COMPARATIVE ANALYSIS BETWEEN THE TRADITIONAL MODEL OF CORPORATE GOVERNANCE AND ISLAMIC MODEL

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Abstract:
Corporate governance represents a set of processes and policies by which a company is administered, controlled and directed to achieve the predetermined management objectives settled by the shareholders. The most important benefits of the corporate governance to the organisations are related to business success, investor confidence and minimisation of wastage. For business, the improved controls and decision-making will aid corporate success as well as growth in revenues and profits. For the investor confidence, corporate governance will mean that investors are more likely to trust that the company is being well run. This will not only make it easier and cheaper for the company to raise finance, but also has a positive effect on the share price. When we talk about the minimisation of wastage we relate to the strong corporate governance that should help to minimise waste within the organisation, as well as the corruption, risks and mismanagement. Thus, in our research, we are trying to determine the common elements, and also, the differences that have occurred between two well known models of corporate governance, the traditional Anglo – Saxon model and also, the Islamic model of corporate governance.

Key words: corporate governance, traditional model of corporate governance, islamic model of corporate governance, shareholders

JEL codes: G34

1. Introduction
Corporate governance has recently become a central issue for the success of corporations in the business environment. In particular, in the wake of a number of scandals, such as Enron, Parmalat, WorldCom or Lehman Brothers, its importance has been understood by both developed and developing countries. But, what exactly is corporate governance? A large volume of studies has been published by describing the main definition of corporate governance. In general, corporate governance consists of shareholders, stakeholders, employees, boards of director, chief executive officers (CEO) and owners.

In this respect, corporate governance can be accepted as an art of management, which provides a well-organized top-down communication between all the above mentioned participants in a company. It is a widely held view that well organized corporate governance is one of the main conditions to the success of corporations and, in parallel with this, for effective functioning of financial markets.

However, although corporate governance plays an important role in the company, sometimes it may also lead to some problems within the corporation. This is because corporate governance has a complex structure. In this respect, it may be difficult to regulate who will control the employee, how much risk of investment will company stand, how company will take into account welfare of shareholder and stakeholder, how the board will be elected and who will be a member in the board. These questions can be expanded and almost every corporation can face these problems in financial markets. In the literature, there are four kind of well-known corporate governance models, such as Anglo American Model, German Model, Japanese Model and finally, Islamic Model.
2. Literature Review

Corporate governance is a concept developed over time; the concept had started to be used extensively with the advent and development of corporations. Thereby, Tricker, 2000 and Crowther and Seifi, 2010 support the idea that the concept of corporate governance has its origins in the practice before 1990, reaching a high level with a strong development in the last two decades and being currently involved in a wide range of issues related to finance or business.

The authors Baysinger and Butler, 1985 were the first who used the concept of corporate governance by studying the effects of changing the Board of Directors on corporate governance performance. Cadbury, 1992 defines corporate governance as a set of processes and policies by which a company is managed, controlled and guided towards achieving its main objectives preset by the shareholders in management activity. According to Perez, 2003, corporate governance is considered "the management of management" meaning it should be addressed closely related to the concept of "good governance" (designates a participatory and deliberative system, which sets and achieves goals, ensures the most efficient use of resources and has as a result, improved relations between the organization and the different types of stakeholders).

Finally, a legally relevant point of view on the concept of corporate governance is expressed by the Organization for Economic Cooperation and Development (OECD), 2004. According to this, as a whole, the rules and practices that govern the relationship between managers and shareholders of a company, as well as stakeholders (such as employees and lenders) contribute to economic growth and financial stability and represent the pillars underpinning market confidence, financial market integrity and economic efficiency. In spring 2004, the Organization for Economic Cooperation and Development has revised and improved corporate governance principles, published for the first time in 1999, having forefront these global importance of good corporate governance and its contribution to economic vitality and stability. Whether they are addressing listed companies, economic unlisted entities, or public institutions, in drafting regulations and codes of corporate governance the pillar of reference is given by the OECD set of principles.

