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THE CORPORATE GOVERNANCE CHARACTERISTICS AND RISK-TAKING IN THE ISLAMIC FINANCIAL INSTITUTIONS: A THEORETICAL REVIEW

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ABSTRACT

The present study intends to examine existing literature and summarized the effects of the corporate governance characteristics on risk-taking and justified with existing most relevant theories in the Islamic financing system. The study extracted available literature from Google Scholar, ProQuest, and Scopus as well as other online data-based. The theoretical review findings summarized that there are two theories such as agency theory and stakeholder theory are considered most relevant for underpinning to justify the literature summary of this study. Moreover, the agency theory explains the role of corporate governance characteristics on the risk-taking of IFIs. The present study also shows the stakeholder theory paradigm that, influences the creates effective measurement of risk-taking and the stakeholders which leads to insolvency, economic collapse, liquidity shortage, financial institution corruption, financial institution scandal, enterprise fall, and monetary instability even misunderstanding amongst the stakeholders that lead to credit risk, liquidity. The study recommendations will be used to develop a research framework to examine relationships between corporate governance characteristics and risk-taking based on empirical data and the findings could be a valuable source of knowledge for policymakers and regulators in the Islamic financial services sectors in the world.

Keywords: Corporate Governance Characteristics, Agency Theory, Stakeholder Theory, Risk Taking.

INTRODUCTION

The journey of Islamic finance has a long history in global finance. In the early of Islamic revolution, Islamic finance was an uneven competition but today, Islamic finance has become much popular due to safe and competitive packages with compliance of Islamic Shariah which follows specific Islamic norms, principles and compliance of Islamic law. This compliance of Islamic law is maintained under the Islamic financial institutions (IFIs). IFIs are those institutions that practically and officially abide by Islamic compliance (Shari'a law), which issue guidelines for financial transactions, with ethical conduct (Abu-Tapanjeh, 2009). The IFIs include Islamic banks, Islamic insurance companies, Islamic mutual funds, Islamic hedge funds, and issuers of Islamic bonds (Sukuk) institutions (Rammal, 2006).

The intention of this section is to discuss the most appropriate theories that can be used to analyse the thesis conceptual frame work in order to effectively explore the effect of the corporate governance characteristics that influence on risk taking. This section is conducted based on two teaching and learning theories which are agency (Michael, Jensen, William, & Meckling, 1979) and stakeholder theory (Andre, Laplume, Sunpar, & Reginald, 2008b). These two theories will be the backbone of the thesis analysis and study framework development. These theories are embedded to outline the importance of relationships between corporate governance characteristics including; BOD characteristics, AC committee characteristics, RMC characteristics, SSB characteristics and other influencing and moderating factors that affecting risk taking of IFIs. In the context of Bangladesh, there are six core risk in financial sectors such as credit risk credit policy 8 (CP8), market risk credit policy 13 (CP13), liquidity risk credit policy 14 (CP14), operational risk credit policy 15 (CP15) and interest rate risk credit policy 16 (CP16) (Bangladesh Bank, 2012). However, there are several studies have examined on the issues of risk taking which has become the most concerning issues to the Islamic financial institutions(Abu-Tapanjeh, 2009; Islam, Bhuiyan, & Kassim, 2019; Mollah, Hassan, Farooque, & Mobarek, 2017). In light of this fact, it cannot be denying the influence of credit and liquidity risk on a sound economic infrastructure of IFIs in Bangladesh. To minimize these risks, the study has examined the characteristics of corporate governance and risk taking of IFIs in Bangladesh.

RESEARCH PROBLEM

The present study examines the effects of the corporate governance characteristics on risk- taking among Islamic financial Institutions in Bangladesh. Risk is the most concerning issues in the study that borrowers not repay their loans on time (Cecchetti & Schoenholtz, 2011), unsatisfied debt and demand with depositors (Dermine, 1986), uneven distribute of liquidity underpin credit and Liquidity risk which has become the most concerning issues of IFIs in Bangladesh (Molla, 2017; Ameni et al., 2017). According to Basel accord (iii) and BD central bank: About 75% of banking failures or scandal is occurred due to credit risk. In 2016, A survey was conducted of IFIs in Bangladesh, there were 134 valid respondents, about 87.2% of those respondents gave argument that around 86.3 % risk is occurred due to liquidity and credit limitation.

