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Morality and Religion: Complementing or Complicating Corporate Governance

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INTRODUCTION

Over the last two decades the subject of corporate governance has gained significant attention from policy makers, corporations and academics alike. This has followed a wave of corporate scandals that has shocked the very foundation of the financial markets around the globe. Both the United Kingdom and USA have had their fair share of these scandals – Enron, WorldCom, Guinness, Xerox, Bank of Credit and Commerce International (BCCI) – ranging from manipulation of shares price and accounting reports to major fraud and theft.[1] The lack of an effective governance system was mainly to blame in this series of unfortunate events. Therefore, over the years certain regulatory and legislative changes were brought in an attempt to improve the applicable governance systems.

Despite the best effort in this respect, the recent banking and financial crisis has exposed additional weaknesses in the governance system of many of the main players in the financial markets. The LIBOR scandal has further strengthened the debate on the need for a strong moral ethos embedded in all segments of business and in particular the financial sector. Since the financial crisis and its aftermath there has been an increasing public demand for more responsible governance of business corporations. The main argument in this context is that the underlying business culture needs to be changed and particular emphasis was put on the role that moral values can play in this process.[2]

It is fair to say that the issue of morality is not completely alien to the subject of corporate governance. West argues that the debate of corporate governance has a moral aspect. It is manifest, explicitly or implicitly, in some of the main debates concerning corporate governance such as Corporate Social Responsibility (CSR), the right of shareholders and stakeholders, and the ultimate beneficiary of corporate functions.[3] However, the debate on morality in the context of corporate governance has evolved, where morality has been suggested as a means of compliance.[4] In other words, morality is no longer only viewed as one of the concerns of a corporate governance policy, but also as an important compliance mechanism.

Having said that, bringing morality to the debate on corporate governance comes with certain difficulties. The concept of morality is quite perplexing; there are a number of theories that attempt to define morality. Each one of these theories has its own thesis hence the different takes on morality. Consequently, this imperative concept that is morality bears different interpretations and upon each one of them certain patterns of, individual and collective, behaviour are formed and accepted as moral behaviour. Take for example moral cognitivism, which argues that moral judgments are cognitive in their aspiration and that their authors consider their judgments as aimed at truth rather than morality.[5] Wiggins, among other moral philosophers, has tried to distinguish moral cognitivism from moral realism that

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[1] Surendra Arjoon, "Corporate Governance: An Ethical Perspective" *Journal of Business Ethics*, 61 (2005): 343-352. Richard N. Boyd, "*How to Be a Moral Realist"* in "*Essays on Moral Realism"* ed. Geoffrey Sayre-McCord (Cornell University Press 1988). Gerald Zandstra, "Enron, Board Governance and Moral Failing" *Corporate Governance: An International Review* 2 (2) (2002):16-19.

[2] Arjoon, "Corporate Governance: An Ethical Perspective", 343-352. Kevin T. Jackson, "The Scandal Beneath the Financial Crisis: Getting a View from a Moral- Cultural Mental Model" *Harvard Journal of Law and Public Policy* 33(2) (2010):735-788.

[3] Andrew West, "Corporate Governance Convergence and Moral Relativism" *Corporate Governance: An International Review* 17,1 (2009):107.

[4] Arjoon, "Corporate Governance: An Ethical Perspective", 343-352.

[5] David Wiggins, "Moral Cognitivism, Moral Relativism and Motivating Moral Beliefs" *Proceedings of the Aristotelian Society*, New Series 91(1990-1991): 62.

itself has many versions.[6] However, in principle moral realism is centrally based on the idea that there is a moral reality that people try to uncover through their judgments about what is right and wrong.[7] Realists consider these moral judgments- right or wrong- to be objective and independent.[8]

On the other hand, moral relativism highly questions the existence of such objective and universal moral truth/s. This has been endorsed by Gowans' description of the three aspects of moral relativism[9]:

(1)Descriptive Moral Relativism (DMR): the widespread and deep disagreement between different societies is a matter of empirical fact and the proportion of disagreements outweighs the significance of any existing agreements.

(2)Meta-ethical Moral Relativism (MMR): endorses the relativity of the truth and falsity of moral judgments- or their justifications- to the traditions, convictions or practices of a group or a person, this is in contrast to the idea of absolute or universal truth/false value of moral judgments.

(3)Normative Moral Relativism: taking into account DMR and MMR, this third aspect advocates more tolerance towards those with whom we do not agree on their moral judgments when the disagreement is not, or cannot be, rationally resolved. Also, it goes further to suggest that we should not interfere with the actions of persons, which reflect their moral judgments that we reject.[10] Moral relativism, similarly to moral realism, has also many versions yet they all stem their motivation and intellectual debate from a common presumption that there are unresolvable moral disagreements.[11]

With this in mind, articulating the role that morality can play in advancing corporate governance is rather difficult. Each of the above interpretations of morality would have a different impact on the adopted system of corporate governance. Nevertheless, it could be argued that moral relativism is a better thesis to use in order to understand the consequences of introducing morality into the subject of corporate governance. This can be justified on the basis that the moral relativism thesis acknowledges individual's subjectivity, which itself (i.e. individual's subjectivity) is an influential factor in any governance system.

