions, therefore, one of the proposals worth considering regarding the political impact on Shariah corporate governance practices is to have a code of conduct and a pledge to be seen and signed as a moral obligation on those concerned with Shariah corporate governance. It is worth noting here that the signing of the pledge does not occur in the event of a specific document leak (i.e., by the Shariah auditor), but rather the signature is made before receiving work duties from the beginning. Indeed, the moral commitment to the regulatory restrictions, such as not having a close relationship between a Board of Directors member and the SSB member, would violate the principle of independence and contribute to limiting bad practices.

4.5 The Legal Context of Kuwaiti Shariah Corporate Governance

The legal aspect of the Islamic financial industry generally and Shariah corporate governance in particular form the cornerstone of the industry’s growth and continuity. Previously, Islamic banks and investment companies operated

without legal cover, until 2003, when the Islamic banking law was issued as part of Law No. 32 from 1968, which governs currency, the CBK and the organisation of banking business, besides also containing amendments. Thus, these financial institutions had been operating in accordance with the corporate law issued in 1980 and were not subject to a specific supervisory authority (e.g., the CBK) or certain requirements (e.g., not being legally obligated to send periodic reports to the supervisory authority).

As Wilson (2012) explains, a challenge facing IFIs is the occasional conflict between SSB decisions and the laws regulating financial and commercial transactions. For example, a lease ending with ownership (referred to as *Ijarah Muntahia Biltamleek* in Arabic) is a tool that Islamic banks and financial institutions use. Disputes have arisen between the clientele and management of Islamic banks regarding the consequences of a management contract that ends with ownership (such as whether the bank has the right to mortgage the rented house the tenant will own at the end of the contract term). In one prominent instance, the disputes were submitted to the Kuwaiti courts for adjudication. As Kuwaiti laws do not regulate a lease ending with ownership, the courts ruled in favour of the clients and held that this contract is not considered a lease but rather an instalment sale. EXBLC explains the issue.

If there was a dispute between a client and a bank regarding a Tawarruq contract,⁵⁸ which law would apply to it? Selling applied? This is not a sale. Is financing applied to it? Is it not financing? Is it leasing? It's not a lease, so what do you do? So, the courts will make the Shariah fatwa far from practical and far from the legal system in which they live. This is like an ectopic pregnancy. You have an integrated legal system, but you have something outside this system. So, there is supposed to be a reconciliation between Islamic products and the legal system, i.e., a law is issued regulating [Islamic] financing operations, [but] this does not exist.

SAM2 confirmed EXBLC's opinion and explained:

⁵⁸ *Tawarruq* is a "purchase of a commodity for a deferred payment and the buyer selling it for cash to a third party" (Ahmed and Aleshaikh, 2014, p. 5).

Yes, it [has negative effects], and this is a [significant] problem. We in the banks are afraid. In the banking system, you know that there are some clients, if they know about the judicial rulings issued by the Court of Cassation, they will blow up the Islamic banking sector as a whole.⁵⁹

The conflict between SSBs and the legal system is considered a legal and compliance risk, and it may lead to undesirable results (i.e., losing customer confidence) in the Islamic financial industry. Furthermore, this conflict creates uncertainty regarding industry credibility (Ginena, 2014; DeLorenzo, 2007). For example, IFIs inevitably damage their reputations when they are known as Shariah non-compliant institutions in the market (e.g., by providing prohibited products to customers). SAM2 added:

Therefore, there are very big shortcomings that threaten the Islamic banking sector, and God has preserved us. But there are great shortcomings that must be changed and the National Assembly should issue legislation in cooperation with banks and the Federation of Banks to issue special laws for Islamic banking because in the absence of these laws the situation is frightening.

As there is no explicit stipulation in the laws that govern the Islamic products and services that IFIs provide, disputes arise between IFIs and their customers. Consequently, judges in the Kuwaiti civil law system find themselves in a dilemma, and in many cases the judges use their understanding to interpret the contract based on the closest applicable legal text. INVCH1 stated:

Regarding the courts, they rule by law. For example, if you have an Islamic transaction that is not described by law, meaning that a law was issued in it that clarifies what this transaction is, the judge tries to describe it with what knowledge he has of contracts and therefore invalidates it or agrees to conduct it according to this thing [similar law].

This issue is evidently not necessarily related to the lack of laws. Rather, the problem concerns some IFIs' improper application of contracts and products,

⁵⁹ There are three levels of litigation according to the Kuwaiti court system: the Court of First Instance, the Court of Appeal, and the Court of Cassation.

leading some judges to rule these as not Islamic in substance. Put differently, the IFIs affect their own credibility, and the issue is not the absence of specific laws or legal texts that govern Islamic financial products, ergo the solution is not the introduction of these. BREG2 explains:

I don't think we need legislation. Did the judges rule these provisions out of their ignorance? My personal assessment is no. Rather, [it is] as a result of their knowledge of the reality of the wrong practice, not in the judge's understanding of the transaction but the error of the one who implemented the transaction.

BREG1 stated the following:

Honestly, I do not want to blame the judiciary. Unfortunately, today there is a glitch in application. We started in the infancy and cradle. Certainly, if we read the context of judgement and the judiciary, we find that the judge adopted the legal aspects. And the process was fictitious, and rent doesn't apply since the ownership of the asset was not transferred to the other party. There are some striking remarks that called the court [to make] such judgements.

SAE2 agrees with these regulators' viewpoint about the judiciary not necessarily being the obstacle, and sometimes the court decisions correct the distortion of some IFIs' malpractices. As SAE2 says:

What happens in reality is that Islamic financial institutions may contradict the decisions of the Fiqh councils⁶⁰ in some of the cases and consequently, the ruling of the Court of Cassation [transactions] as being fictitious. This is an issue [Court of Cassation ruling] that was not weakened [i.e., IFIs operation]; rather he [the judge] strove as much as he can to reform the malpractices. Thus, the judiciary sometimes plays a positive role in controlling business in IFIs.

Furthermore, some interviewees agree that the problem does not relate to the absence of texts and instead say it concerns the contracts for Islamic financial products, which depends on those who wrote them, as these individuals may not

⁶⁰ *Fiqh* councils, such as the International Islamic *Fiqh* Academy of the Organization of Islamic Cooperation, (established in 1981), are made up of Shariah scholars in Islamic countries who meet periodically to consider issues of Islamic jurisprudence, including those relating to IFIs, their services and products. It issues advisory decisions after each meeting.

have the capability and understanding of financial and economic information and Islamic science. For EXREG2:

The civil law does not contradict the provisions of Islamic Shariah, but you must come up with formulas that can be adapted as valid financing contracts. And the real gap is between Shariah thought and legal thought on the one hand and Shariah thought and economic thought on the other hand. And many of those who work in Sharia supervision do not receive adequate education in the financial and economic aspects, so, how do you expect them to give you other forms of dealing? But as long as he – the Shariah scholar – does not understand the financial issues it is easy for you to deceive him and tell him that the contract is Shariah compliant.

In addition to the issues related to those who wrote Islamic financial products contracts' text (that may be ambiguous or inaccurate), it also extends to those (SSB members/Shariah auditors) who interpret the text inaccurately. EXREG2 further stresses concern about the competency of those who serve on the SSBs and said this is the issue:

One of the veterans in the Shariah committees tells me that there were people who attended with us in the Shariah committees [who did] not know how to read the budget. So, the problem is not in the texts but rather the fault in the souls. And the text does not rule you and is sometimes applicable, but how do you want to explain it? Want to explain it to your advantage? The self-interested interpretation is the one that corrupts, and today you must understand the civil law, understand the legal rulings in Islamic financial transactions and understand the needs of those in front of you, such as a company, a bank or others.

Also, an argument unrelated to the enactment of an integrated law for Islamic financial products or the lack of understanding of the judges, is that legislators in the National Assembly do not have a comprehensive understanding of the issues when they draft a law to solve a specific problem. Therefore, the law creates another problem or provides a competitive advantage to one sector over another. EXREG1 states:

I think the holistic thought that looks at the issue in all its dimensions is absent in the National Assembly.

EXREG1 argues that, instead of issuing a new law, it is more practical to add exceptions to the existing laws that enable the IFIs to develop some of their products:

The legal framework sometimes restricts and does not help in the issue of product development. I mean, as I told you, the role of the National Assembly is more negative than positive and does not take into account the special nature of Islamic institutions — part of their products are [needed if] we can [provide] certain exceptions.

EXREG1 elaborates further:

I mean, it is true that banks do not have the right to own private housing, but some [laws] that were issued based on the idea that they want a law to reduce private housing prices, etc., prevent companies from owning [it]. But you assume that when you put such legislation in mind that some Islamic products cannot be developed and [are not developed]. It can be put on the market only through [implementing] some exceptions.

Different perspectives thus exist on the legal aspects of IFIs' products, the extent of Islamic contract execution in the market and compliance with applicable laws. The first perspective is that the problem arises from legislative deficiency and lack of explicit legal provisions regarding IFIs' products. The second addresses the malpractice of Islamic financial institutions, and the third considers the current laws sufficient but that the problem is the lack of SSBs' members understanding, especially regarding validity of contracts. The last stresses the importance of establishing exceptions in the current laws regarding IFIs so they can offer products that currently cannot present.

In addressing the aforementioned challenges, some interviewees agree with Nadar (2009) and Ginena (2014) about how arbitration can help. Arbitration, a dispute resolution mechanism, is known as *tahkim* in Arabic (Labanieh et al., 2019). A former parliamentarian argues that one cannot rely on judges' understanding or perception of Islamic products or the application of existing laws to Islamic financial products. Instead, legalising these products better

protects the religion from the malpractice of those who practise Islamic finance in the name of Islam. POL explains:

I have been definite in my opinion for a long time. I am with legalisation. I am not in favour of leaving things as they are because experience [improves] the process. I mean, you have provided me [with] a lot of interpretations. And if we look at the financial aspects of IFIs, that means there are many interpretations. Islamic financial institutions [have] a problem, that is, with very many mistakes. And in particular, the problem is that these mistakes amount to people losing their money or going to the courts ... They return them to the religion itself and return them to the applications of religion even though they are human interpretations that are not necessarily related to religion.

For Hasan (2012), the lack of some judges' specialisation in Islamic finance causes undesirable court judgments. In the current work, a leader of a regulatory authority agrees with the problematic lack of a specialised judge and judiciary but adds that this is not specific to Islamic financial instruments as it arises in all financial cases. In INVREG3's words:

This is a general problem in the courts. It is not only [relating to] Islamic instruments. For example, we have sukuk regulation, Islamic bonds, in the executive regulations of the authority. And banks that operate in accordance with Islamic Shariah are dependent on the contract. And the contract is structured, and the contract is the law of the contractors as it is in the law, and now, if the transaction is organised doctrinally, it [becomes] legal for the courts to consider. The court did not understand or properly adapt the contract. This is not only for Islamic financial instruments. No, this is a general thing in all cases, even if they are traditional products.

INVREG3 also shares his comments to a senior leader in the Kuwaiti judiciary regarding France's specialised judiciary:

This is what I told XXX in the presence of the vice president. I told him: 'The reason for the absence of the specialised judge: for example, in France, when the judge is first appointed and until he retires, he only sees cheque cases. He does not see bills of exchange and promissory notes. This is what you expect from him – the judge

– I expect from him that the case does not remain with him for one day, and I do not expect mistakes from him’.

As an alternative to resolving legal challenges outside of traditional courts and arbitration centres, HSSA suggests using disciplinary councils as they can use specialists in Shariah and legal fields and quickly decide issues.

I have a proposal in this section instead of introducing legislation or commercial courts for the legislation of Islamic financial products. If we assume that we have disciplinary councils that have [obligatory status], meaning they are investigated and the violator is obligated to pay compensation and is obligated in it from a legal point of view, [then] this solves a big problem. It [provides] more speed than the judiciary because the judiciary takes time. And this does not mean that the disciplinary councils do not have judges, but rather, [they have] knowledge of the law in addition to their knowledge of Islamic law, so that I can account for the two areas, that is the traditional sector and the Islamic financial sector at the same time.

4.6 Shariah Corporate Governance and Other Stakeholders in the Macro Environment

Sustaining Shariah corporate governance is not limited to the dichotomy of state and institutions, as Cuomo et al. (2016) and Nakpodia et al. (2018) argue for co-regulation which simply means having other stakeholders. Examples include those educational and academic institutions that can equip Shariah supervision personnel with necessary knowledge and skills (Farook and Farooq, 2013) besides non-governmental organisations and professional syndicates concerned with Shariah supervision and the Islamic financial industry. Also, standard-setting institutions, such as the AAOIFI and IFSB, in their role of harmonising IFIs’ practices or the most dominant Islamic financial products (i.e., *Murabaha*) are others.⁶¹ Each of these needs considering further.

4.6.1 Educational Institutions and Shariah Corporate Governance

Kuwait is a leading country in the Islamic financial industry as the second Islamic commercial bank in the world, the Kuwait Finance House, was

⁶¹ See page 38 (footnote number 16).

established in 1977. In Kuwait, the current number of Islamic banks is five and conventional banks also number five, while the percentage of Islamic banks assets exceed 40% of the banking sector's total assets. Despite this, neither Kuwait University nor the Public Authority for Applied Education and Training provide any specialisation in Islamic finance or Islamic economics, and the country lacks concerted efforts in this regard. Indeed, Kuwait offers only scattered subjects in the College of Shariah and Islamic Studies and the College of Administrative Sciences at Kuwait University, besides some scattered efforts at training provided by faculty members. This means that there is no significant training to equip graduates in the science of and knowledge about Islamic economics and finance and related topics, not to mention the development of suitable skills. As SSM puts it:

I will talk about the academic aspect as I am a doctor at Kuwait University, so you can imagine that we are in the College of Shariah for nearly 18 years. We have been trying hard with the university administration to found a department of Islamic economics. I told them that this is a serious matter, so our students travel abroad to specialise in this specialty. We are in the College of Shariah, which is considered to have weight in Islamic banking in the Gulf [countries]. We do not have Islamic economy taught, nor do we have students who specialise in Islamic economics.

This challenge reflects key problems with the Islamic finance culture among the labour market's upcoming young generations. When students graduate from the college of business administration or the college of Shariah and Islamic studies, they need to have knowledge and to have had practical training if they want to work in IFIs, but this is not the case. Consequently, IFIs will have to train fresh graduates in all such matters to deal with educational issues, including understanding what IFIs actually are and the nature of their transactions, but the problem with this option is availability of financial resources and the time needed to deal with it. Supposedly, students should experience a field training programme during their university studies to gain the necessary knowledge in this regard, but actually the educational system, including the college of Shariah and Islamic studies, is not designed to deal with Islamic finance. As SSM says:

There are even laws that are designed to serve these banks in its conventional form, and not only this, but even the accounting system in the whole world is designed to serve this conventional banking and not only that, but all university studies are designed to study this conventional system.

Evidently, preparations for conventional finance predominate those for Islamic finance in universities. Even so, a distinction here is between academic certificates, which may contain a practical and field aspect, and professional certificates, which Farook and Farooq (2013) note, is called a certified Shariah audit. AAOIFI says the latter has many shortcomings, including that participants are not trained on the topics of the certificate but are given the scientific material then tested on it. Also, most certified Shariah audit participants work in the Shariah audit sector but obtain this certificate to be recognised and to boost their CVs. Accordingly, Farook and Farooq (2013) suggest that preparing a new generation of Shariah scholars should be done through a planned and systematic process within postgraduate programs (e.g., PhD scholarships). In this vein, BREG1 notes:

There is a role for education and university. When it comes to Kuwait, there is no academic majors for Islamic economics, Shariah supervision and Shariah audit. It's worth having an academic major that sets out what should be done and what shouldn't be done.

The same interviewee suggests having Islamic finance education done by educational bodies in Kuwait:

Nowadays, the volume of IBs and their impact on the local economy and their importance for the shareholders in operation in accordance with the Islamic Shariah [is important]. Unfortunately, there is no impetus or interaction. The reference of education and training received by those who are working in the field is through personal effort in individual development and qualification. Undoubtedly, the academic and training agencies have influential and effective in tightening Shariah supervision.

Interestingly, sometimes the problem is not caused by external factors, such as restrictive laws or regulations, but rather by the professionals themselves – those interested in training students to work in the Islamic financial industry. For

example, a ready-for-implementation bachelor's degree in Islamic economics at Kuwait University was proposed about 15 years ago, but a dispute arose between the faculties of business administration and that of Shariah and Islamic studies as to which of these would adopt, oversee and control this programme. Among other factors, this tension delayed the proposal's approval until recently.⁶² As SAM2 comments:

We suffer from a very big problem, which is bad education outputs. We do not have a bachelor's degree that helps with the requirements of the Kuwaiti market, and I am this one (I said it in a conference of the College of Shariah and Islamic studies), and I represented the private sector, and they hosted me in 2018 or 2017, and all of the attendees were doctors in the College of Shariah and Islamic studies. They did not like my talk, as the curriculum does not help and the tension that is happening now between the College of Shariah and Islamic studies and the College of business administration is bad and affects the industry. This is the root of the problem. We need to try to solve some problems, but the root of the problem is education and qualifications.

Notably, in 2008 the Islamic economics unit was established in the College of Business Administration at Kuwait University, which belongs to the Centre for Excellence in Management. Initially, the unit was rather active in organising conferences and events (e.g., seminars) regarding the topics within its specialisation and in sponsoring the establishment of the Islamic Economics section in the college, which is a student section for raising awareness of Islamic finance principles and products but also their institutions. However, over time the Islamic economics unit's activity (and consequently the student section) declined for several reasons but especially the lack of financial resources allocated to it. Also, the college of business administration was not sufficiently convinced of its feasibility or importance, and it seems that the unit's establishment occurred because of personal compliments or social relations between the college administration (the dean) and the unit's founders rather than from being part of a plan.

⁶² The Kuwait News Agency KUNA reported on 14 September 2021 that the Kuwait University Council has approved the establishment of a specialisation (Jurisprudence of Islamic Economics) in the College of Shariah and Islamic Studies (Kuna, 2021).

The College of Shariah and Islamic Studies also established an Islamic Economic Club in 2019 to raise awareness of the principles of Islamic finance, the products and services Islamic financial institutions provide, the role of regulatory institutions in this field and the laws and regulations governing Islamic finance. Another similar club is the Islamic Finance Club at Gulf University, which was established in 2009 for the same purposes. The above efforts may be good in raising awareness about Islamic finance and economics, but as noted they are scattered and unsustainable efforts – not being based on a long-term vision or strategic state planning or what is called the master plan for Islamic finance, which applies in many countries such as Malaysia and Kazakhstan (see Section 4.6.2). INVCH1 has stated that:

I participated in the development of the Malaysian road map for Islamic finance. That is, the road map committee – the prime minister, the minister of finance and the governor of the central bank were all present and I was vice president of international body. They brought international experiences, a person from the Bank of England, they saw the results and directed how the road map would be, and finally this committee became like what they say. I mean, it is possible not to implement it all. If 70% is applied, this is considered an integrated effort rather than separate efforts.

Moreover, the issue is relating not only to Shariah and Islamic studies or business administration colleges but also to law colleges. No doubt the Faculty of Law graduates will help create future judges in the courts or public prosecution, but it does not have adequate understanding of the Islamic financial industry from the legal aspect or how to distinguish between IBs and conventional banks. As SSM says:

Today I go to the Faculty of Law and ask them: ‘Do you have subjects taught Islamic banking?’. Its law? Its own rulings? The law, we are for Islamic banking, do they study a chapter or chapters on the laws? Everyone is taught the laws of conventional banks, as if Islamic banking still does not exist.

Without having a solid educational infrastructure for teaching Islamic finance, then, the extent of deep knowledge about the IF industry and its issues,

challenges and ambitions is questioned. SAM3, who has a deep knowledge of Shariah supervision, proposes having a specialisation in Islamic economics in Kuwaiti universities:

Regarding educational or academic institutions, I think that universities have a major role in particular [and that they should] adopt the concept of Islamic banking or in general Islamic financial transactions at least as well as the subject of Islamic economics because you know the subject of economics is a general topic that talks about resources and the disposal of resources and others. Because there are people who confuse Islamic economics with Islamic financial transactions.

Moreover, SSA stated that:

Universities should be the first ... responsible for creating specialisations [i.e., Islamic finance and/or Shariah audit] that keep pace with the market. And this specialisation becomes subjects in administrative sciences as well [accounting and others], so this basic laboratory generates these competencies, not that I rely on institutes only. From entering this programme and having a practical side with it, not just theoretical, this is what the jurist [mufti] in the CBK and IBs should have.

This matter relates to a previous point about the Islamic financial industry being a nascent industry and this bringing certain challenges, including that the regulations and laws are not designed to serve them but are designed to serve conventional finance. Nonetheless, this could be acceptable at the beginning or early stage of Islamic finance, especially in Kuwait – a leading country in the realm of IF. There is thus an imperative need in Kuwait to establish specialist departments in both the College of Business Administration and the College of Shariah and Islamic Studies to supply the Kuwaiti market with scientifically and practically qualified human resources in the field of Islamic finance and economics. The Malaysian experience serves as a relevant case regarding Shariah corporate governance from an educational perspective.