A survey of result decomposition analysis shows that credit risk in the short term (2 months) was mostly affected by own shocks up to 79.30% and by MTC (10.52%) in the long term (12 months) risk are the most concerning issues in a financial sector. Previous some studies have explored that corporate governance characteristics and risk taking (Stojkovic, 2013; Vazquez, Francisco, Federico, & Pablo, 2015). There was lack of theoretical discussion in previous literatures but present study has examined corporate governance characteristics on risk under agency and stakeholder's theory.

LITERATURE REVIEW UNDERPINNING OF THEORIES

Agency Theory: The study examines the corporate governance characteristics on risk taking of IFIs. Governance, risk and IFIs are the interconnected and build up a frame work whereas, IFIs size influence on governance and risk taking. This interconnected network is adherence to respective organization 'objectives. To obtain the IFI's objective, the components of governance examine the owner (principal) and manager (agent) relationship under an organizational ups and down relation among the variables like agency theory that impact on risk taking of IFIs (Eisenhardt, 1989; Jensen & Meckling, 1979). According to the present literatures review that trace a conceptual framework with a set of reviewed variables which provides fundamental knowledge of dynamics connection among the board characteristics, shareholders as well as the management committee. Moreover, the agency theory explains mutual relationship of IFIs between dual boards (SSB) (Garas & Pierce, 2010). The board machine, whereas executives and non-executive board and SSB is performed with spiritual audit (Garas, 2012a). In addition, the board structure keep the organization relationship of decision making that have an effect on the economic overall risk taking (Alagha, 2016; Haider, Khan, & Iqbal, 2015). The Corporate governance mechanisms make business enterprise hyperlink to the specific events of an organization. This includes the board of administrators , the role of leadership structure /(CEO), the number of board characteristics and others internal and exterior factors that have an effect on company risk taking (Christopher, 2010).

The board characteristics means board size, board independence and leadership structure, the separation of CEO from chairmanship's role might create organizational safe relationship (Eisenhardt, 1989). The agency concept additionally claims that the board of the association better environment offer principal-agent relationship (Shleifer & Vishny, 1997). The preceding some studies have strongly highlighted about the significance of effective governance factors such as audit committee, risk management committee and Sharia Supervisory Board that hold a relationship chain in the (IFIs that affect about controlling and monitoring ability like (principal) and agent theory (Gul & Leung, 2004; Mollah, Hassan, Farooque, & Mobarek, 2017).

The audit committee expresses his/her opinion on financial statement and prepares report to the interested parties. Hence audit committee members gradually build up relationship but this relation is to be like principal and agent role that help to reduce risk behaviour (Huang, 2010). The administrators of an employer positively related with risk elements (Sheikh & Kareem, 2015). Ownership types control the whole management (Bukair & Rahman, 2015). On the other hand board size and board independent create interconnecting that is positively related to the twin board management shape (Ntim, Lindop, & Thomas, 2013).Risk is arisen in 1960 and early 1970s, from the period risk is considered as major issues in business (Arrow, 1971). The major issues of risk is being highlighted now as down grade relation among the variables (Christopher, 2010). The senior level Board and characteristics of RMC is considered as legend variables in the study that maintains triangle relation among chairman ,board and risk management committee, however there are build-up a corporate relationship among the RMC and the proper relation depend on right putted place of board members that impact on risk behaviour (Pearl-Kumah, 2014; Tazilah & Rahman, 2014).

Moreover, the existing study shows about the relationship between top level board and risk factor's influence (Fayed & Ezzat, 2002). On the one hand, the principles of Sharia Supervisory Board (SSB) is the most effective setting board to recognize all legal and illegal transaction on the view of Islamic law, on the other hand SSB has to delivery opinion about transaction that is the balancing guidelines among parties of an organization (Safieddine, 2009). The present study also has figured out that managerial ownership cut down agency cost and create short relation chain between principal and agent that ultimately impact on risk, differently, institutional ownership diversify control mechanisms on management and build-up prolong relationship with its stakeholders (Stela & Rhumah, 2017). Even, the BOD maintains difference committee (Subramaniam, McManus, & Zhang, 2009) where internal audit committees are positively influences of risk element that locate a higher rationalization of the relationship (Lachheb & Chokrislim, 2017). However, internal audit committee and RMC appreciably related with risk taking and in the period of down face financial growth (Aebi, Sabato, & Schmid, 2012). The managerial possession is an abolish dimension of rival of activity and board conspirator and there are many alternative solutions like strong ownership control, and managerial ownership; impartial board participants can lead to reduce the company conflict (Brahmadev & Leepsa, 2017). Therefore, sound CG provides a superior platform whereas is maintained about rights, accountability, transparency method that could be attributed to the oblique impact on chance taking (Fayed & Ezzat, 2017). Even, some previous study has found that, firm size build up a link among the variables that influence on risk (Zahra & Pearce, 1989).

