

Adoption of Shari'ah Governance Framework of Islamic Financial Institution Industry into the Muslim Friendly Hospitality Industry in Malaysia: Is it Possible?

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Abstract: Background-governance could be defined as the manner in which the power is executed in the management of an organization. Also, governance is described as the process of decision making and the process by which decisions are implemented in various aspects, i.e., economic, political and administrative power of the state. Meanwhile, it is believed that having good governance may contribute to an efficient organization. These encompass the concepts of accountability, transparency, participation, democracy, free media and access to information, human rights and rule of law. To achieve these, it requires mechanisms, processes and institutions through which citizens could articulate their interest and exercise their legal rights. Shari'ah governance on the other hand is another pertinent set of framework developed by Shari'ah based industry particularly in Islamic finance industry in Malaysia. Shari'ah Governance in IFIs currently in force in Malaysia is governed by the Shari'ah Governance Framework (SGF). The establishment of an effective independent oversight of the Shari'ah compliance over IFIs functioning of SG within IFIs could not merely ensure that the transparency and disclosure are increased but also would strengthen investor's confidence in the industry. Considering the importance of developing Shari'ah governance framework to another sector of Halal industry, this study conceptually seeks to discuss the regulatory framework currently in force with special attention given to the muslim friendly hotel sector. Reviews of various related documents demonstrate that the loopholes within the governance part appear to exist despite the establishment of Muslim friendly Halal hospitality service-requirement MS 2016: 2015. This study therefore recommends that a set of comprehensive and updated piece of Shari'ah governance framework for the muslim friendly hospitality should also be developed. In order to achieve this objective, current SGF of Islamic Finance Shari'ah Institutions could be adopted as a model. This study however further proposes that certain modification should be made owing to the different needs and sustainability of industry in order to meet the needs of each sector. It is hoped that this study will create an alarm among the policymakers, key hotel operators and regulatory bodies to embark on the same journey.

Key words: Propose, adopted, operators, modification, governance

INTRODUCTION

Similar to Muslim countries, being a global Halal hub has been a major goal for the Malaysian government. This is evident by the great emphasis put forward for Halal products and services in fulfilling the demands of the Muslim countries across the world. Given that various segments of Halal industry have taken place, Muslim

friendly hospitality sector has also been recognized as one of the key factors in generating economic growth. Malaysian hospitality industry has grown steadily in parallel with tourism industry (Salleh *et al.*, 2014). In 2014, the total of 71, 661, 381 Malaysia hotel guest including domestic and foreigner increase by 25.44% from the previous year (Malaysia, 2015). Similarly, Muslim-friendly hotels have significant opportunities and had been given

some recognition in the region by crescent rating of Singapore (Samori and Rahman, 2013). The Muslim tourists market in Malaysia has shown high and consistent growth rate since 2001 due to lavish spending pattern of Middle East Muslim tourists that visit Malaysia (MS, 2016).

Parallel with the above situation, statutory regulation governing the formation of hotel industry in Malaysia has also been established. Malaysian Hotel Association (MAH) for instance is a corporate body which acts as the official national network for the hotel industry of Malaysia. Meanwhile, the available halal standard for Muslim friendly hospitality namely Muslim halal hospitality service-requirement MS 2610: 2015 has also been gazette in December 2015.

However, in terms of legal policies, to date there is no Shariah governance framework which specifically designed for Muslim friendly hospitality industry. On top of that the absolute power in monitoring and providing clear principles and guidelines remains unresolved. Considering to this scenario, initial feedback has indicated that there is significant needs to have a Shariah governance framework to properly govern Muslim Friendly hospitality industry. To ensure the soundness of this industry having structured framework is therefore vital. Consequently, in order to achieve this the existing Shari'ah governance framework for Islamic finance currently in force could be well adopted as a good model in developing Shari'ah governance framework for Halal industry other than the Islamic finance. However, in order to meet the needs of different sector, certain modification should be made owing to the different needs and sustainability of industry.

Shari'ah governance: As by Sharifah and Ismail (2011) the notion of "good governance" is crucial in today's government practice. Governing the state in Islam which is known as Al-Siyasah Al-Shar'iyah is closely associated with an effective governance. While siyasah carries multiple meaning, i.e., to arrange, to manage to rule and politics in order to achieve certain objectives, its conceptual meaning denotes it as an act of providing human benefit and protecting them from any destruction. On the other hand as by Abu-Tapanjeh (2009) governance structures in Islam differ from the common corporate governance practices. Islamic institutions imply decision-making in a different and broader ways than conventional institutions do. The management aspect should in line with the divine norms and rules, values of truthfulness, fairness, tolerance and justice. On top of that its structure should meet the expectations of Muslim investors by providing modes that are compliant with

Islamic principles. Meanwhile (Grais and Pellegrini, 2006), further add that systematic framework should be mutually reinforced, offer checks and bounds to corporate.