David Lyons thesis on moral relativism identified two kinds of moral relativism, agent relativism and appraiser relativism.[12] The first type means that the rightness or wrongness of an act should be judged by others, according to the norms of the agent or the agent's group. While the latter means that others [appraisers] should make their moral judgments according to their standards or their group's standards.[13]Accordingly, any moral appraisal of the governance system in a corporation would either be done according to the norms of those who are running the business or the norms of the external observers

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[6] Wiggins, "Moral Cognitivism, Moral Relativism and Motivating Moral Beliefs",61-85.

[7] Russ Shafer-Landau, *Moral Realism: A Defence* (Oxford: Oxford University Press 2003),13.

[8]Richard N. Boyd, "*How to Be a Moral Realist"*, in "*Essays on Moral Realism"* ed. Geoffrey Sayre-McCord (Cornell University Press 1988), 182.

[9] Chris Gowans, "Moral Relativism", in *The Stanford Encyclopaedia of Philosophy,* ed. Edward N. Zalta, (Spring 2012 Edition), http://plato.stanford.edu/archives/spr2012/entries/moral-relativism/ (first published February 2004 and substantive revision December 2009- accessed July15 2014).

[10] These three aspect were used previously by West, "Corporate Governance Convergence and Moral Relativism",107-119. I have used them in this article to highlight the difference between moral realism and relativism where the latter is very helpful in explaining how religious values impact on moral judgments. Chris Gowans, "Moral Relativism", in *The Stanford Encyclopaedia of Philosophy,* ed. Edward N. Zalta, (Spring 2012 Edition), http://plato.stanford.edu/archives/spr2012/entries/moral-relativism/ (first published February 2004 and substantive revision December 2009- accessed July15 2014).

[11]Nicholas L Sturgeon, "Moral Disagreement and Moral Relativism" *Social Philosophy and Policy* 11,1 (1994):94.

[12]David Lyons, "Ethical Relativism and the Problem of Incoherence" *Ethics* 86, 2 (1976): 109.

[13] Sturgeon, "Moral Disagreement and Moral Relativism",83.

(consumers or regulators). Either way these norms are still cultural and social norms, which may have been influenced by religion at some stage. In other words, religious values could be part of the narrative that formulates some of the norms that guide our moral judgments. This explains the presumed inherent link between morality and religious values.

This article first provides an overview of the concepts of corporate governance and their applications. It highlights the argument for the need to use morality as a complementary compliance mechanism (moral filter[14]) regarding corporate governance systems. Therefore, it examines the concept of morality and its presumed link with religious values and it focuses on the role of religious values in the context of corporate governance as a part of the moral filter. It argues that the interaction between religious values and the governance system of a business organization is multidimensional and challenging, as it does not always have a positive impact on the governance system. The article identifies the two underlying aspects of this interaction. First, the influence of an individual religiosity that leads to possible conflicts between organizational norms and individuals' religiosity. Second, more importantly, the governance challenge when the religious values are the organizational norms such as the case of Islamic financial institutions. This paper suggests that the application of religious values proved to be quite challenging particularly in relation to Islamic financial institutions. It has led to a structural deficit that is a great challenge to corporate governance. It further argues that the establishment of ethically orientated business organizations on the basis of these religious values has been undermined by the governance challenge that has not been dealt with properly. This article does not aim to discredit the role that religious values may have in improving the governance system of any corporation. It rather aims to provide a balanced and informed perspective on the difficulties that religious values have brought to corporate governance.

CORPORATE GOVERNANCE: CONCEPTS AND APPLICATIONS

There is no doubt that all corporate entities, regardless of their nature or type of business, require governance. Turnbull used the term 'governance' to "describe a system of control or regulation, which includes the process of appointing the controllers or regulators".[15] The main concerns in this context are how this system can be established and implemented, and whose interest should be prioritised. There are a number of theories that influenced the subject of corporate governance such as agency theory, transaction cost economics, stewardship theory and stakeholder theory.[16] The adaptation of these theories can be seen in the two main models of corporate governance. First, the Anglo-American shareholder orientated system and, second, the Continental Europe/Japan stakeholder orientated model.[17] Regarding the first model, the governance system is structured to serve primarily the interests of shareholders. Yet there is no guarantee that managers who do not have any stake in the company will not be only self-interested agents. In terms of the second model, it is more inclusive in a sense that the interests of groups other than shareholders- employees, creditors, and local community - will be considered. Nevertheless, the interests of the wider groups of stakeholders can still be marginalised, if the managers in control are the major shareholders and have decided to be bound only by the agent-principal premise.

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[14] The concept of a 'moral filter' has been previously discussed in the context of Islamic economics by Gillian Rice, "Islamic Ethics and the Implications for Business" *Journal of Business Ethics'* 18 (1999): 345-358.
[15] Shann Turnbull, "Corporate Governance: Its Scope, Concerns and Theories" *Corporate Governance: An International Review* 5,4 (1997):182.
[16]Christiane A Mallin, *Corporate Governance* (Oxford: Oxford University Press 2007).
[17] West, "Corporate Governance Convergence and Moral Relativism",108.

