



Adaptation of New Institutional Theory in Shariah Governance Practice, Structure and Process

Md. Kausar ALAM¹, Yusuf KARBHARI², Md. Mizanur RAHMAN³

Received: May 3, 2020. Revised: May 14, 2020. Accepted: January 05, 2021.

Abstract

Purpose: The study aims to delineate Shariah Governance Framework (SGF) by applying the components of New Institutional Theory (NIT) to provide an understanding of how Islamic banks theoretically influence Shariah Governance (SG) practice, structure, and process. **Design/methodology/approach:** As it is a conceptual paper, this paper has prepared based on an analytical approach to show how such institutions could provide a more effective system concerning the contents, procedures, and practices for the multiple users in the SG process of Islamic banks. **Findings:** The paper critically explores the adoption of NIT to develop SGF with its existing practice, structure, and procedure. Utilizing NIT, a proposed theoretical framework has developed for exploring the SG through its major components, i.e., 'isomorphism' and 'legitimacy'. It is stated that NIT can offer a useful framework by which homogenous structures, comprising guidelines, standards, and practices become recognized and authorized as a satisfactory standard corporate exercise. Thus, the proposed theoretical framework would be beneficial in understanding and exploring the SGF. **Conclusion:** The application of this SGF could help to justify the key dimensions of NIT with its overall formation, function, and practices that might also help to attain legitimacy.

Keywords: Conceptual Framework, Islamic Banks, New Institutional Theory, Shariah Governance Framework.

JEL Classification Code: M48, G15, G18, G21, G28, G38.

1. Introduction

According to Global Islamic Finance Report (GIFR, 2018), the estimated amount of the world's Islamic finance in 2017 was \$2.4 trillion with an estimated exponential growth rate of 6.02%, making it one of the fastest emerging industries worldwide. The prevalence of Islamic finance is

also evident by its accomplishment towards society (Abdelsalam et al., 2014; Farag et al., 2014; Platonova et al., 2016) and economic growth (Gheeraert, 2014; Gheeraert, & Weill, 2015). In particular, the rapid development of Islamic Financial Institutions (IFIs) has also highlighted the need for Islamic finance strategies to fit into the national and worldwide financial structures (Archer et al., 2010). In particular, the rapid development of Islamic Financial Institutions (IFIs) has also highlighted the need for Islamic finance strategies to fit into the national and worldwide financial structures (Archer et al., 2010). Abu-Tapanjeh (2009) also observed that any Islamic system devoid of a suitable moral and ethical foundation is unlikely to succeed in influencing a comprehensive governance system.

As IFIs are formed entirely on Shariah principles, these institutions' activities must be in absolute conformity with the religious doctrine. Therefore, IFIs have to ensure Shariah compliance in their overall functions. Prior researchers have mentioned that Shariah compliance is the ultimate goal of Islamic banks (Ahmad, & Haron, 2002; Metawa, & Almosawi, 1998; Rashid et al., 2014) and that

* Acknowledgements (if any): The authors would like to thank the Editor-in-Chief and anonymous reviewers for their comments and suggestions for improving the manuscript.

1 First Author and Corresponding Author. Ph.D., Adjunct Faculty Member at Faculty of Business Studies, International Standard University, Bangladesh. Email: kausarflorence@gmail.com

2 Professor, Reader in Accounting, Department of Accounting and Finance, Cardiff Business School, Cardiff University, Colum Drive, UK. Email: karbhari@cardiff.ac.uk

3 Associate Professor, Department of Business Administration, Faculty of Business Studies, International Standard University, Bangladesh. Email: rahman@isu.ac.bd

© Copyright: The Author(s)

This is an Open Access article distributed under the terms of the Creative Commons Attribution Non-Commercial License (<https://creativecommons.org/licenses/by-nc/4.0/>) which permits unrestricted non-commercial use, distribution, and reproduction in any medium, provided the original work is properly cited.

religious compliance provides legitimacy and stimulates confidence in both shareholders and stakeholders (Karim, 1990a; 1990b). For example, Ullah (2014) observed that customers of Islamic banks in Bangladesh were attracted to them mainly due to the banks' Shariah compliance, rather than profit earnings. Therefore, governance from an Islamic perspective, albeit parallel to the Anglo-American model, is much more sophisticated (Karbhari et al., 2018). The supervision and management of religious compliance require a complex set of governance structures to ensure that Islamic banks provide the religious and social legitimacy that stakeholders require. In principle, it is the boundaries specified by Islamic principles and the workings of a Shariah Supervisory Board (SSB)⁴ That constitutes the main mechanisms of a Shariah Governance Framework (SGF). Particularly, from a stakeholder's perspective, SG plays a significant role similar to conventional Corporate Governance (CG), which is used to estimate the extent of compliance of operational activities to ensure the maintenance of religious and ethical observance of Islamic banks.

The principles prescribed by Islam differ markedly from conventional governance systems; there are widespread normative (Islamic spiritual philosophies and values) and critical reviews concerning the uniqueness of Islamic governance frameworks (Lewis, 2005; Rahman, 1998; Choudhury, & Hoque, 2006; Kamla et al., 2006; Abu-Tapanjeh, 2009; Williams, & Zinkin, 2010). In articulating SG guidelines, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB)⁵ are two main organizations that prescribe the Shariah guidelines and standards. The difference between these two organizations is that the IFSB is more connected with regulators; whereas, the AAOIFI focuses at the institutional level (Hasan, 2011). While those organizations' guidelines and governance standards are not mandatory, the principles embedded in those documents are taken into consideration by policymakers and institutions alike.

4 The AAOIFI was established specifically in 1991 to serve the needs of the Islamic finance industry. The AAOIFI defined the SSB as "an independent body entrusted with the duty of directing, reviewing, and supervising the activities of IFIs for the purpose of Shariah compliance and issuing legal rulings pertaining to Islamic banking and finance" (AAOIFI, 2005). Moreover, IFSB-10 has also defined "as a particular body set up or employed by the IFIs with the combination of Shariah scholars to implement and apply its SG structures" (IFSB, 2009).

5 IFSB is similar to AAOIFI, formed in 2003, is a standard-setting organization dedicated to establishing the structure of IFIs. The key objectives are to outline policies to guide the IFI in Shariah compliance in its financial and banking business. From inception, IFSB has published 30 standards, comprising 22 guiding principles, 6 guidance notes, and 2 technical notes for the development of IFIs (IFSB, 2019).