4.6.1.1 Proactive Role towards Educational and Training Gap

Worldwide, the Islamic financial industry has a scarcity of specialists in Islamic finance from an academic point of view and a Shariah one, despite Shariah scholars and Shariah research supposedly being the basis of all Islamic financial products – although, in reality, many products IBs and IFIs offer are mere modifications of conventional products to comply with Islamic Shariah provisions. Malaysia has nevertheless acted proactively regarding this common knowledge gap by establishing two educational and training institutions: the International Centre for Education in Islamic Finance, founded in 2005, and the International Shariah Research Academy, founded in 2008. Both the International Centre for Education in Islamic Finance and International Shariah Research Academy were founded and funded (to the tune of \$200 million) by Bank Negara Malaysia, which is the Malaysian central bank (Rudnyckyj, 2014). The International Centre for Education in Islamic Finance bridges the significant gap between the academic and practical by having practical people and those in the field of the Islamic financial industry lecture alongside academics but also provides workshops, practical projects and field training.⁶³

Remarkably, the initiative to establish these institutions did not come through the Ministry of Education in Malaysia but rather through an initiative, as well as support and funding, from the aforementioned supervisory institution of the banking sector (Bank Negara Malaysia). This initiative was not a mere coincidence or reliant on the whim of the Bank Negara Malaysia governor or its executives; rather, it was part of a ‘master plan’ for Islamic finance in Malaysia that the government developed in cooperation with the Islamic Development Bank, as the next section discusses.

4.6.2 Standard-Setting Institutions and Shariah Corporate Governance

Standard-setting institutions such as the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services

⁶³ According to the International Centre for Education in Islamic Finance website, there are 2166 alumni from 83 countries around the world (International Centre for Education in Islamic Finance, 2020).

Board (IFSB) have an important role in the Islamic financial industry (e.g., framing the work and leading efforts at upgrading the industry according to best practices that suit each country). They also help standardise common IFI products to facilitate their application to institutions that want to operate in accordance with Shariah provisions. Furthermore, standard-setting institutions help solve emerging problems or foresee future issues according to their expertise and navigate accordingly, and bring together stakeholders from regulatory institutions, research centres, banks, IFIs, Shariah scholars and those interested in the Islamic financial industry for discussions in conferences, workshops and round tables. As SAM3 states:

They [IF stakeholders] have a role, although so far it has been timid, but there are attempts, and the most important of these is from AAOIFI's professional reference in Shariah standards and accounting standards for Islamic financial institutions. They [AAOIFI] have a governance and ethics committee, and they issued the external Shariah audit standards, but the matter is still in its infancy. If AAOIFI continues, it will be able to play the role in a way that achieves more effective governance of Sharia supervision.

Nevertheless, some interviewees noted a certain ambiguity surrounding some aspects of Shariah corporate governance, with BREG1 being one:

Due to the recency of the experience, there are no applications or standards for the optimal application in this field [SSB reports] Similar to the international accounting standards or governance in traditional bodies, there are clear and stated standards in place governing disclosure and reporting. However, Shariah corporate governance is still in its infancy and diligence stage. To date, AAOIFI does not have a detailed standard on how to deal with and correct Shariah violations and what paragraphs should be clarified.

By talking about the optimal supervisory approach in the context of Shariah governance, BREG1 notes how the supervisory authority may issue detailed directives regarding Shariah supervision and its roles, departments and tasks associated with it, but in terms of competence the standards-setting institutions may be more appropriate. Unlike the financial accounting profession, where international professional bodies (e.g., International Financial Reporting

Standards (IFRS) foundation) set the standards, in Shariah corporate governance it is the regulatory authorities. As BREG1 says,

If we talk about the aspects [that are under consideration] and if we consider the Shariah supervisory board as a major body therein, there are related bodies there to [SSB body] that have unclear roles in terms of the role of the SSB's Secretariat [in detail and not only as instructions, but we will also see overlapping in application]. Is there an administration for the Shariah supervision? Is it appropriate that the internal Shariah audit handles issues related to products and development? Or should its role be limited to the audit? Currently, such matters, if even they are found to be just as principles and outlines within the instructions, I think it's primarily enough.

Although Kuwait is considered a founder of the IFSB and observer member of AAOIFI, its participation through the regulatory institutions is considered weak. For example, the CBK does not have a joint cooperation agreement with AAOIFI, and nor does it actively participate in the specialised committees and workshops of the IFSB. Therefore, if Kuwait wants to be a leading country in the Islamic financial industry, these aspects need addressing via the CBK participating more effectively in such standard-setting institutions.

4.6.3 Non-Governmental Organisations and Shariah Corporate Governance

Among the stakeholders not addressed so far are public benefit associations, non-governmental organisations and professional unions. Kuwait has the Kuwaiti Economic Society and Kuwait accountants' and auditors' association, which are expected to address issues relating to the Islamic financial industry though their roles are limited. Among the stakeholders directly related to Shariah governance is the Syndicate of Shariah Auditors, which was established in 2015. It was initially active in concluding some cooperation agreements between it and training and educational institutions, but this activity did not continue. SAM3 notes:

We have an important educational aspect that I mentioned earlier, which is the [annual] Shariah audit conferences. We call for new

topics that contribute to the profession and on the basis of which xx [Shariah consultancy firm] issues a research encyclopaedia that collects these presented research called the xx Research Encyclopaedia in Shariah Audit, and how many times have we found people using this research become a reference for them because they are all written by researchers and experts who hold high qualifications, whether they are academic or professional, and work in major banks and financial institutions related to it.

As mentioned above, whoever contributed to developing a ten-year strategic plan in Turkey is an institution of public interest, not a government agency (Yanikkaya and Pabuçcu, 2015). Therefore, public benefit institutions, especially the Kuwaiti Shariah auditors' syndication, are responsible for reforming the Islamic financial sector and developing it for the benefit of all stakeholders, preserving its authenticity and striving for its sustainability. Some interviewees nevertheless said that intellectual and political partisanship, in addition to the social embarrassment among those working in the Kuwaiti Shariah auditing field, makes developing the profession of Shariah auditing through the syndicate difficult. Consequently, the responsibility shifts entirely to the regulatory authorities, making the task slow, complex and/or incomplete.

4.7 'Good' Shariah Corporate Governance in the Kuwaiti Financial Sector

One aspect that is rarely mentioned in the Islamic finance literature is the existence of a strategic master plan or road map for the Islamic financial industry. In this vein, INVCH1 puts it:

The main point is that there is what is called the road map. We want to reach that long-term goal. What are the things that we can do, and this must be a party that adopts it and is responsible for implementing the road map, because the competencies of each party are separate, so there must be a party that is responsible for implementing that map, and this party is most likely the Central Bank or the Capital Markets Authority [that] are responsible for implementing the road map in order to raise the level of Shariah supervision or Shariah governance in these institutions [IFIs]. Otherwise, these institutions will not take off.

A master plan is usually employed by countries to direct and prioritise a government's efforts in promoting specific government goals, such as

diversifying government income sources or sustainable development. According to the World Bank, a master plan is “a dynamic long-term planning document that provides a conceptual layout to guide future growth and development” (World Bank, 2020). Regarding Shariah corporate governance, which is part of Islamic economics and finance, some governments such as Malaysia and Kazakhstan, have developed a plan to strengthen the Islamic financial industry in contributing to the renaissance, progress and prosperity of these countries. On Kazakhstan’s endeavours:

The master plan provides a vision and template in developing the Islamic financial services industry in Astana International Financial Centre and Kazakhstan. It provides the sequencing of priorities and identifies the key infrastructure that needs be put in place before advancing forward.

(Islamic finance master plan for the republic of Kazakhstan, 2020, p. 4)

As per the Malaysian central bank governor (Bank Negara Malaysia), Mrs Zeti Akhtar, the Islamic banking system in Malaysia had ten prerequisites (Akhtar, 2005, pp. 3–4):

- 1) To identify the nature of the Islamic banking system that is appropriate for the country.
- 2) Measures need to be in place to ensure that the Islamic banks are well capitalised and resilient.
- 3) For countries that have a dual banking system, where conventional banks are allowed to offer Islamic banking products, there must be adequate firewalls to ensure absolute separation of banking operations to prevent co-mingling between the Islamic and conventional funds.
- 4) Fourth, regardless of the choice of system, it is important that the stakeholders of the institutions play their role effectively and efficiently to generate improvements in the entity.
- 5) There is the need to put in place a comprehensive legal infrastructure.

- 6) The development of a comprehensive Shariah framework is a fundamental part of the process.
- 7) The importance of a robust and effective regulatory and supervisory framework cannot be over-emphasised. While the financial regulation and supervision of Islamic banking institutions would be similar, the areas such as capital adequacy and the liquidity framework have to take into account the unique risk characteristics of the Islamic banking models that accord with Shariah requirements.
- 8) Research and development are important so as to incorporate core Islamic values into banking products and business models.
- 9) The development of the financial market infrastructure is equally important to ensure the sustainability of Islamic banking. The Islamic interbank and foreign exchange markets are integral to the efficient functioning of the Islamic banking system. They facilitate the liquidity operations of Islamic banks and promote financial stability.
- 10) Consumer education and awareness about Islamic banking are critical to its success and future development.

These preconditions are about understanding the reality, diagnosing issues and understanding challenges, all based on a SWOT (strengths, weaknesses, opportunities, threats) analysis. The next phase involves developing a clear action plan for each challenge to achieve that plan on the ground. For instance, nine areas have been specified in the Kazakhstani master plan regarding IF, and each area has its own issues, challenges, recommendations and action plan.⁶⁴

Given its recency, no assessment has yet emerged on whether the Kazakhstani master plan of Islamic Finance has achieved its objectives, though Malaysia is considered a pioneer in the Islamic financial industry. According to the Refinitiv Islamic finance development report 2021, Malaysia ranked number 1 on the

⁶⁴ These areas are as follows: 1) The internationalisation of Astana International Financial Centre; 2) Islamic banking; 3) Islamic capital market; 4) Islamic insurance; 5) Islamic non-bank institutions; 6) Islamic social finance; 7) financial technology (Fintech); 8) Halal sector; 9) IF education and training (Islamic finance master plan for the republic of Kazakhstan, pp. 3–4).

Islamic finance development index (Islamic finance development index, 2021), which consists of quantitative development, knowledge, governance, corporate social responsibility and awareness. The Islamic finance development index measures these indicators in 135 countries and provides a tool for measuring and evaluating the extent to which each is progressing, or indeed lagging, based on the mentioned criteria. Kuwait, which as noted established the second commercial IB in the world in 1978 (Kuwait Finance House – KFH) – even before Malaysia’s first IB (Bank Islam) in 1983 – is ranked number eight. A possible reason for these different rankings (Kuwait = 8; Malaysia = 1) is Kuwait’s lack of a master plan for Islamic finance, unlike Malaysia.

Furthermore, Yanıkkaya and Pabuçcu (2015) say a main reason for Turkey’s Islamic banking stagnation is the lack of a holistic road map. In this regard, the participation banks association of Turkey⁶⁵ issued a strategic report covering 2015–2025 that discussed the problems facing the Islamic banking sector and determined that all parties concerned with this sector should reach a 15% share of the overall banking sector.⁶⁶ Specifically, there were five main problems (dimensions) for the Islamic banking sector: the lack of a general framework for Shariah governance; the focus on one Islamic financial instrument – namely, *Murabaha* (lack of diversification of financial instruments); the lack of an Islamic banking perception from a broad segment of Turkish people; the inefficiency of Islamic banks compared with conventional banks; and, finally the scarcity of intellectual efforts and academic studies discussing the issues abovementioned and the future of the Islamic banking sector. The participation banks’ association of Turkey’s ten-year (2015–2025) plan was based on these dimensions through 84 actions to reach the goal mentioned earlier (40% under the participation banks’ association of Turkey responsibility and 60% government).

Having a master plan for the Islamic financial industry thus involves making certain efforts in this regard, whether coming from the various regulatory

⁶⁵ Participation banks is equivalent to Islamic banks in Turkey.

⁶⁶ As of 2015, Islamic banks’ market share is 5.1% (Yanıkkaya and Pabuçcu, 2017).

authorities (the Central Bank, the Capital Markets Authority, the Insurance Regulatory Unit and others) or from private, educational and research institutions, but with all striving for the same goal. As for the current situation in Kuwait and the scattered and sometimes conflicting efforts prevailing, in addition to initiatives and judgements from individuals that may harm the country's Islamic financial industry or not, the industry's growth needs to be sustainable. Hence, what INCCCH1 mentions aligns with Rudnyckyj's (2014) and Yanıkkaya and Pabuçcu's (2015) point about the need for a holistic road map or comprehensive plan for Islamic finance, and standard-setters to play a role in this and the Islamic financial industry generally.

Considering the preceding, various determinants of 'good' Shariah corporate governance exist for the Kuwaiti financial sector. Relating to the supervisory aspect, the first is having a mixed (rule-based and principle-based) supervisory approach, but it is currently more appropriate to continue with the rules-based approach for two main reasons. One is the novelty of the Islamic financial industry, considering that Shariah corporate governance instructions have only been in place for six years. The other concerns the changes in the IFIs' leadership from the generation of first founders who established Islamic banks as an alternative to conventional banks (literally committed to the provisions and principles of Islamic law) to a generation mostly of conventional banking leaders (committed pragmatically to Islamic law). The rules-based approach is thus more appropriate for the current stage until the Islamic financial industry matures and the strength of Shariah governance arrangements is tested. Gradually introducing the principles-based methodology in a certain proportion but with the rules-based approach being dominant for a while seems prudent. Over time, the supervisory approach then becomes a hybrid of rules and principles, but notably either approach is chosen according to the importance and degree of risk associated with the subject matter.

In this context, and as the research indicated in section (4.2.1), some interviewees preferred the rules-based approach because it has several advantages. Among the essential merits are clarity and lack of ambiguity. (e.g.,

specifying the number of memberships for SSB members in the banking sector). Also, one of the advantages of this approach (rules-based) is the preservation of the time and efforts of the supervisory authorities that could be spent in interpreting the regulatory principles, as characterised by the principles-based approach. Likewise, a principles-based approach requires a solid regulatory and legal infrastructure (i.e., law enforcement, supervisory effectiveness), and these factors are currently out of stock in the Kuwaiti context.

In contrast, others preferred the principles-based methodology for several considerations. One of these considerations is that the principles-based methodology is flexible. Indeed, It is impossible to anticipate or imagine all the violations that institutions may commit in the first place. In other words, moving away from the so-called over-inclusiveness (Boyum, 1983) that characterises some supervisory instructions, the principles-based is considered appropriate and practical and can be applied according to the size of each institution. At the same time, some interviewees combine the two approaches according to the risks facing the institution. For example, the rules-based methodology is applied in the case of Shariah violations that may threaten the institution's reputation and public image (high risk). While the principles-based methodology is applied if it is not related to high risks such as failure in customer service or the ageing of the IFIs buildings.

The second determinant is having a methodology for measuring the quality of regulations' enforcement to ensure that the instructions have achieved the required objectives so that those instructions are not just ink on paper. This quality can be measured by the DREAM framework proposed by Baldwin et al. (2012).⁶⁷

The third determinant is establishing specialised departments in Islamic finance in the regulatory authorities to deal with the Islamic financial sector's issues and

⁶⁷ See Appendix 8.

challenges with a high degree of awareness and effectiveness, in addition to anticipating this industry's future and responding accordingly (proactive role).

The fourth determinant is having a comprehensive plan or road map to sustain the Islamic financial sector at the country level. Indeed, comprehensive plans have achieved much for Islamic finance in Malaysia, Kazakhstan and Turkey (mentioned above). A comprehensive plan organises the various stakeholders' efforts, facilitating their mutual supportiveness and their working in the same direction.

The fifth determinant is establishing a joint steering committee between the supervisory authorities regarding Shariah governance to prevent conflicting efforts and reach a high degree of consistency in the instructions in a way that is commensurate with and does not harm each sector.

Sixth, a specialised higher education programmes in Islamic economics and finance (Bachelor's, Master's, PhD.) are an essential determinant of 'good' Shariah corporate governance. Despite Kuwait being regarded as the leading country in Islamic finance, there is no sustainable human resource for the Islamic financial industry. In the educational context, a related seventh determinant is attracting distinguished competencies in Islamic finance to establish specialised Islamic finance programmes in private universities within Kuwait.

On the legal infrastructure, a determinant of 'good' Shariah corporate governance is the presence of judges specialised in Islamic financial transactions and courts dedicated to Islamic financial institutions. However, several interviewees note shortcomings in the judiciary, especially regarding Islamic financial industry specialisation, on the part of both the courts and the judges themselves. Also, a determinant that may help speed up the process of issuing judicial rulings and the availability of specialisation in the panel of judges is the arbitration tool for adjudicating disputes between Islamic financial institutions themselves or between customers and between institutions, while a determinant that may help improve the judicial rulings is having Islamic financial

transactions legal statutes for dominant transactions (e.g., *Murabaha and leasing*). The legal system in Kuwait is a civil code, and judges base their rulings on legal texts. In other words, if there are no legal statutes for a transaction, the judge adapts the transaction to the legal text closest to a conventional transaction. However, if he finds a legal text, he strives according to his understanding of Islamic financial transactions. Therefore, specific legal provisions may limit discretion margins.

Regarding institutional social effects, one determinant of ‘good’ Shariah corporate governance is the existence of a code of conduct and pledge for those involved in Shariah supervision (Shariah scholars and Shariah auditors) because they contribute to moral commitment, especially since Kuwaiti society – as the researcher pointed out – is small and interdependent and the relationships among its members are strong (through *diwaniyya*). Although governance is viewed as a culture rather than a set of laws or instructions, the malpractice implicit in nepotism and patronage cannot be eliminated solely through regulatory rules; however, a code of conduct may help strengthen Shariah corporate governance practice. Moreover, increasing awareness among those concerned with Shariah corporate governance of the importance of separating human social communication from the fact that this communication may negatively affect Shariah corporate governance should make a positive difference. To the researcher's knowledge, the current research is the first to study the possible effect of *diwaniyya* on Shariah corporate governance practice. As Kuwaiti society is politicised and exercises elections at several levels (parliament, sports clubs, student unions) and has a freedom margin through which political groupings of different intellectual orientations (liberal and Islamic) operate, this has its repercussions. For example, several interviewees mentioned that SSB members’ or Shariah auditors’ appointments are sometimes subject to the similarity with, or closeness of their political and intellectual tendencies with IFIs owners. Consequently, an institutional political determinant of good Shariah corporate governance is the regulatory authorities’ review of Islamic financial institutions’ appointments of Shariah scholars/Shariah auditors, particularly from a political standpoint.

The macro-determinants of good Shariah corporate governance outlined above form essential aspects. First, as revealed by this research, the institutional factors (regulatory, legal, social, and political) that the institutional theory focuses on are so important that their impact on good Shariah governance should be recognised. Secondly, other macro-determinants, such as the Islamic financial industry roadmap (Master Plan), educational, and Islamic financial industry standard-setting organisations (IFSB, AAOIFI) may constitute a memetic-isomorphism on the Kuwaiti Islamic financial industry as stressed in the institutional theory (see section 2.7.2). In this vein, the so-called best practices proposed by standard-setting organisations are a double-edged sword that may only be better if their suitability is studied (Andrews, 2012). Third, these macro-determinants of good Shariah corporate governance are considered a roadmap for policymakers and regulators in Kuwait if they wish to make the Islamic financial industry an attractive sector for foreign investment. In addition, Kuwait's Islamic financial industry sector would inspire countries that aspire to become a centre for Islamic finance (i.e., Kazakhstan).

4.8 Conclusion

This chapter has addressed the first research question: what are the macro-level determinants of 'good' Shariah corporate governance in the Kuwaiti financial sector? It has done so by investigating the supervisory, social, political and legal aspects of it, and several prominent findings have emerged. First, the research assessed the supervisory regulations in terms of their approach (rule-based or principle-based) and their compatibility with the subject of this research, and it outlined the criteria that determine preferences (e.g., the recency of the industry, reputational risk, low or high enforcement tools) for using an approach that is rule-based, principle-based, or both. The interviewees' opinions differed in this regard, but generally speaking, regulators, board members and executives preferred the principle-based approach because of its flexibility. However, members of Shariah supervisory boards and Shariah auditors preferred the rule-based method because of its clarity and direct impact. Furthermore, some

preferred a combination of the two methods depending on the importance and risks associated with the area being supervised.

The social aspects of Kuwaiti society, which is characterised by its small size and its internal interdependence, were also considered. Specifically, the research analysed the impact of *diwaniyya* on the Shariah corporate governance, SSB members, BOD members and senior executives in IFIs. Most interviewees indicated no direct negative impact on the interaction of those involved with Shariah supervision when they visit the *diwaniyya* of owners they are responsible for monitoring. This interaction (e.g., SSB member of an IFI visiting a CEO *diwaniyya*) does not compromise the independence of these individuals or cause them to change their Shariah decisions, though a few opinions indicated that social relationships inevitably influence SSB decisions one way or another.