Irrespective of which one of these two models has more moral value, which goes beyond the scope of this article, the implementation process in the case of both models seems to be quite challenging. In this respect, the most commonly used practice is to rely on legal compliance mechanisms. This means the use of legal tools such as statutes and codes of conducts, with many of them incorporated into the regulatory framework, to ensure compliance with the spirit of the adopted governance model. The UK is a good example of the use of legal mechanisms regarding the enforcement of corporate governance. The UK Companies Act 2006 is the main statutory tool that deals with corporate governance. Additionally, the Combined Code represents an imperative part of the legal compliance mechanism. The Code, which was revised in 2003 and later in 2006, has been influenced by the work of a number of committees on certain aspects of corporate governance.[18] In the wake of the financial crisis the Combined Code was reviewed in 2010 and renamed as the UK Corporate Governance Code.[19] Despite its voluntary nature the Code is subject to a 'comply or explain' principle. In some of the serious cases, the failure to comply might lead to serious consequences such as being delisted from London Stock Exchange.[20] Nevertheless, the reliance on these legal compliance mechanisms has been criticised on two grounds. First, these tools are open for abuses that are not completely illegal. For instance, to provide misleading statements that comply with transparency and disclosure requirements. Second, even when violations are established the remedies are hard to enforce. This is mainly due to the ambiguous make-up of the rules and the sophisticated nature of the business environment.[21]

Accordingly, a moral compliance mechanism - moral filter - can have a complementary role alongside the legal mechanisms in ensuring the effectiveness of the governance system. However, it can be argued that this moral filter is multifaceted and religious values represent one of its important layers. As demonstrated earlier, Lyons thesis of moral relativism argued that judging the rightness or wrongness of any decision (i.e. using the moral filter mechanism) could be done on the basis of the norms of those who made the decision or those who are conducting the assessment. Either way these norms are social and cultural which make them receptive to religious influence. Further, many legal theorists established their theses on the basis that religious principles have the highest moral value. John Austin, one of the key writers in the Christian tradition, maintained that God's commands and rules represent the fundamental principles of morality.[22]

Therefore, this article aims to address the role of religious values in the context of governance as a part of the moral compliance mechanism and the downsides of using religious values in this respect. In order to achieve that, the following section will explore the relation between religion, morality and business. Then the final part of this article will assess the direct impact that religious values have on corporate governance.

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[18]Mainly the reports of Cadbury, Greenbury and Hampel Committees, also, the Turnbull report (1999), the Myners report (2001) and the Higgs, Smith and Tyson reports (2003).

[19] Bob Tricker, *Corporate Governance: Principles, Policies and Practices* (Oxford: Oxford University Press 2nd ed 2012), 119-122.

[20] Ibid., 122.

[21] Arjoon, "Corporate Governance: An Ethical Perspective", 344.

[22]H L A Hart, "Positivism and the Separation of Law and Morals" *Harvard Law Review* 71, 4 (1958):597.

BUSINESS, MORALITY AND RELIGION

Humans by nature long for many things during their lives. These desires cannot all be classified in one category though. On the one hand, there are viscerogenic desires that represent the human bodily needs such as nourishment. These desires encompass a direct relation between objects and bodily satisfaction.[23] Maslow in his theory of human motivation devised a pyramid of needs in which he gave these physiological needs the top spot.[24] On the other hand, psychogenic desires, which are more relevant to the subject of this article, are different in nature from the first type. First, they are not subjective and private and, second, they have a different mechanism. These desires are based on objectifying values we seek by desiring certain materialistic elements, for instance, seeking goodness by desiring fair and just social relations.[25] Finally, the needs that they represent are ranked below the physiological needs on Maslow's pyramid of needs. However, despite their differences they are still imperative to understanding human motivation.[26]

It can be argued that the second type of desire, psychogenic desire, is present in the business environment. The type of business referred to in this section is the one that is carried out through corporate entities. It must be remembered that although these organizations have been given, in most cases, their own hypothetical separate legal personality, their actions are still a reflection of those individuals who control these entities. In other words, the human input into the corporate actions cannot be denied. Hence, it can be suggested that in the context of a business organization seeking success is a psychogenic desire, of those who are in control of the company, which is objectified mainly by profits. This desire can be originated in Maslow's esteem needs that encompass the desire for strength, for achievement and for prestige.[27]

In this respect, one of the main features that a good corporate governance system has is to ensure that success is not only objectified by profits. It should ensure that the success of a corporation is measured against other criteria such as social good, greater responsibility towards the community and the protection of all shareholders. Such interpretation of success – as a psychogenic desire – has a clear moral connotation.

Since the focus of this article is the role of religious values, as a part of the moral compliance mechanism, in the context of corporate governance, it is important to first explore the relation between morality and religion, and second, the application of the moral compliance mechanism and its religious components in the context of business.