To further strengthen the above indication, the term yudabbiru has been quoted repeatedly in several places in the Quran reflecting on Islamic administration and management as a sub-concept and practice to Al-Siyasah. It entails that basic cooperation between the ruler, the administrator and the citizen is inseparable in governing the country (Ismail, 2010). Given the above, it signifies that consistent systematic Shariah governance framework is the underpinning of effective Shariah corporate governance at the firm level. Allah (SWT) has extensively mentioned on the importance of having well governance in several places in the quran. Allah (SWT) says: "And let there be such a group among you that they may call towards goodness and command what is just and forbid evil. And the very same attained to their goals" (Quran Surah Ali-Imran).

In this regard, it is highly encouraged that the overall general framework designed shall be derived from Quranic principles and hadith Rasulullah (SAW) (Paino *et al.*, 2011) despite the different obligations carried out by different organizations. In this effect, the implementation of Shari'ah governance in Islamic financial institution has been encouraged by International institutions of regulations such as Accounting and Auditing Organizations for Islamic Financial Institution (AAOIFI) and Islamic Financial Services Board (IFSB, 2009) (Hamza, 2013). Other than that the establishment of comprehensive Shari'ah governance for the Islamic banks is essential so as to ensure compliance with the Shari'ah rules in their products, instruments, operations, practices and management.

Legal and regulatory framework for hospitality industry in Malaysia

Legal framework: In the early history of Tanah Melayu, the first written code developed was Undang-Undang Melaka which impliedly provides rules for travelers. After the independence, Malaysian government has given special attention to tourism planning (Hamimah, 2009). Consequently, full supports from the government and major industry players have been received in promoting Malaysia as one of the top tourist destinations. These are evident by the development of a number of regulations and guidelines governing the tourism industry. Amongst the notable ones which have been documented include. The Innkeepers Act 1952 and the Tourism Industry Act 1992 which have a direct effect upon the accommodation operators. Tourism Act 1992 for example specifically

provides guidelines for the operation of the tourism industry and exclusively governs the relationship between the accommodation sector and the guests (Abdullah, 2009).

Meanwhile, the Innkeepers Act 1952 encompasses legal duties of innkeepers towards guests which include duty to provide reasonable refreshment to travelers, duty for registration of guests has right of refusal to receive guests, duty to provide adequate facilities to guests and duty to refrain from discrimination (Abdullah, 2009). On the contrary, legislation indirectly affect the accommodation sector include; the Contracts Act 1950, the Employment Act 1955, the Consumer Protection Act 1999, the Trade Descriptions Act 1972 and the Occupational Safety and Health Act 1994 (Sharija, 2009; Abdullah, 2009).

Malaysian standard: Apart from the legislation, specific standards associated with the tourism and hotel sector have also been developed. Malaysian Standards (MS) are developed by the standards development committees under the auspices of the Malaysian standards development system and approved by the minister of science technology and innovation in accordance with the Standards of Malaysia Act 1996 (Act 549). The technical committees comprises of producers, users, consumers and other relevant agencies appropriate to the subject in hand. In 2012, two Malaysian Standards have been designed to ensure the quality of hospitality services namely MS 2446: 2012 (Accommodation premises-Classification-Criteria and requirements and MS 1926 (Tourism Services-Hotels and Other Types of Tourism Accommodation-Terminology) (Malaysian Standards, 2012; Anonymous, 2006).

Halal standards for muslim friendly hospitality: With regard to Muslim Friendly Hospitality Industry, the new Malaysian Standard, i.e. (MS: 2610:2015) Muslim Friendly Hospitality Services-Requirements has been currently developed in Malaysia. Various agencies, academicians and industry players were involved in developing this standard. They include among others; JAKIM, Institute for Halal Research and Training (INHART) of the International Islamic University Malaysia (IIUM) Department of Standards Malaysia (DSM) Standard and Industrial Research Institute of Malaysia (SIRIM) and representatives of tourism industry players, i.e., the Islamic Tourism Centre (ITC) the Malaysia Association of Hotels (MAH) to name a few.

