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The Impact of Legal Origin Toward Shariah Governance

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Abstract

Legal origin that introduced by La Porta has been widely used as references to scene of the corporate governance indicators. Legal origin is used for the study of corporate governance among countries which have different financial development and implementation corporate governance is also different. This paper tried to discuss the influence of legal origin toward Shariah governance theory by using the two approaches are often served in discussing corporate governance, namely Shareholder theory and Stakeholder theory. The development of Islamic finance is more widespread, thus need clear and good Shariah governance. Good Shariah governance will encourage corporate to use its resources efficiently. With a good governance system, it can help reduce the risks that would be experienced by financial institutions. In addition, a good governance system will also affect the investor perception and motivate them to increase funding. Furthermore, this paper attempts to explain how legal origin may affect the Shariah governance and what is the impression given by the legal origin to the Shariah governance.

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1. Introduction

Discussion on the corporate governance has been carried out by many experts, both in terms of legislation, social, political or economic. Some countries have different approaches in implementing good corporate governance which is adapted to the culture and laws from their country. Basically, corporate governance has a very important role in producing a good performance. Companies must understand very well how to manage their company, whether the company was operating effectively and meet the interests of all parties associated with the company or not. Furthermore, effective management of these companies is also partly used to judge whether the company's objectives are achieved optimally. Generally things has always been a discussion in corporate governance include the implementation of the principles of transparency, accountability, fairness, and responsibility.

For banking institution, the issue of corporate governance is also already widely discussed by the experts. Implementation of good corporate governance will provide positive impact to the bank because it can increase the confidence in the banking system and attract many depositors. Corporate governance for banks has its own uniqueness versus non-bank institutions. This is because the depositor as a group whose interests must be filled and guarded. Beside that, the lack of accountability to the public (one of them is depositor), the management of bank is expected to really comply with the legislation that established.

In addition to responsible with depositors, management of bank also needs to build up the perception for both the shareholders and investors who have interests in the bank. To describe good banking valuation is usually be linked with the share price. The price of the shares held must be high to obtain a high bank valuation from investors. For shareholders, higher bank valuation will improve the welfare of the shareholder. The higher value of bank can provide better banking prospects in the future (long term).

Due to the importance of corporate governance, banking assessment itself has been done by several researchers. Issues to be used in the discussion of corporate governance and bank valuation is quite broad and diverse. Likewise in shariah governance issue was also widely much discussed along with the development of Islamic financial institution. However, the discussion of shariah governance that is related with banking valuation itself has never done. In the conventional banking system, there was also not much discussion on the relationship between corporate governance and bank valuation. In fact, good corporate governance and banking valuation has an important role in banking operations. Therefore, further research on the importance of ensuring the implemantion of principles of corporate governance in banking and banking valuation is welcome, especially for sustaining continuity operational bank for long-term.

In this study, we will try to explain the theory in explaining whether the good corporate governance nor shariah governance will provide a significant impact in banking valuation method. Further, this study also wants to examine the impact, given by the good corporate governance nor Syariah governance, on banking valuation system.

The discussion in this study will look at the basic theory of corporate governance that is derived from two approaches, namely shareholder theory (agency theory) and stakeholder theory. In addition, this study will also provide some implementation corporate governance in several developed and developing countries.

Moreover, we will also see the indicators for corporate governance that has always been used in previous studies. Discussion of shariah governance will also be given in depth so that we can see the differences with the conventional concept. The last discussion will touch on the implementation of banking valuation. The results of the discussion is expected to provide clear guidance regarding shariah governance framework and appropriate direction that can link shariah governance and Islamic banks value.

The discussion in this study will be divided into 4 parts. The first discusses the theories underlying the corporate governance. Second, we will explain briefly about corporate governance and it's implementation in some countries. Third, discusses the concept of shariah governance. Fourth, ending with the conclusion.

2. Underlying Theories for Corporate Governance

There are several theories that are often used as a basis in describing the state of corporate governance. However, the discussion below is only uses two theories that are quite famous to describe the corporate governance namely shareholder theory (agency cost theory) and stakeholder theory.

Shareholder Theory (Agency Theory)

Agency theory is often associated with corporate governance for companies or profit and non-profit institutions. This theory is based on the separation of corporate ownership and supervision of corporate actions in which shareholders as owners of the company handed over management to the manager. Agency theory was first time introduced by Jensen and Meckling (1976). They illustrate that the agency relationship as a form of contract between the owner (as principle) and manager (as agent). The owner lift or appoint managers to manage the company in accordance with their interests. The existence of this contract, the owner must delegate decision-making rights for the interests that involve company towards manager.