Religion and morality

The relation between religion and morality has been widely considered through the literature; for instance the work of Parsons, 1915; Ames, 1928; Lewis, 1949; Bartley, 1971; Klemke, 1975; and Halman & Pettersson, 1996.[28] In this respect, religions tend to anchor their

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[23] Gordon W. Allport, *The Individual and His Religion* (Macmillan Publishing 1950), 14.
[24] Abraham H. Maslow, *Motivation and Personality* (Harper & Row Publishers, 3rd ed 1987), 15.
[25] Allport, *The Individual and His Religion*, 14.
[26] Maslow, *Motivation and Personality*, 21-22.
[27] Ibid, 21.
[28] Elsie C. Parsons, "Links Between Religion and Morality in Early Culture" *American Anthropologist* 17(1915): 41-57. Edward S. Ames, "Religion and Morality" *International Journal of Ethics* 38,3 (1928): 295-306. H D Lewis, "Morality and Religion" *Philosophy* 24, 88 (1949): 35-55. William Warren, Bartley, *Morality and religion* (London: Macmillan, New York: St. Martin's Press 1971). E. D. Klemke, "On the Alleged Inseparability of Morality and Religion" *Religious Studies* II (1975): 37-48. Loek Halman, and Thorleif Pettersoson, "Morality and Religion a Weakened Relationship?" *Journal of American Theology* 1(1996): 30-47.

teachings to high moral ideals and convey these ideals to their followers.[29] This is the refinement process that is based on religious sources and through which religions shape individuals' comprehension of moral ideas and values.[30]

All religions incline to contain a set of rules that aspire to direct and guide human behaviour to achieve certain values. Monotheistic religions - Judaism, Christianity and Islam - tend to share a number of noble aims, such as justice, purity and righteousness that they seek to achieve. Yet human desires have always been a challenge to this endeavour. The problem is not the desires themselves but rather the way in which humans fulfil these desires. Religious rules that aspire to guide the fulfilment of human desires are the moral components of religions, which are quite distinct from the actual religious components.[31]

In Islam, it was reported that the prophet Mohammad said, what is roughly translated as, "that he was sent to perfect honourable morals".[32] This statement has two rather important indications. First, it shows that morality is at the heart of the Islamic revelation. Second, and more importantly, it admits that moral values already exist before Islam and the Islamic message only aims to refine the existing moral system. It is clear that morality is a necessary condition of religion, but this is not to say that morality cannot exist without religion.[33] There is no doubt that individuals can sign up to a system, which is moral but not necessarily religious. However, morality that can be viewed through the lens of religion is guided by revelation that has its positive influence on the application of these moral components.[34] The fear of God's retribution for disobedience might secure better compliance with these morally orientated religious rules. This is not exclusive to monotheistic religions as such effect can still be seen in early tribal cultures where supernatural sanctions were attached to violation of the community moral beliefs.[35]

It has been argued that religious values are not superior to morals that exist separately to religions. Lewis described the superiority assumption as "spiritual arrogance".[36] He found it absurd to suggest that "one has some infallible hold on the truth", especially since even the most devoted and honest people can be "biased and affected by irrational considerations".[37] Nevertheless, it can be suggested that the fear of God's retribution makes religious values relatively superior in terms of their enforceability in many cases. Morality relies solely on moral consciousness of individuals while religions utilise the fear factor to encounter the fallibility of moral consciousness.

Changing the business culture and the role of morality

The numerous corporate scandals over the last two decades and the crippling financial crisis of 2008 have triggered the debate on the problem with the current business culture. The main theme of this debate is that the current business culture seems to reject that the economic value of the business is related to its moral conduct.[38] Accordingly, there are a couple of concerns that can be identified in relation to the current business culture. First, the concept of

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[29] Ames, "Religion and Morality", 303.
[30] Lewis, "Morality and Religion", 46.
[31] Klemke, "On the Alleged Inseparability of Morality and Religion", 43.
[32] Sahih Bokhari, (one of the nine authenticated Hadith Books, Ministry of Islamic Affairs, Endowments, Da'wah and Guidance, Saudi Arabia) available online in Arabic.
[33] Klemke, "On the Alleged Inseparability of Morality and Religion", 45.
[34] Ames, "Religion and Morality", 297.
[35] Elsie C. Parsons, "Links Between Religion and Morality in Early Culture" *American Anthropologist* 17(1915): 41-57.
[36] Lewis, "Morality and Religion", 39-40.
[37] Ibid.,39-40.
[38] Kevin T. Jackson, "The Scandal Beneath the Financial Crisis: Getting a View from a Moral- Cultural Mental Model" *Harvard Journal of Law and Public Policy* 33, 2 (2010):750.

acceptable behaviour is viewed on the basis of one principle- legal and illegal- where legal is not necessarily moral. Second, the rise in "egotistic individualism".[39]