Basically, this respective standard provides guidance for the industry players for managing tourism, facilities, products and services for Muslim travelers in accommodation premises, tour packages and tourist guides. This available standard comprises of 2 Sections, namely the general and specific requirements which are both applicable to accommodation, tour packages and tourist guides. Specific requirements are listed to govern the aspect of hotel accommodation whereas Clause 4 of the MS 2610:2015 encompasses general requirements regarding management responsibilities. Establishing proper documentation and storage are also included as a general requirement for organization.

MATERIALS AND METHODS

Model of Shari'ah governance framework for Islamic financial institution: According to the Islamic Financial Services Board (IFSB, 2009), the actual definition of Shari'ah governance refers to a set of institutional and organizational arrangements through which IFIs ensure that there is effective independent oversight of Shari'ah compliance including the issuance of relevant Shari'ah pronouncements, dissemination of information and an internal Shari'ah compliance review (Shafii *et al.*, 2013).

Historical development of Shari'ah governance in the Islamic finance industry: Owing to the development of Islamic banking in Malaysia, Shari'ah Governance Framework has been specifically developed for Islamic Institution. In 2005, Bank Negara Malaysia (hereinafter referred to as "BNM") developed guideline which covers the scope of duties and responsibilities of the Shari'ah Committee (hereinafter referred to as "SC") and its members. However, in January 2011, the BNM has issued Shari'ah Governance Framework (SGF) for the IFIs which superseded the former guidelines. It is governed by the Shari'ah Governance Framework in pursuant to Section 59 of the Central Bank of Malaysia Act 2009, Section 53A of the IBA, Section 69 of the TA, Section 126 of the BAFIA and Section 126 of the DFIA. This framework has to be complied by all Islamic Financial Institutions (IFIs) in Malaysia within 6 months period from the date of its issuance (Hasan, 2009). The primary objective of the framework is to strengthen the Shari'ah governance structure, processes and arrangements in order to meet the needs of Shari'ah principles. Apart from that this framework could be used as a guideline for the SC and management of IFIs in executing their duties and ensuring the entire operating environment is in accordance with the Islamic principles and rulings (Haqqi, 2014).

An overview of the significance of Shari'ah governance framework: As mentioned by Haqqi (2014) among the objectives behind Shari'ah Governance in IFIs is not only to increase transparency and disclosure but also to enhance professionalism and improve oversight of the IFIs and functioning of the governing body which would lead to strengthen investor's confidence in the industry. To achieve this the formation of the key component, i.e., the Shari'ah board in the Shari'ah Governance of the Islamic Financial Institutions (IFIs) is therefore pertinent. It plays an essential role in ensuring that all objectives of Shari'ah governance are met and these include directing, reviewing, supervising the activities of IFIs and issuing legal rulings (Hasan, 2009). This has been highlighted in Section 28 of Islamic Financial Services Act in (2013).

The main key function of this respective framework comprises of Board of Directors, Shari'ah Committee and Management. Section 2 of SGF 2010 has further outlined the level of oversight, accountability and responsibility expected towards each major component (Idris, 2011).

Board of directors: BOD considered as the principal component of the Shari'ah governance framework. The BOD is ultimately accountable and responsible on the overall Shari'ah governance framework and Shari'ah Compliance of the IFIs. Shari'ah committee. An independent body entrusted with the duty of directing, reviewing and supervising all activities of the Islamic financial institution in order to ensure that they are in compliance with Islamic Shari'ah rules and principle (Hamza, 2013). Management has a duty to observe and ensure executions of business and operations are in accordance with Shari'ah principles and they have to also provide necessary support to the SC (Graham *et al.*, 2003).

Specific requirements of Shari'ah committee in the Islamic finance industry: In view of the above, special focus has been given to the specific requirement, roles and responsibilities of Shari'ah Committee in SGF 2010. By virtue of Section 3, 4 and 5 of SGF 2010, these sections further outlined SC requirements, roles and functions. This demonstrates that SC bears vital responsibility in discharging their duties and remains the most important governance mechanism to ensure the compliance with the Shari'ah in the entire operation of IFIs. Provided are the requirements for the SC members as has been highlighted in SGF 2010.

Independence: Given their vital place and nature of their tasks, the requirement for independence SC has been outlined in principle 3 of SGF 2010. Board of directors as

emphasized has to acknowledge the independence of SC by allowing the SC to exercise their powers and duties without undue influence in deliberating the issues brought before them. Similarly, as this requirement is one of key factor of good governance, Section 3 of SGF 2010 provides that the SC needs to report direct to the board and frequently inform the board on relevant Shari'ah matters. The board shall further ensure that the decision made by SC are duly observed and implemented by IFIs and their decision shall not be modified without their consent. The SC shall also be provided with accurate information by the management and may request additional information whenever needed. Failure to provide the required information, necessary action shall be taken by the board having knowledge on it to rectify the situation. Other than that the SC shall inform the board of directors should they found any non-compliance activities by the IFIs and to recommend suitable measures to rectify the situation. Lastly, to ensure the integrity of the SC, the appointment and the remuneration should be done by the board with the approval of the BNM and Shari'ah Advisory Council (hereinafter referred to as "SAC").

