

# AN ALTERNATIVE CONCEPTUAL CORPORATE GOVERNANCE FRAMEWORK FOR HIGH-CONTEXT CULTURES: A CASE FOR THE ISLAMIC & ARABIAN MIDDLE EAST

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## Abstract

The distinctiveness of Islam and the reaction toward the domination of the Western ideologies on the rest of the world especially on Islamic nations generated a movement among many scholars toward applying Islamic principals in the field of corporate governance. Islam is the dominant religion in the Middle Eastern region. This region consist of two major blocs the Arab League and most importantly the GCC. Thus, the cultural, political and legal environments have a significant impact on both profit and non-profit organisations. The proposed concept is generated by considering; the narrowness of the Agency theory illustrated by its limited explanations of such complexity associated with corporate governance issues yet its greatness of simplicity in regards to accountability; the Stakeholders theory serves wider views and shares many aspect with Islam yet this theory by nature suffers from practical complexity; Institutional theory are considered to ensure some degree of stability in the concept by considering the importance of the Islamic corporate supervisory institution in developing a sustainable Islamic corporate governance standards.

**Keywords:** Middle East; GCC; Saudi Arabia; Corporate Governance; Islam; ICG

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## 1. Introduction

The fact that we live in a singular-polar world is due to the hegemony role of the United States of America, This hegemony produced an almost absolute domination of the business and other literature. Corporate governance is not an exception since the American model and the best practice is considered universal among private corporations around the world.

According to Özkazanç-Pan (2008) postcolonial studies stand as non-Western critiques and reformulations of Western approaches to knowledge and offer possibilities for expanding Western research traditions in the social science field. She presented Edward Said's theory of Orientalism, which is a systematic examination of the different sites of Western knowledge production and their links to Western political, economic, and military institutions of domination. This illustrates how colonial discourse represents the East as backward, unable to change, inferior, and feminine, while it represents the West as progressive, advanced, and masculine. These representations produce a fictionalised Orient and are used to suggest there are 'real' cultural differences between West and East. Said attempts to reverse these binary categories but more important he tries to show how Western academia is implicated in the production of Orientalised representations. For example, how did management ideas and practices developed in the West become normalised as universal theories for studying people and business under globalisation? The different analytic lenses available from postcolonial studies demonstrate that the production (e.g. business schools, researchers) and circulation (e.g., academic journals, business education) of International knowledge have material consequences for the non-west. Suggesting that scholars re-conceptualise the other as legitimate contributor to international knowledge rather than in Western management terms or in need of Western managerial expertise. By doing so, management

researchers can coproduce knowledge with ‘the Rest of the world’ rather than about ‘the Rest of the world’ and disrupt the hegemony of Western epistemology in international research.

Thus, the research question is; what are the characteristics of an Islamic corporate governance (ICG) concept that is in-line with the Western corporate governance theories and compatible with the Islamic and Arabian Middle Eastern environment.

This paper attempts to develop an Islamic concept of corporate governance by integrating Western corporate governance theories with the Islamic principles.

## 2 Literature Review

Muslim countries are considered as transition economies, and many intent to cope with the western standards (Ali 2008; Davis 2005; Ghayad 2008; Siwar & Hossain 2009). However, the majority of the Muslim countries do not have the Anglo-American ‘dispersed ownership structure’, but rather a ‘concentrated corporate ownership structure’, as a result, many scholars recommended that the Muslim countries economies are better of following the corporate governance systems of Germany and Japan (Ali 2008; Davis 2005; Ghayad 2008; Siwar & Hossain 2009). The role of a corporation in social development in the Muslim countries does not overlap with the Anglo-American concept, because of the existing nexus of international relation with the legal development in corporate governance, recent advance technology in communications and available access to the international legislations (Ali 2008; Davis 2005; Ghayad 2008; Siwar & Hossain 2009). It is unfeasible for concentrated corporate ownership structure Muslim countries adopting the American shareholders’ concept of maximising the shareholders’ wealth, since this might lead to social-economic inequality that might negatively affect the market development, so socially responsible shareholders’ concept is preferable (Ali 2008; Davis 2005; Ghayad 2008; Siwar & Hossain 2009).