This study assumed that New Institutional Theory (NIT) was proposed by (Meyer, & Rowan, 1977; Zucker, 1977; DiMaggio & Powell, 1983; Scott, 1995) can offer a suitable theoretical basis. However, with NIT's assumption, it is possible to substantiate the impacts that stimulate Islamic banks' structural practices' persistence and legitimacy. These may include components such as social environments, cultures, rules, customs and history, and monetary policies, whilst recognizing that resources are also significant (Baumol et al., 2009; Bruton et al., 2010; Hirsch, 1975; Lai et al., 2006; Roy, 1997). According to NIT, the societal, political, external, and financial pressures affect corporate policies and managerial decision-making; as organizations intend to implement proper practices or legalize their practices to all stakeholders (Jennings, & Zandbergen, 1995; North, 1990). NIT is also acknowledged as a theoretic posture that stresses rational myths, isomorphism, and legitimacy (Scott, 2014). Intuitively, NIT emphasizes imitation rather than enhancing resolutions, practices, and structures; institutions look at similar institutions for signals to suitable behavior (Marquis, & Tilcsik, 2016). In effect, NIT describes 'how' organizations are responsible socially concerning the nature of practices. Simply put, NIT specifies the guidelines for connecting individuals and institutions.

However, the three commonly used theories, such as 'agency,' 'steward,' and 'stakeholder,' focused the ownership control, interest of the managers, and benefit of the other parties (Alam et al., 2020a; Alam et al., 2020b; Alam et al., 2020c; Tabash et al., 2020), but, unexpectedly, none of the theories outline the roles, functions, and powers of agents, stewards, stakeholders, and other related parties by highlighting accountability, independence, competence, confidentiality, transparency, and disclosure by outlining the SG structure, procedures, and rules (Hassan, 2012). In this regard, to overcome this limitation, this study has adopted NIT, which describes the organization's operational guidelines and procedures. The recent study of Karbhari et al. (2020) stated the relevance of institutional theory (hereby NIT) in the SGF of Islamic banks. They outlined that NIT is the most influential in broadening the SG as it enhances the organizational image, helps achieve religious legitimacy, and inspires a more robust regulatory environment.

Unsurprisingly, prior research on NIT has paid attention to research in the field of conventional corporate governance (CG) (Yoshikawa et al., 2007; Chakrabarty & Bass, 2014; Morrison, 2014). For example, corporations have developed their governance strategies to appear rigorous rather than to comply with strict guidelines (Okhmatovskiy, & David, 2012), developed voluntary self-ruling strategies to anticipate the application of obligatory ones (Glachant, 2007, Delmas, & Montes-Sancho, 2010)

and strengthened their societal image to move the attention of stakeholders from the field of criticism (McDonnell, & King, 2013). However, these studies have failed to include a detailed theoretical exposition of the SGF of IFIs or have offered only negligible discussion. In our perspective, NIT offers a useful framework for understanding how existing practices and standards amongst similar conventional organizations influence the way regulation is interpreted and implemented. Therefore, it is important to adopt NIT in Islamic banks and their SG practices, structures, and processes, not only to a large global Muslim following but also to the wider international financial community.

To the best of our knowledge, there is no prior study that has explored an Islamic SGF through the lens of NIT. From this standpoint alone, this is our study's main contribution adding a novel dimension to the literature in several ways. First, because it was focused on the key influences of SG mechanisms in the light of NIT, our study provides insight into how Islamic banks theoretically influence the development of SGF and how the working methods, content, procedures, and practices of SG benefit and affect the multiple stakeholders associated with Islamic banks. Second, because SG reveals an entwined relationship between governance and regulation, examining this relationship through an NIT lens helps identify the missing link between how Islamic banks impact regulation in society and in what manner they ensure religious compliance. Third, since NIT emphasizes attaining legitimacy as the main aim for institutions to safeguard their existence (Meyer, & Rowan, 1977), they must abide by the norms and belief structures dominant in the firm's setting (Scott, 1995; Meyer, & Rowan, 1977; DiMaggio, & Powell, 1983) because, organizational isomorphism in terms of the structural and procedural achieves organizational legitimacy (Dacin et al., 2002; Suchman, 1995). Therefore, this new institutionalism tactic is pertinent to this present study for examining what organizations can do to realize how they may develop and formulate their SG frameworks. Thus, by considering isomorphic behavior, our study extends the literature on Islamic banking and finance, as it offers a theoretical basis for understanding the structure of SG implemented by Islamic banks.

In sum, this study explores the intricate relationship between NIT and SGF and argues that the acceptance of SG, as a management tool, can be explained by the concept of the coercive, mimetic, and normative aspects of organizational isomorphism (DiMaggio, & Powell, 1983), organizational dependency (Pfeffer, & Salancik, 1978) and organizational legitimacy (Ashforth, & Gibbs, 1990; Scott, 2014).

The next section provides a discussion relating to NIT and outlines the main components of SGF. Section 3

describes the main requisites of NIT and highlights the application of NIT to Islamic banks. Section 4 provides a discussion of the conceptual framework of SG based on NIT. The final section offers the conclusions of the study and highlights policy implications and directions for future research. While this has not been deliberated on in prior SG and NIT literature, it was believed that resource mechanisms within a SGF might influence institutions to implement practices to achieve quality compliance.

2. Literature Review

2.2. New Institutional Theory

The foundations of NIT were first brought to attention by researchers such as Meyer and Rowan—in their influential work after the 1970s on education as an organization (Meyer, 1977; Meyer, & Rowan, 1977). Scott and Meyer's investigation on the significance of educational institutions for social and symbolic perceptions regarding the characteristics of education (Meyer, & Scott, 1983), Zucker's research on the area of established corporate life (Zucker, 1977), and DiMaggio and Powell's works on the establishment of organizational arenas (DiMaggio, & Powell, 1983) all provided a firm foundation for NIT. Generally, the theory and investigation into NIT have attracted researchers to investigate issues on CG structure, accounting standards, heterogeneous policies of large institutions, the enlargement of the European Union, public operation strategies in US corporations, and human rights legislation (Powell, 2005). In principle, NIT is based on a societal structure's political and resilient features as it reflects the procedures through which structures, comprising systems, norms, routines, and guidelines become recognized as influential rules for social conduct (Scott, 2014). NIT's diverse mechanisms also illustrate how these components are formulated, diffused, implemented, and modified over time and space; and how they fall into decline. For example, Scott (2014) has emphasized that organizations are societal constructs that have gained stronger resilience and comprise cultural-cognitive, normative, and regulative components that, together with accompanying resources, deliver constancy and meaning to community life.