Stakeholder Theory: The study has examined the internal and external parties of IFIs that influence on risk taking. The interested parties of an Organization are consider as key player to reduce risk literature (Donaldson & Preston, 1995). According to Freeman, Harrision, and Wicks (2010) has examined that the connected parties' impact on business entity. Therefore, the present study has examined the impact of governance's elements on risk taking. The well- designed Stakeholder doctrine in decision making unit that have impact on organizations and adaption to an accelerate moving world with the help of stakeholder theory. In addition, conceptual framework shows board Size, Board Independence, The CEO leadership, board attendance in meeting, bard education qualification, managerial ownership, audit committee, RMC, Sharia Supervisory Board (SSB) that enhances governance mechanisms and effect on risk taking as well as social obligations of the corporations and its stakeholders increase goodwill in company by risk taking behaviour (Lauesen, 2002).

Moreover, Board Size, Board Independence and leadership structure are the phase of Board diversification that are salience responsible to an organization's aim even, immediately or in a roundabout way have an impact on an organization's risk taking (Andre, Laplume, Sunpar, & Reginald, 2008a). In fact real entity party of managerial ownership who contribution a large portion of their assets in the company's shares and such shareholders authorize the management, and this management authorize his or her supporting committee (Klimczak & Warsaw, 2008). On the different hand the supporting committee is sure to observe role of chairman and CEO separation strength and responsibilities on each different Stakeholder strategy where, reducing the risk and gives an incentive for them to continue preserving their shares (Klimczak & Warsaw, 2008). Basically, stakeholder strategy summarizes the wonderful aspects of corporate governance into four elements namely the episteme, the corporate imaginative and prescient and mission, the chain of management, the managerial possession structure. In the element of religious thought, Islam puts divine unit of almighty as the episteme while the company vision is premised on defending of all the stakeholders' interest and rights in line with the precept of Shariah goal (Hasan, 2008).

The stakeholder method provides three components such as instrument power, descriptive accuracy and normative validity (AAOIFI, 2008; Andre et al., 2008a). The external auditor justifies the accuracy about the board, management and surroundings of IFIs but the most fascinating matter that sometime external auditor lead to reduce risk by checking any unlawful and invalid activities. Again the stakeholder method gives a theoretical framework for checking stability of the place the existing study is maintained the balance of pastime by using recruiting an economic professional as properly true education historical past key character in a board structure (Garas, 2012b). The fundamental argument of the stakeholder strategy set up economics ethics and social responsibilities (Andre et al., 2008a) but SSB provide fatwas and religious opinion about halal and haram product that establish ethics and social obligations and make contributions to chance taking (Nathan, 2010). Eventually, stakeholders generally lead to the multi-theoretical framework that consists of board, leadership structure (CEO), Board shareholders and accommodates insights from stakeholder theories (Ntim et al., 2013). The study has figured out that, opinion of SSB and the document to the SSB are fairness, trustee, responsibilities on each other that prolong the stake holder idea (Freeman et al., 2010).

The stakeholder doctrine affords five steps such as shareholder, customer, employees, suppliers and neighbourhood communities (Andre et al., 2008a) and growing the fee of an corporation that impact the company's risk taking (Harrison & Wicks, 2013). The present study shows independent variables as stakeholder theory paradigm that, creates effective measurement of risk taking and the stakeholders which lead to insolvency, economic collapse, liquidity shortage, financial institution corrupted, financial institution scandal, enterprise fall and monetary instability even misunderstanding amongst the stakeholder that lead to credit risk, liquidity

(Ginena, 2014). The conceptual framework, which will provide credibility to IFIs and ascertain, transparency, mutual trust, moral ideology, underlying trust and belief and ethics and additionally assist defending the stakeholders right and fulfil the broader precept of company objective (Uddin, 2015). Finally, Firm size as moderator, larger firms tend to maintain more formality, complexity and bureaucratic control mechanisms such as written rules, job definitions, cultural norms that leads to managerial progressive. Naturally larger firms are much more visible organizations and attract the attention about scrutiny of a greater number of stakeholders (Hart & Sharma, 2004). Meanwhile, the smaller size boards might be more effective since they are able to make timely strategic decisions (Goodstein & Gautam, 1994). Therefore, firm size maintain stakeholder relationship between ownership (Hart & Sharma, 2004) and on RMC (Gupta, 2011).