Jensen and Meckling (1976) proposed this theory based on conflict of interest between company owners (principle) and managers (agent). The owners want the profit and maintain the continuity of the company for the long term. They are not just thinking about corporate profits in the short term only. They will focus on future business opportunities for wide long-term future. Conversely, manager as running a company would be discharging its responsibilities in meeting the interests of shareholders, more concerned with short-term interests. This is because the manager does not have a share in the company and do not benefit directly from the company profit.

nnnManager feels that they do not have direct benefit to the company's stock value. Manager is hired as workers who run the company and then get a salary. The condition will be different if the managers who run the company get shares in these company or their salaries depend on company profits and stock value. It can give the possibility of such interests of manager to maintain corporate status for the long term. In addition, managers will try to make profits and raise share value of the company to earn a high wage level.

Differences of interest between the owners and managers are generally also can be caused by Moral hazard. This occurs when a manager trying to get more interest from company that they manage through positions in the company. Beside that, it also could caused the level of effort from the manager which is if the manager has a share in the company, there is a possibility he made great effort to promote company their handled. However, because they have no directly interest and benefit from the companies their managed, sometimes the manager is less effort in managing the company.

In agency theory also see how delegation of principle duty to the manager in making decisions and running the company can operate effectively. The possible problems of information asymmetry between company owners (principle) and managers as who running of the company. This will be a basic problem of the principle-agent problem which can be caused moral hazard issues and adverse selection. There is some existing literature suggests that a asymmetric information environment has an important impact on corporate governance mechanisms.

The asymmetric information between principle and and agent could discribed when the agent (the manager) is working on behalf of the principal (the shareholders). The principle who does not observe the actions of the agent. Most importantly, the establishment of the manager's contract would be imperative in order to maintain the linkage between their actions and the interests of shareholders. To avoid this asymetric information, company was always spend expense to supervise and control the managers. The agency costs generally arise as due to contracting costs and the divergence of control, separation of ownership and to control the different objectives with the managers (rather than shareholder maximization).

For example, Cai and friends (2007) has found that the firms whose facing greater asymmetric information tend to use less intensive board monitoring but rely more on market discipline and CEO incentive compensation. In their study, they suggest that regulators should use caution when imposing uniform requirements on firms' corporate governance. Their papers has based on Demsetz and Lehn (1985) reseach which has contend that the cost of monitoring management increases with the noisiness of a firm's operating environment. Then, Bebchuk (2002) shown that such asymmetry might lead firms to adopting – through the design of securities and corporate charters -- corporate governance arrangements that are known to be inefficient both by public investors and by those taking firms public.

In fact, the agency problem can not be eliminated perfectly and the agency cost problem can not be avoided because asymetric information was very difficult eliminated. If there is perfect contract where feasible and implemented effectively, the agency cost can be eliminated. The asymetric information situation indicates that the owner knew exactly what was done by management and the management is really running the interests of owners. However, perfect contract is not feasible and very difficult which resulted will occur "Contract Residual Rights" in the decision making. The residual contract rights may be caused by circumstances asymetric information which managers have and find out some information about the company but not notified and disclosed to the owner of the company and the parties who require such information.

According to Rezaee (2009) book has said that corporate governance (shareholder under the aspect) was established to reduce state agency cost and align the interests of management that is consistent with the interests of the owners can be done through (1) provide incentives and opportunities for management to perform their functions effectively and maximize the welfare of shareholders by giving the executive compensation plans, ownerships or stock options; (2) tighten the shareholder rights to monitor, control, discipline management through enforcable contracts or legal protection; (3) promoting shareholder democracy; (4) improving the vigilance of the board's oversight function, (5) holding directors accountable and liable for fulfillment of Their fudiciary duties; and (6) improving the effectiveness of both internal and external corporate governance mechanism.

The implementation of effective corporate governance that would gave positive impact to reduce and even eliminate the agency cost. The principles of honesty, resilience, responsiveness and transparency owned by corporate governance which, if implemented effectively, it can avoid the agency problem. Some research on the relationship between corporate governance and agency problems (agency conflicts) have been carried out.

Dey (2008) investigate whether corporate governance is associated with the level of agency conflicts in firms. In this reseach, he found that firms with greater agency conflicts have better governance mechanisms in place, particularly those related to the board, audit committee, and auditor. Furthermore, the composition and functioning of the board, the independence of the auditor, and the equity-based compensation of directors are significantly associated with firm performance, but primarily for firms with high agency conflicts. Overall, the results from his reseach support the theory that the existence and role of various governance mechanisms in a firm are a function of the level of agency conflicts in the firm.