The next two sections will try to better understand the Islamic principles and the Western corporate governance theories and finally from the developed understanding of these sections the last section will provide a proposed concept of Islamic corporate governance (ICG).

### 2.1 Islamic Principles & Corporate Governance

First of all, the basic foundation of Islam is the oneness of God that is *Tawhid* which means that all matters are under the superiority of God him self and everything is under his great good well, for example people are users of Gods creation, therefore complying with Islamic *Shari’ah* is a must (Abbasi 2009; Choudhury & Harahap 2007; Choudhury & Hoque 2006; El-Sheikh 2008; Ghayad 2008; Pamuk 2009; Walsh 2007; Williams & Zinkin 2010).

According to Williams and Zinkin (2010), Siwar and Hossain (2009), Islam introduces humans as the representative of God. The emphasis on individual choice and the balance between responsible behaviour and piety come from recognising that man has two missions to accomplish: first the mission as a servant of *Allah*, and second the mission as vicegerent or steward of *Allah*. In the first relationship man is responsible to God as his servant, while in the second, he is accountable for his relationship with creation. Both of these relationships co-exist and have equal weight in determining virtuous behaviour. Islam requires a balance and equilibrium (*‘adl*), which means doing things in a proportionate manner and avoiding extremes.

In addition, Islam by nature is designed to be compatible with all times and places and the most explicit principle is the framework of *Masaleh Mursalah* or “unrestricted” public interest, since undefined issues by the traditional rules of *Shari’ah* can be discussed and dealt with under this unique framework. *Maslahah* includes considerations that meant to promote gains or avoid damages working in-line with *Shari’ah* traditional rules as avoiding forbidden usury (*Riba*), misleading (*Gharar*), and ignorance (*Jahal*). Any other unrestricted issues the regulator is free to achieve *Masaleh* by applying the framework of *Masaleh Mursalah* (Abbasi 2009; Choudhury & Harahap 2007; Choudhury & Hoque 2006; El-Sheikh 2008; Ghayad 2008; Pamuk 2009; Walsh 2007; Williams & Zinkin 2010).

More, Islamic *Shu’ra* principle is another version of democracy means that everyone have the right to delegate his voice through voting for someone trusted (Almoharby 2010).

Moreover, Islamic principles are used to ensure sustainable standards of way of life and the Islamic ethics are similar to many current available and used non-Islamic ethics from this point it many claim the validation of using it in the international arena (Abbasi 2009; Choudhury & Harahap 2007; Choudhury & Hoque 2006; El-Sheikh 2008; Ghayad 2008; Pamuk 2009; Walsh 2007; Williams & Zinkin).

Furthermore, Williams and Zinkin (2010) found that the teachings of Islam not only appear to be in close conformity with the Ten Principles of the UN Global Compact - The compact uses a framework of ten universal principles in the areas of human rights, labour, the natural environment and anti-corruption -, but in many respects go further than the minimum standards adopted by this framework. In particular, Islam exceeds the requirements of the Global Compact in a number of important ways. First, it appears to be wider in scope, for example, in the development of human capital and in the transparency requirements in business transactions. Second, it has a clear codification defining what is permissible or *halal* and what is forbidden or *haram*. Third, Islam has an explicit enforcement mechanism in the *Shari'ah* as well as in community enforcement and the final sanction of the accountability of the individual for unethical behaviour on the Day of Judgment: 'Everyman's fate we have fastened to his neck: On the Day of Judgment we shall bring out for him a scroll, which he will see spread open' (Qur'an, 17, p. 13).

## **2.2 The Arabian Middle East Environment**

### **2.2.1 Arabian Middle East Cultural Environment**

Culture is defined as the collective mental programming of the human mind which distinguishes one group of people from another (Hofstede et al. 2010). This programming influences pattern of thinking which are reflected in the meaning people attach to various aspects of life and which become crystallised in the institutions of a society.