EMPIRICAL LITERATURE REVIEW BY TABLE SUMMARY

Model	Author and year	Majors' findings and areas
GMM by Arellano and Bond 1991.	(Mohidul et al., 2020)	Corporate governance influence on Risk Taking of IFIs in Bangladesh
FEM	(Mohidul et al., 2019)	Board characteristics impact on Risk taking of IFIs in Bangladesh.
OLS regression analysis	(Elamer, Al Hares, Ntim, & Benyazid, 2018)	The board size and board meetings are significantly and negatively related to risk-taking. In contrast, the results show that board independence and audit committee size are statistically insignificant, but negatively related to risk-taking in UK.
Random-effects GLS method	(Mollah et al., 2017b)	Difference in governance structures influences the risk taking and performance of Islamic banks compared to conventional banks in GCC countries.
DGMM	(Akbar et al., 2017)	Board size, board independence and combining the role of CEO and chairperson in boards may affect corporate risk taking in financial firms in UK.
GMM by Arellano and Bond 1991.	(García-Sánchez et al., 2017c).	The relationship between the presence of financial experts on audit committees and the levels of insolvency risk in the banking sector in nine countries (Canada, France, Germany, Italy, the Netherlands, Spain, Sweden, the UK and the USA)
System GMM	(Pervan et al., 2017)	Firms older, benefits of their accumulated knowledge in all crucial aspects of the business (technology, supply channels, Customers relations, human capital and financing costs) on organizational structure.
OLS regression	(Adams & Jiang 2016)	The study finds out no significant relationship between audit committee and risk-taking

First difference GMM	(Jedidia & Hamza, 2015)	the bank size does not matter probably because both small and large Islamic have difficulties to manage their liquidity risk in MENA countries.
OLS regression analysis	(Johl et al., 2015)	Accounting and financial experts figure depends on Board size and board independent uses both financial and non-financial data from annual reports of the 700 public listed firms in Malaysia for the year 2009.
OLS Regression analysis	(Pearl-Kumah, 2014)	Board of Directors, senior staffs and not all staff are actively involved in risk management on risk facing the sampled banks are credit risk, operating risk, solvency risk, interest rate risk, and liquidity risk
OLS regression analysis	(Kurawa & Garba, 2014)	The study finds a significant negative relationship between audit committee and risk-taking.
GMM	(Alman, 2012a)	The compositional characteristics of the SSB influence the loan portfolio risk-taking of Islamic banks. As supervisory functions of a SSB affect the banks' risk-taking behavior. Over the period from 2000 to 2010, we regard cross-country bank-level data from the Middle East and Northern Africa as well as from Southeast Asia.
Linear Regression model	(Asim, et al., 2012)	Bank size have positive and significant relationship with credit risk in domestic banks and positive and insignificant in foreign banks. Liquid assets and credit risk have positive and insignificant relationship in domestic banks and negative and significant in foreign banks.
Regression analysis	(Chan et al., 2012)	Large committee gold big amount of cost that leads to higher risk of a firm
FEM model	(Alkdai & Hanefah, 2012)	The study investigates the effect of audit committee characteristics such as size of audit committee, number of independent non-executive directors, the number of accounting expertise, and the number of Muslim directors in audit committee on earnings management practice in Malaysian listed companies.
	(Garas, 2012b;	The board and its size enhance the in formativeness of risk

	Moumen, Othman, & Hussainey, 2016b)	disclosure as it allows investors to better predict future earnings growth.
GMM	(Mule et al., 2015)Mule, (2015).	The effect of firm size on the firms operating in Istanbul Stock Exchange between the years of 2010 to 2016. The study argued that “large scale firms were less risk compared to small scale firms
Dynamic GMM	(González, 2012)	He has argued that larger firms generate high capacity and less risk while, small firms also document low liquidity as compared to large firms. Thus, small firms can be riskier due to low liquidity and sustainability as compared to larger firms.
Regression analysis	Misman, 2010	The ever-changing global financial markets pose various risks to the financial institutions all over the world including Islamic banks and conventional banks have to face same category major risks; i) credit/default risk, ii) interest rate risk, iii) liquidity risk, iv) underwriting risk and v) operating risk in Bank Islam Malaysia Berhad (BIMB).
	(Pathan, 2009a)	Strong bank boards (boards reflecting more of bank shareholders interest) particularly small and less restrictive boards positively affect bank risk-taking.
Multiple Regression analysis	(Gopalakrishnan & Bierly, 2006)	In a context of small firm is limited with time, human resources and knowledge with a very low maturity level. Conversely, the competitiveness of larger size firms is dependent on speed, and their availability of skilled human resources who devoting dedicated expertise to the exploration of new knowledge without violating the attention on their core activities.
Regression analysis	(Gabrielsson & Huse, 2005)	Qualified board members display an important role in developing the competitiveness and skill of the companies.
Content analysis	(Code, 2004)	Leadership structure (CEO) is the team leader of board that is appointed by board of director. Leadership structure of a board (CEO) is to be separated from chairman so that chair and CEO can protect risk at different way.
Meta analysis	(Hambrick & Mason, 1984)	Board member with a sound degree of education qualification has the ability to deal with any neologism and innovative in a good manner.

