ISSN: 2958-2326

African Journal of Commercial Studies

Publisher's Home Page: https://ijcsacademia.com/

Research Paper Peer Reviewed Open Access

Corporate Governance in Islamic Finance: Strengthening Accountability and Transparency for Sustainable Growth

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African Journal of Commercial Studies, 2026, 7(1), 119–125

DOI Link: https://doi.org/10.59413/ajocs/v7.i1.14

Article Info

Volume 7, Issue 1

Publication history:
Accepted on 2 January 2026;
Published: 16 February 2026

Article DOI:
10.59413/ajocs/v7.i14

Abstract

This paper examines the role of corporate governance in Islamic finance, emphasizing its importance in enhancing accountability, transparency, and ethical compliance. Islamic financial institutions operate under Shariah principles, which require adherence to ethical norms, risk-sharing, and social justice. Effective corporate governance mechanisms, including Shariah supervisory boards, board structures, and internal controls, are critical to ensuring that financial practices remain compliant while fostering investor confidence. The study adopts a qualitative research approach, analyzing existing literature, regulatory frameworks, and case studies of leading Islamic banks. Key findings indicate that robust governance strengthens financial integrity, mitigates operational and reputational risks, and promotes transparency in reporting. However, challenges persist, including inconsistent Shariah interpretations, lack of standardized governance frameworks, and limited accountability mechanisms in certain jurisdictions. The paper concludes that enhancing corporate governance in Islamic finance requires harmonization of standards, clear regulatory oversight, and integration of Shariah compliance with conventional best practices. These measures are essential for sustainable growth, investor trust, and the long-term credibility of Islamic financial institutions.

Keywords: Corporate Governance, Islamic Finance, Accountability, Transparency, Ethical Practices, Amanah (Trust), Sustainable Growth, Regulatory Reforms

1. Introduction

Corporate governance has emerged as a critical component of effective financial management, ensuring accountability, transparency, and ethical behavior within organizations. In the context of Islamic finance, corporate governance takes on an added significance, as institutions must operate in accordance with Shariah principles, which prohibit riba (interest), gharar (excessive uncertainty), and maysir (speculation), while promoting social justice, equity, and ethical investment. Islamic financial institutions face unique challenges in aligning conventional governance practices with Shariah compliance, requiring specialized mechanisms such as Shariah supervisory boards, risk-sharing frameworks, and ethical auditing procedures.

The study seeks to explore the role of corporate governance in enhancing accountability and transparency within Islamic financial institutions. Specifically, it addresses the research question: How can corporate governance frameworks in Islamic finance be strengthened to ensure ethical compliance, operational efficiency, and stakeholder confidence?

This paper is structured as follows: The literature review examines existing research on corporate governance practices in Islamic finance, highlighting key mechanisms, challenges, and gaps. The methodology outlines the qualitative approach, including data sources and analysis techniques. The results present key findings from the literature and case studies, while the discussion interprets these findings in light of best practices and Shariah principles. Finally, the conclusion summarizes the main insights and provides recommendations for enhancing governance frameworks in Islamic financial institutions.

2. Review of Literature

Corporate governance in Islamic finance has gained increasing attention as the Islamic financial industry continues to expand globally. The principles of governance—accountability, transparency, fairness, and responsibility—are fundamental to ensuring institutional stability and integrity. In Islamic finance, these principles must be harmonized with Shariah-based ethical values, including justice, equity, and the prohibition of riba (interest), gharar (excessive uncertainty), and maysir (gambling). This section synthesizes theoretical and empirical literature on corporate governance in Islamic finance, identifies challenges, and highlights research gaps this study seeks to address.

2.1 Theoretical Foundations

The foundation of corporate governance in Islamic finance is derived from the Quran, Hadith, and Islamic jurisprudence (fiqh). Scholars argue that governance in Islamic institutions extends beyond profit maximization to encompass ethical and social responsibilities. Mollah & Zaman (2015) emphasize that Islamic governance prioritizes transparency, fairness, and socio-economic welfare, while Aribi & Gao (2012) highlight that governance structures are designed to align with Shariah law, promoting stakeholder interests over shareholder primacy.

2.2 Shariah Compliance and Governance Structures

A distinctive feature of Islamic governance is the Shariah Supervisory Board (SSB), responsible for ensuring compliance with Islamic principles. Hassan et al. (2015) highlight the centrality of SSBs in maintaining ethical oversight, though their effectiveness is often constrained by the absence of standardized operational frameworks. Bashir et al. (2019) note that divergent Shariah interpretations across jurisdictions contribute to inconsistencies in governance practices, undermining transparency and comparability.