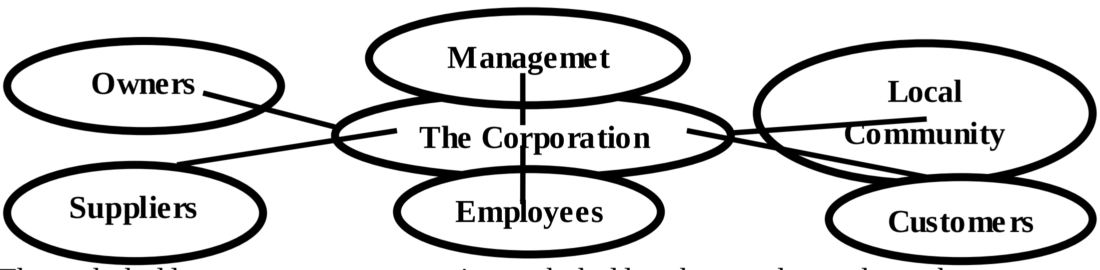
Based on agency theory hypothesis test that used by Berger and Di Patti (2002), they found that higher leverage or a lower equity capital ratio can give higher profit efficiency, all else equal. Furthermore, in their research also showed that large institutional holders have favorable monitoring effects that reduce agency costs, although large individual investors do not. Kholief (2008) use agency theory to explain the relationship CEO duality (the CEO serves also as the board chairman) with corporate performance. His research obtained that corporate governance mechanisms such as independent auditors, internal auditors, audit committees and ownership structure may influence the relationship between CEO duality and corporate performance.

The lack of measurement of the equity agency costs variable in financial economics research has motivated Fleming et al (2005) investigate the relationship between ownership structure and agency cost theory to analyse the impact of equity agency costs on Australian SMEs. In their papers, the analysis of equity agency costs focused on two ratios. First, first ratio is discretionary expenses-to sales and second, the asset utilisation ratio. They found that the magnitude of the agency costs as proxied by the operating expense ratio and the asset utilisation ratio is somewhat lower in Australia, suggesting nation-specific factors may influence the impact of the separation of ownership and control.

Kumar (2004) by using agency perspective try to examines empirically the effects of ownership structure on the firm performance for a panel of Indian corporate firms. The data used in the analysis consists of all manufacturing firms listed on the Bombay Stock Exchange (BSE) and their sample consists of 2517 firms with 5,117 observations. The ownership variable consists of the managerial shareholding (director), institutional investors shareholding (institutional), foreign investors shareholding (foreign), and corporate shareholding (corporate). This research indicate that first, the foreign shareholding pattern does not influence the firm performance significantly. Second, institutional investors especially the development financial institutions affect firm performance positively once their ownership crosses a threshold level. Third, the shareholding by the directors' also influences the performance of the firm beyond a certain threshold. Lastly, the effect of managerial shareholding and firm performance does not differ significantly across group and stand-alone firms

Stakeholder Theory

In the previous section, have been discussed about the agency theory that very often used in research on corporate governance. As described, agency theory looks at the form of the relationship between principle and agent (manager) in which the manager must make decisions based on the interest of principle (shareholder). In this stakeholder theory, managers in making decisions should take into consideration all the interests of stakeholders who related to the companies they manage. Stakeholders include all individuals or groups who can affect or be affected by the company's survival. These stakeholders include not only shareholders but also employees, customers, communities and government officials.
Almost all of the foundation in forming the stakeholder theory based on the view given by Freeman (1984). Freeman defined the stakeholder as any group or individual who can affect or is affected by the achievement of the organization's objectives. Stakeholder model of the coporation that given by Freeman can be drawn as below :



The stakeholder concept as normative stakeholder thoery shown how the managers (as stakeholders) should act and view the corporate purposes, based on some ethical principle (Friedman, 2006). Then, Stakeholder concept that called as descriptive stakeholder theory focused with how managers and other stakeholders actually behave and view the actions and roles. The instrumental stakeholder theory try to explain how the managers should act if they want to flavor and work for their own interets (Fontaine, Haarman and Schmid, 2006).
Jones, Wicks, and Freemen (2002) summarize that stakeholder theorists have argued for two basic premises. First managers need to pay attention to a wide array of stakeholders (e.g. environmental lobbyists, the local community, competitors) to provide good performance. Second, managers have obligations to stakeholders which include, but extend beyond, shareholders. Stakeholders are defined in their study consisted of customers, suppliers, financiers, employees, communities Other stakeholder groups. It is like what has been described in Freemen papers (1984).
Furthermore, Fontaine, Haarman, and Schmid (2006) tried to explain the principle ideas of the stakeholder theory. They seen stakeholder principle concept as normative stakeholder theory, descriptive stakeholder theory and instrumental stakeholder theory. The normative stakeholder theory has given by Friedman (2006) that contains theories of how managers or stakeholders should act and should view the purpose of organization, based on some ethical principle. While, on descriptive stakeholder theory concerned with how managers and stakeholders actually behave and how they view their actions and roles and the instrumental stakeholder theory related to how managers should act if they want to flavor and work for their own interests.