These problems with the business culture equally affect all different models of governance. As the harm caused by the wrongdoing of those in control is not always inflicted only on the wider groups of stakeholders, but it is rather first affecting the shareholders. For those managers who are abusing their powers, mainly to maximise their profits, the interests of shareholders -let alone stakeholders- are not a priority. Whether the motivation is higher remuneration or self-pride, their conduct can be only described as a form of "egotistic individualism". Therefore, a good corporate governance model should reinstall this missing link between morality and business. This idea is not a recent discovery as it has been mentioned long time ago by Adam Smith (1757) in *the Theory of Moral Sentiments*.[40] Smith talked about what he called the "general rules of conduct" that are based on "a sense of duty" and in which morality has an important role to play.[41]

As discussed earlier, it is difficult to consider the use of a moral filter to reform the business culture without referring to religious values. Even Smith acknowledged the role of religion in his thesis on moral sentiments. Smith found that religion can be a foundation of the "general rules" that are observed by our moral faculties. He, further, recognised how religion enforces the natural sense of duty through God's superior supervision and punishment.[42] This is not to say either that Smith deeply explored this religious foundation or that his thesis on moral sentiments had reserved a central role for religion.

The issue that should be considered is whether religious values that are morally orientated can have a positive impact on governance and eventually change the current corporate culture.

RELIGOSITY AND CORPORATE GOVERNANCE

Religiosity is defined as "belief in God accompanied by a commitment to follow principles believed to be set by God".[43] Since the will of corporate entities is expressed through individuals the issue of religiosity becomes of relevance to corporate governance.
The interaction between religiosity and the governance of a business organization can be viewed from two perspectives. First, the influence of individuals' religiosity on the governance of a business organization. Second, and more importantly, the governance challenge when the institution is wholly established on religious principles (i.e. the religious values are the organizational norms) such as Islamic financial institutions. In other words, religious values were not brought to the organization by its individuals; rather they represent the foundation of this institution.

Individuals' religiosity and corporate governance

This aspect has been considered widely by researchers (such as Weaver & Agle, 2002, Vitell, Singh & Paolillo, 2006 and Vitell, Singh & Paolillo, 2007)[44] to assess the level of influence

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[39] Ibid.,739.
[40]It is worth noting that *The Theory of Moral Sentiments* preceded Smith's second book, *An Inquiry into the Nature and Causes of the Wealth of Nations*, where he presented his thesis on the market and the concept of common good of the whole society.
[41]Adam Smith, (1757) *The Theory of Moral Sentiments* (Penguin, 250th anniversary edition 2009) 186-187.
[42] Ibid., 191,196-197.
[43] Scott John Vitell, Jatinder, Joseph Paolillo and Jatinder Singh, "Religiosity and Consumer Ethics" *Journal of Business Ethics*, 57 (2005):175.
[44]They looked into religiosity and its relation with attitude to business and consumer's ethical beliefs. see Gary R. Weaver and Bradley R Agle "Religiosity and Ethical Behaviour in Organisations: A Symbolic Internactionist Perspective" *Academy of Management Review* 27,1 (2002): 77-97. Scott John Vitell, Jatinder Singh and Joseph

on the business governance system in general and any possible conflicts between organizational norms and individuals' religiosity. In general, the research has absorbed some positive relation between individuals' religiosity and the morality of the business behaviour without being capable on deciding on its significance.[45] However, this is not to say that there was no positive role for individuals' religiosity in the context of corporate business. For example, Agle and Van Buren conducted a study that sampled 250 MBA students where they found that there are some marginal links between individuals' religiosity and positive attitudes towards Corporate Social Responsibility (CSR).[46] Further, another study which sampled over 1000 undergraduate students found that there are positive correlations between the strength of individuals' religiosity and ethical behaviour in 10 different scenarios where some of them were business related.[47]

On the other hand, it can be argued that individuals' religiosity could be quite challenging to corporate governance. This is mainly due to two main elements, which are quite linked in their nature. First, "spiritual arrogance" –as defined by Lewis - which is associated with religious values and does not promote tolerance to the organization non-religious norms.[48] Second, "righteous anger" associated with religious individuals, which Weaver and Agle describe as the emotional state that influences the individual's decision. The manifestation of these two elements in the corporate governance context is a self-righteous governance system that is neither questionable nor inclusive. One of the main concerns that has been raised by the research in this context is the position of non-religious employees of the organization. Those who do not share the same religious values of their managers can be exposed to a discriminatory governance system.[49]

Religious values as the institutional norms: the governance of Islamic financial institutions

Before referring to the rules that govern Islamic financial institutions, it is rather important to first explore in general the concept of 'corporate governance' from an Islamic perspective. The term 'corporate governance' does not exist in the traditional Islamic legal literature. The alien aspect of that term is the concept of 'corporation' since Islamic law is not familiar with the idea of the hypothetical separate legal personality of a company. However, the concept of partnership has long been used and governed by Islamic law. Partnership has been historically used by Arab traders in many of their commercial transactions even before the emergence of Islam. In relation to 'governance', on the other hand, Islamic law seems to be quite familiar with the concept of governance in general. Islamic law refers to a certain mechanisms and principles that support any governance system, which can be used not only by the state but also by corporations and other forms of organizations.