The first embodiment of the concept of corporate governance has been developed in relation to large listed companies and, in time, the concept and assimilated practices have acquired a special relevance because of the favorable effects produced on the activities and results achieved by them, the management systems knowing a significant improvement. Today, both in terms of these benefits, and under the impact of globalization, there is a trend towards widening governance, as a way of alternatively driving other kinds of entities.

Related to the specific economic, financial, political, social or cultural characteristics of each state, the corporate governance systems have characteristics and defining elements that distinguish them from one country to another. Solomon, 2010 considers that trying to select a corporate governance model to apply it in a particular country is quite difficult, as the corporate governance structure of each country grows by reference to the factors and conditions within it.

A relevant criteria is highlighted by the authors Pirtea, Ceocea, Ionescu, 2014, the criteria of "insider - outsider", insiders being persons employed by the corporation or having personal relationships or significant business with its management, while outsiders designate persons or institutions from outside the corporation, which have no direct relationship or management thereof. According to these criteria, two types of systems can be defined: insider systems of corporate governance and outsider systems of corporate governance, their essential characteristics being summarized in Fig. 1:

**Outsider model:**
- diffuse property;
- highly liquid equity market;
- the market for control very diffuse;
- defending the interests of shareholders, especially the minority ones.

**Insider model:**
- it often represents the reference shareholders (concentrated ownership in banks or families);
- control is exercised by shareholders;
- capital market relatively illiquid;
- the absence of a market for control.

*Figure no. 1 Features of insider and outsider-type models*  
*Source: Authors own interpretation*
Monks and Minow, 2008 and Tricker, 2012 argue that countries with advanced economies are characterized by two models of corporate governance: the shareholder model, which aims to maximize shareholder value and stakeholder's model, which aims to protect the interests of all parties involved in the company life, as shareholders, managers, employees, trading partners, etc. On the other hand, the authors Choudhury and Hoque, 2006 and MICG, 2007 shows that, in countries characterized by Islamic culture, corporate governance is intended to increase accountability, transparency and trust, values extremely important in Islam.

3. Methodology and data

Considering all aspects of conceptual nature, further we will focus on two systems of corporate governance from the ones mentioned above, the traditional Anglo-Saxon system and Islamic system. In a concrete way, we propose a targeted approach on each model by its defining elements and a comparative analysis of those.

- Traditional Anglo-Saxon model

Regarding the traditional model, it works as a shareholder type model (attention is focused on shareholders) and is used for governing corporations in the United States, Britain, Australia, Canada, New Zealand and other few countries. The model is based on a well-developed regulatory framework, which stipulates rights, responsibilities and relationships between the key players that make up the triangle of corporate governance, namely: managers, directors and shareholders.

According to this model, the corporation has as a priority objective maximizing the value for current investors by focus on outsiders. In this regard, in the United States and Britain, known tendency is to involve more outsiders than insiders in corporate governance structure, in order to avoid abuse of power (for example, a Board of Directors controlled firmly by a person serving both as chairman and as CEO, or a Board of Directors composed solely of insiders interested to keep the power on for long term, without taking into account the interests of other participants). However, in these countries outsiders tend lately to become insiders, as institutional shareholders get to hold majority shares in a corporation and exert a strong influence on management, taking over the role of major insider.

Since it is an outsider model, the traditional model has the characteristic that investors are contributing to capital in order to maintain the ownership within the group, but they generally avoid to assume legal responsibility for corporate demarches, which is why they precede through disposal of management control by paying leaders who act as their agents. The costs of this separation of ownership and control are called "agency costs". However, a problem in this case is the fact that the interests of managers and shareholders do not always coincide. To reconcile these conflicts, a Board of Directors will be elected by the shareholders, with an oversight management role on behalf and in their interest. Therefore, the Board of Directors should provide two functions: business management - achieved by insiders (executive management in which supreme authority is CEO - Chief Executive Officer) and supervision and control - performed by outsiders (called non-executive directors in the British system), as it is highlighted in the Fig. 2.