Evan and Freeman (1990) proposed two principle to purposes of the firm act. First, principle of corporate legitimacy which company should be managed to get benefit for stakeholders. Then based on the stakeholder fiduciary principle, managers must act in the interests of the stakeholders. In this paper, they also explained that managers in addition as employees have a responsibility in safeguarding the welfare of the company. Almost all of the foundation that used in forming the stakeholder theory has based on the view given by Freeman (1984). Fontaine, Haarman, and Schmid (2006) show that the stakeholder theory is not only economic theory but also has a philosophical concept or a substantial sociological. According to their papers, different contributions in governance theories provide a new basis for redefining the stakes of the company and the models of governance.

Brief Explanation and Implemantation of Corporate Governance

Definition and principle of Corporate Governance

Some explanation of the corporate governance has been widely shared by scholars and online websites. Wikipedia (2011) defined Corporate governance as the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. Corporate governance according to Shleifer and Vishny (1997), is concerned with: "…the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment".

In the website of OECD (2004), corporate governance described as a set of relationships between a company's management, its board, its shareholders and other stakeholders, and also the structure through the which objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Further, Cadbury Report (UK), 1992 shown That corporate governance as the system by which companies are directed and controlled.

Based on PWC publishing papers, corporate governance show about how well the business is run. In their papers also describe that good corporate governance is essential to create and engagement between companies and their investors, so contibuting to the long-term success of the business. Institute of Corporate Governance in Malaysia i.e Finance Committee on Corporate Governance (FCCG) defined the corporate governance as a process and structure used to direct and manage the business and corporate activities toward the improvement of business growth and corporate accountability.

From the definition of corporate governance has been shown above explained that corporate governance has have closely related to the relationship between the management company, specifically shareholders and managers. Corporate governance viewed as a procedure for companies to form sustainable relationships among the principle - agent and also to the survival of the company. The existence of an effective and efficient corporate governance within a company considered important. It because of spacious scope and provide significance influence to the operational of a company.

In other hand, corporate governance confronted with a situation to find the way to the interests of all shareholders, managers and other parties who have intercourse with the company can be fulfilled. Implementation of this corporate governance is really considered important for bigger companies which already has a complex management system. In other words, the separation between ownership and management on big companies are quite complicated than small companies. Corporate governance circumstances an effective and efficient on large companies will have a positive impact for the country, both directly nor indirectly.

This condition can be shown if the circumstances of corporate governance a countries do not go well - especially for big companies or go public companies - would provide difficulties for the country to fight and get the trust from the foreign investors. The good, effective and efficient of corporate governance systems will give more credibility and added value in the foreign investors side. This eventually would be bring capital inflows into the country through foreign investment and and increasing foreign exchange reserves.

In a global economy at the present time, companies and even countries that have weak corporate governance system would be faced a crisis and financial problems are quite apprehensive. The globalization demands a shareholder and manager to be careful in managing the company and also to expand their companies. In addition, it need use of substantial capital in bringing the company's to global competition. If a failure occurs in managing corporate finances, it will be providing a considerable impact for individuals or groups who are involved directly or indirectly with the company.

Furthermore, CIPE Handbook (2002) provides several ways that can be done by corporate governance in helping companies and the economy to attract investment, strengthen the economic base and competitiveness. First, by asking for transparency in corporate transactions, in carrying out accounting and auditing procedures, in making a purchase, and in the overall business transaction involving offerings to avoid corruption. Second, the corporate governance helps companies improve the management system by helping managers and Board to form mergers and acquisition show the healthy business and the good corporate performance.

Third, by adopting standards for transparency in dealing with investors and creditors, a strong system of corporate governance helps to prevent systemic banking crises even in countries where most firms are not actively traded on stock markets. The last, previous research has shown that countries with stronger corporate governance protections for minority shareholders also have much larger and more liquid capital markets.