This analysis also considered how political factors, such as the political affiliations and intellectual tendencies of those working in the Islamic financial industry, impact on Shariah corporate governance practices. Most interviewees indicate no direct negative impact, but some say politics have an indirect impact in terms of appointing Shariah supervisory officials who share the same political thought and inclinations to manage institutions, which may influence their (SSB members') efficiency and effectiveness. Another consideration is that politicians, especially parliamentarians, develop and strengthen Shariah corporate governance practices by enacting legislation. Moreover, legal aspects influence Shariah corporate governance in terms of the adequacy of legislation relating to the Islamic financial industry and the impact of court rulings regarding Islamic financial products. In this vein, the interviewees provide various perspectives on their reality (e.g., lack of specialised courts and judges in Islamic financial transactions) and offered solutions (e.g., specialised judge and courts, arbitration, etc.) for the identified issues.

Far from the agency theory usually dominant in corporate governance and Shariah corporate governance literature, the researcher explored the depths of the Shariah corporate governance phenomenon through the institutional theory

lens in this chapter. Indeed, this chapter has dealt in detail with the institutional aspects (regulatory, legal, social, and political) embedded in Shariah corporate governance practices in Kuwait. The social aspects (the social connectedness of society's members and *diwaniyyas*) affect in one way or another the success or failure of the supervisory instructions that aim to govern the Shariah supervision. In addition, corruption levels and the role of the law – as indicated by the research – are considered as one the institutional influences that decision-makers should consider when evaluating the status of Shariah corporate governance practices. For example, nothing in the Shariah corporate governance instructions in Kuwait requires the selection of well-known Shariah scholars in the Shariah supervisory boards. Likewise, there is nothing to prevent the appointment of women as Shariah scholars. However, Islamic financial institutions, especially Islamic banks in Kuwait, appoint only some known names (see Table 4), and no women are appointed to the Shariah supervisory boards of Islamic banks despite the large numbers of graduates of the Faculty of Shariah and Islamic Studies. The reason for the practices above is that Islamic financial institutions want to legitimise their existence (in the case of appointing renowned Shariah scholars) or that these institutions do not want to undermine their legitimacy (in the case of appointing a woman as a member of a Shariah supervisory board with male Shariah scholars). Furthermore, as there is the potential for social embarrassment and sometimes for religious reasons, women are prevented from sitting with men at the same table, even for work. The following chapter now goes on to explore and discuss the micro-level factors affecting Shariah corporate governance in the Kuwaiti context.

Chapter 5

Micro-level Determinants of Good Shariah Corporate Governance in the Kuwaiti Financial Sector: Research Findings and Discussion

5.1 Introduction

Without the macro and micro convergence of Shariah corporate governance, Islamic financial institutions will be unable to achieve their goals. While the macro aspects of Shariah corporate governance concern the state and society, the micro aspects concern Islamic financial institutions and their Shariah-compliant organisational arrangements. In this context, supervisory instructions for Shariah corporate governance and legislation governing the existence and operation of the Islamic financial institution may exist. However, unless every Islamic financial institution has the necessary infrastructure, these instructions and legislation will be futile. One hand does not clap, as the Arabic proverb goes. This chapter answers the second research question: what are the micro-level determinants of ‘good’ Shariah corporate governance in the Kuwaiti financial sector? The micro-level aspects of Shariah corporate governance in Kuwait are divided in two sections: industry-level and firm-level. The former includes an overview of Shariah corporate governance regulation in the Kuwaiti financial sector (banking, investment, and insurance), and the state of Shariah corporate governance in Kuwait. The firm-level aspect concerns Shariah corporate governance arrangements at the organisational level, such as the independence of Shariah supervisory boards (SSBs) and the competence of SSB members; the status of Shariah audit; the extent and level of disclosure of Shariah-related matters; and cross-membership of Shariah scholars. Based on the above, Shariah corporate governance arrangements are examined to determine whether they are sufficient or ‘good’ for achieving Shariah compliance in Kuwait or whether, based on participants’ perspectives, they must be strengthened.

The chapter proceeds as follows. It initially presents an overview of the Kuwaiti financial sector (banking, investment and insurance) and Shariah corporate governance regulations in these sectors (5.1). It then touches on the Shariah corporate governance status in the Kuwaiti financial sector based on

participants' perspectives, including the notion of regulatory multiplicity and its implication in the Kuwaiti context (5.2), before discussing the Central Bank of Kuwait's higher committee of Shariah supervision and its role and effectiveness (5.3). From this, it explores and analyses micro-level Shariah corporate governance or organisational arrangements, such as SSB independence and SSB members' competence (5.4). Next, it summarises the micro-level determinants of good Shariah corporate governance in the Kuwaiti financial sector (5.5). Finally, Section 5.6 concludes the chapter.

Before examining Shariah corporate governance micro-level arrangements in depth (firm-level), it is worthwhile to touch upon Shariah corporate governance regulations in Kuwait regarding the Central Bank of Kuwait (CBK), the Capital Markets Authority (CMA) and the Insurance Regulatory Unit (IRU) as most IFIs fall under these regulatory bodies, including banks, investment companies and insurance companies. Moreover, discussing the status of Shariah corporate governance in Kuwait, with special attention to the regulatory multiplicity and the Central Bank of Kuwait Higher Committee for Shariah Supervision.

5.2 Shariah Corporation Governance Regulation in the Kuwaiti Financial Sector (Industry-Level)

In their comparative study and based on leximetrics⁶⁸ and a content analysis of relevant laws and regulations, AlQassar and Ahmed (2022) argue that Kuwait's Shariah corporate governance banking regulatory regime is the second best, behind Malaysia (the most robust one), with Pakistan (third best) following and the UAE being the weakest. Although the authors do not discuss Shariah corporate governance regulatory regimes in capital markets regarding Islamic companies (investment sector), they do indicate the level and extent of Shariah corporate governance in terms of regulation robustness. They nevertheless also did not discuss Shariah corporate governance status from the perspectives of IFI stakeholders and experts in Kuwait, leaving a research gap that inspired the current researcher to examine Kuwait's Shariah corporate governance

⁶⁸ Leximetrics is "the process of translating legal materials, principally texts of statutes, decrees and judgments, into a form which can be used in statistical analysis" (Adams et al., 2017, p. 7).

arrangements from such perspectives – not only in the banking industry but also in the investment and insurance sectors.

5.2.1 The Kuwaiti Banking Sector

Despite their abovementioned shortcoming, AlQassar and Ahmed (2022) describe Shariah corporate governance regulations in the banking industry accordingly, stating that Islamic banks (IBs) are regulated under the following laws and regulations:

- Banking Law No. 30 of 2003 amended Law No. 32 of 1968 concerning currency, the CBK and the organisation of banking business to include a special section on IBs.
- Instructions No. 2/IBS/100/2003 issued by CBK outlines the rules and conditions for SSB appointments and responsibilities in IBs. These instructions were repealed by CBK with the issuance of a more detailed Shariah Supervisory Governance (SSG, 2016) document regulatory guidelines for IBs in 2016.
- The latest amendment (Law No. 3 of 2020) added provisions to Law No. 32 of 1968 and allowed the CBK to establish its higher Shariah supervision authority (HSSA).

The CBK adopts a mandatory philosophy concerning SSBs, which must consist of at least three Shariah scholars and conduct mandatory internal and external SAs of IBs. Also, the CBK established its own Shariah board to oversee Shariah corporate governance affairs at the macro level.

5.2.2 The Kuwaiti Investment Sector

The financial market primarily includes investment and real-estate companies, and IFIs have been regulated by CMA laws and regulations since the issuance of Law No. 7 of 2010, which established the CMA and documented regulations regarding securities' activity. Based on this law (No. 7/2010), the regulation of investment companies shifted from the CBK's authority to that of the CMA. The issuance of the CMA executive by-laws followed in 2011, which stipulated a

new model for internal Shariah audit of investment funds and the introduction of external Shariah audit. In 2013, the CMA issued a regulation for IFIs practising external Shariah audits and in 2015 it amended executive by-laws by adding a special chapter on external Shariah audit firms (Alnahedh and Shurafa, 2020). In 2021, a CMA executive by-law was amended – namely, concerning the conditions and requirements for registering ESA offices and their obligations to enhance Shariah corporate governance.

Evidently, the CMA's Shariah corporate governance model is based on the mandatory presence of internal Shariah audit and external Shariah audit (with their focus being on enhancing the latter's ESA function). Since 2011 the CMA has had its own Shariah board called the Shariah Supervision Advisory Council. What is unique about the CMA's Shariah corporate governance model is that the SSB is optional and not mandatory, unlike the CBK model. The different Shariah corporate governance models will be discussed in detail later in this chapter.

5.2.3 The Kuwaiti Insurance Sector

Before 2019, insurance companies in Kuwait, both conventional and Islamic (*Takaful*), were supervised by the Ministry of Trade and Industry. Given this sector's importance and the complexity of this ministry's responsibilities, in 2019 an independent unit for the insurance sector was established, called the IRU, and Law No. 125 of 2019 was issued regarding insurance regulations. An executive by-law was also issued in 2019 concerning insurance regulations, according to which insurance companies operating in accordance with Islamic principles were obliged to establish their own SSB, in addition to the internal Shariah auditor.

The Shariah corporate governance system for the insurance sector thus currently consists of an SSB and ISAs. In addition, the IRU is obligated, according to the law governing its establishment, to have a Shariah supervision advisory council, as found in both the CMA and the CBK – albeit under different names. Notably,

the Shariah corporate governance model for the insurance sector is devoid of external Shariah audits (see Table 5 below).

Table 5: Shariah Corporate Governance Structure of Financial Sector Regulators in Kuwait

	Regulatory Body	SSB	ISA	ESA	Central Shariah Board (CSB)
1	Central Bank of Kuwait (CBK)	✓ ⁶⁹	✓	✓	✓
2	Capital Market Authority (CMA)	✗	✓	✓	✓
3	Insurance Regulatory Unit (IRU)	✓	✓	✗	✓ ⁷⁰

Source: Regulatory Authorities Shariah Corporate Governance's Instructions

5.3 Shariah Corporate Governance Status in the Kuwaiti Financial Sector (Industry-Level)

This subject is relatively new and seldom discussed in assessments of Shariah corporate governance laws and regulations in Gulf Cooperation Council (GCC) countries, and participants' views on it varied, with some asserting satisfaction with the situation (describing Shariah corporate governance regulations as a 'quantum leap') and others asserting that Shariah corporate governance regulation (issued in December 2016, applied in January 2018) is relatively new and needs time to show its effectiveness. Others believe the situation is good but insufficient, while some believe the different Shariah corporate governance models operating among the various regulatory authorities do not serve the Islamic financial industry. An SA expert (SAE4) stated:

⁶⁹ The tick means, for example, establishing SSB is required and mandatory according to a specific regulator, while the cross indicates SSB is not required and is optional according to another regulator.

⁷⁰ Not established yet (as of 31 December 2022).

Of course, as an evaluation of an excellent presence. I consider it [Shariah corporate governance regulation] excellent. It is possible that it did not cover aspects or an event in certain responsibilities, but its presence I consider ... a qualitative leap in the governance of Shariah supervision.

A Shariah scholar (SSM) alluded to Islamic financial industry being what is called an ‘infant industry’⁷¹:

I say that we still in Islamic banking believe that it is a very modern experience. Therefore, when we talk about such as the existence of new governance systems, I say this is a good thing and serves Islamic banking, but these systems need application, experiments and study more and control in implementation and the problems that we are faced with the application of such governance because we still say that it is so far in the beginnings.

SSM further alludes to an ‘infant industry’:

Islamic banking is nearly 40 years old. But if it is compared with conventional banks whose age is more than 300 years, then 40 years are considered few and not enough in front of the history of these conventional banks, which have [for] more than 300 years practiced and applied and were subjected to a lot of pressures and experiments, and there are even laws that are designed to serve these banks in its conventional form.

Much work, follow up and experimentation are thus needed in the Islamic financial industry against various challenges ahead. One interviewee nevertheless indicated that the legal framework for Shariah corporate governance is excellent, especially because SSB members are linked to the institution’s general assembly and not the board of directors (BOD), but a problem lies in shareholders and major owners of IFIs being concerned about annual profits coming via ways that flout provisions and principles of Islamic Shariah. As EXSSM stated:

⁷¹ An infant industry is “a new industry that may merit some protection against foreign competition in the short term” (Jonathan, 2016, p. 312).

This point, actually [an excellent Shariah corporate governance legal framework], did not lead to the desired goal of Shariah corporate governance. The reason is that the power in IBs is unfortunately not for those with an Islamic banking orientation but rather for those with financial interests to prevail over Shariah interests [that seek] to make profits in an Islamic manner.

Concerning attitudes of IFIs owners towards IF principles, Abozaid (2016, p. 225) argues that this is “to realise the self-interest of the bank”. In this vein, some major owners of IBs are eager to appoint Shariah scholars who are lenient in their *fatwas*.⁷² An ex-executive (EXE) put it as follows:

When we push for a product and we get pushback or negative feedback or, ‘No, this cannot be done’. The management gets frustrated because ultimately they have budgets to achieve and I’m certain they would like to have a more lenient Shariah compliance.

It is easy to negotiate with Shariah scholars using the bank’s management to Islamise some conventional products that may not comply with the provisions of Islamic principles. As EXSSM added:

They, the IFIs owners, took usurious formulas and tried to Islamise them through SSB so that it becomes an acceptable Islamic image, and unfortunately most of these matters contain ploys that are not Shariah compliant.

Another participant (SSE1) argued:

Look at the Shariah supervision until this day, and to be realistic, unfortunately, you have nothing to do with what is said by major IFI owners [about how] the Shariah aspect is inevitable and vital and so on, but the major owners or shareholders feel that SSB is a weird body inside IFIs. Unfortunately, the success or lack of Shariah supervision is still in the hands of the board of directors.

What respondents mention here parallels Haridan et al.’s (2018) argument about how fulfilling shareholders’ desires, which often concern profit and often at the

⁷² *Fatwa* refers to “the Shariah opinion given by a Shariah specialist over something” (Abozaid, 2016, p. 233). The person who issues a *fatwa* is called a *mufti*.

expense of abiding by Shariah, requires lenient Shariah scholars or, as they call them, liberals, as, in a sense, it is easy to dictate to them the owners' desires, even if these are not in accordance with the provisions of Islamic law. This manifestation (shareholders' effects on SSBs) will be discussed in detail later in this chapter (5.7).

5.3.1 Regulatory Multiplicity

As mentioned earlier (Section 5.1), multiplicity of Shariah corporate governance models among regulatory authorities, especially regarding the mandatory and non-mandatory presence of an SSB in IFIs and the extent of their impact on Shariah corporate governance generally, may adversely affect customers' trust in and the credibility of IFIs. For instance, the CMA does not require IFIs to establish their own SSB (it is optional), despite this being a mandatory condition for Islamic banks that their regulator, the CBK, has instituted. Osemeke and Adegbite (2016, p. 431) suggest that multiplicity of models could "reduce compliance by firms and ineffective enforceability by regulatory agencies". In this regard, SSE3 argues that "the multiplicity of regulatory authorities is a prejudicial phenomenon".

Participants addressed this issue, and their opinions varied. Some believe a bank's size and the impact of customers' shaken confidence in the bank (because of Shariah non-compliance risks) are more significant than the size of the companies' sector and the resultant impact of this, for the number of bank clients, is much greater than for number of investment companies. Consequently, if there is Shariah non-compliance risks in both institutions (Islamic banks and Islamic investment companies), the impact on banks will be greater. As such, the CBK was keen to oblige the entities subject to it (IBs and IFIs) to establish their SSB in compliance with the provisions of Shariah. As HSSA stated: "Undoubtedly, the CBK, given that it is in control of the local banks, and there is people's money in these banks, makes Shariah corporate governance rules more stringent".

BREG1 supports this:

The SSB is supported by the secretariat and the Internal Shariah Audit. If there is a department concerned with Shariah supervision over the development of products, the external audit will support it and the shareholders through clarification of Shariah observations. If it wasn't named 'SSB' but named 'internal audit' under an accredited fatwa from an SSB, then the difference would only be in form and not in content.

Others, however, argue that the CMA's stance is that Shariah supervision should be handled similarly to the process adopted by accountancy auditing firms do. Consequently, IFIs may contract with Shariah auditing offices and these offices offer Shariah supervisory board services. In other words, IFIs contract firms (rather than individuals) approved by regulatory authorities. In addition, this office must change in the company's accounting cycle after three years, so audit offices rotate and hence one office does not remain for many years with the same entity. So, they (Shariah auditing offices) through rotation will be likely to institutionalise and depersonalise the work and enhance governance. Also, Shariah auditing offices will ensure their work is more accurate and professional, so as to continue being registered with the supervisory authority and thus having the right to work as a Shariah auditor. As a former supervisor at a supervisory authority (EXREG2) said:

Today there is awareness and a feeling of holding the auditor accountable. In the law, he – the auditor – may be held accountable if he did not make these observations or gave incorrect advice and misled the shareholders and thus the company lost as a result, because he wants to see his interests with the company's BOD, which renews his contract every year. So, the CMA has set a rule that the external auditor cannot stay for more than three years, and he is monitored and held accountable [by the shareholders] and SSBs are appointed in the same way.

Although the Shariah supervision philosophy differs between the CMA and the CBK, as mentioned above, the former is open to changing this philosophy, which seems that of the CMA founder's philosophy prior to 2010. Indeed, the CMA's current leaders do not mind changing the philosophy if there is a clear

benefit or particular problems, though INVREG1 argues that “*but so far, it has not been revealed to us that there are shortcomings*”. He also said:

I am speaking out loud, if you see that the CMA today assumes the reins of responsibility in supervising the SSB by registering them in its records, similar to other obligatory jobs, as well as supervising them through off-site surveillance and on-site supervision and field inspection. The CMA has no perception now of it, but if there is a need, on the contrary, we look at it from the technical side and from the Shariah side through our Shariah advisory council.

Shariah audit managers in Islamic banks are notably satisfied with the current Shariah corporate governance regulations, and they do not have severe criticisms or comments (only minor technical suggestions). A Kuwaiti proverb says that ‘[t]hose who gain in the market are the only ones who praise it’, so it is understandable that those outside the banking sector would have more criticisms, some of which are severe, such as concerning the appointments of the Higher Committee of Shariah Supervision in the CBK, as the next section discusses.

5.4 The Central Bank of Kuwait and the Higher Committee of Shariah Supervision

Most interviewees agree that although establishing the higher committee of Shariah supervision was a positive development for the IF industry, this body has so far not disclosed the actual roles it plays. For example, there was much controversy about a certain public company listed on the Kuwait Stock Exchange and the extent of the permissibility of public subscription to this company, especially as it dealt with banks that issued usurious loans. Amid the issue of contradictory Shariah *fatwas* from respected Shariah scholars, the higher committee of Shariah supervision did not issue a *fatwa* in this regard. In this vein, SSE1 stated:

There are matters that must be entered into as a supervisory body [higher committee of Shariah supervision]. The activation of the higher committee of Shariah supervision is required to read the doctrinal conclusion, as the topic [investing in a controversial

company] *is very serious and there is no joke; whether they like it or not, they may hold a conference in which they discuss the issue.*

Another SA expert (SAE2) argues:

I do not know what the policy of the CBK with this body [higher committee of Shariah supervision] is, but it was supposed to have some disclosures and to tell what is happening in the arena.

Various studies (Alam et al., 2019; Abu-Tapanjeh, 2009; Grais and Pellegrini, 2006) have discussed the necessity of disclosure and transparency in Shariah-related matters generally. Nonetheless, transparency is even more critical if it relates to central Shariah boards for regulatory authorities (e.g., higher committee of Shariah supervision), as it will sustain the public's confidence in IFIs and facilitate its conformity with Islamic principles.

Despite what SAM1 indicates below, the higher committee of Shariah supervision asked for the CVs of Shariah audit managers in Islamic banks and details of their experience in IBs to approve their reappointment, but the matter did not go further:

We have not seen anything of higher committee of Shariah supervision and have not felt its existence except when they asked us, as managers and members of the Shariah Board, to submit our CVs and experiences that were approved by the SSB. So, we submitted and were approved.

Some respondents criticised the higher committee of Shariah supervision composition itself, seeing appointment to it as a largely political rather than professional matter, as SAE2 explicitly acknowledges:

I saw the existing composition of higher committee of Shariah supervision members as if it meant a political formation rather than a professional one.

Also, the CBK contradicted itself in these appointments. While requiring SSB members in its affiliated IFIs to be Shariah scholars, when the CBK appointed

higher committee of Shariah supervision members it relinquished this condition and appointed an academic specialising in accounting. For POL:

I have reached [the view] that CBK in my research lays down very detailed rules for selecting banks' BODs and SSBs and places many obligations on them, but these do not apply to the CBK's BOD and do not apply to their choices.

As a result, there are some noteworthy observations about the higher committee of Shariah supervision's effectiveness, starting with not expressing an opinion on fundamental issues like contributing to the subscription in controversial companies, to the appointment of non-Shariah members (unlike the SSBs in IFIs), to not disclosing its roles in the Islamic finance field. As a result, one of the determinants of good Shariah governance is the ability of the central or supreme Shariah bodies in the supervisory authorities to be influential and disclose their roles in order to raise awareness in society and constructively criticise their work. The following sections discuss Shariah corporate governance arrangements in the micro-firm level.