![Figure no. 2 - Traditional Anglo-Saxon Model](Source: Own processing)

Another feature of the traditional model is that stock exchanges play an important role in establishing the requirements for listing and information services. The disclosure requirements are high, but nowhere are as stringent and complex as the United States. From the multitude of them, we remember the following: a breakdown of the capital structure, corporate financial data, detailed and substantial information on each candidate to the Board of Directors, information on mergers and restructuring, proposed amendments to the Articles of Association etc. The operating
arrangements of Anglo-Saxon model in the UK and in other countries that use it are similar, with the specification that it requires less data, but in multiple categories. In addition, regarding corporate actions requiring shareholder approval, they fall into two categories: routine actions and non-routine actions. Routine actions require the approval of shareholders and include election of directors and the selection of auditors. On the other hand, non-routine actions also require the approval of the directors although refers to mergers and takeovers, restructurings, as well as amendments of the Articles of Association.

However, between the American system and the British system there is a significant difference: in USA, shareholders do not have voting rights on the proposed dividend in the Board of Directors, unlike Britain, where shareholders have this right. Regarding the right to vote, the traditional model allows voting by proxy, without the shareholders being required to effectively attend the General Assembly. The process can be shortly described as follows: shareholders receive an e-mail about the agenda of the meeting, including information on all the proposals, the draft of the annual report of the corporation and a voting card, which must be completed and returned by e-mail. Thus, the shareholders authorize the Chairman of the Board to consider votes as indicated on the card.

- Islamic model

Islamic model is based on the idea that, in corporate governance both managers of companies and auditors should perform their professional duties, having as a final objective satisfying the needs of shareholders and the will of Allah. According to Fig. 3, the principles of corporate governance in Islamic model are:

- Liability - according to this principle, Muslims believe that they will be held accountable for everything they do in their life and in the afterlife. Thus, every action must be consistent with Islamic teachings, without the existence of fraud and misstatement that may be reflected in their conduct;
- Transparency - the corporation is responsible for a broad spectrum of stakeholders, so it is obliged to provide clear and accurate information about its policy, integrity and honesty being the basic features of a good management. Thus, by applying the concept of transparency, the company should disclose information on its policy, activities undertaken, contribution in the community, resource use and environmental protection;
- Correctness - Islam supports collective approach in making decisions process, as well as tolerance and political freedom. Thus, when they have to take a decision Muslims put their trust in Allah;
- Responsibility - according to this mentality, everyone in the organization must comply with ethical conduct in the exercise of commercial activities. In these conditions, the leader should be judged by how well he managed property based on Islamic principles, not how much has increased the wealth.

![Figure no. 3 The pillars of corporate governance in Islamic model (Source: Authors own interpretation)](image)

Within the model, managers have the obligation to run the business in the interests of all stakeholders. However, each stakeholder has the freedom to protect its rights through systematic institutional arrangements in order to resolve the conflicts of interest. Apart from regulatory approach of corporate governance, Islamic beliefs are viewed as a model of self-regulation, with fear of responsibility before Allah on the Day of Judgment as well as during life. In spite of all these religious restrictions, the principle gives human beings freedom in meeting their daily activities to comply with it.

Briefly, it can be said that Islamic principles of corporate governance determines three dimensions of decision-making: "by whom", but with a mutual consultation with the Advisory Board, "for whom", having as an
ultimate goal to win the grace of Allah, and, not finally, the size "with whom and to whom", meaning that corporate governance decisions require religious effective supervision in order to be sure the operations and procedures are in accordance with the rules of the Koran. Secondly, Islamic instructions for Muslims suggest teamwork, and reflects the fact that team members must follow the command of the group leader, whether CEO or Chairman of the Board. Thirdly, the Prophet's life is a model of running a business under an Islamic state, whether in wartime or peacetime, and can be considered a procedure in determining corporate strategy

4. Data and Results

As it can be seen from the above mentioned information, there are some different corporate governance systems all over the world. Therefore, we will attempt a comparative analysis of those two highlighted above, by presenting the similarities and differences between them.