In the globalization era has made corporate governance framework needs to be established and maintained its accuracy. If there are no binding rules and structure, it can lead to the anarchy which business condition will be running arbitary and didn't care of the situation around. At the present time, every state has introduced corporate governance codes and guidlines. Among of them, Combined Codes (2006) that are recommended by the Cadbury, Greenbury and Hampel reports which include:

Allow the company chairman to serve on (but not to chair) the remuneration committe where he is considered independent on appointment as chairman;

Provide a “vote withheld” option on proxy appointment forms to enable a shareholder to indicate that they wis to withhold their vote;

Recommend that companies publish on their website the details of proxies lodged at general meetings where votes were taken on a show of hands.

Implementation of corporate governance, will be different for each country. This is influenced by culture, law, economy, demographics and governance. Mallin book (2004) has described the characteristics influencing corporate governance in certain countries. Mallin use 5 key characteristics which may affect the corporate governance, including: main business form, predominant ownership structure, legal system, board structure, and important aspect (See Appendix A).

Based on the Economic Co-operation and Development (OECD), provided some principles which is addressed in the table below:
Table 1: OECD Principles of Corporate Governance (2004)

No.	Principle	Explanation
1.	Ensuring the Basis for an Effective Corporate Governance Framework	The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.
2.	The Rights of Shareholders and Key Ownership Functions	The corporate governance framework should protect and facilitate the exercise of shareholders' rights.
3.	The Equitable Treatment of Shareholders	The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.
4.	The Role of Stakeholders in Corporate Governance	The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
5.	Disclosure and Transparency	The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.
6.	The Responsibilities of the Board	The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

Next, in the world bank's banking activities focus on corporate governance: the rights of shareholders; the equitable treatment of shareholders; the treatment of stakeholders; disclosure and Transparency; and the last, the duties of board members. According to the Basle Committee (2006) guidelines for the implementation of the corporate governance in banking has shown eight principles. They are:
Principle 1 : board members should be qualified for their positions, have a clear understanding of their role in corporate governance, and be able to exercise sound judgement about the affairs of the banks;
Principle 2 : the boards of directors should approve and oversee the Bank's strategic objectives and corporate values that are communicated throughout the banking organization;

Principle 3 : the board of directors should set an enforece clear lines of responsibility and accountability throughout the organization;
Principle 4 : the board should ensure that there is appropriate oversight by senior management consistent with board policy;
Principle 5 : the board and senior management should effectively utilize the work conducted by the internal audit function, external auditors, and internal control functions.
Principle 6 : the board should ensure that compesation policies and practices are consistent with the bank's corporate culture, long term objectives and strategy, and control environment;
Principle 7 : the bank should be governed in a transparent manner;
Principle 8 : the board and senior management should understand the bank's operational structure, including where the bank operates in jurisdictions, or through structures, that impede transparancy.

Implementation of Corporate Governance in Banking

Implementation of good corporate governance is very important because of the banking operations will give widely impact to the economy of a country. Corporate governance of banking has specific traits with complex system work rather than non-banking institutions. Moreover, bank regulation can not quickly respond to innovative banking products which go through the stages of determining regulatian for new products. According to Basel's paper, on the enhancement of corporate governance in banking institutions indicates that supervision cannot operate efficiently in the absence of good governance.
In practice, the bank received the money largely from its depositors. The size of money that deposited into the bank there in large numbers are also small amounts. Beside that, not all of these depositors have sufficient knowledge about the products issued by the bank. When bank failed to managing depositors fund, it would be cause a financial loss for the depositrs then gives the bad impact to the economy. Therefore, the depositors interests must be protected through good corporate governance. The several studies in the banking system will be described in this section.
Studies in the corporate governance of banking has been widely performed using different approaches. Leaven and Levine (2008) examined the relationship between risk-taking by banks, ownership structure, and national bank regulations. hey found that banks with more powerful owners tend to take greater risks and the impact of bank regulation on bank risks depend heavily on the bank's ownership structure. This paper also imply the same regulation will have different effects on risk-taking by banks which depending on the bank's corporate governance structure.
Furter, Guo, et al (200_) investigates whether corporate governance variables can affect bank performance and risk taking differently for contraction years and for expansion years. Their sample contains about 15,000 firm-year observations and covers two contraction periods, specifically, 1990-1991 and 2001 recession. Based on the result on their papers shown that that investors should focus on different governance variables for different stages of business cycle. On contraction years, investors should choose banks with higher institutional ownership and choose banks with higher percentage of outside board members and higher CEO ownership during expension years. They also found that the larger board and more capable CEO are always beneficial to the banks.