5.5 Shariah Corporate Governance and Organisational Arrangements (Micro Firm-Level)

As this chapter's introduction indicated, the internal regulatory determinants of Shariah corporate governance are the same as those of IFIs. In other words, these determinants relate to the principles of Shariah corporate governance addressed in the CBK's 2016 instructions regarding Shariah corporate governance in Kuwaiti IBs. Specifically, these principles are as follows: SSB independence (the extent to which the BOD or general assemblies of shareholders of IFIs influence their decisions); competency or fit of and proper criteria for SSB members regarding academic or professional qualifications and experience; consistency in members' opinions and board composition; confidentiality and preservation of information by SSB members; disclosure and transparency of Shariah-related matters; and the commitment to Shariah compliance of IFIs, as well as shareholders and clients of IFIs and their effects on Shariah corporate governance.

5.5.1 Shariah Supervisory Board Independence

Much literature has covered SSB independence, which is considered a central requirement of sound Shariah corporate governance in IFIs (Graiss and Pellegrini, 2006; Abozaid, 2016; Basiruddin and Ahmed, 2020). SSB independence is “a way of exercising its functions impartially and in complete freedom. They [its members] shouldn’t be influenced by any kind of pressure (from IFI management or shareholders) that may negatively affect their decisions’ (Al-Khalifi, 2003, as cited in Alkhamees, 2012, p. 144). Also, the CBK (2016, p. 22) says SSB independence is about:

Allowing the SSB in the bank to issue Shariah fatwas and rulings in accordance with the requirements of the rules of jurisprudence and the conditions of fatwas without affecting the SSB members, in a manner that ensures the enhancement of confidence among shareholders and stakeholders in the integrity of transactions from a Shariah point of view.

Al-Shabili (2009, as cited in Alkhamees, 2012) suggests three facets of SSB independence, the first being that SSB members should not be IFI employees, and that the Shariah compliance/supervision department should not be under the CEO’s authority. The second concerns financial independence, and on this many respondents suggest that, if SSB members receive remuneration from IFIs, this will affect their independence, regardless of whether the remuneration is received via being voted for in the Annual General Meeting (AGM) or from the BOD directly. The third is the appointment and dismissal of SSB members. In other words, who appoints SSB members? Is the IFI’s executive management or the BOD responsible directly or does this happen via the AGM (i.e., all shareholders)? If the former, SSB member independence becomes questionable; if the latter (AGM), independence remains. These three facets of AlShabili (2009, cited in Alkhamees, 2012) aligns with the AAOIFI governance standard.

In the Kuwaiti Shariah corporate governance environment, SSBs are appointed by an AGM post nomination from the IFI’s BOD, so the SSB is considered an independent body affiliated to the general assembly of shareholders. SSB members fall under this form of nomination by the BOD then appointment by

the general assembly of the institution, which represents independence from the executive management and the BOD and which aligns with international best practices, as outlined in the Shariah corporate governance guidance and standards by Islamic financial standard-setting institutions, such as the AAOIFI and Islamic Financial Services Board (IFSB).⁷³ However, many studies, as well as research respondents, question the independence of SSBs (Abozaid, 2015; Alkhamees, 2012; Grais and Pellegrini, 2006; Ginena and Hamid, 2015). A legal counsellor (EXBLC) stated:

This is not independence, because there is an important thing in the IB that you should know. There are two groups of people in the bank whose interests are conflicting, and they are the depositors and the shareholders, and this you do not see in the conventional bank. The conventional bank depositor has a loan agreement, and he knows from the first day how much he will take, how much he will pay and so on.

As SSE1 put it:

You want real independence. The supervisory authorities are the ones who must nominate so-and-so to enter the bank/company, and then at the end of the year the bank writes a report on all members, so the supervisory authority can follow up on whether the report is accurate concerning whether the bank wants to renew Shariah scholar membership. For example, the supervisory authorities check what is happening and do not leave the control of the members of the Shariah boards with the BOD, and then they claim the matter is with the general assembly. The BOD and the General Assembly are two sides of the same coin.

SSE1 in fact considers SSB independence not real:

I consider SSB independence fictitious, even though I am still a member of SSBs in companies because a board member does not take comfort in speaking out except what my Lord had mercy on.

⁷³ The IFSB, which is based in Kuala Lumpur, Malaysia, was officially inaugurated on 3 November 2002 and started operations on 10 March 2003. It serves as an international standard-setting body for regulatory and supervisory agencies that have a vested interest in ensuring the soundness and stability of the IF services industry, which is defined broadly to include banking, capital market and insurance (IFSB, 2022).

Another opinion supports this lack of independence from a different angle (see below). As two Shariah scholar groups, or lobbies, in Kuwait decide who enters the SSBs in IFIs and who does not, especially in Islamic banks, so powerful an influence that an interviewee called these ‘the Mafia’. The academic, ACA2, commented:

I do not think there is independence, because if you are independent ... that means I express my opinion without financial consequences and without prior accounts, because it is a Shariah opinion. But if I as a new Shariah scholar do not make an account for the group I work with [i.e., favouring] and its impact on this decision, I will not be in this body, and if I do not focus on this group, I will not be present in another body.

ACA2’s assertion aligns with what Nakpodia and Adegbite (2018) suggest concerning the effect of religious leaders or elites. Such a lobby or group, or even ‘mafia’, as ACA2 calls them, tries to keep the state of Shariah corporate governance regulations unchanged to preserve their privileges (monetary and non-monetary) gained from sitting on different SSBs in Islamic banks.⁷⁴ According to institutional theory, as alluded to in Chapter 2 regarding the social aspects and social connectedness of Kuwaiti society, EXSSM stated:

Then there is a second problem that the members of the supervisory board are subject to pressures. It is not underestimated, and many of them are desperate to maintain their presence in the body for the goals and aspirations of the shareholders present in the bank. Unfortunately, this led to deviation [from Shariah principles].

Another viewpoint, however, suggests that SSBs are, in fact, independent, and that the matter of independence does not concern the strength or weakness of the person himself, because in the appointment of an SSB member by the Foundation’s general assembly, no one has authority over the member, whether an executive management or a BOD. SAM1 stated:

⁷⁴ SSB members may serve up to three IBIs in Kuwait (Shariah Supervisory Governance Regulations, 2016, p. 16).

I have a conviction regarding independence in general, whether when we talk in Kuwait about the independence of the judiciary or the independence of the SSB. There are no compelling laws and no authority over SSB members. For example, there is nothing that makes the bank put pressure on an SSB member to agree to or refuse something, unless he is afraid the IFI will not renew him at the end of the year.

Also, in SSE3's experience in the Shariah supervision field, which has spanned more than 40 years, the BOD of an IFI (whether a bank or company) has no negative impact on the SSB. He argues:

Through my experience that has continued since the late 70s until now in the X bank and in some foreign banks in Kuwait and Bahrain, or in some IB branches in Germany and Austria, I did not notice the influence of the BOD over the SSB.

SAM1 and SSE3 agree that SSB members are independent and thus disagree with Grais and Pellegrini (2006), Alkhamees (2012), Grassa (2013), Abozaid (2016) and Oseni et al. (2016), who argue that IFI BODs or executives place pressure on SSB members, albeit with variations between one IFI and another, hence, this may concern, for example, a particular product, passing through 'whispering', that is reminding the chairman/member of a BOD that a SSB member should not have a renewed contract or even threatening dismissal. Actually, though, a central distinction on these perspectives seems to be between those currently practising and those not, or more specifically, personnel within each of these, as academics, some ex-SSB members and ex-IB consultants question the state of SSB independence while current SSB members in charge of IBs and SAs in IBs support the idea of SSB independence.

An SSB's independence sometimes relates to economic incentives (Grassa, 2013) as some are attracted by monetary enticements (as a human instinct), especially if they are prominent Shariah scholars and members of many SSBs. As such, they are not ready to lose their privileges. So, when asked for his opinion on setting a limit on the number of Shariah scholars with SSB memberships, in this vein, SSM argued:

If there is one member for each Shariah committee, we will raise our cost. Instead of giving me this amount as a Shariah board, I am a specialist expert for nearly 20 years, and I will increase my cost because I used to distribute my costs to banks, but today there is only one bank.⁷⁵

Another respondent in contrast exemplified a certain SSB member's demonstrating his independence using a *sukuk*⁷⁶ transaction that was structured to not be Shariah compliant but the company's management exerted pressure on the member to approve the transaction. The IFI's SSB refused to approve the transaction, and the entire SSB consequently resigned. HSSA stated:

This company wanted to issue a type of sukuk, but it entered the deferred sale of these sukuk, and as the company, if it was possible to liquidate the amount upon payment, it would give another term with another interest. Of course, from a Shariah viewpoint, we explained to them that this is the essence of usury, it is not permissible and the case is not in dispute, and they tried to put pressure on an SSB individual, as he – a Shariah scholar – is from their country (Kuwait) and the committee consisted of members from inside and outside Kuwait. They tried to put pressure on him to adopt their opinion. Immediately after, the SSB collectively resigned.

However, this SSB was not satisfied with the resignation alone, as it also mentioned the explicit violation of Islamic law in its annual report, which was read aloud in the AGM before shareholders and placed responsibility on them (entire SSB) for this matter. HSSA added in the same case:

In our report to the general assembly, we recorded that the company, although we gave them a fatwa from the SSB, prohibiting the entry into this transaction, it violated and entered. Now, all the profits that result from this transaction are forbidden profits. Accordingly, there became a big problem in this company, and the company that wanted to issue the sukuk violated and did what it wanted; in the financial

⁷⁵ The participant said he proposed this idea to the CBK when they wanted to limit the number of SSBs that Shariah scholars can be members of (one membership only).

⁷⁶ *Sukuk* is an Arabic term that is the plural form of *sack*, which means certificate. The term *sukuk* is broadly translated as 'Islamic bonds', although the correct translation is 'Islamic investment certificates' (Afshar, 2013, p. 45). The AAOIFI (2003, p. 468) officially defines *sukuk* as "certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services" (see also El Mosaid and Boutti, 2014, p. 226).

crisis, a loss came out of this transaction of 80 million Kuwaiti dinars.

This example shows that HSSA and SSB show independence. Hence, the SSB's lack of independence claim is unacceptable, though the instance of SSB resignation is rare. Some participants pointed out, however, that the independence of the SSB is assured, but there may be some 'indirect pressures' in some IBs based on the SSB's pre-knowledge of the BOD's desires. Therefore, the SSB may relinquish the BOD's desire if it is permissible from a Shariah viewpoint. As SSE1 stated:

In fact, some indirect pressures may replace this transparency⁷⁷, and these indirect pressures are felt by the members of the board. Some bodies know what the board members' orientation is in certain issues, so the head of the board can give some guidance.

One thing that directly and indirectly influences SSB members' independence is the extent of any links between SSB members and the company providing external Shariah audit services, such as whether the member has an executive position or owns shares in the company. If this company is appointed to provide external Shariah audit services to an Islamic banks that is a member of its SSB, then its independence will be debatable. Hasan (2012) mentioned that Shariah advisory firms are owned by either independent parties, IFIs or Shariah scholars and SAE4 explicitly stated:

It is not permissible for me to be a member of a Shariah board in a bank and for me to be the owner of a company [i.e., an SA] and to present myself to a bank as a Shariah auditing body. It is not permissible. This is a conflict.

This relationship of SSB members with Shariah consulting and auditing firms is rarely discussed in the literature. It is also not mentioned in the Shariah corporate governance instructions of the Kuwaiti supervisory authorities (CBK, CMA,

⁷⁷ This person mentioned that at the beginning of the establishment of IBs, the chairman of the BOD of the interviewee's IB used to sit with them and warn them against falling into approving transactions or products that were suspicious and not Shariah-compliant. In his opinion, he considered this behaviour by the IB chairman to be transparent.

IRU). Thus, one determinant of ‘good’ Shariah corporate governance is whether an SSB member has any direct or indirect links with Shariah auditing and consulting firms, which is one practical contribution of this research (regarding the micro-level determinants of ‘good’ Shariah corporate governance).

5.5.1.1 Shariah Supervisory Boards and Third Parties

Several respondents’ views aligned with Grais and Pellegrini (2006), Ginena and Hamid (2015), Abozaid (2016) and Oseni et al. (2016) concerning lack of SSB independence. These respondents argue for dealing with this issue proactively and thinking ‘outside the box’, so they proposed the appointment, remuneration and dismissal of SSB members be conducted by a neutral third party, not the IFI to which the SSB members belong and are designated to supervise its products and services. Ginena and Hamid (2015) similarly suggest supporting SSB independence by SSB members’ remuneration coming from a special fund established by a regulatory authority.

Many participants also suggest dealing with this defect by a supervisory body (whether the CBK, CMA or IRU) being the third party and the financing being an annual deduction as a percentage of the institution’s profits, with variations according to each institution’s size. With this, the member would be rewarded through a supervisory authority fund. Others propose the neutral party to be the Council of Ministers under the supervision of the Ministry of Endowments and Islamic Affairs in cooperation with the regulatory authorities. A third proposal is to form an association with Shariah scholars, who would elect members from among the Shariah scholars and nominate them for IFIs. EXSSM argued:

The SSB should be completely independent from the bank’s management. [It should be] like a department affiliated with the CBK so it achieves goals far from the ambitions of the shareholders, because all that matters to them is to achieve the largest possible return at the expense of the Shariah aspect. If we give the SSB full independence, so that its appointments are done like independent government institutions, it has its independence, work and arrangement, and so positions are nominated for the SSB from within it, and it takes its internal votes and not from the power of shares.

Another proposal regarding SSB independence derived from EXBLC:

I believe the issue of Shariah supervision is supposed to come out of IBs and IFIs and be under the supervision of a central apparatus in the country affiliated with the CBK or the Ministry of Commerce, and it does not matter to whom this body is affiliated. The important thing is that it be a neutral party that receives its rewards from the state and not from the company; this is a vital issue.

SSE1 put forward a similar suggestion but with more emphasis on fulfilling the neutral party's requirements (financial, managerial and technical):

The regulatory authorities represented by the CBK, the Ministry of Commerce, the CMA, and the Ministry of Endowments, represented by the fatwa sector, all of them [agreed] to choose this member to be placed in banks and investment companies; tell me from where he takes his money? I say from a fund established for Islamic companies, like the National Employment Support Fund, by deducting a percentage of the companies' profits annually to reward the members of the SSB.⁷⁸ Therefore, they take their remunerations from the fund to ensure their independence.

While these proposals seem logical, different parties have opposing views (regulators, Shariah scholars, auditors, etc). For example, a regulator has argued that this proposal (suggested by SSE1) is taking SSBs from one authority (general assembly) and giving them to another (regulatory authority or Council of Ministers). Consequently, the new authority may coerce SSB members so doubt concerning SSB independence remains. In fact, the mechanism used for appointing SSB members (via shareholders' annual general meeting) is considered the best available, and until a better option is found it should remain. As BREG2 argues:

⁷⁸ SSB members of banks differ from SSB members of investment companies and of services or insurance companies, and even business size is a factor. For example, KFH (the biggest IB in Kuwait) is not like Warba Bank (the smallest IB in Kuwait), and, based on size, the remunerations of SSB members vary (e.g., an SSB member in from Warba Bank may take 1,000 Kuwaiti dinars, while SSB members from KFH may take 10,000 or 20,000 owing to its size, says SSE1). There is a complete breakdown of this proposal, but it is only available in Arabic.

I think this is the matter of centralisation [appointing the SSB members] that they have moved from the authority of the BOD and have become under the authority of those who appoint them, whether it is the Council of Ministers or others, the same doubt exists about whoever appoints them can influence them, and this also leads to centralisation.

Another regulator (BREG1) argues that ensuring IFIs abide by Shariah law is not the regulator's responsibility but that of the institution itself, as IFIs chose to work under the principles of Shariah:

Let us assume a supervisory body intervened by appointing an SSB. In this case, who is responsible for achieving the Shariah aspect? It is the regulatory authority because it appointed and relieved the BOD and shareholders from responsibility. Is the purpose of this step to make the regulatory authority responsible for everything? I think this might lead to abortion of experience in the IF industry. Indeed, time has a role. Intervention should be adopted only in cases of serious violations.

As indicated above, the third-party proposal is tempting in theory, but it is not practical. For instance, Alkhamees (2012, p. 145) notes five factors that may influence SSB members' independence: (1) the appointment approach (as discussed above); (2) high remuneration; (3) providing credit facilities to SSB members; (4) ownership of IFI shares; and (5) working in an executive position. Some of these points are addressed by certain regulations (e.g., CBK's Shariah corporate governance regulation), but the main argument here is the lack of practicality as regards factors (2) and (3). Because an SSB member in essence is someone with needs and desires that can be met only through loans, how can a member be prevented from funding (i.e., loans)? The proposal may be logical if a clause of 'no borrowing' from the institutions it legally monitors is added, with 'preferential terms' or financing ceilings with 'lower requirements'. In this case, the proposal is feasible, logical and applicable, as it has added specific details that may affect the members' independence. In this vein, SSE3 added:

Reality does not have to be true, no. However, I say reality must be considered, and solutions to errors and problems of reality are 'viable'.

Furthermore, concerning some SSB members' high remuneration (2)⁷⁹ one proposal is having certain organisational arrangements that preserve SSB members' independence, meaning remuneration does not matter. For instance, by not assigning Shariah scholars to executive roles, the remuneration, whether high or low, does not affect SSB members' independence.

5.5.2 Shariah Scholars' Multi-Memberships

Unlike those interviewed from outside IBs, Shariah auditors inside them have little objection to the multiplicity of memberships that exist among a few (usually prominent) Shariah scholars in many SSBs, saying it helps members expand their horizons and perceptions and deepen their practical experience. Indeed, such respondents clearly oppose capping Shariah scholars' multi-membership. Meanwhile, certain literature (Farook and Farooq, 2013; Grais and Pellegrini, 2006, Alkhamees, 2012) suggests multi-memberships have negative implications for independence, while Nawaz et al. (2021, p. 15) acknowledge that having prominent scholars on an Islamic bank's SSB increases profitability but can also "reduce market value possibly due to the market perceiving them as less independent and too busy to actually perform their role effectively". Furthermore, prominent or senior scholars may contribute to standardising dominant products and services, which benefits the Islamic financial industry (Farook and Farooq, 2013). Overall, SAM2 supports such multi-membership:

The fact that a member of the SSB is in more than one bank has its pros and cons. In terms of the negatives, they are well known, but their positives are a great thing, as it stands on the practical application of each bank. So, the member will have experience, and his view will be deeper and more comprehensive.

Both SAM2 and SSM offer a practical suggestion for furthering such benefits whereby regulators increase the minimum number of SSB members from three to four, thereby allowing junior Shariah scholars to become SSB members and to learn and gain experience from senior SSB members. Learning should occur

⁷⁹ Oseni et al. (2016) mentioned that some prominent Shariah scholars who sit on more than 50 IFI SSBs worldwide may earn 500,000 US dollars yearly, in addition to other allowances, such as travel fees.

between senior and junior Shariah scholars via knowledge transfer, but this is not always so. According to Farook and Farooq (2013, p. 143), “[t]op Shariah scholars are not involved at all in training and thus do not serve as a bridge to transfer their accumulated knowledge and experience to the successor generation”. SSM also values the proposal mentioned above and explains it likewise:

What we are thinking is that we bring two or three distinguished doctors from the Faculty of Shariah to come to us so they can live the atmosphere of the SSB. They are assigned with research and they know the method of discussion, the important things in the discussion, what things should be paid attention to, what are the prohibitions and what are the principles that we proceed from in Shariah rulings. At least junior Shariah scholars become quasi-full-members in a training course but without the right to vote.

This proposal seems logical, but it requires regulatory intervention. In response to the CBK’s and IRU’s Shariah corporate governance instructions about the minimum number of SSB members being three, that for IBs ranges from three to four. If the regulatory authority wants to benefit from and thus adopt this proposal, it needs to amend the minimum number of SSB members to four, or even five, to allow junior scholars to join SSBs. Also, another amendment would allow new members to join but without the right to vote and only for a specified period, after which they would become a member with full rights. While this proposal risks creating a second and third class of Shariah scholars, it could also reduce the concentration of a few prominent Shariah scholars among many SSBs, thus facilitating Shariah supervision of IFIs.

5.5.3 Shariah Supervisory Board Members’ Competence

Respondents second most noted aspect of micro-level Shariah corporate governance challenges is SSB members’ competence. The backbone of IFI transactions and services is Shariah-based, and those responsible for ensuring this are SSB members, or ‘gatekeepers’ as Farook and Farooq (2013) call them. SSB competence refers to Shariah scholars having at least an elementary knowledge of banking and finance but also qualifications in IF law, including gaining professional accreditation by passing special IFI exams (Abozaid,

2016). Grais and Pellegrini (2006, p. 10) argue that SSB members should be “knowledgeable in both Islamic law and commercial and accounting practices (*Fiqh al-Muamalat*)”. Islamic finance experts and Shariah scholars vigorously debate whether technical members who are experts in (economics, accounting, law, etc) should be included in SSBs.

Abozaid (2016) goes beyond previous point, taking the strong position that SSB members should have a higher education certificate in Islamic law (MA/PhD). For Abozaid (2016, p. 226), “[m]any Muslims still fail to realise that a preacher is not necessarily a Shariah scholar, and the Islamic law is of different branches, the most sophisticated of which is the Islamic law of transactions, so specialisation is required”. The next section (5.5.3.1) describes and discusses SSB competency and related issues. Further it suggests practical recommendations.