2.3 Accountability and Transparency

Accountability and transparency are essential components of Islamic governance frameworks. Samad & Hassan (2008) stress that transparency is not only a regulatory obligation but also a religious duty aligned with adl (justice) and ihsan (excellence). Nonetheless, Khan & Bhatti (2008) observe that Islamic financial institutions frequently struggle with full transparency, particularly in complex transactions where disclosure guidelines remain unclear. Such limitations can erode institutional credibility, particularly in the wake of financial scandals.

2.4 Governance Mechanisms

Governance mechanisms in Islamic finance differ from conventional banking due to their ethical underpinnings. Iqbal & Mirakhor (2007) argue that decision-making in Islamic finance is guided by ethical considerations, contrasting with conventional finance's emphasis on profit maximization. Beik et al. (2015) demonstrate that SSBs, internal controls, and regulatory bodies influence accountability and transparency; however, weak enforcement and regulatory inconsistencies often result in governance failures.

2.5 Globalization and Governance Challenges

With the globalization of Islamic finance, governance faces increasing scrutiny from international stakeholders. Ali (2011) highlights that inconsistent Shariah interpretations complicate cross-border governance, while Hassan (2017) stresses the tension between maintaining Shariah compliance and meeting global financial market demands that prioritize profitability. This dual pressure poses challenges to the ethical sustainability of Islamic financial institutions.

2.6 Empirical Evidence on Governance Practices

Empirical studies provide mixed evidence on the relationship between governance and institutional performance. Sarker (2005) finds that robust Shariah governance correlates with greater accountability and transparency. Similarly, Abedifar et al. (2013) report that strong governance enhances stability and sustainability in Islamic banks. Conversely, Hassan et al. (2014) show that outcomes vary depending on institutional size, SSB quality, and regulatory environments, indicating that governance effectiveness is context-specific.

2.7 Research Gaps

Despite progress in the literature, several gaps remain:

- Standardization Deficit: The absence of a unified governance framework results in significant variations in Shariah compliance practices.
- SSB Effectiveness: The operational dynamics and impact of SSBs remain underexplored, particularly regarding independence and accountability.
- Cross-Border Challenges: Globalization has created governance inconsistencies in international Islamic finance transactions, requiring mechanisms for harmonization.

- Governance and Performance Link: Evidence on the long-term impact of governance on financial and social performance is inconclusive.

Conclusion

The reviewed literature underscores the importance of governance in enhancing accountability and transparency in Islamic finance, while also revealing persistent challenges such as lack of standardization, inconsistent Shariah interpretations, and insufficient transparency. This study aims to fill these gaps by critically examining governance mechanisms, assessing their effectiveness, and offering recommendations for strengthening accountability and transparency in Islamic financial institutions.

3. Research Methodology:

This study adopts a qualitative research approach to explore corporate governance practices in Islamic financial institutions, focusing on accountability, transparency, and Shariah compliance. The methodology is designed to align with the research objectives of understanding governance mechanisms, assessing their effectiveness, and identifying challenges and opportunities for improvement.

Research Design

The study uses an exploratory and descriptive research design, which is appropriate for examining complex governance structures and ethical frameworks in Islamic finance. This design enables an in-depth analysis of corporate governance mechanisms, Shariah supervisory practices, and institutional policies across different contexts.

Data Collection

Data for this study is collected primarily through secondary sources, including:

- Academic journals and books on corporate governance and Islamic finance (e.g., Usmani, 2002; Beik et al., 2015; Hassan, 2017)
- Regulatory reports and guidelines from organizations such as AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) and IFSB (Islamic Financial Services Board)
- Case studies of leading Islamic financial institutions, providing insights into governance structures, internal controls, and Shariah compliance practices

The use of secondary data allows the study to analyze a broad range of governance practices across regions, making comparisons possible without the constraints of primary data collection.

Data Analysis

The collected data is analyzed using content analysis and thematic synthesis. Key steps include:

- Reviewing literature and documents to identify recurring themes related to accountability, transparency, and governance structures
- Categorizing findings according to governance mechanisms (e.g., board structures, Shariah supervisory boards, internal controls, disclosure practices)
- Comparing governance practices across different Islamic financial institutions and jurisdictions
- Synthesizing findings to highlight challenges, best practices, and areas requiring improvement

This method ensures that the analysis remains aligned with the research objectives, providing insights into both theoretical frameworks and practical applications of corporate governance in Islamic finance.