Hsin-Yu Liang and LI-Ju Chen (2010) studied about difference of governance structure between specialized and diversified U.S. banks (financial conglomerates), examine the link between agency problems and bank diversification, and relate those differences in governance to the value discount of diversified banks. They used board characteristics, ownership structure, CEO compensation, role of audit committee, and external governance level as governance variables. By using univariate analyses, they found that diversified banks tend to have lower insider ownership and institutional holdings. Farther, multivariate analyses shown that bank diversification usually leads to higher board independence, higher outside director's holdings and higher percentage of CEO equity-based pay.

The investigation of the board of directors role as corporate governance indicator has done by Andres and Vallelado (2008). They found an inverted U-shaped relation between bank performance and board size. This means that more directors give benefit the monitoring and advisory functions, improve governance, and raise returns. They also found that partially concurs with a recommendation usually included in the codes of good practices: the advisability of appointing outside directors. Their findings held after after controlling for the measure of performance, ownership structure, the weight of the banking system, or differences in the regulatory and institutional setting, and go beyond the national boundaries of any one particular country or year.

The issues related to corporate governance such as ownership structure, board of directors and control-enhancing mechanisms has also studied by Palmberg (2010). She used Swedish banks over the period 1985-2008 and found that Swedish banking sector is highly concentrated, with four banking groups controlling over 80 percent of the market. Her analysis shows further that the banks in Sweden have relatively large boards of directors.

Kim and Rasiah (2010) tried to explain relationship between corporate governance and bank performance in Malaysia during the pre and post asian financial crisis. Their study employed foreign and domestic commercial bank data from 1995 to 2005. CAR has used as indicator for corporate governance and proxy for bank performance is return on equity (ROE). They got that positive and significant association between the corporate governance and bank performance in Malaysia. They also shown that different types of ownership may have different concerns on implementing good corporate governance. The foreign-owned banks has better performance in the pre crisis than that of private domestically owned banks in the Malaysian banking system.

Henceforward, Cornett, et al (2005) examined performance differences between privately-owned and state-owned banks in sixteen Far East countries from 1989 through 1998. They used use cash flow and accounting based measures to examine the performance privately-owned and state-owned banks. Their study shown that state-owned banks operate less profitably and less efficiently than privately-owned banks over this period. Beside that, state-owned banks performance worsens as the extent of state ownership increases.

Shariah Governance Concept and Implementation

The discussion about corporate governance in Islamic context is relatively new. Until now, there is no general model that accepted wo explain about corporate governance theory in Islamic perspective. Based on Islamic Financial System Handbook (2011) describe that corporate governance in Islam as a set of organisational arrangements on how a corporation is directed, managed, governed and controlled. Based on Islamic

Financial Services (IFSB) as guiding principles on corporate governance for institutions, defines the corporate governance as a set of relationship between a company's management, its board of directors (BOD), its shareholders and other stakeholders which provides the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined.

Suleiman (2000) shown that governance structure of Islamic banking are quite different from conventional banking because the in the Islamic institution must obey the Holy Qur'an. There are two major difference from the conventional framework. First, an Islamic organisation must serve God. It must develop a distinctive corporate culture, the main purpose of which is to create a collective morality and spirituality which, when combined with the production of goods and services, sustains the growth and advancement of the Islamic way of life. Second, interest-free banking is based on the Islamic legal concepts of shirkah (partnership) and mudaraba (profit-sharing).

The concept of Tawhid as one of the philosophical pillars of Islamic economic agreed upon by the jurists of Islam or Muslims, but still very rare are using epistemological methodology of Tawhid in corporate governance. In 1992, Choudhury and Malik discussed about the principle of Tawhid as the epistime of corporate governance and human solidarity in Islamic political economy. Tawhid as the foundation of Islamic faith so that the basis for the corporate governance framework also emanates from this concept.

Allah (s.w.t) says in al-Quran "Men who celebrate the praises of Allah standing, sitting, and lying down on their sides, and contemplate the wonders of creation in the heavens and the earth, (with the thought): "Our Lord! Not for naught Hast thou created all this! Glory to Thee! Give us Salvation from the penalty of the Fire" (3: 191). This verse provides fundamental principle of governance where everything created by Allah has a purpose and human being is created to be the world's vicegerent. By putting a trust to mankind as a vicegerent, Allah plays actively roles to monitor and involve in every affairs of human being and He is aware and knowing everything all the times (Chapra, 1992: 202).