Expanding this discourse, DiMaggio and Powell (1983) have advanced the work of Meyers and Rowan's (1977) work on isomorphism to the organizational level (i.e., micro-level) from the social level (macro-level). They defined organizational isomorphism based on Hawley's (1968) explanation as a compelling procedure that compels one component in a population to be similar to other components within a similar environment. They outlined

three isomorphic procedures, such as 'coercive' to attain legitimacy, 'mimetic' to eliminate uncertainty, and 'normative,' for professionalization. However, 'coercive' isomorphism originates from the external pressures of the organizational changes or the general cultural expectations and pressures from large groups, depositors, accounting policy-setting agencies, regulators, stock exchanges, and others (DiMaggio, & Powell, 1983; Carruthers, 1995). Also, 'mimetic' pressures are said to be created due to the uncertainty which forces institutions to follow and implement the more successful organization's activities (Carruthers, 1995). Apart from this uncertainty, lack of clear objectives, limited diversity of institutions, limited proper models, ambiguous environment, and inappropriate structures, systems, and procedures are also the causes to

create mimetic pressures (DiMaggio, & Powell, 1983). To become successful, institutions are compelled to apply the same structures, systems, and procedures of successful institutions. Conversely, the 'normative' isomorphism signals how a group of members from similar professions similarly run their activities in diverse institutions (Carruthers, 1995), while the professions rely on the 'normative' procedures and attempt to form cultural rules that are relevant to their goals and opinions (Scott, 1995). Moreover, Granlund and Lukka (1998) highlighted that pressure might also arise from financial reasons, coercion from organizations, normative resulting from proper social behavior, and the intention to mimic superficially successful practices.

Table 1: An overview of new institutional theory framework

	Pillars		
	Regulative	Normative	Cultural-Cognitive
Basis of compliance	Expedience	Social obligation	Taken for Grantedness Shared understandings
Basis of order	Regulative Rules	Binding Expectations	Consultative schema
Mechanisms	Coercive	Normative	Mimetic
Logic	Instrumentally	Appropriateness	Orthodox
Indicators	Rules Laws Sanctions	Certification Accreditation	Common beliefs Shared logics of action Isomorphism
Affect	Fear Guilt/Innocence	Shame/honor	Certainty/ confusion
Basis of legitimacy	Legally sanctioned	Morally governed	Comprehensible Recognizable Culturally supportive

Source: Scott (2014).

In this context, Scott (2014) suggested three main pillars of organizations (shown above in Table 1): the regulative, normative, and cultural-cognitive. The regulative pillar emphasizes regulations and related procedures (North, 1990), while the normative pillar focuses on the prescriptive, evaluative, and mandatory measurements of community life (Scott, 2014). Finally, the cultural-cognitive pillar recommends that the mutual ideas which establish the nature of social authenticity generate the surroundings over which sense is produced (Scott, 2014). These three pillars have been conceptualized alongside three other measurements, which are obligation (the step to which performers are liable to follow), accuracy (the step to which guidelines specify obligatory conduct), and delegation (the scope to which third bodies have been approved power to implement guidelines). Here, the regulatory procedure is anticipated to show high standards in these dimensions; whereas, the normative system displays lower standards. The three-pillar structure demonstrates how important matters and operations are established (Fligstein & Brantley, 1992). These three pillars provide the three interconnected

but distinct foundations of legitimacy (Scott, 2014). Besides, these pillars provide a base for study when it moves towards institutional decision constructing (Grosse, & Trevino, 2005).

2.2. Shariah Governance Framework

SG is a system that informs Islamic institutions on how to follow principles in directing business activities following the rules prescribed in religious doctrine. The IFSB (2009) defined SG as a structural process of procedures, where IFIs assure Shariah compliance throughout its operational activities. In addition, the central bank of Malaysia, namely Bank Negara Malaysia (BNM) (2010), also outlined the SGF of an Islamic financial institution to comprise of: (i) the BOD oversight on overall operational activities of IFI's regarding the Shariah compliance aspects; (ii) a SSB with skilled members who are capable of outlining the issues of Islamic finance and deliver rigorous judgements; (iii) effective management accountabilities to provide sufficient properties and skilled

employees to support every function related to the execution of SG₇; (iv) an internal Shariah review directed in a constant process; (v) a continuous Shariah audit, at least once annually, confirming that the IFIs' main functions and operational activities abide by Islamic principles; (vi) a risk management procedure to recognize all probable Shariah doubtful risks and, where suitable, corrective actions that are required to be taken to lessen risk; (vii) an in-house research unit to perform Shariah research; and (viii) issuance and propagation of Shariah resolutions to key stakeholders. As the ultimate goal of SGF is *Maqasid al-Shariah* (or the objectives of Shariah), it is believed that a sound SG would inevitably lead institutions operating in the Islamic finance landscape towards achieving its ultimate aim. To achieve this goal, Islamic banks should implement Shariah principles to improve the quality of Shariah compliance, and for this reason, effective SG guidelines are required (Alam et al., 2019; Alam et al., 2020d).

Arguably, it is SSB, which is the embodiment of an SG paradigm. This SSB plays a significant role in ensuring Shariah principles within Islamic banks and financial institutions' activities. Conversely, shareholders also have the right to participate in the resolution process and strategy-making structure to safeguard stakeholders' benefit rather than merely focusing on maximizing profit. Therefore, the overall tactic of a SG structure emphasizes that both the ex-ante and ex-post procedures are important fragments of a reliable governance system where the ex-ante procedure comprises the deliberation of Shariah resolutions and scrutinizing for Shariah compliance is essential before announcing a product into the market (Kasim et al., 2013). After offering the products and services, IFIs undertake an ex-post procedure, namely, an in-house Shariah review to efficiently accomplish Shariah compliance risk that may result at any time. In describing the functions, guidelines, and standards, several international standard-setting organizations have been established. Still, the two renowned international institutions are AAOIFI and IFSB that assist IFIs to achieve their objectives. In general, the AAOIFI standards tend to cover the accounting treatments of Islamic finance and, to date, AAOIFI has published a total of 109 standards containing 35 accounting standards, 57 Shariah standards, 9 governance standards, 6 auditing standards, and 2 code of ethics (AAOIFI, 2019).