Professor Geert Hofstede conducted one of the most comprehensive studies of how values in the workplace are influenced by culture. He analysed a large database of employee value scores collected within IBM between 1967 and 1973. The data covered more than 70 countries, from which Hofstede first used the 40 countries with the largest groups of respondents and afterwards extended the analysis to 50 countries and 3 regions. Subsequent studies validating the earlier results include such respondent groups as commercial airline pilots and students in 23 countries, civil service managers in 14 counties, 'up-market' consumers in 15 countries and 'elites' in 19 countries. In the 2010 edition of the book *Cultures and Organizations: Software of the Mind*, scores on the dimensions are listed for 76 countries, partly based on replications and extensions of the IBM study on different international populations and by different scholars.

The values that distinguished country cultures from each other could be statistically categorised into four groups. These four groups became the Hofstede dimensions of national culture (See Figures 1,2 & 3 for our target region):

1. Power Distance (PDI)
2. Individualism versus Collectivism (IDV)
3. Masculinity versus Femininity (MAS)
4. Uncertainty Avoidance (UAI)

A fifth dimension was added in 1991 based on research by Michael Harris Bond, supported by Hofstede, who conducted an additional international study among students with a survey instrument that was developed together with Chinese professors. That dimension, based on Confucian thinking, was called Long-Term Orientation (LTO) and was applied to 23 countries. In 2010, research by Michael Minkov generated two dimensions using recent World Values Survey data from representative samples of national populations. One was a new dimension, and the second was more or less a replication of the fifth dimension. The number of country scores for the fifth dimension could now be extended to 93. On one hand, the fifth dimension of Bond and of Minkov correlate strongly, yet the constructs are not fully identical. The country scores used on this site are the scores of Minkov's research. We refer to this fifth dimension as *Pragmatic versus Normative (PRA)*.

In the 2010 edition of *Cultures and Organizations*, a sixth dimension has been added, based on Michael Minkov's analysis of the World Values Survey data for 93 countries. This new dimension is called *Indulgence versus Restraint (IND)*.

#### **2.2.1.1 Power distance (PDI)**

This dimension deals with the fact that all individuals in societies are not equal – it expresses the attitude of the culture towards these inequalities amongst us. Power distance is defined as the extent to which the less powerful members of institutions and organisations within a country expect and accept that power is distributed unequally.

Saudi Arabia scores high on this dimension (score of 95) which means that people accept a hierarchical order in which everybody has a place and which needs no further justification. Hierarchy in an organization is seen as reflecting inherent inequalities, centralization is popular, subordinates expect to be told what to do and the ideal boss is a benevolent autocrat

#### **2.2.1.2 Individualism (IDV)**

The fundamental issue addressed by this dimension is the degree of interdependence a society maintains among its members. It has to do with whether people's self-image is defined in terms of "I" or "We". In Individualist societies people are supposed to look after themselves and their direct family only. In Collectivist societies people belong to 'in groups' that take care of them in exchange for loyalty.

Saudi Arabia, with a score of 25 is considered a collectivistic society. This is manifest in a close long-term commitment to the member 'group', be that a family, extended family, or extended relationships. Loyalty in a collectivist culture is paramount, and over-rides most other societal rules and regulations. The society fosters strong relationships where everyone takes responsibility for fellow members of their group. In collectivist societies offence leads to shame and loss of face, employer/employee relationships are perceived in moral terms (like a family link), hiring and promotion decisions take account of the employee's in-group, management is the management of groups.

#### **2.2.1.3 Masculinity (MAS)**

A high score (masculine) on this dimension indicates that the society will be driven by competition, achievement and success, with success being defined by the winner/best in field – a value system that starts in school and continues throughout organisational behaviour.

A low score (feminine) on the dimension means that the dominant values in society are caring for others and quality of life. A feminine society is one where quality of life is the sign of success and standing out from the crowd is not admirable. The fundamental issue here is what motivates people, wanting to be the best (masculine) or liking what you do (feminine).

Saudi Arabia scores 60 on this dimension and is thus a masculine society. In masculine countries people "live in order to work", managers are expected to be decisive and assertive, the emphasis is on equity, competition and performance and conflicts are resolved by fighting them out.