Competencies and qualification: Section 4 of the SGF 2010 further outlines the requirement and expected competencies of the SC to ensure the Shari'ah governance within IFIs are implemented. Principle 4 of the SGF 2010 recommends that any person bearing responsibilities for an IFI shall possess necessary competency and enhance their knowledge and understanding on the Shari'ah and keep abreast with latest developments on Islamic finance. They should have sufficient knowledge in finance and also in Islamic finance to enable them to comprehend with the Shari'ah issues. Further, the IFIs are encouraged to set proper criteria for the appointment of SC member using the minimum criteria set by the BNM. This element is crucial as it could provide assurance that this organization is governed and monitored by such a credible committee. Apart from that professional services shall be engaged for example lawyers, accountants and economists to provide assistance regarding issues on law and finance to the respective SC.

Amongst the notable qualification set out by the SGF 2010 are Members of SC shall be Muslim individual, members of SC shall at least hold bachelor's degree in Shari'ah which includes study in Usul fiqh or Fiqh mu'alamat from recognized university, they should be able to demonstrate strong proficiency and knowledge in written and verbal Arabic and have good understanding in Bahasa Malaysia and English language. Experts from

relevant backgrounds may be appointed as SC members who could support the Shari'ah deliberations. However, they could not form the majority of the SC. In addition, it is highly recommended that the SC members should consist of diverse backgrounds in terms of qualification, experience and knowledge.

Confidentiality and consistency: Another element which is related to the SC is the confidentiality of information. This is stated in Section 5 of the SGF 2010. Principle 5 of SGF 2010 provides that internal and privileged information obtained by the SC shall be kept confidential and shall not be misused. They shall be given necessary access to files, records, draft materials and conversations include those categorized as confidential. Further to that confidential issues acquired by the SC member while serving their duties shall not be used in any manner that could be harmful to the IFIs. Also, The SC members will not be liable for breached on the confidentiality if the sensitive information and data were disclosed to the BNM in good faith when reporting serious breaches of Shari'ah by the IFIs. To maintain the confidentiality of information, the IFIs shall not appoint any member of its SC from a SC of another IFI within the same industry as to avoid any conflict of interest. Principle 6 of SGF 2019 further stresses that professional ethics, judgment and consistency shall be maintained at all time in ensuring the quality and consistency of the Shari'ah decisions. Thus, they are required to respect and observe the published Shari'ah rulings issued by the SAC and must not go against the decisions of the public. However, in the event where uncertainties are deemed to be occurred among the SC members due to divers opinion and views, the IFI may seek advice and refer from a ruling from the SAC. However, it is notable that when there is a dissenting judgment between SAC and IFIs's SC members, the ruling of the latter shall prevail.

RESULTS AND DISCUSSION

Other requirements-Shari'ah compliance and research functions: Apart from having strict and stringent requirements for SC as abovementioned, possessing a robust Shari'ah compliance function is also pertinent to establish such a comprehensive Shari'ah governance framework in financial industry. These may include; review and audit function supported by risk management control. As has been stated in Section 6 of SGF 2010 (Idris, 2011), Principle 7 further denotes that review and audit function supported by risk management shall be carried out. Shari'ah review for example shall make a regular assessment on Shari'ah compliance in the activities and operations of the IFI to ensure the activities

are not contradict with the Shari'ah principles. The scope of examination and evaluation of the IFIs level of compliance to the Shari'ah covers the entire operations from process and end product offered. Meanwhile, Principle 7 of SGF 2010 (Idris, 2011) further outlines the requirement of Shari'ah audit which should be conducted from time to time by internal auditors who possess Shari'ah related knowledge and training. Independent assessment should be conducted on a periodical basis in order to improve the degree of compliance (Hasan, 2009). The internal auditors may engage the expertise of the IFI's Shari'ah officers in conducting the audit process. This thorough audit process is important as to enable the IFI to assess whether a sound and effective internal control system for Shari'ah compliance have been implemented. Also, this end process would enable to provide recommendations and rectification measures to be taken. Shari'ah risk management's function on the other hand covers, identify, measure, monitor and control of Shari'ah non-compliance risks to mitigate any possible of non compliance events. The function shall be performed by risk officers who have a vast experience in the subject matter due to the complexity in managing the risk of non-compliance to the Shari'ah. This function is important to ensure the effectiveness of IFIs operations without exposing to unacceptable level of risk.