In reality, the notion of "effective governance" emphasizes organizations to fulfill their fiduciary duties and responsibilities to the foremost stakeholder group (i.e., the shareholders). This is exemplified in management strategies and management tactics for achieving CG efficiency (Brennan, & Solomon, 2008; Davis, 2005; Parkinson, 1993). As a result, prior studies in accounting and finance

have concentrated on this aspect of governance where responsibility had been illustrated but only as corporate responsibility towards shareholders (Brennan & Solomon, 2008). This was demonstrated in previous empirical studies relating to the BOD and its role in aligning management interest with those of shareholders over its supervision and monitoring role (e.g., Dalton et al., 2003; Johnson et al., 1996; Mizruchi, 1983). For these reasons, information disclosure to enhance transparency becomes even more critical in Islamic banking.

3. The Adoption of NIT in Shariah Governance Practice, Structure and Process

Based on the pioneering studies of (Meyer, & Rowan, 1977; Zucker, 1977; DiMaggio & Powell, 1983; Scott, 1995), it was recognized that NIT to be acceptable for the study of SGF in Islamic banks. The fact that attention is political and imitates the comparative control of structured benefits (DiMaggio & Powell, 1991) or the underpinning of the difference between results and procedures is irrelevant (Covaleski et al., 1996). Drawing on NIT-and, in particular, the notion of isomorphic behavior, the motivation of this paper is to draw a theoretic portrayal of the structure of SG by examining the relationships between NIT and SGF. Therefore, the adoption of SGF as a management tool can be explained by the concept of the coercive, mimetic and normative aspects of organizational isomorphism (DiMaggio & Powell, 1983), organizational dependency (Pfeffer, & Salancik, 1978), and organizational legitimacy (Ashforth, & Gibbs, 1990; Scott, 2014).

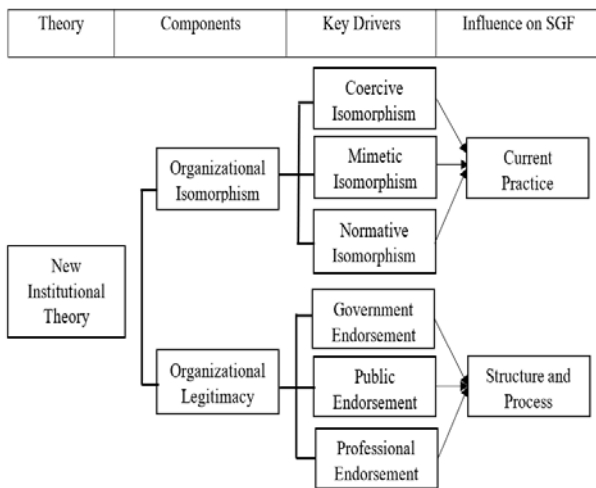
NIT is used to outline the SG structure and policies to develop better policies, systems, and structures. This application enhances the practices' quality, image, performance, and legitimacy and increases the confidence of all Islamic banks' stakeholders. In outlining SG structure, NIT delivers a beneficial structure (a combination of isomorphism and legitimacy) for realizing the social, economic, and legal effect on the countries and institutions and their tactical replies to those effects (Covaleski, & Dirsmith, 1988; Carruthers, 1995; Brignall, & Modell, 2000; Khadaroo, 2005). It also suggests that the components of proper structures, strategies, and processes are usually generated from the mythologies relating to suitable social and economic customs (DiMaggio & Powell, 1983). In this case, SGF also provides the overall guidelines, strategies, and procedures for Islamic banks to monitor and control their activities. SG structure ensures fairness to all stakeholders to improve transparency and accountability (Majeed et al., 2015) by stimulating Islamic principles (Mittal et al., 2008).

However, though the companies are compelled to follow the regulatory rules, organizational environment, or diversified organizational actions or strategies, they can reply to the institutional pressures in a diversified way (Oliver, 1991; Greenwood, & Hinings, 1996). In this regard, Oliver (1991) also theorized that institutions reply to organizational pressures that influence them by applying acquiescence, avoidance, defiance, and manipulation. The acquiescence tactic signifies that organizations accept and follow organizational pressures by altering their structures and processes to adopt broadly acknowledged practices and processes. Besides, institutions can avoid the requirement to follow organizational pressures by covering their non-compliance. After all, only a few corporations, at their risk, can 'defy' instructions and suitable standards to dismiss, stimulate, or criticize organizational pressures. Still, others can manipulate rules and standards by striving to impress and regulate them. Essentially, NIT suggests that organizations implement structures, systems, and processes that are apparent as legitimate in the social order to enhance their probabilities. These corporations perform their activities with coercive, normative, and mimetic pressures in their organizational setting and continually set acquiesce, compromise, avoid, defy, and manipulate tactics to react to these pressures. Below, figure 1 shows a conceptual paradigm of SGF based on NIT.

structure for recognizing the social, financial, and legal impacts on jurisdictions and institutions and their tactical reactions to those effects (Meyer & Rowan, 1977; DiMaggio & Powell, 1983; Covalleski & Dirsmith, 1988; Carruthers, 1995; Brignall & Modell, 2000; Hussain & Hoque, 2002; Khadaroo, 2005). Finally, NIT highlights the structural, strategic, and procedural components that commonly originate from the mythologies about societal and economic practices (Meyer & Rowan, 1977; DiMaggio & Powell, 1983). After all, mythologies are universal faiths about broadly acknowledged rules which have developed within a social order and have obtained acceptability over time (Meyer & Rowan, 1977).

Prior research elucidates that NIT has a rich contribution to make in religious institutions by focusing on the concepts of procedural, symbolic perceptions, and social legitimacy (DiMaggio, 1998). For religious organizations, DiMaggio (1998) specified that symbolic procedures assist in establishing the institution. In this context, Islamic banks' corporate image might be described by two perspectives: 'institutional image' and 'performative image' based on NIT. Islamic banks' image can comprise being Islamic, modest, fair, and reliable, and with a clear institutional image, along with being friendly, truthful, pleasing, leading, trustworthy, and protected (performative images). In this case, the 'institutional image' is the central concern for Islamic banks because they perform their banking functions following the Shariah principles. Shariah compliance is the main motivator for Muslims. Interestingly, the study by Hoq, Sultana, and Amin (2010) has revealed that 'institutional image' has a positive influence on trust, which enhances customer loyalty. Furthermore, the name image, privacy, practical experience, endorsements of customers, contacts and family inspiration, and excellence in services are similarly significant to the customers in their decision-making process in choosing a bank (Metawa & Almosawi, 1998; Yeo & Yussuf, 2010). Studies suggested that Islamic banks need to revise their SG and banking practices in an ethically responsible way as per Shariah law if they wish to secure existing customers and attract potential ones (Rahmi et al., 2020; Tabash et al., 2020). Studies on 'corporate image' concerning Saudi Arabian Islamic banks suggest that these elements affect corporate image where corporate management plays a dominant role (Yeo & Yussuf, 2010). The authors have also reported that the managing procedures and communication systems of large commercial banks in Saudi Arabia directly impact 'corporate image.' In this regard, the Shariah is the most significant factor to customers, and even the slightest Shariah violation could motivate customers to switch banks.