#### **2.2.1.4 Uncertainty avoidance (UAI)**

The dimension Uncertainty Avoidance has to do with the way that a society deals with the fact that the future can never be known: should we try to control the future or just let it happen? This ambiguity brings with it anxiety and different cultures have learnt to deal with this anxiety in different ways. The extent to which the members of a culture feel threatened by ambiguous or unknown situations and have created beliefs and institutions that try to avoid these is reflected in the UAI score.

Saudi Arabia scores 80 on this dimension and thus has a preference for avoiding uncertainty. Countries exhibiting high uncertainty avoidance maintain rigid codes of belief and behaviour and are intolerant of unorthodox behaviour and ideas. In these cultures there is an emotional need for rules (even if the rules never seem to work) time is money, people have an inner urge to be busy and work hard, precision and

punctuality are the norm, innovation may be resisted, security is an important element in individual motivation.

**2.2.1.5 Pragmatism (PRA)**

This dimension describes how people in the past as well as today relate to the fact that so much that happens around us cannot be explained. In societies with a normative orientation, most people have a strong desire to explain as much as possible. In societies with a pragmatic orientation most people don't have a need to explain everything, as they believe that it is impossible to understand fully the complexity of life. The challenge is not to know the truth but to live a virtuous life.

The normative nature of Saudi Arabian society can be seen in its low score of 36 on this dimension. People in such societies have a strong concern with establishing the absolute Truth; they are normative in their thinking. They exhibit great respect for traditions, a relatively small propensity to save for the future, and a focus on achieving quick results.

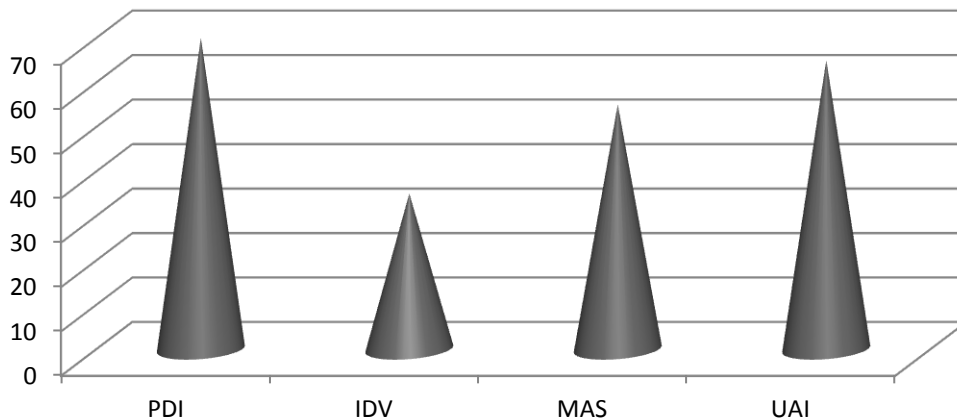
**2.2.1.6 Indulgence (IND)**

One challenge that confronts humanity, now and in the past, is the degree to which little children are socialized. Without socialization we do not become "human". This dimension is defined as the extent to which people try to control their desires and impulses, based on the way they were raised. Relatively weak control is called "indulgence" and relatively strong control is called "restraint". Cultures can, therefore, be described as indulgent or restrained.

Saudi Arabia's intermediate score of 52 does not point to a clear preference on this dimension.

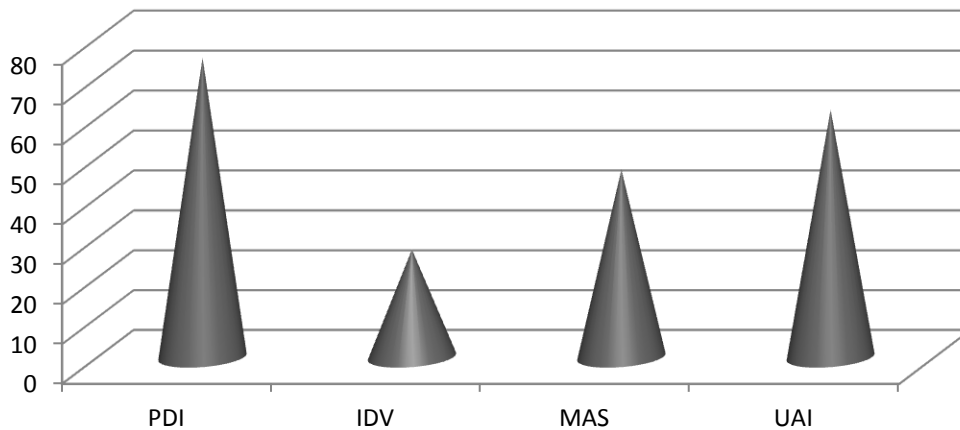
Understanding culture is essential in the field of international business, most notably; verbal and nonverbal language, religion, values and attitudes, manners and customs, material elements, aesthetics, education and social institutions (Czinkota et al. 2005).