5.5.3.1 Shariah Supervisory Board’s terms of appointment

Regulatory authorities (CBK, IRU) notably differ regarding SSB members’ terms of appointment. For instance, while the CBK explicitly mentions a required bachelor’s degree in Islamic law, especially in the jurisprudence of transactions (*Fiqh al-Muamalat*), the IRU simply requires SSB members to be experts specialising in Shariah (*Fiqh al-Muamalat*), law and economics without mentioning qualifications (see Appendix 9). Furthermore, the CBK stipulates that SSB members must have five years’ experience in the Shariah supervision field, whereas the IRU does not mention a required period of experience (also see Appendix 9). The IRU nevertheless does allow those who are not Shariah scholars to become SSB members (meaning each SSB must have a majority of Shariah scholars), while the CBK does not allow any person to be in the IB’s SSB except Shariah scholars (though the SSB may invite any expert/consultant from within the IB but outside this board to illustrate a specific aspect, but without having voting power). In fact, the differences reflect what is called ‘regulatory multiplicity’ (Osemeke and Adegbite, 2014), as covered in Section 5.3.1.

One of the possible reasons for the multiplicity of regulatory approaches regarding the SSB members' competency is the scarcity of specialised Shariah scholars in the jurisprudence of Islamic financial transactions. Therefore, it is challenging to require that all of the SSB members in Islamic financial institutions be Shariah scholars. As IFI administrations claim, a dearth of specialists in Islamic financial transactions prevails, so famous scholars are often chosen for SSBs. SAM1 justifies this, stating:

I think it is natural that the bank wants a [good] reputation. So, when I say that I have Dr X and Dr XX, people will trust [in that], and if you leave the choice to the bank, it is natural that the decisions will fall on this type of member.

One reason for the dearth is the weak output from the College of Shariah and Islamic Studies of Kuwait University, which is supposed to produce all or most future SSB members. In this vein, albeit in another context, when the Central Bank of Malaysia (Bank Negara Malaysia) set the condition that an SSB member should not be involved in more than one financial institution in one sector,⁸⁰ it was trying to solve several problems, including the limited concentration of SSB members noted above. Simultaneously, the Bank Negara Malaysia was trying to ensure that the second tier of Shariah scholars should be members of the SSB to gain experience. Many academics approved of this and actually demanded its implementation across many countries as an ideal practice, but it is nevertheless considered a double-edged sword. In environments that have qualified graduates, having one membership for each sector is considered good, but in environments where the Islamic finance industry is more recently developed and does not have a solid infrastructure, such a cap is considered a burning of the stages and negatively affects the industry's development. The concern is that applying this cap in an unfavourable environment may result in inexperienced Shariah scholars approving products

⁸⁰ According to Shariah governance framework (Bank Negara Malaysia, 2019, p. 20), “[a] Shariah committee member must not accept any appointment in more than one licensed Islamic bank, one licensed Takaful operator and one prescribed institution.

that mimic those of conventional financial institutions, thereby harming Islamic financial institutions' reputation and their future.

Specifically in the Kuwaiti context, ACA2 describes the educational challenge regarding SSB competence:

I am speaking from an academic viewpoint. Today you have an industry [IBs] that represents 50% of banks and 40% of the banking industry. It is not conceivable that the university does not have specialisations; that is, it serves the IF industry.

In fact, the two colleges that supposedly graduate competent individuals specialising in IF and Shariah auditing (College of Shariah and Islamic Studies and College of Business Administration) do not have specialised programmes in this regard. SAA pointed out this issue:

Universities are primarily responsible for creating specialisations that keep pace with the market, so why not create a specialty for Shariah auditing at the College of Shariah or the Mufti of Islamic Economics? And this specialisation could become a subject in administrative sciences as well (accounting and others), so this basic lab generates these competencies.

SSA and ACA2 both explicitly note that Kuwait, where the second IB in the world was established in 1977 (Kuwait Finance House (KFH)), does not have bachelors' or postgraduate programmes in Islamic economics or Islamic finance. This educational shortcoming is a particularly critical challenge facing Shariah corporate governance in Kuwait. In line with Farook and Farooq (2013), SSA and ACA2 are thus pushing for universities to adopt at least one specialised IF bachelor's programme and thereby equip students (future SSB members/Shariah auditors) with the necessary knowledge for such roles, while Farook and Farooq (2013) and Abozaid (2016) call for postgraduate programmes relating to the IF industry (masters' and PhD. degrees), so Kuwait can keep pace with global economic developments and compete on solid scientific foundations.

Some challenges are interrelated and may lead to others, as the educational one is. For example, Kuwaiti society has two Muslim sects: Sunnis (most of society) and Shiites (a minority). Shariah scholars of the Shiite sect do not study Shariah in the College of Shariah and Islamic Studies, as they teach no sect-affiliated curricula. Consequently, many scholars of the Shiite school study through the traditional method (a religious scholar and students in a mosque). Thus, SSB membership in all the abovementioned supervisory institutions is not limited to those holding a bachelor's degree or higher in Shariah studies, and this is understandable. Therefore, members of some SSBs in Kuwaiti IBs are from the Shiite sect, as well as the Higher Committee of Shariah Supervision in the CBK, which includes one of the Shariah scholars of the Shiite sect. As the Kuwaiti financial sector's Shariah corporate governance guidelines evidence, hence, exploring Shariah corporate governance must include analysing a society's institutional features and their regulatory influence.

5.6 Shariah-Related Matter Transparency

A transparent IFI would disclose accurate and verified information on various Shariah-related matters: SSB competences and compositions; the number of SSB meetings during the year; the number of SSB meetings each member attends; SSB members' compensation; Shariah *fatwas*; and Shariah convictions, if any, etc. Such transparency would enhance an IFI's credibility, which is a cornerstone of the IF industry that also boosts the banking system's financial stability. Grais and Pellegrini (2006, p. 12), however, lament how IFIs' transparency is poor, with few disclosing Shariah compliance information in their annual reports. In total, seven of the 13 IBs they investigated:

... did not provide detailed information on the professional background of SSB members. Moreover, only two banks disclosed the fatwas authorising the provision of financial services and products. Only one disclosed a provision for decision-making and interaction with other bodies of the firm. Finally, only one institution disclosed on its website the duties and obligations of the SSB.

INVREG3 gave an example of how the governance culture and centres of power and influence play vital roles in supporting or opposing reforms towards a more transparent market. He argued:

Believe it or not, the head of the companies' federation, during a meeting, said: 'Brother, I do not want my wife to see how much my income is. If you look at my income, you will tell me to change my car. It is a culture, also the Chamber of Commerce objected; this confirms that this is a culture [change] that must be applied gradually'.

Governance is a culture, and influential centres of power represent conflicts of interest between two categories (managers and owners), as in agency theory. Hence, the current research addresses Shariah corporate governance using institutional theory, which attributes the effect of governance to other factors – for example, as the previous example shows, how the centres of power, such as the Chamber of Commerce and Industry and the Federation of Companies, stand against adopting more instructions and legislation that encourage transparency.

5.7 Shareholder/Stakeholder Engagement

Several respondents mentioned the role of shareholders in changing the existing (and, in their view, undesirable) status of Shariah corporate governance and asserted their ability to make a difference. Before proceeding, though, shareholders and depositors in conventional financial institutions and IFIs need differentiating. According to Wilson (2012), in an IFI a bank's money mostly comes from depositors, or what the Islamic finance literature calls an investment account, where customers put their money as investors, not as lenders, into a conventional financial institution. In return, the bank invests this money as a speculator and not as a borrower (Ayub, 2007). At the end of the contract term, profits are distributed. So, investment account holders (depositors) in Islamic banks are divided into two categories: unrestricted and restricted investment accounts. While the former gives the investor the freedom to invest money in any sector, with restricted accounts, the latter obliges the bank to invest the money into a specific sector (e.g., real estate).

In traditional banks, however, the relationship between the depositor and the bank is a lender–borrower relationship, where the customer lends to the bank to obtain a predetermined interest rate and the bank lends to another customer at a higher interest rate than it pays to the depositor, in order to benefit and profit (the difference between the interest paid on deposits and the interest earned from loans provided). The essential point here is that IBs mix shareholders and depositors’ money (IA holders) in one investment pool, and at the end of each year the shareholders reap a higher percentage of profits than the IA holders. The paradox here is that IA holders, who make up most of the investment pool funds, do not have representation, and their voice is not heard in AGMs. As Wilson (2012, p. 208) argues, “[a]s the returns of these depositors are dependent on the performance of the IFI, they should have more stakeholder rights than conventional depositors, although not necessarily the equivalent to those of shareholders who are the owners”. In this vein, EXBLC states:

There is an important thing in the IB that you should know. There are two groups of people in the bank whose interests are conflicting, and they are the depositors and the shareholders, and you do not see this in a conventional bank.

He explains how these group interests are conflicting and where the SSB could stand on this:

A conventional bank depositor has a loan agreement, and he knows from the first day how much he will take and how much he will pay, and so on. As for matters in IBs, things are not that easy. In many cases, a clash occurs between the interests of the depositors and those of the shareholders. Where will you as a Shariah committee stand? Sure, with the shareholders [laughs]: he says ‘feed the mouth, the eyes will be ashamed.’ Depositors – in IBs – what will they give you? Nothing, because the general assembly is owned by the shareholders. There is a defect in this aspect.

EXBLC notes a genuine difference between IBs and conventional banks regarding interest groups within the institutions: depositors in IBs are considered investors, while depositors in conventional banks are merely lenders. Consequently, depositors in conventional banks know from day one how much

they will get at the end of each financial period, but those in Islamic banks do not know precisely how much they will earn based on Islamic finance principles. Their interests therefore sometimes conflict with those of shareholders, but their voice is not represented at the AGM, as reflected in the matter of shareholder engagement.

Although the AGM has a significant influence and authority over a company's affairs, the peculiarities of each country, including its culture and legal framework for the rights of the majority and protection of the rights of minority shareholders, should be considered (Adegbite et al., 2012). For example, Kuwaiti banks are owned by two main groups called controlling blockholders: the government and commercial families (Li et al., 2015).⁸¹ Thus, it may be difficult for minority shareholders or depositors to have an influential voice at the AGM if objections to certain bank policies or products exist.

Therefore, there are often no conflicts of interest or differences in vision in conventional banks between shareholders and depositors. As the depositor in the conventional bank is a lender and, as mentioned above, knows from day one the interest rate, there are no clashes between shareholders or owners and depositors. In IBs, however, conflicting interests or differences in visions between shareholders (owners) and depositors sometimes exist. As the IB depositor is considered an investor (*Rab al-mal*), he reaps an expected profit at the end of each financial year and not a predetermined profit – a principle of IF is that profit is not guaranteed – and the speculator (the bank in this case) does its best to invest the depositor's money (*Rab al-mal*), but this depositor, at least in theory, may see a loss.

In this context, much research has discussed what is called 'shareholder activism' as a tool of good corporate governance (Adegbite et al., 2012; Gillan

⁸¹ The National Bank of Kuwait (NBK), the first and largest CB in Kuwait, is owned by Kuwaiti commercial families, but the KFH, the largest Kuwaiti Islamic bank, is owned by the government to the extent of 47.4%. The remaining percentages of shares are owned by two commercial families, and Boubyan Bank, the second largest IB in Kuwait, of which the NBK and Kuwaiti commercial bank own 59.9% and 9.7%, respectively.

and Starks, 2000), which concerns “actions taken by shareholders with the explicit intention of influencing corporations’ policies and practices, rather than as latent intentions implicit in ownership stakes or trading behaviour” (Goranova and Ryen, 2014, p. 1232).

5.7.1 Shareholder Activism

Under Law No. 1 of 2016 concerning company law, only one article mentions explicitly the minority right to oppose or challenge an AGM decision if that minority believes a decision may endanger company interests or it serves its makers’ private interests.⁸² In this case, minority shareholders’ rights are not sufficiently protected while depositors’ rights are completely neglected because of the legislator’s failure to consider the idea and nature of IFIs, as mentioned above. Consequently, minority shareholders are not motivated enough to oppose or change BOD or AGM decisions. In other words, shareholders, especially minority groups, are acting passively in AGMs. In this legal environment, shareholder activism is not a tool of corporate governance – as Li et al. (2015) point out. IFC describes minority shareholders’ status in the AGM:

The minority has lost its right, only its right to hold a general assembly, but the decision in the end rests with the majority, like what happened to the XXX company. There is a group that held a general assembly and did nothing. The majority was in control, that’s it. The most that minorities can do is hold an extraordinary general assembly, and in the end the majority will attend and stop everything.

⁸² Article no. 220 states: “Each shareholder may file a claim on the invalidity of any resolution of the board of directors, ordinary general meeting or extraordinary general meeting that is in violation of the law or the company contract or if it is aimed at harming the interests of the company. In addition, compensation can be requested when filing such a claim. The invalidity claim shall be time-barred two months from the date of the resolution of the general meeting or the date on which the shareholder gained knowledge of the resolution of the board of directors. Resolutions of the ordinary general meeting and extraordinary general meeting that prejudice the rights of minority shareholders may be challenged before the court. The challenge can be made by shareholders holding at least 15 per cent of the issued capital of the company and who have not agreed to such a resolution. The lawsuit challenging such resolutions shall be time-barred two months from the date of the resolution of the general assembly. The court may uphold, modify or repeal the resolution or postpone the execution of the resolution until an appropriate settlement for the purchase of the shares of the dissenting parties is reached, provided that such shares shall not be purchased from the company’s capital..”.

BREG1 said shareholders are responsible for Shariah corporate governance shortcomings when they are not voicing concerns:

But the blame should not only be placed on the SSBs, as I think they play their role, but the other parties must have a role equally in guiding the bodies, as well as the shareholders. There should be inquiries into the bodies for more clarification and details of the general assemblies to know these aspects, that is, to address the shortcomings, if any.

Moving from the status to the roots and reasons why shareholders, specifically minorities, are inactive at AGMs, EXREG1 states:

Historically, general assemblies and until now, with great regret, as they are supposed to have an important role in checking and balancing all institutions and sectors, they did not play their role properly, and here come issues with social dimensions, perhaps; you know, the oversight work is greatly affected by the level of economic development, value aspects of society, relationships, etc.

Here, EXREG1 agrees with Adegbite et al. (2012) in that each country's peculiarities should be considered when addressing corporate governance issues, especially regarding shareholder activism. This is covered by institutional theory, which recognises political, social and legal factors. For instance, the social connectedness in Kuwait is high (as indicated in Chapter 4), leading to solid social relationships that are particularly reflected in business matters – and sometimes negatively so, including here, as such relationships often hinder the voicing of objections at AGMs (Almutairi, 2021).

Unlike existing shareholder activism tools or initiatives in Nigeria, such as the Independent Shareholders' Association and the Association for the Advancement of the Rights of Nigerian Shareholders (see Adegbite et al., 2012), Kuwait has no such initiatives or associations led by shareholders and stakeholders. Hence, no non-governmental organisation or government bodies encourage such stakeholder engagement, and no legislation gives shareholders and stakeholders more comprehensive representation on IFIs' BODs or effective influence on AGM decisions. All these factors may constitute reasons and

motives for amendments to the laws or regulations of companies and financial institutions that encourage stakeholders to play their part proactively.

In this vein, EXBLC suggests that just as bond/*sukuk* holders have a representative assembly that defends their rights (as in company law),⁸³ Islamic Banks depositors have the right to a body that represents them:

The general assemblies of Islamic Banks are supposed to have a special status, meaning the rules of companies' laws may not be applied to them as they are. They must have a body that represents their interests and has the right to object, such as the bond holders' body, which has the right to object the decisions of the BOD and the general assembly.

This proposal has several advantages, first by recognising the special nature of the work of IFIs (depositors, IA holders) and second that the proposed body of depositors will defend the rights of depositors and object to decisions that may negatively affect them. In this context, Johed and Catasús's (2015) study, which was also based on institutional theory, indicated that marginalised groups will resist any change that might advance the interests of one group over another. However, the opposite may be true herein, where depositors (as a marginalised group in IBs) will support changes that help defend their rights and interests. Third, this proposal may contribute to correcting the course of IFI practice, as there will be another voice concerned with the authenticity and reliability of the entity's business as well as annual/periodical profits.

83 Article No. 254 of company law states: "The transformation of a shareholding company that has borrowed by issuing bonds or *sukuk* requires the approval of the bondholders or *sukuk* holders' assembly to the transformation resolution. Such approval requires at least a two-third majority of the represented bonds. If the transformation or the settlement by such majority which is offered by the company to the bondholders' assembly is not approved, or such assembly could not be held, the representative of the bondholders or *sukuk* holders' assembly shall refer the matter to the Court of First Instance within 30 days of publication of the transformation resolution. Filing the claim shall not result in suspending the transformation procedures. The court may rule to reject the objection or to oblige the transformed company to pay the value of the bonds or *sukuk* pursuant to the terms of the issuance or oblige the transformed company to provide adequate security to fulfil its obligations". (Companies' Law No. 1 of the year 2016, Kuwait society of lawyers.

See https://kuwaitlawyers.com/images/library_book/xzxdz.Sharekat%2010.pdf.

Despite the proposal's reasonable nature, however, it may face various obstacles. The first concerns its being entirely new and thus not universally applicable to IFIs, meaning that decision makers may not accept it. Such a proposal may also face resistance from IFI owners (shareholders), as for years they have not been confronted, peer to peer, at AGMs. Second, the proposal requires a legislative amendment to the companies' law, which requires a medium or long period for consideration for three reasons: to crystallise the idea, to formulate it in a well thought out manner and, finally, to persuade stakeholders (the government and legislators in the National Assembly) to approve it in parliament then complete the implementation procedures.

Regardless of the logic of the proposal and its obstacles, simply putting it up for discussion may contribute to crystallising and developing the idea, and this is one contribution of this research. The following section will define and discuss the Shariah audit, its importance, its types and the challenges that face this aspect of Shariah corporate governance.

5.8 Shariah Audit

Tackling the lack of competency of Shariah scholars and multi-memberships Shariah boards, Shariah scholars gave insufficient time to review and audit contracts and products IFIs offered, from a legal viewpoint. Consequently, the so-called Shariah audit appeared, which for Hussan et al. (2013, p. 4) comprises:

A comprehensive assessment and examination of all products, services, contracts, agreements, policies, procedures, transactions, financial statements, circulars and other matters which may arise and form part of the IFI's operations, either directly or indirectly, in their business transactions.

Additionally, Khalid and Sarea (2021, p. 334) state: "Islamic Shariah auditing provides a mechanism to generate advice, especially with proposed new Islamic financial products, and to monitor performance so that the IFIs operate strictly on Islamic principles". As these definitions indicate, Shariah audit is a kind of check on the actual implementation of SSB decisions by IFI management and of new proposed products or services. Moreover, an Shariah audit's functions

extend to an institution’s policies, procedures and marketing campaigns. An Shariah audit is thus akin to having an eye inside an IFI (the Shariah auditors exist in the IFI and follow up the IFI’s operations daily). Furthermore, the Shariah audit heavily contributes to IFIs’ accountability (a part of Shariah corporate governance), as these institutions conduct their operations based on Shariah principles to maintain their existence and progress towards a sustainable future (Islam and Bhuiyan, 2021).

As IFIs derive their values from Shariah, they are obliged (strategically or even tactically) to adhere to these values under the pressure of social normative factors, as indicated by institutional theory (Scott, 2005; Elamer et al, 2019). Basically, then, IFIs derive their legitimacy from their commitment to obeying Islamic law principles. Both internal and external Shariah audits in IFIs are akin to financial auditing in all financial institutions. The main difference between IFIs and conventional financial institutions concerns extra lines of defence regarding Shariah corporate governance through a Shariah audit, whereas conventional financial institutions have comparably few lines of defence, as Table 6 below shows.

Table 6: Financial Institution Types and Lines of Defence

	Institution/Line of Defence	BOD	Internal Audit	External Audit	SSB	Internal Shariah Audit	External Shariah Audit	Total Defence Lines
1	Conventional Financial Institutions	✓	✓	✓	✗	✗	✗	3
2	IFIs	✓	✓	✓	✓	✓	✓	6

Source: Researcher

As Table 6 shows, IFIs have six lines of defence (SSB, Internal Shariah audit, external Shariah audit, the BOD, internal audit and external audit) that maintain and preserve IFI stakeholders’ interests. With such protections, IFIs should be less corrupt and have more corporate governance and Shariah corporate

governance, though these conditions rely heavily on the extent and degree of staff knowledge, skills and experience of those conducting the Shariah audit.