Rashid et al. (2013) comparatively examined Islamic banks in Bangladesh, Malaysia, and the GCC region. They focused on the inclination of Islamic bank customers



Source: Alam (2019).

Figure 1: A Paradigm for Examining SGF using NIT

In sum, the institutional procedure in SG establishes the SSB as the moral guardian of the structure because it serves as the conscience of Islamic bank stakeholders. Therefore, the establishment of SSB becomes crucial as it plays a pivotal role in the SG structure of IFIs. NIT further allows a

towards efficiency and satisfaction from Shariah's perspective. They found Islamic banks to be "too customer-centric and efficiency-driven" (p. 359) at Shariah's expense. Also, researchers like Ul-Haq (2012) observed, "banks are not individual corporations; they operate in an environment of "secular living, which at its core, are consumerist and often criticized for being exploitative" Similarly, Abdul-Baki and Uthman (2017) highlighted that Islamic banks are not detached institutions, as they operate alongside conventional banks that do not provide same mission and vision. It is also stated that even scholars have long argued that Islam provides an alternative with any philosophy of life, including capitalism and socialism, and that these may not co-exist (Abdul-Baki & Uthman, 2017). Even researchers such as Tinker (2004) highlighted that Islam also competes with capitalism in a noticeable and occasionally melodramatic way. He argued that similar to Christianity, Islam exhibits a multiplicity of postures towards capitalism. Given this apprehension, Islamic banks' societal objectives and any assessment on the performance of Islamic banks is only suitable when the system of Islamic banking is presented in its pure form rather than being affected by the isomorphic pressures arising from culture. Thus, Islamic banks' societal ends' success is only attainable when the entire structure is purely Islamic.

A further component of NIT is organizational legitimacy, which prescribes that Islamic banks need to attain legitimacy to survive. Legitimacy here denotes the implementation of sound practices realized as suitable (DiMaggio & Powell, 1983). Organizational legitimacy is also defined as an authorization given by exterior parties (Pfeffer & Salancik, 1978; Ashforth & Gibbs, 1990). Organizational legitimacy is the acknowledgment of an institution by its outside monitoring bodies and other authorities (Meyer & Rowan, 1977; Meyer & Scott, 1983; DiMaggio & Powell, 1983), where the identity of these authorities is significant, and this legitimacy is a vital idea in NIT, working like a key-point of a massively extended hypothetical instrument (Suchman, 1995). A legitimate corporation is one whose standards and activities are similar to legitimacy imparting categories. Assuming, of course, that organizational legitimacy is the accreditation of a corporation by outer groups, and the identity of these groups is significant. Public prosecutors confer this endorsement as a regulatory authority (Pfeffer & Salancik, 1978; Ashforth & Gibbs, 1990), such as the government, or government agency (i.e., a regulator), which controls the organization, the public, through public opinion, setting and upholding standards of adequacy, and the professionals over the systems (Meyer & Rowan, 1977; Meyer & Scott, 1983; Galaskiewicz, 1985; Baum & Oliver, 1991; Elsbach, 1994). Furthering the debate, Carpenter and Feroz (2001) asserted that effective organizations and governments attain

legitimacy by the general public and stakeholders by resorting to legitimacy rituals to establish societal and financial stability. As a result, proficiency is not the only way of existence; attaining legitimacy and belief is another very significant strategy for Islamic banks. In this case, the Islamic banking industry has to face various pressures from governments and regulatory authorities.

4. Conclusion

This study highlights that through NIT, an effective SGF can best be developed and applied, as NIT provides the procedures by which homogenous structures, comprising guidelines, standards, and practices, become recognized and authorized as a satisfactory standard corporate exercise. Attention is also drawn to three key complementary mechanisms that emerge in the context of Islamic banks, their legitimacy, and the quality of Shariah governance. First, 'Institutional isomorphic modification' is regarded as the aspiration of organizations to implement homogeneous structures, policies, and procedures in line with other organizations operating in a similar environment. This can be achieved through three factors, which include (a) 'coercive' isomorphism stemming from administrative effect, (b) 'mimetic' isomorphism emanating from the ordinary replies to ambiguity, and (c) normative isomorphism, which is connected to professionalism and proficiency (DiMaggio & Powell, 1983). Second is the issue of organizational legitimacy, which arises from the official perception that a corporation's existence depends on its need to obey societal or religious norms of acceptable behavior ascending from the position deliberated by external parties such as government, the community, or the professions (Meyer & Rowan, 1977; Covaleski & Dirsmith, 1988; Deephouse, 1996). Finally, a good combination of the infrastructures, power, and functions of the BOD and management and the SSB interaction in influencing quality Shariah compliance. After all, proponents of SSB claim that incorporating an effective SSB as an internal mechanism of SG increases the reliability, integrity, and legitimacy of Islamic banks.

As with other studies, this research has beneficial implications. First, the study is useful for Islamic banks and regulators operating in different jurisdictions. Regulators can develop and maintain an effective SGF for its Islamic banking and finance industry by considering the organizational culture, individual country mythologies, and the different pressures applied by diverse authorities towards the proper implementation of SG strategies. Second, international regulators such as the AAOIFI and IFSB can also take advantage of this research by re-examining their SG guidelines and standards to improve SG

practices in line with NIT. Based on our findings, NIT is an appropriate lens for explaining differences in governance practices across countries.