**Figure 1.** The PDI, IDV, MAS & UAI dimensions scores for the Arab World



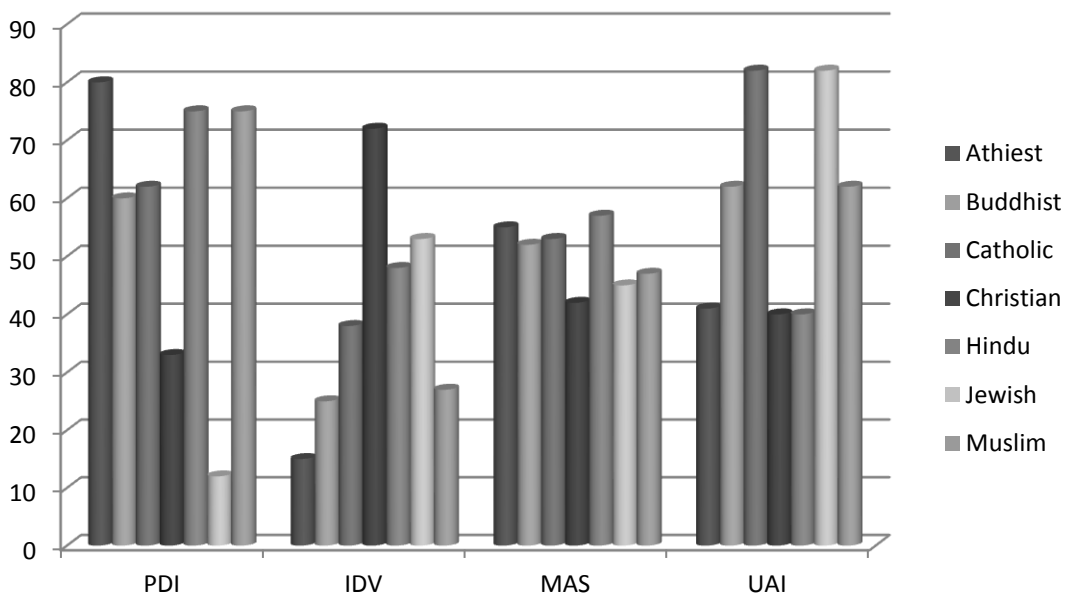
Source: <http://geert-hofstede.com/national-culture.html>

**Figure 2.** The PDI, IDV, MAS & UAI dimensions scores for the Muslim countries



Source: <http://geert-hofstede.com/national-culture.html>

**Figure 3.** The PDI, IDV, MAS & UAI dimensions scores by Religion



Source: <http://geert-hofstede.com/national-culture.html>

### **2.2.2 Arabian Middle East Political and Legal Environments**

The political and legal environment in the home and host countries, and the laws and agreements governing relationships among nations, are important from an international business perspective. Compliance is mandatory in order to do business successfully abroad. To avoid problems that can result from changes in the political and legal environment, it is essential to anticipate changes and to develop strategies for coping with them. Governments affect international business through legislation and regulations, which can support or hinder business transactions. For instance, export embargoes are imposed to enhance foreign policy objectives where such controls are used to preserve national security. Nations also regulate the international business behaviour of firms by setting standards that relate to bribery and corruption and restraint of competition.

Through political actions such as expropriation, confiscation or domestication, countries expose firms to international risk. Management therefore needs to be aware of the possibility of such risk and stay alert to new developments. Many private sector services are available to track international risk situations. In the

event of a loss, firms may rely on insurance for political risk or they may seek redress in court. International legal action, however, may be quite slow and may compensate for only part of the loss.