Shariah audit was not recognised as a specialised field prior to 2010, when it was mentioned explicitly in Law No. 7 of 2010 about establishing the CMA and regulating securities' activities, but at that time it was either under an SSB or Shariah consultant in general. Shariah audits are conducted by an employee appointed by executive management, who can hire and dismiss him at their discretion. After 2010, the situation changed for entities subject to the CMA. Law No. 7 of 2010 stipulated that every entity licensed to operate in accordance with the provisions of Shariah principles should establish an internal Shariah audit and an external Shariah audit. While the internal Shariah audit reports to the BOD, the external Shariah audit follows and reports to the general assembly of shareholders. In addition, the instructions for the Shariah Supervisory Governance of Kuwaiti IBs issued in 2016⁸⁴ stipulates that Islamic banks must have an internal Shariah audit affiliated to the BOD. Further, an external Shariah audit is appointed and dismissed by the general assembly of shareholders based on the nomination of the BOD (like the situation with the financial auditor and the SSB) to maintain the independence of internal Shariah audit staff (AlShabli, 2009, as cited in Alkhamees, 2012). In this vein, SAM3 noted certain changes after the CBK's 2016 instructions and described the situation before:

I noticed the development and improvement in all levels of Shariah supervision in IBs, especially at the level of Shariah audit departments, which are my field, of course. They were just ghosts, so to speak. They were employees who have certain jobs that they perform within the institutions, but they do not have a presence on paper, they do not have a clear entity, they do not have a job ladder and they do not have a structure for the administrative system in which they work or under its umbrella, so the job (Shariah auditor) was repellent.

⁸⁴ The instructions were issued in December 2016, and IFIs subject to the CBK were given a deadline of January 2018 to adjust their positions regarding the internal Shariah audit. The external Shariah audit instructions were implemented in January 2020.

SAM1 also described the situation of Shariah audit before the CBK's 2016 instructions:

We, as Shariah auditors, were a gelatinous thing with few powers, and everyone thinks we were like the secretaries to arrange the affairs of the SSB or acted on their behalf in the bank.

After the CBK's Shariah corporate governance instructions in 2016, the status of Shariah audit and Shariah auditors changed significantly. SAM3 stated:

Some of the requirements requested by the CBK in their Shariah governance instructions gave us an importance that we did not consider, especially our dependencies and the great power stipulated in the Shariah governance instructions. I see it has been developed a lot through the SSB or the auditing body.

The interviewees' opinions regarding the internal Shariah audit are generally congruent (internal Shariah audit status is 'good'), but their views regarding the external Shariah audit reflect many challenges. For example, Shariah consulting and Shariah auditing firms are not ready to take Shariah audit responsibility, as the number of these firms and the Shariah auditors are not commensurate with the size of Islamic banks and the diversity of their business. Also, the experience of external Shariah auditors is limited to the work of Islamic investment and real-estate companies, which are small compared with Islamic banks. SAE4 put it as follows:

When we came to the external Shariah audit as a new experience as well, we were apprehensive. Of course, I was very apprehensive, frankly, about how to deal with them. I have experience in the issue of audit companies. Shariah auditors are with companies because they remain companies, not like banks.

Although Hasan (2012) indicates that Shariah audit firms have adequate experience to take responsibility for Shariah audit, reality clearly differs. Also, Shariah auditors' competency is crucial in providing suitable assurance regarding the extent of Shariah conformity among IFIs (Hussan et al., 2013). As such, Shariah auditors need to hold a bachelor's degree in Islamic law

(especially *Usul al-Fiqh*) besides having adequate knowledge of finance, accounting, and financial and banking work to understand what is presented to them in reports, budgets, etc. Whether the academic and professional backgrounds of Shariah auditors are sufficient for performing required duties accordingly also needs considering.

A challenge of Shariah audit in Kuwait concerns the monopoly a few Shariah consulting and Shariah auditing firms have on the Kuwaiti market, as five of them have a few Shariah auditors who audit all Kuwaiti IFIs (investment companies, real-estate companies, Islamic banks and *Takaful* insurance companies). What has contributed significantly to this monopoly is the inadequate regulation of the Shariah audit market. For example, any Shariah audit office can audit any institution, whether a bank with assets exceeding one billion Kuwaiti dinars or a company with assets under 100,000 Kuwaiti dinars. On this, issues have thus also arisen from the regulatory authorities in that the CBK and the CMA did not classify these offices according to their size and number of employees (Shariah auditors).

This lack of effective regulation may also cause confusion, especially when implementing the new supervisory instructions, as occurred with the implementation of the January 2020 external Shariah audit instructions. As SAM2 stated:

The practical practices of external Shariah audits are still on-going, and I am talking about the end of the year 2020, and I will not speak as a manager of Bank XX but rather as the director of a concerned committee in the Federation of Banks. We have discussed this issue repeatedly, and I have information about the application in the five Islamic banks. I am not satisfied with the application because there are major failures in the instructions, conditions and controls of the CBK on the one hand; on the other, we do not have qualified companies and there are no competencies so far.

SAM2 described the external Shariah audit status but without details of defects, though SAE4 gives an example:

Shariah audit offices have a conflict over the client and break bones [i.e., prices war]. There must be an authority that tells them, the Shariah audit offices: 'Come on, the contract should not drop with you and the price is': a Shariah auditor should be appointed.

As mentioned above, and as SAM2 and SAE4 suggest, serious challenges exist and must be dealt with, either by the regulatory authorities (regulatory failure) or the professionals themselves (Shariah auditors). Moore et al. (2006, p. 15) illustrate the price offers or price war between audit firms via the concept of 'low-balling', which involves "offering a discounted price for audit services in order to build a relationship that could become profitable later, either by increasing audit fees or by cross-selling services". An auditing firm offering a low price may, however, put the auditors at the mercy of the client, and some evidence supports this (Moore et al., 2006). Hence, what SAE4 mentions here is a real threat to auditors' independence.

Furthermore, the race for, and sometimes conflict over, clients among Shariah auditing companies, as SAE4 indicates, may reflect regulatory failure. Windholz (2017) says the regulatory authority may succeed in diagnosing defects (the lack of external Shariah audit instructions) and determine specific aims and objectives. However, they could fail to design appropriate instructions and implementation procedures. To illustrate this, the CBK, for instance, issued Shariah corporate governance regulations for Kuwaiti Islamic banks in 2016 that requested that they have both internal Shariah audit and external Shariah audit. When the CBK issued the regulations, they knew beforehand that the market (Shariah audit) was unprepared to take Shariah audit responsibility in terms of the availability of competencies and the number of Shariah audit firms/offices. The CBK thus allowed one year for internal Shariah audit and three years for external Shariah audit as a grace period to implement the regulations, but when the Shariah corporate governance regulations, specifically external Shariah audit, were implemented, a failure resulted (e.g., inaccurate estimation of Shariah auditors' readiness, failure to classify Shariah audit offices/companies). In other words, the implementation was superficial and uneven, as SAM2 and SAE4 indicate.

5.8.1 Shariah Auditor Personality

The Shariah auditor's personality is another dimension research respondents raised, specifically their self-esteem and confidence. Also, how they deal with ignorant, neglectful or indifferent executives or managers is vital. Given this, knowledge and professional skills are not everything for a high-profile Shariah auditor. For SAE4, a strong personality is also needed to report his critiques and/or to voice his objections:

We need an auditor with all the soft and technical skills. Not everyone is qualified to be an auditor. The quiet person/pacifist is not fit to be an auditor. He must have a strong personality. He enters the concerned department and says to them without fear: 'These are my observations and this is my report. Please, respond to it professionally and give me your comment on it'.

SSE3 agrees:

But I tell you about independence issues? Yes, there is a problem and a big problem, whether due to the member, his morals or his personality – even the personality affects, so your choice of a quiet, weak personality without discussion will affect the workflow. So, the personal interview, I hope it will be one of the main requirements for appointment.

Both comments align with AlBawwat et al. (2021), who suggest that emotional stability as a trait (part of discipline personality traits)⁸⁵ generates self-confidence, which in turn leads to highly persuasive audit messages or reports to concerned customers and ultimately internal audit effectiveness. Despite knowledge and skills not being everything, they are still an important part of the more complete auditor and indeed may themselves influence the Shariah auditor's personality.

Further, the degree of freedom of expression, corruption status and internal culture of an IFI also influences the extent an auditor can voice his opinions

⁸⁵ Emotional stability traits are self-confidence, stress sensitivity and frustration resistance (AlBawwat et al., 2021).

(Hudaib and Haniffa, 2009). For example, Saudi Arabia, which lacks freedom of expression, discourages the criticising of behaviour or voicing of objections in general, and this is consequently reflected in Shariah auditors' behaviour (Hudaib and Haniffa, 2009). This is not so much the case in Kuwait, as it has more freedom of expression than Saudi Arabia,⁸⁶ though perhaps improvements can still be made in this regard. Nakpodia and Adegbite (2018) say that those affected by such limitations in this context are elite Shariah scholars and religious leaders. The concern herein is religious leaders, or specifically the narrow religious circle of SSB members in Kuwait. As ACA2 says, one group of SSB members controls the Shariah supervision market:

The CBK adopts a group in the industry that we call the 'liberal': Dr ABC and Dr ABD [the market calls them the X-bank Group]. This shows that Shariah opinions are taken from this group, that is, by the CBK, which controls the market, and the CBK was unable to get them off the Shariah board.⁸⁷ Everyone knows the question marks are on them and the role they play in it.

ACA2's 'liberal' point parallels Haridan et al.'s (2018) 'liberal scholars' phrase, and the authors add how these are more lenient than others and have influence over decision makers. Specifically, Nakpodia and Adegbite (2018) identify three influences religious leaders have on corporate governance: the importance of religion, the impact of religion and beliefs, and what they term religious 'herd behaviour'. A crucial aspect of Kuwaiti reality is indeed religion, and most interviewees indicate that people are keen to keep their money in IFIs and to earn legitimate (*Halal*) profits, as reflected in numerous examples. On the one hand, the number of IBs (five) is equivalent to the number of conventional banks (five) and Islamic investment and real-estate companies on the capital market. On the other hand, however, many people have refrained from subscribing to Shamal Azzour Company and the Kuwait Stock Exchange⁸⁸ because the origin

⁸⁶ So says the Institute for Democracy and Electoral Assistance (2017) (<https://www.idea.int/gsod-indices/world-map-table>).

⁸⁷ When the CBK established its own Shariah board, it could not appoint this group of Shariah scholars to it (by virtue of that they will lose part of their influence and financial benefits).

⁸⁸ Shamal Az-Zour Al-Oula Solar Energy Company was established in 2013 to develop and operate Az-Zour North's power and water plant. Although the subscription was covered by 127%

of these companies' work is mixed and ignores some Shariah prohibitions, such as by having usurious loans and dealing with companies that do not adhere to Islamic Shariah (especially the Kuwait Stock Exchange). This matter reflects the extent to which investors in Kuwait appreciate the religious dimension and as such their unwillingness to invest in companies that do not comply with Islamic principles: most SSB members in IFIs issued a *fatwa* against investing in the company (though one Shariah scholar issued a *fatwa* on the permissibility of this investment, which undermined public confidence in Shariah scholars because of the proliferation of *fatwas* on the same topic). INVREG3 notes this:

Society, by its nature, wants these products [Islamic financial products] and the evidence for this is the companies listed on the market; that is, it is something that has imposed itself and we have clearly seen it with the subscription of the Shamal Azzour Station Company and the subscription of the Stock Exchange Company. The people were reluctant to subscribe because of the fatwas that said that the subscription is not in accordance with Islamic law.

5.8.2 Lack of Accredited Shariah Audit Standards

While financial audits have approved international standards, such as generally accepted accounting principles (GAAP or International Financial Reporting Standards), Shariah audit, whether internal or external, does not have approved global standards on which a Shariah auditor can rely when performing his work. What are available are AAOIFI judgements in setting some guiding and hence non-mandatory standards, such as the Basel standards,⁸⁹ but their voluntary nature also allows much variation, which bring its own issues and does not compensate fully for the lack of international standards. SAM2 alludes to this shortcoming:

But in the ESA, we do not have agreed-upon standards. You find that every SA company applies SA principles in a certain way, and there

of the subscription shares of Shamal Azzour Company, a large part of Kuwaiti citizens who are entitled to subscribe have refrained for religious reasons.

⁸⁹ The Basel Committee on Banking Supervision (BCBS) is the primary global standard setter for the prudential regulation of banks, and it provides a forum for regular cooperation on banking supervisory matters. Its 45 members comprise central banks and bank supervisors from 28 jurisdictions (Bank for International Settlement, 2022).

is a disparity in application, there is give and take and there are quarrels. Consequently, this caused very big problems in 2020.

Although the AAOIFI and IFSB issue Shariah audit standards, these standards lack recognition and enforcement by many countries with IFIs. The AAOIFI and IFSB must therefore coordinate and cooperate with different countries that have IFIs on standards to gain more recognition and to move these standards from a prescriptive to a mandatory status, as with the Basel criteria (Ayub, 2018).

5.9 Conclusion

This chapter has addressed several Shariah corporate governance micro-industry level aspects ranging from the state of Shariah corporate governance in Kuwait through micro-firm level challenges of Shariah corporate governance and ending with Shariah audit (internal Shariah audit and external Shariah audit). The data analysis found that Shariah corporate governance in Kuwait is currently sound, thanks to the existence of Shariah corporate governance regulations (micro-industry level). Nevertheless, in terms of implementation, a clear gap between expectations and reality prevails. For example, various respondents were concerned about how the role of national Shariah boards in regulatory authorities – that is, the Higher Committee of Shariah Supervision in the Central Bank of Kuwait (CBK) or advisory council for Shariah supervision in the Capital Market Authority (CMA) – is absent. Notable among the results is regulatory multiplicity, which many interviewees reported as reducing clients' confidence in IFIs while possibly causing confusion in the practical applications of Islamic finance among IFIs. Also, the supervisory instructions are light on some parties but strict on others, which may create unbalanced models for IFIs. Thus, the patterns of these institutions become distorted owing to regulatory multiplicity, so one determinant of 'good' Shariah corporate governance here would be the harmonisation of regulations among regulators.

Interesting findings regarding Shariah corporate governance at the micro-firm level concern SSB independence, competence, transparency generally and Shariah-related matter transparency. For instance, respondents intensively discussed SSB independence. Although the best practice of appointing and

compensating SSB members is through the annual general meeting (AGM), this method is questionable because the annual general meeting and the BOD are two sides of the same coin, as participants have pointed out. In this vein, two groups have differing opinions: the team of former executives, who are members of SSBs, along with Shariah audit managers in IBs and regulators, who believe independence is complete and unquestioned; and another group made up of Shariah scholars, legal experts and executives outside the framework of IBs along with academics, who see independence as questionable, as alluded to above: SSB members are rarely nominated by a BOD and then objected to by shareholders in the AGM.

One interpretation of this opposition could be that whoever has an interest in or gains privileges from the status quo will oppose changes that may go against their interests or remove their privileges. This argument aligns with the vested interest theory in the realm of institutional theory (Moe, 2015).⁹⁰ A creative and easily applicable method, which proposes a third party to which the SSBs in Islamic financial institutions are affiliated and handles their affairs (i.e., rewards, appointment, and dismissal), is thus crucial for ensuring SSBs' independence, though this must ensure that one party's duties do not significantly overlap with another's (i.e., the supervisory authorities take on some of the duties of the AGM). Regarding SSB members' competency, there is almost unanimity among interviewees about the need to develop university graduates. However, there is no university specialisation in Kuwait regarding Islamic finance or Shariah audit, which negatively affects the soundness of IFIs' Shariah supervision.

The data analysis also found that Shariah audit requires more attention and effort than is currently spent on it. Although internal Shariah audit is acceptable according to the interviewees, numerous challenges exist in the realm of external Shariah audit, such as the poor design and implementation of Shariah audit

⁹⁰ "Vested interests benefit from the status quo, and thus they are disinclined to seek radical changes in the established order, while pressure for radical change typically comes from reformers who do not like the established order and make proposals that are threatening to those who do" (Moe, 2015, p. 291).

instructions, not classifying Shariah audit firms in the instructions and not analysing every Shariah audit firm and what suits it in terms of the type and number of IFIs it audits (any Shariah audit firm can audit any Islamic bank or company, irrespective of the available numbers of Shariah auditors and their competencies). Accordingly, such challenges bring implementation difficulties, especially because external Shariah audit started being applied only recently, at the beginning of 2020, which may add to the concern felt among regulators that the instructions are new but not well designed, thus leading to implementation problems, as alluded to in Section 5.8. Considering this, supervisory authorities must move quickly to address the deficiencies in the instructions so that adverse consequences are minimised in the future and customer confidence is preserved.

This study further revealed that Shareholder activism is lacking within the Kuwaiti setting, despite its significance for various reasons (see section 5.7). One of the primary factors contributing to this issue is the absence of legislation that grants minority shareholders the entitlement to board involvement inside Islamic institutions. The research proposed an approach whereby depositors in Islamic banks would be allowed the right to be represented on the board of directors. This suggestion is anticipated to serve as a viable strategy for safeguarding the rights of depositors. Furthermore, it serves to rectify any potential malpractices exhibited by Islamic banks, if deemed essential. Notwithstanding these virtues, the proposal exhibits many shortcomings. One of the limitations is its reliance on legislative revision through the National Assembly and the Council of Ministers, a process that can be time-consuming. Furthermore, it should be noted that this approach is novel and lacks empirical validation within the realm of the Islamic banking sector. Consequently, there is likely to be opposition towards these proposals. Therefore, the presence of this suggestion within academic spheres is a scientific contribution, as it allows for an assessment of its dimensions, feasibility, and potential for application.

Concerning this study's contributions, a most important one is the use of institutional theory to consider the legal, social and political aspects of Shariah corporate governance, not just the aspects concerning conflicts of interests

between shareholders and managers, as happens with agency theory. In addition, this research has contributed to expanding the scope of institutional theory to include the religious aspect, which is Shariah corporate governance and its application to a new scope and context: Kuwait. In addition to the aforementioned, this research has other policy recommendations in terms of micro-determinants of good Shariah corporate governance in the financial sector:

(A) Creating a body for Islamic banks depositors, similar to the bondholders' body, which looks after the interests of depositors and defends their rights. In addition, having such a body (representing Islamic bank's depositors) helps preserving the authenticity of IFI's nature (preserving the substance and the form).

(B) Establishing pressure groups among IFIs' stakeholders, that work to correct institutions' in the event of a deviation, such as mimicking the Conventional financial institutions activities and products.

(C) Personal characteristics of the Shariah auditor such as self-esteem and the ability to argue with institutions' leaders are just as important as a Shariah auditor's educational attainment and skills. Therefore, policymakers should pay attention to it in the training and terms of appointment of Shariah auditors.

Chapter 6

Conclusion

6.1 Introduction

This chapter reflects on this study's main findings regarding macro- and micro-level determinants of 'good' Shariah corporate governance in the Kuwaiti financial sector. It also conveys this work's key contributions, addresses its limitations and makes recommendations for future research. Regarding the main findings, it begins by addressing the overall institutional aspects, which include the legal and supervisory, the social and the political. It also covers other macro aspects, such as institutions that set standards for Islamic financial institutions and non-governmental organisations that are interested in Shariah corporate governance, educational and academic aspects and how they relate to and influence Shariah corporate governance, as well as Kuwait's strategic plan or roadmap for the Islamic financial industry. It then examines the status of Shariah corporate governance regulations within the financial sector's main regulatory authorities: the Central Bank of Kuwait (CBK), the Capital Markets Authority (CMA) and the Insurance Regulatory Unit (IRU). Next, it considers micro-level determinants of 'good' Shariah corporate governance, including the Shariah supervisory board (SSB), SSB independence, SSB members' competency, the transparency of Shariah-related matters, and the Shariah audit – both internal and external – and its role in the realm of Shariah corporate governance.

A main objective of the thesis has been to evaluate the status of Shariah corporate governance in the Kuwaiti financial sector via the perspectives of Islamic financial industry stakeholders. Despite comments above about the Kuwaiti Islamic financial industry being a pioneer in establishing IFIs and having a significant market share, especially in the banking sector (see Chapter 5, section 5.2.1), it suffers from a dearth of academic studies that address Shariah corporate governance. Hence, it is imperative to study the characteristics of the Kuwaiti environment, and it is likewise important to do this from various perspectives of participants who have impacted on or been affected by Shariah corporate governance in Kuwait. Doing all this, then, means the results of this

study can benefit Kuwait's banking and financial sector, not merely by addressing a significant lacuna in research, but also by eliciting a more comprehensive understanding of this sector and generating practical suggestions for addressing its shortcomings and improving Shariah corporate governance practices in Kuwait in a long-term strategic way.

6.2 Macro-Level Determinants of Good Shariah Corporate Governance: Summary and Recommendations

The supervisory aspect significantly influences the reality of Shariah corporate governance specifically and corporate governance in general, and the most dominant means of oversight in dealing with governance are the rules-based approach (e.g., the Sarbanes-Oxley Act 2002 in the USA) and the principles-based approach (e.g., as in the UK) which inherent in the 'comply or explain.' The rules-based approach concerns specific and detailed rules, and whoever does not abide by these may face penalties. In contrast, the principles-based approach concerns generality, and whoever does not follow these principles must explain the reason(s) for their non-compliance under the principle of 'comply or explain'. The current research has dealt with these two approaches in detail (see Chapters 2 and 4), but what is crucial here is highlighting the diversity of participants' views regarding the regulatory approaches according to the sectors in which they work, their seniority and their engagement in the Islamic financial industry.