For now, future researchers are being suggested to consider applying NIT in other areas of Islamic finances, such as Islamic Insurance (Takaful), Islamic microfinance, non-bank financial institutions, and Islamic cooperative institutions. Such studies would substantially add to the prevailing literature. Future studies can also address how NIT justifies the influences of government policy, national laws, and regulations in the formation of an over-arching centralized SGF as already practiced in several Islamic economies. A further innovative research area is for researchers to employ quantitative or qualitative methodology to comparatively examine the governance frameworks adopted by different Islamic jurisdictions. This would provide valuable insights into the similarities, differences, and prospects for governance standardization across the Islamic world. Undoubtedly, such efforts would lead to a much broader understanding of the issues surrounding SG and quality compliance.

References

- AAOIFI. (2005). Governance Standards for IFIs, No. 1-5, Bahrain, AAOIFI. Accounting and Auditing Organization for Islamic Financial Institution. <http://aaoifi.com/standard/accounting-standards/lang=en>.
- AAOIFI. (2019). Bahrain: Accounting and Auditing Organization for Islamic Financial Institutions. Retrieved from <http://aaoifi.com/?lang=en> on December, 15, 2018.
- Abdelsalam, O., Duygun, M., Matallin-Saez, J.C., and Tortosa-Ausina, E. (2014). Do ethics imply persistence? The case of Islamic and socially responsible fund. *Journal of Banking and Finance*, 40, 182–194.
- Abdul-Baki, Z., and Uthman, A.B. (2017). Exploring the “social failures” of Islamic banks: a historical dialectics analysis. *Journal of Islamic Accounting and Business Research*, 8(3), 250-271.
- Abu-Tapanjeh, A.M. (2009). Corporate Governance from the Islamic perspective: A comparative analysis with OECD principles. *Critical Perspectives on Accounting*, 20(5), 556–567.
- Ahmad, N., and Haron, S. (2002). Perceptions of Malaysian corporate customers towards Islamic banking products and services. *International Journal of Islamic Financial Services*, 3(4), 13-29.
- Alam, M.K., (2019). Development of a centralized Shariah governance framework for Islamic banks in Bangladesh, PhD Thesis, Universiti Putra Malaysia.
- Alam, M. K., Rahman, S. A., Mustafa, H., Shah, S. M., & Hossain M. S. (2019). Shariah Governance Framework of Islamic Banks in Bangladesh: Practices, Problems and Recommendations. *Asian Economic and Financial Review*, Vol. 9(1), 118-132.
- Alam, M. K., Tabash, M. I., Thakur, O. A., Sahabuddin, M., Hosen, S., & Hassan, M. F. (2020a). A central Shariah regulatory authority for the Islamic banks in Bangladesh: Legalization or formation. *Journal of Asian Finance, Economics and Business*, 7(1), 91-100.
- Alam, M. K., Miah, M. S, Siddiqui, N., & Hossain, M. I. (2020b), The Influences of board of directors and management in Shariah governance guidelines of the Islamic banks in Bangladesh, *Journal of Islamic Accounting and Business Research*. 11(9), 1633-1647. <https://doi.org/10.1108/JIABR-08-2019-0155>
- Alam, M. K., Ahmad, A. U. F., & Muneeza, A. (2020c). External Shari'ah Audit and Review Committee Vis-a-Vis Shari'ah Compliance Quality and Accountability: A Case of Islamic Banks in Bangladesh. *Journal of Public Affairs*. <https://doi.org/10.1002/pa.2364>.
- Alam M. K., Mustafa, H., Uddin, M. S., Islam, M. J., Mohua, M. J., & Hassan, M. F. (2020d). Problems of Shariah Governance Framework and Its Mechanisms: An Empirical Investigation of Islamic banks in Bangladesh. *Journal of Asian Finance, Economics and Business*, 7(3), 265-276. <https://doi.org/10.13106/jafeb.2020.vol7.no3.265>
- Archer, S., Karim, R.A.A., & Sundararajan, V. (2010). Supervisory, regulatory, and capital adequacy implications of profit-sharing investment accounts in Islamic finance”, *Journal of Islamic Accounting and Business Research*, 1(1), 10-31.
- Ashforth, B.E., & Gibbs, B.W. (1990). The double-edge of organizational legitimation. *Organization Science*, 1(2), 177-194.
- Baum, J.A., & Oliver, C. (1991). Institutional linkages and organizational mortality. *Administrative Science Quarterly*, 36(2), 187-218.
- Baumol, W.J., Litan, R.E., and Schramm, C.J. (2009). Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity. Yale University Press, New Haven, CT.
- BNM (Bank Negara Malaysia). (2010). Shariah Governance Framework for Islamic Financial Institutions. (BNM/RH/GL 012-3). Kuala Lumpur: Bank Negara Malaysia.
- Brennan, N.M., and Solomon, J. (2008). Corporate governance, accountability and mechanisms of accountability: an overview. *Accounting, Auditing & Accountability Journal*, 21(7), 885-906.
- Brignall, S., and Modell, S. (2000). An institutional perspective on performance measurement and management in the ‘new public sector. *Management Accounting Research*, 11(3), 281-306.
- Bruton, G.D., Ahlstrom, D., and Li, H.L. (2010). Institutional theory and entrepreneurship: where are we now and where do we need to move in the future? *Entrepreneurship Theory and Practice*, 34(3), 421-440.
- Carpenter, V.L., and Feroz, E.H. (2001). Institutional theory and accounting rule choice: an analysis of four US state governments' decisions to adopt generally accepted accounting principles. *Accounting, Organizations and Society*, 26(7-8), 565-596.
- Carruthers, B.G. (1995). Accounting, ambiguity, and the new institutionalism. *Accounting, Organizations and Society*, 20(4), 313-328.
- Chakrabarty, S., and Bass, A.E. (2014). Corporate governance in microfinance institutions: Board composition and the ability to face institutional voids. *Corporate Governance: An*