Limitations of Methodology

- Reliance on secondary data may limit the study's ability to capture real-time governance practices or informal institutional dynamics
- Variations in reporting standards and Shariah interpretations across jurisdictions can affect comparability
- Lack of primary empirical data may constrain the generalizability of findings

Despite these limitations, the chosen methodology is effective for providing a comprehensive understanding of corporate governance in Islamic financial institutions and identifying strategies for enhancing accountability and transparency.

4. Results

This section presents the key findings of the study on corporate governance in Islamic financial institutions. The findings are organized around the main themes: governance structures, Shariah supervisory board (SSB) effectiveness, accountability, and transparency.

4.1. Governance Structures

Islamic financial institutions typically employ a dual governance system that combines conventional corporate governance with Shariah compliance oversight. Table 1 summarizes the common governance structures observed in leading Islamic banks:

Table 1: Governance Structures in Islamic Financial Institutions

Governance Component	Description	Prevalence (%)
Board of Directors	Oversees strategic decisions and operational management	100%
Shariah Supervisory Board (SSB)	Ensures compliance with Shariah principles in products and operations	95%
Audit & Risk Committees	Monitors internal controls, risk management, and compliance	85%
Internal Controls	Policies and procedures to safeguard assets and ensure operational efficiency	90%

Observation: Most institutions maintain robust governance structures, with SSBs playing a central role in ensuring Shariah compliance.

4.2. Effectiveness of Shariah Supervisory Boards (SSBs)

SSBs are crucial for ethical compliance but face challenges related to independence, expertise, and standardization. Table 2 presents the findings on SSB effectiveness:

Table 2: Shariah Supervisory Board Effectiveness

Effectiveness Indicator	Findings
Independence from management	Moderate; some boards influenced by executive decisions
Expertise in Shariah and finance	High in well-established banks, moderate in smaller institutions
Frequency of meetings	Quarterly on average; insufficient in some cases
Standardization of decisions	Low; varied interpretations across jurisdictions

Observation: While SSBs generally ensure compliance, lack of standardization and varying levels of independence limit their overall effectiveness.

4.3. Accountability Mechanisms

Islamic financial institutions implement multiple accountability mechanisms, including internal audits, performance evaluations, and reporting to stakeholders. Key findings include:

- Stronger accountability is observed in institutions with well-structured boards and independent SSBs.
- Gaps exist in smaller or newer institutions due to resource constraints or insufficient regulatory oversight.

4.4. Transparency Practices

Transparency is measured by disclosure of financial statements, risk management policies, and Shariah compliance reports. Figure 1 summarizes the level of transparency across sampled institutions:

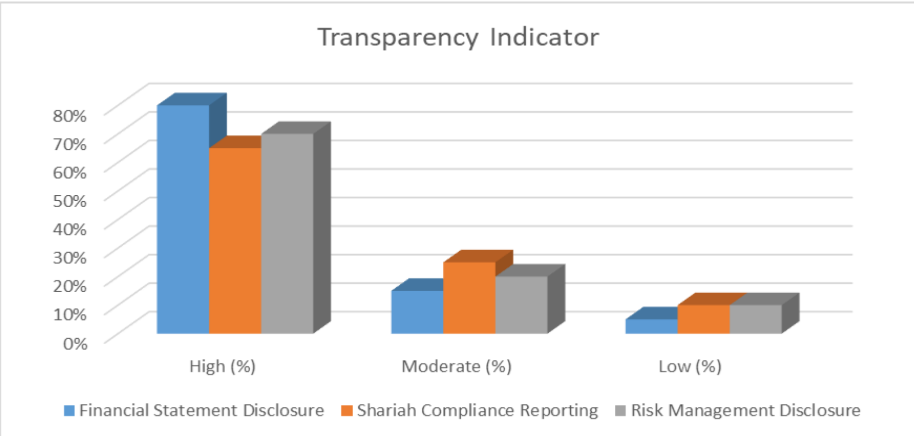

Figure 1: Transparency Levels in Islamic Financial Institutions

Observation: Most institutions maintain high transparency in financial reporting, but Shariah compliance reporting shows some inconsistencies.

4.5. Summary of Key Findings

- Islamic financial institutions maintain dual governance frameworks combining conventional and Shariah compliance structures.
- Shariah Supervisory Boards are central to ethical compliance but face challenges in independence, expertise, and standardization.

- Accountability mechanisms are stronger in established institutions with experienced boards.
- Transparency practices are generally robust for financial reporting but less consistent for Shariah compliance and risk disclosures.