Most regulators in this research were inclined towards a principles-based approach or a combination of the two approaches, but some interviewees who were not regulators preferred a rule-based approach. Several interviewees indicated that while the Islamic financial industry is still in its infancy stage it is best for the supervisory instructions to be specific and clear (rule-based), though the regulators do not want Shariah supervision subject to the regulatory authorities. From many regulators' perspectives, compliance with Shariah principles is based on IFIs' preference. Therefore, it is incumbent on the institutions to take all necessary steps to ensure Shariah compliance. Intriguingly for this, there will be a trade-off between regulation intensity and institutional

efficiency in that the greater the intensity and specificity of the instructions then the lower the efficiency and innovation of the institutions that are subject to regulatory authorities (Samuels, 1978). Also, regulatory unreasonableness⁹¹ may encourage Islamic financial institutions to make a formal commitment to Shariah corporate governance instructions without regard to its substance (Boyum, 1983), or, as Cohen et al. (2008, p. 187) put it “fulfil ritualistic roles.”

A particularly interesting research result concerns how some Shariah scholars who are current members of Islamic banks' SSBs as well as being Shariah auditors believe that the principles-based approach is more appropriate (in agreement with regulators). An interpretation for this is that they benefit from the status quo and avoiding change preserves these interests; they will thus stand against any change that may affect these interests, which is consistent with institutional theory. The aforementioned trade-off between the two supervisory approaches thus depends on several factors, as the interviewees indicate. For example, reputational risks and sensitivity within the industry is a critical determinant that influences choices for a rules-based instead of a principles-based approach because of the seriousness and sensitivity associated with the non-compliance of Islamic financial institutions with Shariah law. In other words, if there is a Shariah governance aspect that harms the existence of an IFI (e.g., multiplicity of *fatwas* in one Islamic financial product), it is prudent for the supervisory authority to clarify the aspects and dimensions of this matter and not leave it to the institutions because, ultimately, these institutions prioritise their own interests and would not see an issues holistically (such as a multiplicity of *fatwas*).

In this vein (the supervisory aspect), the first determinant involves having a mixed (rule-based and principle-based) supervisory approach, though it is currently more appropriate to continue with the rules-based approach for several reasons. One is the recent development of the Islamic financial industry,

⁹¹ For Boyum (1983, p. 752), “[r]egulatory requirement is unreasonable if compliance would not yield the intended benefits. Further, a regulatory requirement is unreasonable if compliance would entail costs that clearly exceed the resulting social benefit”.

considering the fact that the Shariah corporate governance instructions were issued only six years ago. Another reason for currently continuing with the rules-based approach concerns changes in the leadership of IFIs from the generation of the first founders who established Islamic banks as an alternative to conventional banks (literally committed to the provisions and principles of Islamic law) to a generation mostly comprising conventional banking leaders (committed pragmatically to Islamic law). The rules-based approach is more appropriate for the current stage until the Islamic financial industry matures and the strength of Shariah corporate governance arrangements is tested. Then it will be possible to introduce the principles-based approach gradually but until then maintain the predominance of the rules-based approach. Over time, the supervisory approach will become a hybrid of rules and principles. Each aspect of each approach will then be chosen according to the importance and degree of risk associated with the subject matter.

In the long run, though, a principles-based approach with touches of a rules-based approach is likely to prevail, as the principles-based approach requires the least effort and cost from the supervisors in dealing with Shariah-related matters. In addition, following up on compliance with Islamic law becomes the responsibility of the Islamic financial institutions, so that, accountability falls upon them and not upon the regulatory authorities. The second determinant of good Shariah corporate governance from regulatory perspective is having a methodology for measuring the quality of regulation enforcement to ensure that the instructions have achieved the required objectives so that these instructions are not inked on paper. This quality is measured by the DREAM framework proposed by Baldwin et al. (2012).⁹²

One of the findings to which policy makers should pay attention is the multiplicity of regulatory models for Shariah corporate governance. For example, the CBK obliges the entities subject to it (banks and finance companies) to operate according to the provisions of Shariah law and to have a

⁹² See Appendix 8.

SSB. Simultaneously, the CMA does not oblige the entities subject to it (i.e., investment companies, real-estate companies) to have an SSB, though it does oblige them to have internal and external Shariah audits. Consequently, IFIs may migrate from one supervisory authority to another that requires less Shariah corporate governance commitment. Such multiplicity of regulatory models may also shake customers' confidence in the Islamic financial industry as the practices of entities of the same nature are divisive and, sometimes, one IFI implements a financial product while another party prohibits it for a Shariah reason. In light of this, one practical recommendation needed is that there should be a higher coordinating committee among the supreme Shariah boards of the supervisory authorities to align efforts and reduce the potential for conflict.

The social aspects of Kuwaiti society, which is characterised by its small size and its internal interdependence, were also considered. Specifically, the research analysed the impact of the *diwaniyya* on Shariah corporate governance, SSB members, BOD members and senior executives in IFIs. Most interviewees indicate no direct negative impact on the interaction of those involved with Shariah supervision when they visit the *diwaniyya* of owners whom they are responsible for monitoring. They also say that this interaction (e.g., where an SSB member of an IFI might visit a CEO's *diwaniyya*) does not compromise the independence of these individuals (SSB members or Shariah auditors) or cause them to change their Shariah decisions, though some opinions indicate that social relations inevitably influence in one way or another the decisions of the SSB. For example, it is common in Kuwaiti culture that the abundance of familiarity reduced the cost, as alluded to in Chapter 4 (see section 4.3.1). A concern, though, derives from Regan's (2022) point about how in social gatherings ideas and opinions are transmitted subconsciously; hence it may be recommended that the visits to *diwaniyyas* be reduced between members of the SSB, the BOD members and Executive Management. This recommendation is not an attack on the integrity of these people but rather an acknowledgement of possible uncontrollable negative influences and an effort to preserve the Shariah control process from being disturbed by any suspicion of malpractice.

In addition, this research considered the extent to which political factors, such as the political affiliations and intellectual tendencies of those working in the Islamic financial industry, impact on Shariah corporate governance practices. Most interviewees indicate no direct negative impact, but some expressed concerns about a possible indirect impact of politics in terms of appointing Shariah supervision officials who share the same political thought and inclinations to manage institutions which may affect their efficiency. It is consequently vital in reference to the role of members of the higher Shariah boards in the supervisory authorities to review the names of candidates for SSB membership and Shariah audit managers in Islamic financial institutions. Specifically, the supervisory authority, represented by its national Shariah board, must match over-arching requirements, each institution's needs and particular SSB concerns with suitable candidates, and in doing this they should study personal characteristics, the method of appointment and the fairness of procedures against such broader concerns. If this is done, favouritism and subjective considerations in appointing SSB members and Shariah audit managers will be likely to be reduced.

Moreover, the research has discussed the legal aspects that affect Shariah corporate governance in terms of the adequacy of legislation relating to the Islamic financial industry and the impact of court rulings regarding Islamic financial products. The interviewees provided various perspectives on their experiences and offered solutions for the identified issues. The first main perspective is that the problem arises from the legislative deficiency and the lack of explicit provisions in the existing laws that address IFIs' products. The second addresses IFIs' malpractice (e.g., fictitious application of Islamic financial products), while the third perspective considers current laws to be sufficient but that a problem is the lack of capacity of SSB members, especially regarding validity of contracts. The fourth perspective stresses the importance of establishing exceptions in the current laws regarding IFIs because this will enable IFIs to offer products that cannot be currently provided. The fifth concerns specialisation: the absence of specialised courts in financial cases, specialisation in Islamic finance and the absence of specialised judges for

Islamic finance issues. This matter is not limited to the judiciary side but also extends to lawyers, as there is a dearth of lawyers specialising in Islamic economics and finance. With all the above, the legal and judicial problems provide a real challenge that must be dealt with seriously and promptly.

Among the essential recommendations concerning the legal determinants of 'good' Shariah corporate governance is therefore to increase the number of judges specialised in Islamic financial transactions along with having courts dedicated to Islamic financial institutions, to address the shortcomings in the judiciary remarked upon by interviewees, especially regarding Islamic financial industry specialisation, whether on the part of the courts or regarding the judges themselves. Another determinant, which may help accelerate the process of issuing judicial rulings and increasing the availability of specialisation in the panel of judges, would be to introduce the arbitration tool for adjudicating disputes between Islamic financial institutions themselves or among customers and institutions. A further development for improving judicial rulings and would take the form of having legal statutes for dominant Islamic financial transactions (e.g., *Murabaha* and leasing). In this regard, the legal system in Kuwait is a civil code, hence judges base their rulings on legal texts. In other words, if there are no legal statutes for a transaction, the judge will adapt the transaction in accordance with the legal text which is closest to a conventional transaction, thus exercising a degree of discretion. This situation is fraught with potential difficulties, but the addition of further specific legal provisions may limit the discretion margin, even though that discretion may be exercised wrongly sometimes. Hence, policy makers in Kuwait should consider this study's results; in fact, it is essential that they do so.

6.3 The Islamic Financial Industry: A Comprehensive Plan

Regarding Shariah corporate governance in Kuwait, efforts are notably scattered and uncoordinated among the various agencies – whether governmental, private or civil. Indeed, such wasted efforts are likely to be detrimental to the Kuwaiti Islamic financial industry in the long term, so a comprehensive plan or road map for this industry is a recommendation worth considering (as Malaysia,

Kazakhstan and Turkey have done). Such a comprehensive plan would help organise efforts based on an assessment of the prevalent strengths, weaknesses, opportunities and threats (SWOT analysis). In addition to understanding what the country wants from the Islamic financial industry and how this industry will contribute to achieving Kuwait Vision 2035, such a plan should also provide the necessary infrastructure and setting for Kuwait's short-, medium- and long-term development. Importantly, putting in place a comprehensive plan for the Islamic financial industry requires the participation of all parties concerned – from the public, private and civil sectors – in its development, implementation and follow-up.

6.4 Micro-Level Determinants of ‘Good’ Shariah Corporate Governance: Summary and Recommendations

The micro level contains two sub-levels: industry level and firm level. While the former concerns the current status of Shariah corporate governance in Kuwait from interviewees' perspectives, the latter discusses the main aspects and arrangements of Shariah corporate governance. The data analysis found that, thanks to the existence of specific regulations, the current status of Shariah corporate governance in Kuwait (industry level) is generally sound. Nevertheless, in terms of implementation a clear gap exists between expectations and reality. For example, several respondents indicate that the role of national Shariah boards in regulatory authorities – that is, the role of Higher Committee of Shariah Supervision in the CBK or the Advisory Council of Shariah Supervision in the CMA – is absent. Notable among the results is regulatory multiplicity, which many interviewees referenced. They reported that this would reduce the clients' confidence in IFIs and may create confusion in the practical applications of Islamic finance among IFIs. Indeed, the supervisory instructions are light on some parties and strict on others, which may create unbalanced models for IFIs. Thus, because of regulatory multiplicity the patterns of these institutions have become distorted, so one determinant of ‘good’ Shariah corporate governance here would be to have harmonised regulations among regulators.

One of this study's most important findings is the identification of a clear shift in the orientation of the owners and executive managers of Islamic financial institutions, namely from Islamic economic principles to a profit orientation. In other words, profit dominates Islamic economic principles so much that profit is the driving value of Islamic financial institutions' activities. As a result of this shift in orientation, shareholders' choices for Shariah supervisory board members tend to favour those who are known to be lenient (e.g., sometimes twisting religious texts to contribute to the Islamisation of a questionable financial instrument). Theoretically, an IFI's desire to be isomorphic with its peers prompts it to legitimise its tools by selecting Shariah scholars who are known to be lenient, which is consistent with institutional theory. Therefore, this research is a useful new addition to the literature as it discusses Shariah corporate governance specifically in the Kuwaiti context.

Interesting findings have also emerged regarding Shariah corporate governance at the micro (firm) level) in reference to SSB independence, competence and transparency as well as the transparency of Shariah-related matters, though respondents mostly discussed and debated SSB independence. Although the best practice of appointing and compensating SSB members is through the AGM, this method is still questionable given that the AGM and the BOD are two sides of the same coin, as has been pointed out in Chapter 5. In this vein, there are two groups whose opinions differ in this regard: the team of former executives, who are members of SSBs, and Shariah audit managers in Islamic banks are against the regulators, who believe independence is complete and unquestioned. A second group, composed of Shariah scholars, legal experts and executives outside the framework of Islamic banks, along with academics, see independence as questionable, as it is rare for SSB members to be nominated by a BOD or objected to by the shareholders in the AGM.

As noted, a possible consequence of this issue could be that whoever has an interest in or benefits from the status quo will oppose any change that may go against their interests or affect their privileges – an argument that aligns with the vested interest theory in the realm of institutional theory (Moe, 2015). A creative

and applicable method is thus crucial for ensuring SSBs' independence. Also, the duties of one party must not take over those of another (e.g., the supervisory authorities must not fulfil the duties of the AGM). Regarding competency, there is almost unanimity among those interviewed about the need to develop university graduates. However, there is no university specialisation in Kuwait on Islamic finance or Shariah audit, which affects the sustainability of the Shariah supervision of IFIs.

Furthermore, the data analysis found that the Shariah audit requires much attention and effort, though internal Shariah audit is acceptable according to the interviewees. There are numerous challenges in the realm of external Shariah audit, such as the poor design and implementation of Shariah audit instructions, not classifying Shariah audit firms in the instructions and not analysing every Shariah audit firm and what suits it in terms of the type and number of IFIs it audits (any Shariah audit firm can audit any Islamic bank or company, irrespective of the available numbers of Shariah auditors and their competencies). Accordingly, such challenges have caused implementation difficulties, especially because the external Shariah audit started being implemented only recently (the beginning of 2020), which may add to the concern felt among regulators that the instructions are new but not well designed, thus leading to implementation problems. Considering this, supervisory authorities must move quickly to address the deficiencies in the instructions so that adverse consequences are minimised in the future and customer confidence is preserved.

6.5 Research Contributions

This section consists of four sub-sections: theoretical, literature, practice and policy contributions.

6.5.1 Theoretical Contribution

An essential contribution of this research concerns using institutional theory to consider the legal, social and political aspects of Shariah corporate governance, and hence not merely aspects regarding conflicts of interests between

shareholders and managers, as with agency theory. As such, this research has also expanded the scope of institutional theory to include the religious aspect, which here is Shariah corporate governance and its application to a new context – that of Kuwait. It is this theory that has provided the necessary depth to understand and evaluate Shariah corporate governance practices. The Kuwaiti social, political, and legal environment constitutes a vast space for potential influences on the Shariah corporate governance practices, which was explored and evaluated through the institutional theory lens. Likewise, institutional theory considers the social, political, and legal embeddedness and differences among nations, and consequently its possible effects on the Shariah corporate governance applications.

Furthermore, the contextual expansion of the organisational field notion, a core concept of institutional theory, is a major theoretical contribution of this research. Shariah supervisory board scholars are a sub-field of Islamic financial institutions in this regard. Consequently, an implication here concerns the existence of a powerful group of Shariah supervisory board scholars that, through its strong relationships with the key shareholders of most Islamic banks and the regulatory bodies, controls who sits on Shariah supervisory boards and who does not. Because of this, a small number of Shariah scholars serve on the various Shariah supervisory boards of Islamic financial organisations.

6.5.2 Literature Contribution

This research adds to the academic literature on Islamic finance and Shariah corporate governance in several respects. First, it shows that Shariah corporate governance principles or best practices in the regulatory instructions need to be revised. In turn, though, while the implementation of these revised principles does indeed need to be effective, it is their practical impact that is more important than the mere presence of regulations ('box ticking'). Secondly, most Shariah corporate governance literature on the case of Kuwait is either arguably outdated (e.g., Ahmed, 2011; Hassan, 2012; Grassa, 2013) or discusses only one aspect of Shariah corporate governance (either a macro or micro aspect) (e.g., Al-Qassar and Ahmed, 2022). More comprehensive contemporary broader

considerations (macro and micro), as addressed in this work, can elicit broad understandings of specific concerns within certain contexts. This research has studied both and added much new knowledge. Regarding Shariah corporate governance from the macro institutional aspects (regulatory, social, political and legal) that directly and indirectly impact on Shariah corporate governance practices. For instance, to the best of the researcher's knowledge this research is the first to study the impact of the *diwaniyya* and social connectedness on Shariah corporate governance practices. In this, it indicates an indirect negative effect of the frequent visits between SSB members and CEOs or members of the board of directors in Islamic financial institutions (see Chapter 4).

Thirdly, concerning internal and external Shariah auditing practices in Kuwait, this research adds to literature in a way that is particularly important as regards the recently developed process of Shariah auditing. For example, this research shows a relationship between the Shariah supervisory board members and Shariah audit and Shariah consulting firms, which may constitute a conflict of interest and thus necessitates prudent handling of this matter to deal with it accordingly. Therefore, this research adds value, particularly for policy makers in supervisory institutions. Fourth, this research confirms the importance of the Shariah auditor's personality traits and his ability to argue and express his opinion in front of executives (Rashid and Ghazi, 2021; Albawwat et al., 2021; Samagaio and Felicio, 2022). Fifthly, this research reveals an evident supervisory shortcoming regarding regulating the work of Shariah auditing and consulting firms. For example, there is no classification of these entities that allows the regulators to know whether the firm can carry out this work properly. In other words, the classification of Shariah consulting and auditing firms would contribute to regulating the Shariah audit market and breaking the monopoly of some firms. As such, this work adds a valuable dimension to the Shariah audit and Shariah corporate governance literature.

6.5.3 Practice Contributions

Based on the results of this research, several practical implications regarding good Shariah corporate governance have emerged. First, regulators should apply

what is seen as relevant, rather than what is deemed best practice. Indeed, this study's results show that the experience of the Capital Markets Authority regarding applying international best practices of corporate governance without considering the Kuwaiti context is useless and has produced what is called regulatory unreasonableness, which is consistent with institutional theory. Secondly, the regulatory authorities should strive in the long term for the supervisory approach of Shariah corporate governance to be principles-based for several reasons. On the one hand, this requires the least effort and cost from the regulatory authorities, and on the other hand it distances regulatory authorities from Shariah-related issues that are not at the core of their work. Furthermore, the principles-based approach puts the onus of complying with the principles of Islamic law entirely on the Islamic financial institution. Taking into account the gradual transition from the rules-based approach to the principles-based approach, as this study's research findings indicate in echoes of what Nakpodia et al. (2018) proposed, multi-stakeholder co-regulation.

Third, Islamic financial institutions' management personnel should consider competence rather than intellectual leanings and political affiliations as criteria for employing Shariah auditors and Shariah audit managers. In this context, this research shows that Islamic financial institutions are cantons of Islamic currents in Kuwait. Fourth, having an arbitration mechanism would resolve disputes between Islamic financial institutions themselves or between clients and those institutions. Generally, arbitration is a speedy mechanism, as the arbitral tribunal is specialised and judges specialising in Islamic finance are chosen with the consent of all parties to the dispute. In this vein, it is crucial to consider the need to create the legal infrastructure for implementing the arbitration mechanism in Kuwait.

6.5.4 Policy Contributions

A crucial determinant of good Shariah corporate governance is establishing specialised departments in Islamic finance regulatory authorities to deal with the Islamic financial sector's issues and challenges with a high degree of awareness and effectiveness, in addition to anticipating the future of the Islamic financial

industry and responding accordingly (adopting a proactive role). Moreover, courts and judges specialising in Islamic financial transactions and finance are among the most critical elements of the required Shariah corporate governance infrastructure in Kuwait, and specialised higher education programmes in Islamic economics and finance (Bachelor's, Master's, PhD.) form an essential determinant of 'good' Shariah corporate governance. In the educational context, another macro-determinant concerns attracting distinguished competencies into the field of Islamic finance to establish specialised Islamic finance programmes in private universities in Kuwait. In Chapter 4, the researcher indicated that Kuwait University approved the teaching of the jurisprudence of Islamic economics in the Shariah and Islamic Studies college in 2021. However, this has yet to commence, which poses a challenge to the Islamic financial industry, as people who are sufficiently qualified in Islamic economics and finance will not be working in Islamic financial institutions any time soon. From a strategic point of view, this challenge will consequently accelerate what was noted above regarding the orientation shift (from Islamic economic principles to profit-orientation) of those in charge of Islamic financial institutions, which may eventually lead these latter becoming conventional institutions – albeit ones with mere token Islamic slogans. Hence, expediting this programme's teaching of jurisprudence of Islamic economics is imperative.

This study has discussed several developmental proposals made by some interviewees regarding the Shariah supervisory board's independence. One of these is having a neutral party entrusted with appointing, rewarding and dismissing Shariah supervisory board members – one that is outside the influence of the Islamic financial institution. Likewise, a practical proposal for rewarding Shariah supervisory board members is to make an annual deduction from the profits of Islamic financial institutions, with the percentage of the deduction being based on each institution's asset size. From this finance, the institutions' Shariah supervisory board members can be compensated financially directly from these annual proceeds, not from the IFI. In addition to the financial aspect, appointing Shariah supervisory board members is another challenge to the board's independence. Although the mechanism by which the Shariah

supervisory board members are appointed resembles the mechanism of appointing the auditor through the annual general meeting, and this is compatible with best practices in corporate governance, the objections interviewees raised are considered reasonable here because of the Kuwaiti social context or, specifically, the social connectedness mentioned earlier. Basically, the professionalism of the Shariah supervisory board members may be affected because of the frequent visits between them and members of the board of directors or executive managers in their *diwaniyyas*. Therefore, the researcher suggested that Shariah supervisory board members sign a pledge, or a professional code of conduct, that constitutes a moral and ethical obligation not to violate their own independence and professionalism. Essentially, this research stems from a fundamental rule: Shariah scholars, under their religious commitment, are not immune from mistakes or bad practices, as they are, in the end, human.