- International Review*, 22(5), 367-386.
- Choudhury, M.A., and Hoque, M.Z. (2006). Corporate governance in Islamic perspective. *International Journal of Corporate Governance*, 6(1), 116-128.
- Covaleski, M.A., & Dirsmith, M.W. (1988). An Institutional Perspective on the Rise, Fall and Social Transformation of a University Budget Category. *Administrative Science Quarterly*, 33(4), 562-587.
- Covaleski, M.A., Dirsmith, M.W., & Samuel, S. (1996). Managerial accounting research: The contribution of organizational and social theories. *Journal of Management Accounting Research*, 8, 1-35.
- Dacin, M.T., Goodstein, J., & Richard Scott, W. (2002). Institutional theory and institutional change: Introduction to the special research forum. *Academy of Management Journal*, 45(1), 45-56.
- Dalton, D.R., Daily, C.M., Certo, S.T., & Roengpitya, R. (2003). Meta-analyses of financial performance and equity: fusion or confusion? *Academy of Management Journal*, 46(1), 13-26.
- Davis, G.F. (2005). New directions in corporate governance. *Annual Review of Sociology*, 31(1), 143-162.
- Deephouse, D.L. (1996). Does isomorphism legitimate? *Academy of Management Journal*, 39(4), 1024-1039.
- Delmas, M.A., & Montes-Sancho, M.J. (2010). Voluntary agreements to improve environmental quality: Symbolic and substantive cooperation. *Strategic Management Journal*, 31(6), 575-601.
- DiMaggio, P. (1998). *The relevance of organizational theory to the study of religion*, In N. J. Demerath, P. D. Hall, T. Schmitt & R. H. Williams (Eds.), Sacred companies. USA: Oxford University Press.
- DiMaggio, P., & Powell, W. (1983). The iron cage revisited: Collective rationality and institutional isomorphism in organizational fields. *American Sociological Review*, 48(2), 147-160.
- DiMaggio, P., & Powell, W. (1991). *The New in Organizational Analysis*. Chicago: University of Chicago Press.
- Elsbach, K.D. (1994). Managing organizational legitimacy in the California cattle industry: The construction and effectiveness of verbal accounts. *Administrative Science Quarterly*, 39(1), 57-88.
- Fligstein, N., & Brantley, P. (1992). Bank control, owner control, or organizational dynamics: Who controls the large modern corporation? *American Journal of Sociology*, 98(2), 280-307.
- Farag, H., Mallin, C., & Ow-Yong, K. (2014). Corporate social responsibility and financial performance in Islamic banks. *Journal of Economic Behavior & Organization*, 103, 21-38.
- Galaskiewicz, J. (1985). Inter-organizational relations. *Annual Review of Sociology*, 11(1), 281-304.
- Gheeraert, L. (2014). Does Islamic finance spur banking sector development? *Journal of Economic Behavior & Organization*, 103, 4-20.
- Gheeraert, L., & Weill, L. (2015). Does Islamic banking development favor macroeconomic efficiency? Evidence on the Islamic finance-growth nexus. *Economic Modelling*, 47, 32-39.
- GIFR (Global Islamic finance report)(2018), Available at: https://www.zawya.com/mena/en/story/Global_Islamic_finance_report_GIFR_208_to_be_launched_a_t_Astana_Islamic_Economic_ForumZAWYA20180614073908/
- Glachant, M. (2007). Non-binding voluntary agreements. *Journal of Environmental Economics and Management*, 54(1), 32-48.
- Granlund, M., & Lukka, K. (1998). It's a small world of management accounting practices. *Journal of Management Accounting Research*, 10, 153-179.
- Greenwood, R., & Hinings, C. R. (1996). Understanding radical organizational change: Bringing together the old and the new institutionalism. *Academy of Management Review*, 21(4), 1022-1054.
- Grosse, R., & Trevino, L.J. (2005). New institutional economics and FDI location in Central and Eastern Europe. *Management International Review*, 45(2), 123-145.
- Hasan, Z. (2011). Shari'ah governance in Islamic financial institutions in Malaysia, GCC countries and the UK (Doctoral dissertation, Durham University).
- Hassan, A.F.S. (2012). An empirical investigation into the role, independence and effectiveness of Shari'ah boards in the Malaysian Islamic banking industry. PhD Thesis, University of Cardiff.
- Hawley, R. (1968). Solid insulators in vacuum: a review. *Vacuum*, 18(7), 383-390.
- Hirsch, P.M. (1975). Organizational effectiveness and the institutional environment. *Administrative Science Quarterly*, 20(3), 327-344.
- Hoq, M.Z, Sultana, N, & Amin, M. (2010). The effect of trust, customer satisfaction and image on customers' loyalty in Islamic banking sector. *South Asian Journal of Management*, 17(1), 70-93.
- Hussain, M., & Hoque, Z. (2002). Understanding non-financial performance measurement practices in Japanese banks: a new institutional sociology perspective. *Accounting, Auditing & Accountability Journal*, 15(2), 162-183.
- IFSB-10. (2009). Guiding Principles on Shari'ah Governance Systems for Institutions Offering Islamic Financial Services. Kuala Lumpur: International Financial Service Board.
- IFSB. (2019). Islamic Financial Service Board, Malaysia", Retrieved from www.ifsb.org on December, 15, 2018.
- Jennings, P.D., & Zandbergen, P.A. (1995). Ecologically sustainable organizations: An institutional approach", *Academy of Management Review*, 20(4), 1015-1052.
- Johnson, J.L., Daily, C.M., & Ellstrand, A.E. (1996). Boards of directors: A review and research agenda. *Journal of Management*, 22(3), 409-438.
- Kamla, R., Gallhofer, S., & Haslam, J. (2006). Islam, nature and accounting: Islamic principles and the nation of accounting for the environment. *Accounting Forum*, 30(3), 245-265.
- Karbhari, Y., Muye, I, Hassan, A. F. S., & Elnahass, M. (2018). Governance mechanisms and efficiency: Evidence from an alternative insurance (Takaful) market. *Journal of International Financial Markets, Institutions and Money*, 56, 71-92.
- Karbhari, Y., Alam, M.K. & Rahman, M.M. (2020). Relevance of the application of institutional theory in Shariah governance of Islamic banks. *PSU Research Review*. <https://doi.org/10.1108/PRR-05-2020-0015>
- Karim, R.A.A. (1990a). The independence of religious and external auditors: The case of Islamic banks. *Accounting, Auditing & Accountability Journal*, 3(3), 34-44.