Adoption of Shari'ah governance framework of Islamic finance institution industry into the muslim friendly hospitality industry in malaysia: (is it possible?): The emergence of muslim friendly hospitality services in Malaysia appears to be significant, in line with the booming of Muslim travelers from the Middle East, Western Asia and other Islamic countries. Hence, apart from being an Islamic country, Malaysia could also be considered to be a perfect and convenient destination for Muslim travelers. Since, the core value of such hotel involves adherence to the Islamic rules in all aspects ranging from cleanliness to accounting and financial practices many hotels in Malaysia have shown interest to implement the concept of muslim friendly hospitality in their premises.

In view of the emergence of the muslim friendly hospitality services concept, in 2015, the new Malaysian Standard, i.e., MS 2610:2015-Muslim friendly hospitality Services-Requirements has been published. This newly introduced standard compliments the already existing standards namely MS 2446:2012 and MS 1926:2006. Nevertheless, a thorough study of the MS 2610:2015 conducted demonstrates that the standard gives more attention to the physical aspect of accommodation premises, facilities and services but less attention is given to address the aspect of shariah governance. The

researchers assert that Muslim friendly hospitality services should not be characterized with only physical and tangible characteristics. It should be beyond. It should be holistic to embrace the intangibles as well. As further highlights that the appointment of personnel with appropriate qualification and skills is indeed indispensable in organizations offering Muslim friendly hospitality services. The researchers also emphasized that in order to be accurately “guided by Shariah requirements and to be “ensure that the requirements related to the product and services are Shariah compliant” it is inevitably vital for the organization to appoint a Shariah compliant officer. It was submitted that the inclusion of appointment and minimum qualification of such officer should be considered in future review of the MS 2610 as it would further assure that Shariah critical control points within the organization’s activities or processes can be effectively controlled and non-compliance to the principles of Halal and haram and principles of muamalat can be prevented and mitigated, so as to ensure compliance to Shariah requirements.

From the above, it can be said that despite the existence of the MS 2610:2015, the aspect of “Shariah governance” which is an important element in any organizations aspire to run Shariah compliant businesses has been overlooked. According to Shariah compliance is the backbone of any shariah-based organizations be it Islamic finance and the like. Having Shariah governance framework in place would boosts the confidence of the shareholders and the public that all the practices and activities are in compliance with the Shariah requirements at all time. With the development of Shariah Governance Framework (SGF), it can help muslim friendly hospitality services industry in Malaysia to grow.

Hence, it is further proposed that the current SGF in IFIs should be looked into by the Muslim friendly hospitality services industry. The development of SGF for the muslim friendly hospitality services industry should be considered to ensure Shariah compliance in all operations and activities of the institutions which make them different from conventional ones. Even though both industries are different in terms of the nature of business and transactions but both are still under uphold the Shariah principles. The framework should include the active roles of the Shari’ah Committee (SC) Shari’ah Audit, Shariah Research and Shari’ah Review. The role of SC in particular should not be restricted to the Islamic Finance but should be extended to the Muslim friendly hospitality industry. On top of that apart from the qualification of SC mentioned in the IFI’s SGF, it is further suggested that the SC members should also comprehend with the variety of Malaysia’s Halal Standard

requirements for Halal products and services and keep abreast with the latest development of the industry.

On the same vein, the same principles upheld in the Islamic finance SGF that put great concern on the values and structure, accountability, responsibility, competency, transparency and strict adherence to Shari’ah principles should also be implemented in the muslim friendly hospitality services industry.

CONCLUSION

In view of the above discussion, it is apparent that the Shariah governance framework plays an important role to assure Shariah Compliance. It sets the institutional and organizational arrangements through which Shariah based organizations and businesses ensure that there is effective independent oversight of Shari’ah compliance including the issuance of relevant Shari’ah pronouncements, dissemination of information and an internal Shari’ah compliance review. This is evident by the tremendous growth and success of the Islamic finance industry all over the world and in Malaysia particularly.

As such it is believed that the implementation of the same Shariah governance framework in the muslim friendly hospitality services is possible as it shares the same core values and principles of the Islamic Finance industry. Nevertheless, certain modifications and adaptations has to be made to ensure the sustainability of the MFH services industry and in order to achieve this more inputs and feedbacks from the industry players are needed.

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