Thus, we can note that the Anglo-American model is focused on the capital market around which revolves a large number of listed corporations. We can also notice that specific for the USA and Great Britain is the shareholders type of corporate governance, in which the attention is focused on maximizing the shareholders’ profit. However, we can observe the same characteristic in the Islamic model, when both managers of companies as well as the auditors should perform their professional duties, having as a final objective the satisfaction of shareholders' needs and the will of Allah.

Separation of ownership and control can be accepted as the main problem in corporate governance structures. This system can be usually seen in the Anglo American model. As I have mentioned previous in the paper, shareholders may not have enough ability to run the company in a professional manner. Therefore, they may need an external agent for the daily running of company’s issues. However, this “divorce” can be accepted as the main reason of the conflict of interest between the shareholders and the external agents. Theoretically, this problem is defined as ‘the principal-agent problem or agency problem’ in the literature. Therefore, shareholders hire external agents in order to increase long – term returns, but there are cases in which external agents may prefer to focus on short – term profits and to pursuit their personal objectives.

The Islamic principles of corporate governance determine the three dimensions of decision-making: by whom, with mutual consultation of Consultative Council; for whom, the ultimate aim of any corporate activity is to gain grace of Allah and the decision makers on the earth regarded as trustees of the given powers to take decisions in the best interests of His people and with whom and to whom; the corporate governance decisions require an effective religious supervision to ensure the conformity of all operations and procedures. Secondly, the Islamic instructions for Muslims to follow the commands of God as told by Prophet, suggested teamwork and cooperation with all members while the concept of group leader reflects that team members should follow the command of group leader either he is CEO or Chairman of the board. Thirdly, the life of Prophet set an example to run the business of Islamic State either during war-time or in peace time provides the concept of planning and strategy which might be regarded as a procedure to determine the corporate strategy. Lastly, the use of auditing, accountancy, and documentary records of all corporate transactions by good man who possesses credibility might be a source of internal control and risks management as well as financial disclosure and reporting which is a key element of corporate transparency of modern era.

On the other hand, the principles of traditional Anglo – Saxon Model of corporate governance focus on corporate transparency, effective monitoring, efficient management, sound system of internal control and risks management through competent board of directors who should be free from conflicts of interests and possess skills and experience to run the corporate affairs in competitive environment. They should ensure corporate stability to protect investors’ confidence through transparent reporting and disclosure. The comparison of both Islamic and Western systems of corporate governance suggest that the basic theme of corporate governance is not different and both system based on capitalism with some priorities of wealth maximization for investors and rest of the stakeholders by providing them opportunities to contribute in corporate decision-making by promoting fair, just and honest business dealings.

The objectives of both systems of corporate governance seem similar and are to establish the sound system of corporate governance through efficient, effective management, corporate reporting and disclosure for long-term corporate stability which should not only be beneficial to investors but to the rest of the stakeholders as well.

5. Conclusions

The aim of this paper was to clarify the term of corporate governance, to understand its fundamental problems in the financial markets and to investigate two important models of corporate governance. In this respect, the main definitions of well-known scholars were examined and the fundamental problem of each model of corporate governance was analyzed. Due to rapidly changing in global financial markets, corporate governance needs to be updated and to consider common value of all players in the financial markets. In general, therefore, in order to make a unique definition, corporate governance can be evaluated from legal and economic perspectives and its universal values, such as transparency, accountability, reliability and responsibility can be highlighted. This research has also shown that a well-organized corporate governance structure can be accepted as one of the elements to the success of corporations. However, due to these differences, the fundamental problems of corporate governance can be varying in the financial markets.
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