In another verse of al-Qur'an further describe the Tawhid deminsion in Islam as Allah (s.w.t) says, "And I created not the Jinn and minkind except that they should worship me" (51:56). The principle of Tawhid defines a firm's obligation and objectives to include a large group of stakeholders rather than the shareholders alone. It is also show the concept of accountability or taklif indicating that everyone is accountable to God for hiw own deeds (Islamic Financial System Handbooks, 2011). Choudhury and Hoque (2006) has shown the Islamic corporate governance approach as premised on the Tawhid epistemological model whereby the functional roles of corporation are working via the Shari'ah rules. The figure can be given by appendix B.

Zulkifli Hassan (2009) shown that Islamic corporate governance as a combined the element of Tawhid, Shura, Interactive, Integrated and Evolutionary Process, Shariah rules or Islamic law and maintains the private goal without ignoring the duty of social welfare. Then, Wafik Grais and Matteo Pellegrini (2006) explain that good governance is crucial to the ability of a business to protect the interests of its stakeholders. These interests may extend beyond the purely financial to the stakeholders' ethical, religious, or other values. In the case of an institution offering Islamic financial services, stakeholders expect its operations to be carried out in compliance with the principles of Shariah (Islamic Law).

Iqbal and Mirakhor (2004) explain that Islamic corporate governance model is a stakeholder-centered model in which the governance style and structures protect the interest and rights of all stakeholders rather than shareholders. Their arguments supports Chapra and Ahmad (2002) opinion that the notion of equitably protecting the rights of all stakeholders irrespective of whether they hold of equity or not. The design of Islamic corporate governance is unique and presents distinctive comparison with shareholder theory (Anglo-Saxon Model) and stakeholder theory (European Model). The difference of three models would be shown as below:

Aspects	Anglo-Saxon Model	The European Model	The Islamic Model
Episteme	Rationalism and Rationality	Rationalism and Rationality	Tawhid
Objective			
Rights and Interest	To protect the interest and rights of the shareholders.	The right of community in relation of the corporation.	To protect the interest and rights of all stakeholders but subject to the rules of Shariah
Corporate Goal	Shareholders control manager for the purpose of shareholder profit.	Society controls the corporation for the purpose of social walfare.	Shariah objective or maqasid al-shariah
Nature of Management	Management dominated.	Controlling shareholder dominated.	Concept of vicegerency, shura and interactive, integrated and evalutionary process.
Management Boards	One-tier board.	Two-tier boards: executive and supervisory hold separate responsibilities.	Shariah board as the ultimate governance
Capital and Ownership Structure	Widely dispersed ownership; dividends prioritised.	Bank and other corporations are major shareholders; dividens less prioritised.	Shareholders and depositors investment account holders.

Furthermore, based on Bank Negara Malaysia (BNM), 2010, the primary objective to develop the Shariah governance framework is enhancing the role of the board, the Shariah Committee and the management in relation to Shariah matters, including enhancing the relevant key organs having the responsibility to execute the Shariah compliance and research functions aimed at the attainment of a Shariahbased operating environment. Beside that, Shariah governance framework for the Islamic has designed to meet the following objectives:

Sets out the expectations of the Bank on an IFI's Shariah governance structures, processes and arrangements to ensure that all its operations and business activities are in accordance with Shariah;
Provides a comprehensive guidance to the board, Shariah Committee and management of the IFI in discharging its duties in matters relating to Shariah; and
Outlines the functions relating to Shariah review, Shariah audit, Shariah risk management and Shariah research.

In La Porta et al (1997) research, countries with smaller and narrow capital markets have poorer investor protection. In addition, they also see countries that adhered French law has the protection of investors and capital market development is much weaker compared to countries that follow common law. They seek to understand and explain corporate governance to the legal approach. This research was later further developed by subsequent researchers.

In understanding the investor protection across countries, the differences in cultural can not be ignored. There is a strong connection between culture and rights of investors (Stulz and Williamson; 2003). Research provided by Stulz and Williamson also found that creditor rightsof Catholic countries is more weaker than other countries. They also explained that the Muslim countries show the culture of a country may have little impact because of institutional hysteresis.

Furthermore, Stulz and Williamson described that charging interest can be a sin in one a religion but not in the other. The prohibition against interest charge (Riba) as known as basis of Shariah finance system. Prohibition of riba is not only based on theory but directly forbidden by Allah in Al Quran. In practice, Islam can not be expressed as culture because culture as a human heritage that be continued to subsequent generations. Research by Stulz and Williamson has clearly indicated about Riba as a sin but they did not mentioned in details.