- Karim, R.A.A. (1990b). Standard setting for the financial reporting of religious business organizations: The case of Islamic banks", *Accounting & Business Research*, 20(80), 299-305.
- Kasim, N., NuHtay, M.S.N., & Salman, S.A. (2013). Shariah Governance for Islamic capital market: A step forward. *International Journal of Educational Research*. 1(6), 1-14.
- Khadaroo, M.I. (2005). An institutional theory perspective on the UK's Private Finance Initiative (PFI) accounting standard setting process. *Public Management Review*, 7(1), 69-94.
- Lai, K.H., Wong, C.W., & Cheng, T.E. (2006). "Institutional isomorphism and the adoption of information technology for supply chain management. *Computers in Industry*, 57(1), 93-98.
- Lewis, M.K. (2005). Islamic corporate governance", *Review of Islamic Economics*, 9(1), 5-29.
- Majeed, S., Aziz, T., & Saleem, S., (2015). The Effect of Corporate Governance Elements on Corporate Social Responsibility (CSR) Disclosure: An Empirical Evidence from Listed Companies at KSE Pakistan. *International Journal of Financial Studies*, 3(4), 530-556.
- Marquis, C., & Tilcsik, A. (2016). Institutional equivalence: How industry and community peers influence corporate philanthropy. *Organization Science*, 27(5), 1325-1341.
- McDonnell, M. H., & King, B. (2013). Keeping up appearances: Reputational threat and impression management after social movement boycotts. *Administrative Science Quarterly*, 58(3), 387-419.
- Metawa, S.A., & Almosawi, M., (1998). Banking behavior of Islamic bank customers: perspectives and implications. *International Journal of Bank Marketing*, 16(7), 299-313.
- Meyer, J.W., (1977). The effects of education as an institution. *American Journal of Sociology*, 83, 55-77
- Meyer, J.W., & Rowan, B. (1977). Institutionalized organizations: Formal structure as myth and ceremony. *American Journal of Sociology*, 83(2), 340-363.
- Meyer, J.W., & Rowan, B. (1991). *Institutionalized organizations: Formal structure as myth and ceremony*, in Powell, W. and DiMaggio, P. (eds.) *The New Institutionalism in Organizational Analysis*. Chicago: University of Chicago Press, 41-62.
- Meyer, J.W., & Scott, W.R. (1983). *Organizational Environments: Ritual and Rationality*, Beverly Hills, CA: Sage Publishers.
- Mittal, R.K., Sinha, N. & Singh, A. (2008). An analysis of linkage between economic value-added and corporate social responsibility. *Management Decision*, 46(9), 1437-1443.
- Mizruchi, M.S. (1983). Who controls whom? An examination of the relation between management and boards of directors in large American corporations. *Academy of Management Review*, 8(3), 426-435.
- Morrison, S. (2014). Shariah Boards and the Corporate Governance of Islamic Banks in the United Kingdom. *Journal of Islamic Economics, Banking and Finance*, 10(1), 96-109.
- North, D.C. (1990). A transaction cost theory of politics. *Journal of Theoretical Politics*, 2(4), 355-367.
- Okhmatovskiy, I., & David, R.J. (2012). Setting your own standards: Internal corporate governance codes as a response to institutional pressure. *Organization Science*, 23(1), 155-176.
- Oliver, C. (1991). Strategic responses to institutional processes. *Academy of Management Review*, 16(1), 145-179.
- Parkinson, J.E. (1993). *Corporate Power and Responsibility. Issues in the Theory of Company Law*. Oxford, Oxford University Press.
- Pfeffer, J., & Salancik, G.R. (1978). *The external control of organizations: A resource dependence approach*. NY: Harper and Row Publishers.
- Platonova, E., Asutay, M., Dixon, R., & Mohammad, S. (2016). The impact of corporate social responsibility disclosure on financial performance: Evidence from the GCC Islamic banking sector. *Journal of Business Ethics*, 151(2), 451-471.
- Powell, W.W. (2005). *Institutional theory*. The Blackwell Encyclopedia of Management. Cooper, Cary L. Blackwell Publishing.
- Rahman, A.R.A. (1998). Issues in corporate accountability and governance: An Islamic perspective. *American Journal of Islamic Social Sciences*, 15(1), 55.
- Rahmi, M., Azma, N., Obad, F. M., Zaim, M., & Rahman, M. (2020). Perceptions of Islamic banking products: Evidence from Malaysia. *The Journal of Business Economics and Environmental Studies*, 10(3), 35-42.
- Rashid, M., Abdeljawad, I., Ngalm, S.M., & Hassan, M.K. (2013). Customer-centric corporate social responsibility: A framework for Islamic banks on ethical efficiency. *Management Research Review*, 36(4), 359-378.
- Rashid, M., Hassan, M.K., and Ahmad, A.U.F., (2014). Quality perception of the customers towards domestic Islamic banks in Bangladesh. *Journal of Islamic Economics, Banking and Finance*, 5(1), 109-131.
- Roy, W.G., (1997). *Socializing Capital: The Rise of the Large Industrial Corporation in America*. Princeton, NJ. : Princeton University Press.
- Scott, W.R. (1995). *Institutions and Organizations*. Thousand Oaks, California: SAGE Publications, Inc.
- Scott, W.R. (2014). *Institutions and organizations: Ideas, interests, and identities*. Thousand Oaks, CA: Sage Publications.
- Suchman, M.C. (1995). Managing legitimacy: Strategic and institutional approaches. *Academy of Management Review*, 20(3), 571-610.
- Tabash, M. I., Alam, M. K., & Rahman, M. M. (2020). Ethical legitimacy of Islamic banks and Shariah governance: Evidence from Bangladesh. *Journal of Public Affairs*. DOI: 10.1002/pa.2487
- Tinker, T. (2004). The enlightenment and its discontents: Antinomies of Christianity, Islam and the calculative sciences. *Accounting, Auditing & Accountability Journal*, 17(3), 442-475.
- Ul-Haq, R. (2012). Viewpoints: when the Islamisation model doesn't work. *Journal of Islamic Accounting and Business Research*, 3(1), 57-66.
- Ullah, H. (2014). Shari'ah compliance in Islamic banking - An empirical study on selected Islamic banks in Bangladesh. *International Journal of Islamic and Middle Eastern Finance and Management*, 7(2), 182-199.
- Williams, G., & Zinkin, J. (2010). Islam and CSR: A study of the compatibility between the tenets of Islam and the UN global compact. *Journal of Business Ethics*, 91(4), 519-533.
- Yeo, R.K., & Youssef, M.A. (2010). Communicating corporate image into existence: the case of the Saudi banking industry.

- Corporate Communication: An International Journal*, 15(3), 263-280.
- Yoshikawa, T., Tsui-Auch, L. S., and McGuire, J. (2007). Corporate governance reform as institutional innovation: The case of Japan. *Organization Science*, 18(6), 973-988.
- Zucker, L. G. (1977). The role of institutionalization in cultural persistence. *American Sociological Review*, 42(5), 726-743.