Another crucial policy recommendation is to have a comprehensive plan or road map for the Islamic financial sector's sustainability at the country level, which can organise the various stakeholders' efforts and make them mutually supportive and work in the same direction. Indeed, comprehensive plans for Islamic finance exist for Malaysia, Kazakhstan and Turkey. The fifth suggestion is to establish a joint steering committee among the supervisory authorities regarding Shariah governance to prevent conflicting efforts and to reach a high degree of consistency in the instructions in a way that is commensurate with and does not harm each sector.

Regarding institutional social effects, one determinant of good Shariah corporate governance would be to have a code of conduct (as well as the pledge noted above) for those involved in Shariah supervision (Shariah scholars and Shariah auditors) that contributes to moral commitment, especially since Kuwaiti society – as has been pointed out – is a small and interdependent society within which the relationships of its members are strong (through *diwaniyya*). Although governance is viewed as a culture rather than a set of laws or instructions, the malpractices of nepotism and patronage cannot be eliminated solely through

regulatory rules. Hence, a code of conduct may help strengthen Shariah corporate governance practice. As such, this will increase the awareness among those concerned with Shariah corporate governance of the importance of separating human social communication from the fact that this communication negatively affects Shariah corporate governance.

To the researcher's knowledge, this research is the first, as mentioned, to study the possible *diwaniyya* effect on Shariah corporate governance practice. Kuwaiti society is a politicised society and exercises elections at several levels (parliament, sports clubs, student unions) and has a freedom margin through which political groupings of different intellectual orientations (liberal and Islamic) operate, though this has its repercussions. For example, several interviewees mentioned that the SSB members' or Shariah auditors' appointments are sometimes influenced by the similarity or closeness of their own political and intellectual tendencies to those of IFIs' owners. Consequently, an institutional political determinant for 'good' Shariah corporate governance is the regulatory authorities' review of Islamic financial institutions' appointments of Shariah scholars/Shariah auditors, particularly from a political standpoint.

In addition to the aforementioned recommendations, this research has other policy recommendations in terms of micro-determinants for 'good' Shariah corporate governance in the financial sector:

(A) Creating a body for Islamic banks' depositors, similar to the bond holders' body, which looks after the interests of depositors and defends their rights. In addition, having such a body (representing an Islamic bank's depositors) would help preserve the substance and the form of an IFI's nature.

(B) Establishing pressure groups among IFIs' stakeholders, that work to correct institutions in the event of a deviation, such as mimicking the Conventional financial institutions activities and products.

(C) Paying attention to the personal characteristics of the Shariah auditor, such as self-esteem and the ability to argue with institutions' leaders. These are just as important as a Shariah auditor's educational attainment and skills. Therefore, policy makers should pay attention to them in the training and terms of appointment of Shariah auditors.

To the best of the researcher's knowledge, this research is the first to deal intensively with Shariah corporate governance in Kuwaiti Islamic financial institutions, and it has done this in various ways. First, the research dealt with the macro-level institutional aspects (social, political, legal). Next, the researcher studied the status of Shariah corporate governance and the extent of its strength or weakness, doing so via participants' perspectives (micro-industry level). Then, it examined micro-level aspects at the firm level and their relationship to Shariah corporate governance practices, including the associated challenges in this relationship. Accordingly, the research suggested appropriate policy recommendations to address these challenges in a way that sustains the Islamic financial industry and preserves the authenticity of Islamic finance (substance and form). This research has thus laid an essential brick in the wall of the Islamic financial industry in terms of strengthening its adherence to the provisions and principles of Islamic law. As such, it is crucial for this to come to the attention of public policy makers in Kuwait so they can develop the financial sector in Kuwait accordingly.

6.6 Research Limitations and Future Studies

This research is not without limitations. For instance, as this is a qualitative study, generalisability is a concern – though it could theoretically be generalised as a single case or single research method for theoretical propositions when considering the difference between analytical and statistical generalisation (see Chapter 3). Indeed, according to Yin (2003, as cited in Kelliher, 2005) a researcher could generalise such findings for developing theoretical propositions, so this qualitative study could be applied in other contexts based on the aforementioned 'good' Shariah corporate governance determinants in the

Kuwaiti financial sector. However, future studies may also quantitatively examine the determinants of good Shariah corporate governance by studying the institutional aspects (regulatory, social, political, and legal) and their impact on Shariah corporate governance practices.

Furthermore, Given the current period characterised by the widespread adoption of artificial intelligence, it is imperative to explore the potential implications of this phenomenon on the Shariah corporate governance practises. Consequently, future research endeavours may delve into this subject area. According to the researcher's knowledge, Kuwait's Shariah supervision lacks artificial intelligence technologies application. In this vein, can artificial intelligence have a role in improving Shariah compliance? To what extent will the implementation of artificial intelligence techniques impact the Shariah supervision? Is there a steady reduction in SSB members Shariah auditors? To what extent will these technologies be utilised within the Islamic financial sector? These inquiries require further investigation and meticulous examination in forthcoming studies.

Also, this research does not address the absence of women as Shariah scholars in SSBs, despite the large number of female graduates of the College of Shariah and Islamic Studies at Kuwait University, as this in itself requires a detailed study that would arguably detract from the focus herein. This, nevertheless, needs addressing. As such, future studies concerned with Shariah supervision can address this omission and study the reasons for the absence of women as members of SSBs and ways to bring them into the field.

Another limitation is that the study covers Kuwait only, though a positive from this is that such a focus has allowed a thorough examination of this specific context. To complement and build on the current work, further studies may each focus on another country while some may even expand on this to include several countries and provide a work-specific comparison.

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Appendices

Appendix 1: Drivers of Good Corporate Governance

According to Filatotchev et al. (2007, p. 4), the drivers of ‘good’ corporate governance in the UK context are summarised as follow:

1) Corporate boards

- Board independence (driver 1)
- The diversity, human and social capital within the board (driver 2)
- High engagement in board processes (driver 3)

2) Share ownership and shareholder activism

- Presence of large-block shareholders (driver 4)
- Shareholder activism (driver 5)

3) Information and disclosure

- Breadth and depth of public information disclosure (driver 6)
- Breadth and depth of private information sharing (driver 7)

4) Audit and internal control

- Independence of the external auditors (driver 8)
- Competence of the audit committee (driver 9)
- Presence of internal control systems and support of whistleblowing (driver 10)

5) Executive pay

- Long-term performance-related incentives (driver 11)
- Transparent and independent control of the remuneration committee (driver 12)

6) Market for corporate control

- An active market for corporate control (driver 13)
- Transparency and protection for shareholders and stakeholders during mergers and acquisition (driver 14)
- Board power regarding takeover bids, subject to shareholder veto (driver 15)

7) Stakeholder

- Stakeholder involvement within corporate governance (driver 16)
- Voice mechanism for debt holders (driver 17)

- Employee participation in financial outcomes and collective voice in decision-making (driver 18)

Appendix 2: The Big Five Model

The big five model suggested by McCrae and Costa (1997, cited in Samagaio and Felicio, 2022, p. 797) consists of the following personal traits:

1) Extraversion:

This personality trait is characterized by a desire to be with other people, to be very sociable, fun-loving, friendly, affectionate, talkative, and emotionally positive, but such people pull energy from others. These individuals are outgoing, assertive, and energetic. They tend to be too talkative and have high activity levels and can be perceived as domineering. Such people are an inspiration to others, but for themselves this can be exhausting.

2) Agreeableness:

Agreeableness is a “classic dimension of character, describing ‘good’ versus ‘evil’ individuals”. This personality trait is judged by its disagreeable pole, antagonism, which characterizes people that remain always against others, are skeptical, uncooperative, stubborn, rude, selfish and arrogant. This personality trait is also described as dependent and flattering, and in leading positions agreeable people have difficulty to provide negative feedback and make decisions that can disappoint others.

3) Conscientiousness:

Conscientiousness people are described as hardworking, ambitious, energetic, and preserving, with a high sense of duty, scrupulous, perhaps moralistic and disciplined. They tend to be perfectionist, concerned with small details, which can lead them to lose the big picture.

4) Neuroticism:

These individuals tend to experience negative emotions easily, being characterised as impatient, overreaching, less resilient to stress, struggle to stay calm, and show anger. Neuroticism people that are sad and scared, and on the opposite pole are individuals characterised as being calm and stable.

5) Openness to Experience:

These individuals described as intellectual, imaginative, and independent-minded and with an original and complex mental and experiential life. These individuals are also described as too complex and too innovative, which can lead them to be frustrating to their colleagues

who can get more confused than enlightened with their abstract communication.

Appendix 3: CG Antecedents and Propositions in Nigeria

The following table shows the good CG antecedents and propositions in Nigeria (suggested by Adegbite, 2015).

Item	Antecedent and Proposition
Board independence	The author argues that Previous studies suggested that the independence level would be high if there is segregation of duties between the board chairman and CEO. Also, family firms' owners and their impacts on the management performance and motivations need considering. The data investigated seemingly has a mix of executives with and without links with BODs.
Board heterogeneity	Board heterogeneity or board diversity (culture, age, tribe, etc.) is essential for the author, as is having a rigorous opinion regarding a firm's affairs. For example, the age mixture (youth and elderly or retired expertise) is vital for combining enthusiasm and experience.
Board reputation	The author argues that highly reputable boards have more credibility, and more credibility means more public trust in such firms' services and/or products. However, there is a scarcity of reputable, highly experienced and educated persons, especially in the Nigerian context, for various reasons such as low working incentives in Nigerian-listed firms.
Board evaluation	According to the author, there are two kinds of board evaluation. The first type, outsourcing evaluators, involves a good level of independence, but this may risk 'box-ticking' behaviour and consequently useless or superficial evaluation. The second, self-evaluation, is more reliable and consistent with various studies. However, this method may convert to a boss-employee type, especially considering the Nigerian inclination for showing the elderly great respect. The author thus suggests having an advisory council appointed from shareholders, although it would have not

	compulsory (binding) power but ethical commitments from the BODs.
Active and independence Audit Board committee	The author argues that to yield significant benefits from the board audit committee, those in charge should have the integrity and commitment to do their job in the best interests of the firm's stakeholders. This step goes beyond regulation, checks and balances.
Foreign institutional investors	As there are more foreign institutional investors, the author says this brings more pressure on the board and management to apply best CG practice.
Executives' performance-related compensation	Although performance-related compensation in Nigeria is regulated (i.e., stock exchange commission and Nigeria central bank), the culture of such things is still not mature. The executives create their own means of accumulating wealth if their compensation is not adequate. Thus, the author proposes that applying a performance-related compensation scheme may only minimise the 'window dressing' practice of corrupt managers to hide their intentional mistakes and to accrue money at the expense of firm benefits.
Full and transparent information disclosure	The author argues that full and accurate information disclosed about various aspects, such as governance structure, board and management members and their compensation, ownership structure and employee share ownership schemes (ESOs) is essential. Such disclosure may minimise poor CG practice by corrupt managers and encourage the public to use this information to hold company management accountable.
Effective shareholder activism	For Adegbite et al. (2012, p. 3), shareholder activism is "the range of actions taken by shareholders to influence management and the board. These actions are normally categorised as either an exit (selling shares) or expression (letter writing), meeting with shareholder association, asking questions at general assembly and using of voting rights." Drawing on the above, shareholders can be classified into two categories: sophisticated shareholders, who, for instance, ask questions in an AGM, and second reputable shareholders, who challenge the

	existing board and management based on respected levels of experience. As such shareholders can leverage their power to influence company leaders, the author suggests that encouraging both types of shareholders is recommended for boosting good CG practice.
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Appendix 4: Some Footnotes Details

Footnote number	Detail	Country
19	Article 5 states that “a Higher Shariah Authority shall be formed by a cabinet decision, incorporating Shariah, legal and banking personnel to undertake higher supervision over Islamic banks, financial institutions and investments companies to ensure legitimacy of their transactions according to the provisions of Islamic Shariah law, and also to offer opinion on matters which these agencies may come across while conducting their activities. The opinion of the said higher authority shall be binding on the said agencies. This authority shall be attached to the Ministry of Justice and Islamic affairs” (Federal Law No. 6 of 1985, United Arab Emirates).	United Arab Emirates
20	After the decision no. 102/2w/1 of the Council of Ministers to establish the higher Shariah authority in 2016, the Central Bank of the United Arab Emirates announced its establishment in February 2018.	United Arab Emirates
21	Article 93, 2nd paragraph states that “in case of a conflict of opinions among members of the Shariah Supervisory Board concerning a Shariah rule, the board of directors of the designated bank may transfer the matter to the Fatwa Board in the Ministry of Awqaf and Islamic Affairs, that shall be the final authority on the matter” (Law No. 32 of 1968, Kuwait).	Kuwait
26	Principle 12.7: “A Shariah committee member must not accept any appointment in more than one licensed Islamic bank, one licensed Takaful operator and one prescribed institution” (Shariah Governance, 2019, p. 12).	Malaysia
27	Article 6-ii: “Up to three (3) years i.e., June, 2021, the SB members, except the resident	Pakistan

	Shariah board member., can serve as a member on the Shariah boards of up to three IBs in Pakistan” (Shariah Governance Framework for Islamic Banking Institutions, 2018, p. 13).	
28	Article No 2.2.4.18: “No SSB member can be on the Shariah Supervisory Boards of more than one competing institution in Oman. However, SSB member can be on the Shariah Supervisory Boards of more than one non-competing institution (e.g., the SSB member of an Islamic Bank can also sit on the SSB of a Takaful (Islamic insurance) company or an Islamic fund management company, etc.). Overall, no SSB member can be on the SSBs of more than four institutions in Oman” (Islamic Banking Regulatory Framework, 2012, p. 67).	Oman

Appendix 5: Interview Questions Guide

General question(s):

- How do you understand Shariah corporate governance (SCG)?
- How important is SCG for the Islamic finance (IF) industry?

SCG current state:

- How would you describe the current state of SCG in Kuwait? Do you think it is adequate/satisfactory? Please can you explain why/why not.
- How do you evaluate the existing laws (No. 32 of year 1968 and its amendments)⁹³/regulation (12/2016)⁹⁴ concerning SCG? (Are they effective and sound in terms of current SCG practice)?

Macro-level questions:

- Does the Kuwaiti banking system need more or less SCG regulation? If yes, what are the main areas where support is needed? If no, why not?
- Do you think that a rules-based approach is appropriate? What do you think about a principles-based approach?
- In the long term, what are the appropriate strategies, in your opinion, for regulating Shariah-related matters in the banking and financial system?
- As the Central Bank of Kuwait (CBK) has recently (as of 5 October 2020) established its new Higher Committee of Shariah Supervision, what do you think of this development?

Kuwaiti context questions:

- To what extent do you think that cultural aspects (e.g., cronyism, nepotism ('wasta' in Arabic, etc.) affect SCG practice?
- Do you think that politics and political bodies (e.g., parliament) have a significant role regarding SCG legislation and therefore practice?
- To what extent is the legal system (e.g., enforcement of law, regulatory effectiveness, etc) in Kuwait generally an issue affecting SCG? And why?

Micro-level questions:

⁹³ Law No.32 of the year 1968 concerning currency, the Central Bank of Kuwait and the organisation of banking business.

⁹⁴ Instruction of "Shariah supervisory governance for Kuwaiti Islamic banks", issued by Central Bank of Kuwait on 20 December 2016.

- To what extent are the following SCG principles and arrangements adequate – SSB independence, confidentiality, competence ‘fit & proper’, consistency, and transparency about Shariah-related matters?
- What are the greatest challenges with respect to these arrangements? And what do you think are the solutions?
- Based on the high social connectedness of Kuwaiti society, do you think the existing regulations/instructions meet confidentiality requirements? If yes, how? If no, what can be done to enhance the confidentiality in SSB or minimise conflict of interest between SSB and BOD/Executives?
- How would you describe the role and responsibilities of the following SCG stakeholders: BOD, SSB, Non-governmental Organisations, regulators, educational bodies, etc.? What are the challenges facing each of those stakeholders? Please indicate any other aspects that you consider important in promoting good SCG.
- Concerning Shariah audit (SA), how do you assess SA regulation and experience in Kuwait? What are the greatest challenges facing SA in Kuwait?

The way forward:

- What do you think constitutes a ‘good’ or ‘bad’ SCG framework/arrangement in general?
- How do you describe the future of IFIs in Kuwait in general and of SCG in particular?

Appendix 6: NUBS Research Ethics Committee – Ethical Approval



**University of
Nottingham**
UK | CHINA | MALAYSIA

09/02/2021

To whom it may concern,

Ethics Review Application: 201929103 – Abdulrahman Alqassar: The Determinants of Shariah Corporate Governance in Kuwait

I am writing as chair of the Nottingham University Business School Research Ethics Committee (NUBS REC) to confirm a favourable ethical opinion for the above research on the basis of the documentation submitted below. This opinion was given on the above stated date.

The School REC operates according to the University of Nottingham's *Code of Research Conduct and Research Ethics, and the Economic and Social Research Council (ESRC) Framework for Research Ethics*.

The documents reviewed and approved are:

- NUBS REC Ethics Review Checklist
- Research Participant Information Sheet
- Research Participant Privacy Notice
- Research Participant Consent Form
- Research Participant Instructions

The following condition applies to this favourable opinion:

1. The research must follow the protocol agreed and any changes will require prior NUBS REC approval.

For further information about the School's Research Ethics Committee or approval process, please contact the Research Ethics Officer, Davide Pero at davide.pero@nottingham.ac.uk or +44 (0)115 84 67766.

Yours faithfully,



Appendix 7: World Governance Indicators

According to Kaufmann et al. (2009, p. 6), World governance indicators are as follow:

- 1) **Voice and Accountability:** capturing perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.
- 2) **Political Stability and Absence of Violence/Terrorism:** capturing perceptions of the likelihood that the government will be destabilised or overthrown by unconstitutional or violent means, including politically-motivated violence and terrorism.
- 3) **Government Effectiveness:** capturing perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.
- 4) **Regulatory Quality:** capturing perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.
- 5) **Rule of Law:** capturing perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.
- 6) **Control of Corruption:** capturing perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.

Appendix 8: Regulatory Tasks: The Dream Framework

The following table shows the DREAM framework for the regulations measuring proposed by Baldwin et al., (2012)

	Regulatory Task	Description
1	Detecting	The gaining of information on undesirable and non-compliant behaviour.
2	Responding	The developing of policies, rules, and tools to deal with the problems discovered.
3	Enforcing	The application of policies, rules, and tools on the ground.
4	Assessing	The measuring of success of failure in enforcement activities.
5	Modifying	Adjusting tools and strategies in order to improve compliance and address problematic behaviour.

Appendix 9: SSB Members' Terms of Appointment

	Regulatory Body	SSB Members' Terms of Appointment
1	Central Bank of Kuwait (CBK)	<p>SSB members must have a bachelor's degree in Islamic law, especially in the jurisprudence of transactions (<i>Fiqh al-Muamalat</i>), from one of the universities accredited by the Ministry of Higher Education in the State of Kuwait or the National Authority for Academic Accreditation and Quality Assurance of Education for universities outside the State of Kuwait.</p> <p>Alternatively, a member should be one of the scholars known for his competence and experience, especially in the jurisprudence of transactions, and he should have sufficient knowledge of finance in general and of IF in particular.</p> <p>It is important that a member of the SSB has the following:</p> <ul style="list-style-type: none"> - High skills in jurisprudence and its origins, as he must know the jurisprudential methods accurately to elicit Shariah <i>fatwas</i>, with knowledge and awareness of the provisions and purposes of Islamic Shariah applicable to the activities of the bank. - At least five years of practical experience in the field of Shariah supervision. - Sufficient knowledge of the legal and regulatory framework of the CBK that relates to the tasks assigned to it. - Good knowledge of the Arabic language, as he must have sufficient knowledge of basic legal sources, and it is recommended that SSB members be able to speak English, as this helps in improving communication between him and the stakeholders in the bank. - Understanding of the technical aspects and economic effects of IF services and products within the framework of the purposes of Islamic law.

2	Capital Market Authority (CMA)	<p>The CMA law or its by-law did not include the conditions for the members of the SSB, as they are not mandatory but rather permissible: ”The authorised entity Shariah supervision system shall consist of an ISA unit and an ESA office, and the authorised person may appoint a Shariah supervisory body to carry out the tasks stipulated in Article 2 –28 of this book.”⁹⁵</p>
3	Insurance Regulatory Unit (IRU)	<ol style="list-style-type: none"> 1. To have full legal capacity. 2. He must not have been previously convicted of a felony with a penalty restricting freedom, or a crime of negligent bankruptcy, or fraud, or a crime against honour or trust. 3. To be one of the experts specialised in the jurisprudence of IF transactions, law or economics, provided that the majority in the formation of the body is from specialists in Shariah. 4. He shall not be a shareholder in the company or a member of its BOD or the security of its employees. 5. Not to be a member of more than three SSBs in companies licensed in accordance with the provisions of the law and these regulations. 6. Not to be a member of the Shariah Supervision Advisory Committee at the Unit.

⁹⁵ According to CMA’s by-law, 5th book (2018, p. 30).