In the case of our target region and one of the major trading blocs in the Middle East is The Arab League, although the most important one is the Gulf Co-operation Council (GCC). The GCC was created in 1980 as a defensive move against Iraq-Iran war threats. It is one of the most powerful trade groups in the world, holding 19 percent of the world's per-capita income, and has only six members only; Saudi Arabia, Kuwait, Oman, Qatar, Bahrain, and United Arab Emirates (UAE). The GCC's main goals are to facilitate good economic relationships with the European Union (EU), European Free Trade Agreement (EFTA) and with western European nations. By 2010 GCC members supposed to have a common currency by dismantling trade barriers among members and establishing a GCC member bank (Czinkota et al. 2005). However, this common currency still under the GCC's working agenda.

The Kingdom of Saudi Arabia has an autocratic political system ruled by the royal family; this is similar to other GCC member states. The government and legal system in Saudi Arabia is totally referred to the king. Yet the judicial system is based on Islamic *Shari'ah* law (or the law of Islam) which prohibits paying interest and taxes (Czinkota et al. 2005).

### **2.3 Western Corporate Governance Theories**

First of all, the dominant Nexus-of-Contracts theory is defined as "each constituency or stakeholder group bargains with the firm over a set of rights that will protect the firm specific assets that it makes available for production" (Boatright 1996). One of the mysteries facing the Nexus-of-Contracts Theory is whether business ethics is terribly stalled in cultural relativism or whether there are, at least some, "hypernorms" that form the basis for universal human rights (Abbasi 2009; Davis 2005; Hansmann & Kraakman 2001; Phillips 1996; Saint 2005). The theory states that much of the difference between "legality" and "morality" centre on the use of the coercive power of the state, so drawback of this theory is the avoidance of state interference, which is, pictured negatively ignoring the positive states interference during crisis (Abbasi 2009; Phillips 1996).

In addition, the Agency theory is widely common among the private corporations where the board of directors act as the stakeholders' agent, which the management is accountable to. This theory is very clear and simple but at the same time shows great limitations regarding explaining the many complex corporate ownerships and control issues (Abbasi 2009; Anonymous 2002; Bonazzi & Islam 2007; Eisenhardt 1989; Hansmann & Kraakman 2001; Saint 2005)

Furthermore, the stakeholder theory looks at the corporation as a whole interaction between all stakeholders (workers, managers, owners, customers, suppliers, competitors, interest groups, media, communities, government) and the goal is to achieve healthy balanced corporation (Abbasi 2009; Bonazzi & Islam 2007; Velamuri & Venkataraman 2005). The theory holds a similar Islamic principle that is the *Tawhid* principle since all stakeholders should be equal under Islam and other Laws and religions share the same principle of equality. This aim might produce complexities among stakeholders because of lobbying and other bargaining techniques disturbing balanced relationships (Abbasi 2009; Bonazzi & Islam 2007; Velamuri & Venkataraman 2005).

Thus, the combination of the compatible parts of the previous theories with the Islamic principles is considered to propose an Islamic corporate governance concept in the next section.

### **3 Islamic Corporate Governance (ICG) Framework**

The proposed Islamic Corporate Governance (ICG) framework consists of four Islamic principles:

- *Khilafa* principle (sustainability and environmentally sensible)
- State of mind principle (creativity, knowledge base economy and protection of intellect thoughts)
- Prosperity principle (entrepreneurship, encourage investment and protection of private-ownership)
- Human rights principle

The proposed concept of Islamic corporate governance is an attempt to recognise the uniqueness of Islam in relation to the subject of corporate governance and the many existed theories generated from the