METHODOLOGY

This study covers all Islamic financial institutions in Bangladesh over a six-year period (2013-2018) and includes Islamic banks, insurance and financial investment companies ltd. The secondary data is filtered from the most recent literature by conducting mete analysis technique literature findings. In order to include a firm in the sample this study has applied three different criteria. First, for applying the agency theory that maintains an adjacent relationship between corporate governance characteristics and risk-taking. Second, due to the stakeholder theory employed in this paper, it is required to measure the interest of stakeholders that impact on risk taking. Third, the study used key words extracted available literature from Google Scholar, ProQuest, and Scopus as well as other online data based. The study summarized the empirical review on the corporate governance characteristics which analyses the effects of governance attributes on the risk taking for IFIs.

DISCUSSION

The presents study analysis the corporate governance characteristics and risk taking among IFIs in Bangladesh. The corporate governance characteristics indicate BOD, AC, RMC and SSB characteristics. From the empirical studies highlighted that the average board size, whereas more than one-third independent directors and dual position of leadership strongly able to control risk. In addition, director’s ownership and maximum participate in meeting (more than 75 %) highly able to control excess risk taking. Audit committee and risk management committee place in right position which is highly supervise and monitor to control risk. It has also explained that multiverse board play a significant role to control excess risk taking. The present study indicates that board characteristics, AC, RMC and SSB characteristics have built up a conceptual framework where there is a corporate relationship on each other that underpin agency theory.

However, financial firms are more complex and larger in size where the bigger board is generally expected. In addition, there is evidence in the existing literature which suggests a positive relationship between board size and complexity of the firm. Previous literatures show a noticeable statistic that even though financial services have the smallest board size containing around six directors, the majority of those directors are independent with an average figure of around 76%, which is the highest satisfactory position to risk control. The present study shows independent variables as stakeholder theory paradigm that, creates effective measurement of risk taking and the stakeholders which lead to insolvency, economic collapse, liquidity shortage, financial institution corrupted, financial institution scandal, enterprise fall and monetary instability even misunderstanding amongst the stakeholders that lead to credit risk, liquidity risk. Finally, theoretical review findings summarized that there are two theories such as agency theory and stakeholder theory are considered as most relevant for underpinning to justify the literature summary of this study. Moreover, the Agency theory explain role of the corporate governance characteristics on risk taking of IFIs. The present study also shows stakeholder theory paradigm that, influences on the creates effective measurement of risk taking and the stakeholders which lead to insolvency, economic collapse, liquidity shortage, financial institution corrupted, financial institution scandal, enterprise fall and monetary instability even misunderstanding amongst the stakeholders that lead to credit risk, liquidity. The study recommendations will be used to develop a research framework to examine relationship the corporate governance characteristics and risk taking based on empirical data and findings could be a valuable source of knowledge for policy makers and regulators in the Islamic financial services sectors in the world.

CONCLUSION

This study has been conducted through a systematic research review formality to identify the key corporate governance characteristics to fill the gap among the Islamic financial institutions (IFIs). The corporate governance characteristics capture the two theory that affecting the risk taking and has justified with most relevant theories in the particular area. The findings of this study thus offer the theoretical rationale way that BOD, AC, RMC and SSB influence corporate risk taking of IFIs in Bangladesh. Finally, the study has examined the perceptions of Islamic financial firms' BOD, AC, RMC and SSB through the application of qualitative methods provide interesting and in-depth insights to the link between corporate governance mechanism and risk taking in Islamic financial firms. This study contributes to IFIs literature on corporate governance. Additionally, future research could further extend the role of the Shari'ah supervisory board.

AUTHOR CONTRIBUTIONS

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CONFLICT OF INTEREST STATEMENT

The authors declare that they have no competing interests.

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All authors contributed equally to the conception and design of the study.

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