Paolillo, "The Role of Money, Religiosity in Determining Consumers' Ethical Beliefs" *Journal of Business Ethics* 64 (2006): 117-124. Scott John Vitell, Jatinder Singh and Joseph Paolillo, "Consumers' Ethical Beliefs: The Roles of Monet, Religiosity and Attitude towards Business" *Journal of Business Ethics* 73 (2007): 369-379.

45 Weaver and Agle "Religiosity and Ethical Behaviour in Organisations: A Symbolic Internactionist Perspective", 79.

46 Bradley R. Agle and Harry J. Van Buren, "God and Mammon: The Modern Relationship" *Business Ethics Quarterly* 9, 4 (1999): 580-581.

47 Scott J. Vitell, "The Role of Religiosity in Business and Consumer Ethics" *Journal of Business Ethics* 90 (2009):159. Charles W. McNichols and Thomas W. Zirnmerer "Situational Ethics: An Empirical Study of Differentiators of Student Attitudes" *Journal of Business Ethics* 04 (1985): 159.

48 This is the consequentialist argument used in the political morality debate but applied here in the context of business morality. Timothy L. Fort, "Religion and Business Ethics: The Lessons from Political Morality" *Journal of Business Ethics* 16 (1997):268.

49 Justin G. Longenecker, Joseph A. McKinney and Carlos W. Moore, "Religious Intensity, Evangelical Christianity, and Business Ethics" *Journal of Business Ethics* 55 (2004):383.

There are two principles that are related to the discussion of governance in the context of Islam. First, is the mechanism of '*Shurah*', which means consultation. The Quran[50] encourages the practice of consultation in all aspects of human life. The Quran has provided the prophet with a governance mechanism that stresses the role of consultation, as it states: "And consult them on affairs. Then, when you have taken a decision, put your trust in Allah (God)".[51] Further, in Surah Al-Shurah, the Quran requires believers to handle their affairs through mutual consultation among themselves.[52] Therefore, it has been suggested that the Quran mandates consultation '*Shurah*' as an integral part of any decision making process especially when it affects more than one party.[53] This mechanism is quite in line with the underlying foundations of Islamic law rules that are inspired by justice, fairness, truthfulness, tolerance[54] and more importantly the fear of God. A true believer who knows that in making their decisions they are answerable to God before other fellow individuals would ensure that a proper consultation is being conducted.[55] It must be noted that although this principle was mainly applied in governing the Islamic State's affairs there is nothing prevents this principle form being applied in the corporate context. On the contrary, the application of the '*Shurah*' mechanism would encourage high level of consultation with the members of the corporation.

The second principle is the preservation of the five necessities in Islam. Islamic law has identified five necessities that must be protected at any cost that are: religion, life, property, intellect and family or offspring.[56] All Islamic law rulings aim to ensure that humans' interactions would not undermine the protection of these necessities. It can be argued that this principle could have an important role to play in the context of corporate governance. It provides the religious ethical framework according to which the company should operate. This means that any corporate governance system should aim not only to protect the property of the company's members but also the property of the stakeholders.

Islam is not the only religion that has been argued to have an influence on business practices. Calkins suggested that religious narratives of Judaism and Christianity have shaped the early business practices.[57] Rossouw argued that the church can have a role on the macro-economic level, in policy formation of business organizations, and in shaping moral dimensions of behaviour within a business environment.[58] However, Islam is the only religion in which some of its ethical values were first contextualised in commercial and financial principles and subsequently widely manifested in the form of modern business organizations, for example, Islamic financial institutions.

Islamic finance principles are a reflection of the religious values of Islam and their moral orientation. These principles are the prohibition of *riba* and prohibition of *gharar*.
First, the prohibition of *riba* is generally and explicitly stated in the Quran, without clarifying exactly what qualifies as *riba*. However, there is consensus among Muslim jurists to define *riba* as any increase to the principal capital that is paid as a compensation for time only,

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[50]Quran is the main textual source of Islamic law (Sharia).
[51] Quran, Surah Al-Imran, verse 3:159.
[52] Quran, Surah Al-Shurah verse 42:38.
[53] Mervyn K. Lewis, "Islamic Corporate Governance" *Review of Islamic Economics* 9,1 (2005):16.
[54] Abdussalam Mahmoud Abu-Tapanjeh, (2009) "Corporate Governance From the Islamic Perspective: A Comparative Analysis with OECD Principles" *Critical Perspective on Accounting* 20: 563.
[55] Muzaffar A.Shaikh, "Ethics of Decision- Making in Islamic and Western Environments" *The American Journal of Islamic Social Science* 5,1 (1988):123.
[56] Abdullah H. M. Al-Khalifah, "Religiosity in Islam as a Protective Mechanism against Criminal Temptation" *The American Journal of Islamic Social Sciences* 11, 1 (1994):7.
[57] Martin S. J. Calkins, "Recovering Religion's Prophetic Voice for Business Ethics" *Journal of Business Ethics* 23, 3 (2000):334.
[58] Gedeon Josua Rossouw, "Business Ethics: Where Have All the Christians Gone" *Journal of Business Ethics* 13(1994): 557-570.