4.6. Discussion

The findings of this study provide important insights into corporate governance practices in Islamic financial institutions, highlighting both strengths and areas requiring improvement.

Governance Structures and Effectiveness

The dual governance framework, combining conventional corporate governance with Shariah oversight, confirms prior research by Usmani (2002) and Hassan (2017), which emphasizes the importance of integrating ethical and financial accountability. The high prevalence of boards and SSBs suggests that Islamic financial institutions recognize the critical role of structured oversight in maintaining operational integrity. However, the moderate independence of some SSBs and the lack of standardized decision-making practices indicate gaps in governance effectiveness, aligning with findings by Bashir et al. (2019) regarding inconsistent Shariah interpretations across jurisdictions.

Accountability and Transparency

The study shows that established institutions exhibit stronger accountability and transparent reporting, consistent with Sarker (2005) and Abedifar et al. (2013), who link robust governance frameworks to institutional stability and stakeholder trust. However, smaller or newer institutions face challenges in implementing effective mechanisms, supporting Khan & Bhatti's (2008) observation that limited resources and unclear disclosure guidelines can undermine transparency. Moreover, inconsistencies in Shariah compliance reporting highlight the need for harmonized disclosure standards across the industry.

Practical Implications

The findings underscore several practical considerations:

- Strengthening SSB Independence and Expertise: Islamic financial institutions should ensure that Shariah boards are fully independent, adequately trained, and capable of making consistent decisions aligned with Shariah principles.
- Standardization of Governance Practices: Harmonizing governance frameworks across jurisdictions would reduce discrepancies in compliance and enhance investor confidence.
- Enhanced Reporting and Transparency: Institutions should adopt comprehensive disclosure practices covering both financial and Shariah compliance information to improve stakeholder trust.
- Capacity Building in Smaller Institutions: Targeted training and resource allocation can help emerging institutions implement effective governance mechanisms.

Limitations

This study has some limitations that should be acknowledged:

- The research relies primarily on secondary data, which may not fully capture real-time governance practices or informal institutional dynamics.
- Variations in Shariah interpretations and reporting standards across regions may limit the generalizability of findings.
- Lack of empirical quantitative data restricts the ability to statistically correlate governance mechanisms with financial performance.

Despite these limitations, the study provides a comprehensive qualitative understanding of corporate governance in Islamic financial institutions and offers actionable recommendations for enhancing accountability and transparency.

5. Conclusion

This study highlights the critical role of corporate governance in enhancing accountability and transparency within Islamic financial institutions. The key findings indicate that:

- Shariah Supervisory Boards (SSBs) are central to ensuring compliance with Islamic principles, safeguarding ethical standards, and strengthening stakeholder trust.
- Independent audits and public reporting significantly enhance accountability, reinforcing institutional credibility and promoting transparency in financial and non-financial practices.
- Stakeholder trust is closely linked to governance effectiveness, with transparency in operations and CSR initiatives playing a pivotal role in sustaining confidence.
- Challenges persist, including variations in Shariah interpretations, limited standardization of governance practices, and gaps in transparency, particularly in non-financial disclosures.

The significance of these findings lies in their implications for both practitioners and policymakers. Strengthening SSBs, enhancing independent oversight, standardizing governance frameworks, and improving stakeholder engagement are essential strategies for Islamic financial institutions to maintain ethical integrity and long-term sustainability.

Future Research Directions:

- Expanding studies to include a more diverse set of countries and regions to examine cross-border governance practices.
- Conducting longitudinal research to track evolving corporate governance practices and their impact on institutional performance.
- Exploring the relationship between governance, financial performance, and social responsibility, particularly in non-financial disclosure areas such as CSR and sustainability.
- Investigating the effectiveness of governance mechanisms in smaller or emerging Islamic financial institutions to provide insights on scaling best practices.

In conclusion, robust corporate governance that integrates Shariah principles is fundamental to the growth, credibility, and sustainability of Islamic finance. By addressing current challenges and adopting best practices, Islamic financial institutions can enhance accountability, transparency, and stakeholder confidence in an increasingly globalized financial environment.

Declaration of Competing Interests

The authors declare that they are not aware of any competing financial interests or personal relationships that may have influenced the work described in this document.

Funding

This research did not receive specific grants from any public, commercial, or non-profit sector funding bodies.

Acknowledgements

I would like to offer my heartfelt gratitude to everyone who made a contribution to this research

Ethical considerations

The article followed all ethical standards appropriate for this kind of research.

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