Conclusion

This paper tried to look at the relationship Shariah Governance and Legal Origin. Basic theory used to explain shariah governance is shareholder theory and stakeholder theory. While the basis for the legal origin theory used the approach given by La Porta et al (1997). In the present study also illustrates that Islam is not part of the culture. Islam is a religion that is directly endowed by Alllah SWT. The law used in the implementation of Shariah financial systems based on Al Quran and Hadith. Accountability in running the financial system in Islam is not only horizontally (human beings) but also in the vertical (to Allah).

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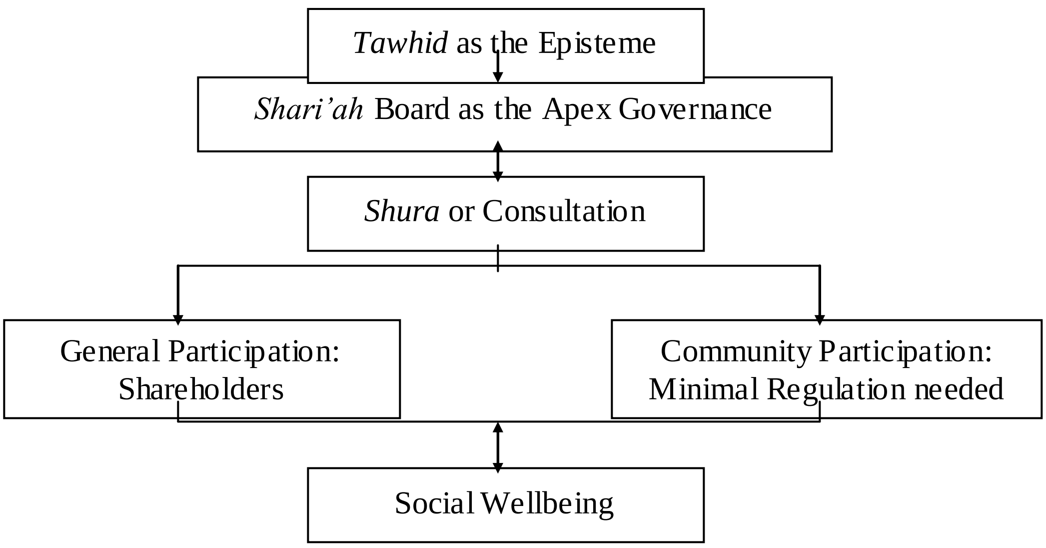
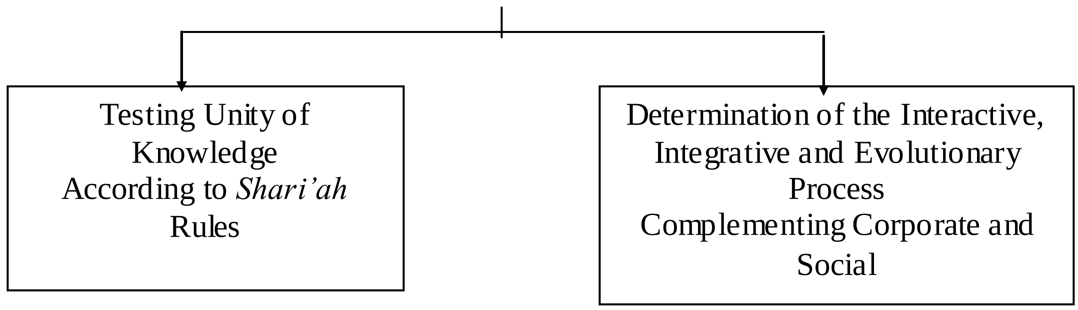
Appendix A

Feature	Key Characteristic					
	German	Russia	Japan	Malaysia	China	India
Main Bussines Form	Public or privates companies limited by shares	Mass Privatization via voucher	Public limited company	Public limited company	State-owned enterprises, joint stock companies	Public limited company
Predominant Ownership Structure	Financial and non financial compenies	Insiders (managers and workers) although outsiders increasing	*Keiretsu*; but institutional ownership is increasing	Controlling shareholder (family, corporation, or trust nominee)	State	Corporate bodies; families; but institutional investors' ownership increasing
Legal System	Civil Law	Civil law	Civil law	Common law	Civil law	Common law
Board Structure	Dual	Dual	Dual	Unitary	Dual	Unitary
Important Aspect	Compulsary employee representation on supervisory board	Covers dividend payments	Influance of *keiretsu*	Influence of Bumiputera shareholders; emphasis on director training	Influance of community party	Some aspects of the code are mandatory recommendations

Appendix B




Testing Unity of Knowledge According to *Shari'ah* Rules
Determination of the Interactive, Integrative and Evolutionary Process Complementing Corporate and Social