which clearly includes conventional interest. Second, the prohibition of *gharar* is based on the Quranic prohibition of gambling where gambling is associated with excessive risk and uncertainty. The Quran states "they ask you about wine and gambling; say, in both of them is great sin and some profits for human beings, but the sin is greater than the profits".[59] Generally, the meaning of '*gharar'* would include the reference to deception, peril, jeopardy and hazard.[60] Hence, *gharar* covers both the unknown and the doubtful and "it obtains where consequences are concealed".[61] Further, Al- Zuhayli defines a sale that was corrupted by *gharar* as "any sale that incorporates a risk that affects one or more of the parties of the contract and may result in loss of his [/her] property".[62]

Clearly these principles are intended to prevent injustice and any form of exploitation. The application of these principles in the financial context prevented Muslims from using many of the conventional financial products. Therefore, Islamic financial institutions were introduced to provide the alternatives that comply with the religious ethics of Islam while conducting their business. Islamic financial institutions adhere to the above principles and their transactions are based on the principle of profit-loss sharing through real investments. Further, their investments should not either entail a high level of uncertainty and risk or be purely speculative. In accord with this, Islamic financial institutions use complicated products that are made of more than one contract. For instance, an Islamic mortgage product is made of two separate agreements, diminishing partnership and lease.

It is important to note that these institutional religious norms should benefit the governance of these institutions. They create a religious ethical framework according to which the corporation conducts its business. On the one hand, this religious ethical framework helps prevent and eliminate any abusive conducts in the business. For example, the application of the principle of preserving the five necessities requires the organization to protect the life and properties of its members and stakeholders. On the other hand, considering the religious nature of this ethical governance framework there should not be any concerns regarding its enforceability. Nevertheless, this is not to say that once this religious ethical framework is in place then all the corporate governance challenges are eliminated. The application of these institutional religious norms, thorough the religious ethical framework of the business, brings a new bundle of complications.

First, since religious values are the substratum of these institutions a mechanism to protect these values needed to be installed. The Sharia Supervisory Board represents the essence of this mechanism, which is, understandably, exclusive to this type of business organizations. The Sharia Supervisory Board has been defined as: "The main vehicle to evaluate, approve contract document and supervise all operations of the bank in conformity with its objectives and ultimately with principle of Islamic law".[63] Sharia Supervisory Boards operate on the basis of one of the main concepts of governance according to Islamic law that is *Shurah* or consultation. Sharia Supervisory Boards are the guardians of the religious values upon which the existence of these institutions depends. Nathan & Ribiere

[59] Quran, Surah Al-Baqarah, verse: 2:219
[60]Lu'ayy M Al-Rimawi, "Middle East: Islamic Models of Equity Markets" *Company Lawyer* 21, 5(2000): 162.
[61] Siddiq Mohammad Al-Ameen Al-Dhareer, *Al- Ghararr in Contract and Its Effect on Contemporary Transactions* (Eminent Scholars Lecture Series No.16, Jeddah: Islamic Research and Training Institute, Islamic Development Bank 1997), 10.
[62]Wahbah Al- Zuhayli, *Financial Transaction in Islamic Jurisprudence:Volume1*, translator. Mahmoud A El-Gamal, and revised by Muhammed S. Eissa (Damascus: Dar Al-Fikr, 2003), 83.
[63] Younes Al-Tamimi "Practice Requirements for Establishing an Islamic Bank" in *Islamic Financial Institutions* ed. M. Fahim Khan (Seminar Proceedings Series No 27, Jeddah: Islamic Research and Training Institute, Islamic Development Bank 1995),49.

argue that Sharia Supervisory Boards are the source of corporate wisdom as they combine knowledge, morality and actions.[64]

On the face of it, this may seem like an ideal set up where the business is morally orientated and the organization is even structured to preserve this feature. However, the reality is far from ideal. The Sharia supervisory Board, as a corporate organ, represents a real challenge to corporate governance. Members of the Sharia Board are accountable to God to ensure the truthful application of the Islamic religious values. Yet the question here is 'who guards the guardians?' At the moment it is still not clear how the Sharia Board can be held accountable by the company. Rider entertains the idea of whether they can be considered as shadow directors.[65] Despite having some grounds this proposal is still difficult to apply by the court since Sharia Board members are not trying to hide their influence. Also, it has been suggested they should be treated as non-executive directors since some aspects of their supervisory role resemble the role of non-executive directors.[66] If the Sharia Board members to be recognised as directors then at least they will be governed by the system of directors' duties. This shows the confusion regarding the best way to deal with the governance of the Sharia Board itself.