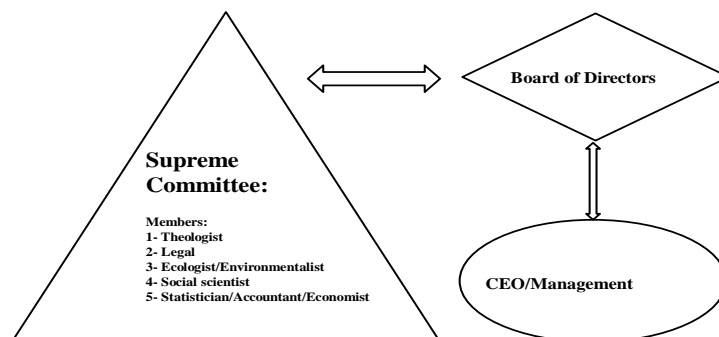
western schools of thoughts in this important field in business. The proposed concept (as shown later) consists of three phases (See Figure 4): the relationship between the stakeholders and the corporate board of directors; the relationship between the corporate board of directors and both the corporate management and the Islamic corporate supervisory; and the Islamic corporate supervisory structure from an international prospective.

*The first phase* of the proposed concept is the relationship between the stakeholders and the corporate board of directors. Here the stakeholders are represented by the corporate board of directors toward the public and the corporate management, by voting through practicing the Islamic *Shura* principle which is similar to the Democratic theory. The stakeholders through this contract expects that the board of directors is accountable toward them and complying with *Shari'ah* through their commitment to the Islamic corporate supervisory.

*The second phase* consists of the relationship between the corporate board of directors and both the corporate management and the Islamic corporate supervisory. Here the corporate management is accountable to the board of directors as indicated by the Agency theory, this contract is made to ensure the ease recognition of any future failure regarding responsibility. Also the corporate board of directors as mentioned earlier is committing to the Islamic corporate supervisory by complying to them through taking serious consideration of their advice regarding the corporate vision, strategies and any issues raised in the future.

*The third phase* of this concept is the Islamic corporate supervisory structure from an international prospective. The design of this concept's phase is made attempting to produce a standardised out-line of a universal Islamic corporate governance principle that can be clear and easy to be followed by corporations in the future. Since Islam does not belong to certain corporation also to cope with the current globalisation phenomena.

**Figure 4.** Islamic Corporate Governance Concept



The whole concept is based on clear contracts under Islamic principles derived from the teachings of *Quran*, *Sunnah* and other Islamic sources which is illustrated by *Shari'ah* and that's only serve the Devine's great well of humanity in this world.

#### 4 Conclusions

The distinctiveness of Islam and the reaction toward the domination of the Western ideologies on the rest of the world especially on Islamic nations generated a movement among many scholars toward applying Islamic principals in the field of corporate governance. The main Islamic foundation is the Devine-unity *Tawhid* principal as a result Islamic scholars attempted to developed and produce on this foundation an Islamic version of corporate governance. Along with this other Islamic principles are applied in the Islamic corporate governance concepts, such as the *Shurah* principle were freedom and democracy are guaranteed, and *Jahalah* principle were free-flow of information is ensured. Islamic scholars recognised other non-Islamic corporate governance theories such as the Agency theory, Stakeholders theory, Institutional theory and many others, also they understood the Islamic principles in the process of developing their own concepts of Islamic corporate governance.



Islam is the dominant religion in the Middle Eastern region. This region consist of two major blocs the Arab League and most importantly the GCC. Thus, the cultural, political and legal environments have a significant impact on both profit and non-profit organisations.

The proposed concept is generated by considering; the narrowness of the Agency theory illustrated by its limited explanations of such complexity associated with corporate governance issues yet its greatness of simplicity in regards to accountability; the Stakeholders theory serves wider views and shares many aspect with Islam yet this theory by nature suffers from practical complexity; Institutional theory are considered to ensure some degree of stability in the concept by considering the importance of the Islamic corporate supervisory institution in developing a sustainable Islamic corporate governance standards.

The proposed concept consists of three phases: *phase (1)* the relationship between the stakeholders and the corporate board of directors; *phase (2)* the relationship between the corporate board of directors and both the corporate management and the Islamic corporate supervisory; and *phase (3)* the Islamic corporate supervisory structure from an international prospective. The whole concept is based on clear contracts under Islamic principles derived from the teachings of *Quran, Sunnah* and other Islamic sources which is illustrated by *Shari'ah* and that's only serve the Devine's great well of humanity in this world.

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