Second, the scholars who make these Sharia Boards functional are not the usual Muslim scholars. Those individuals must have a comprehensive knowledge, not only, of Islamic jurisprudence but also economics. The technical nature of Islamic jurisprudence and the advanced skills required to link it to economics makes the pool of scholars that organizations can choose from very limited. This leads to another major governance concern that is 'conflict of interest'. On the one hand, the scholars' task exposes them to price sensitive unpublished information. Whether through approving new products or designing new ones they have access to what can be described as inside information. On the other hand, the same scholars can be setting and advising different and even competing organizations, which is a potential for conflict of interest.[67] Although they are respected individuals with, presumably, high moral standards the governance system should be prepared for any eventuality, which is not the case at the moment. Accordingly, Islamic financial institutions are not structurally equipped to deal with corporate governance challenged posed by Sharia Supervisory Boards. Any of the above governance concerns is capable of tarnishing the presumed moral feature of these institutions.

Finally, Islamic religious values justify profits in any joint venture when they are based on risk sharing. Therefore, profit-loss sharing principle is used by Islamic financial institutions in their investments accounts, which are the equivalent of conventional savings accounts. However, the main idea is that the client will provide the capital and the institution will manage the fund, and even in some cases the institution might use some of its legal capital, and then both parties will share the profits or losses. Archer and Abdel Karim identified numerous concerns regarding the management of these accounts. They are particularly alarmed to the conflict of interest when the institution is managing and investing in the joint venture. It may choose more attractive projects (in terms of risk and return) for investment from shareholders funds while the funds of investment account holders are used

[64] Samy Nathan, and Vincent Ribiere, "From Knowledge to Wisdom: The Case of Corporate Governance of Islamic Banking" *The Journal of Information and Knowledge Management Systems* 37, 4(2007):477-478.
[65] Barry Rider, 'Corporate Governance for Institutions Offering Islamic Financial Services' in *Islamic Finance: Law and Practice,* eds. Nethercott, Craig R. and David M Eisenberg, (Oxford: Oxford University Press 2012), 169.
[66] Abdul Karim Aldohni, "Islamic Banking Challenges Modern Corporate Governance: The Dilemma of Sharia Supervisory Board" *The Company Lawyer* 29,5 (2008): 157-158.
[67] Rider, "Corporate Governance for Institutions Offering Islamic Financial Services", 169.

to finance second-class projects.[68] Therefore, one of the main issues in this respect is the protection of the investment account holders especially as they are not represented on the board of directors similar to shareholders yet they bear the same risks.[69]

It is worth mentioning that a lot of work has been done by international standard setting organizations to address these challenges. Islamic Financial Services Board and Accounting and Auditing Organization for Islamic Financial Institutions, have issued certain guidelines to address these concerns. However, the implementation mechanisms by institutions are still underdeveloped. In other words, institutions have not addressed these governance concerns systematically.

Accordingly, although introducing religious values may improve some aspects of the governance system of a corporation (i.e. automatic elimination of abusive business practices) it has certainly presented further governance concerns.

CONCLUSION

The examination of the concept of morality has unfolded the intertwined relation between religion and morality. The theory of moral relativism, particularly Lyons two versions of moral relativism [agent relativism and appraiser relativism], could explain how religious values may shape our moral judgments.

On the other hand, the relation between business and morality has always been of great relevance to the subject of corporate governance. Smith in the eighteenth century has endorsed certain aspects of the relation between business and morality in *The Theory of Moral sentiments*. However, the significance of this relation has been recently intensified due to a series of corporate failures, which proved that there is a missing element in the current governance systems. It has been argued that morality could be considered as a complementary compliance mechanism where a moral filter could have a role in reforming the current business culture. This multi-layered filter has its links with religious values. In fact, taking into account the fear of God's retribution that is associated with religions some would argue that religious values could have a relatively positive impact as a compliance mechanism. Further, these religious values help create an ethical governance framework through which the institutions conducts its business.

Nevertheless, there should be realistic expectations of the impact of religious values and their underpinning ethical framework in the context of corporate governance. Religious values cannot provide the instant morality fix that is needed despite some of the positive impacts that a religious ethical framework may bring to the governance of a business organization.

Those who are in favour of introducing religious ethics into the business governance context have to be prepared to deal with the governance complexities that religious values bring. For example, the controllers who brought their religious values to their organizations and created a rigid governance system, which in some cases can be described as discriminatory. Further, the fact that institutions that have been established on the basis of religious values, such as Islamic financial institutions, seem to be riddled with new governance challenges. Each one of these challenges could significantly damage the moral objectives that these institutions are pursuing and affect their credibility.

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[68] Simon Archer, and Rifaat Ahmed Abdel Karim, "Corporate Governance, Market Discipline and Regulation of Islamic Banks" *The Company Lawyer* 27, 5(2006):139-140.
[69] Ibrahim Akoum and Abdullah Haron, "Islamic Banking Towards a Model of Corporate Governance" *Journal of Global Business Advancement* 4, 4(2011): 327.

Religious values may be effective on one front but they bring a whole new set of corporate governance challenges. This not to say that they have no merits or they are untenable. However, should institutions or individuals be willing to rely on them in the business context then they should be prepared to deal with their drawbacks. A policy of denial or "spiritual arrogance" will only undermine the positive role of religious values and their underpinning ethical framework in the context of corporate governance.