



## A Comparison between the Islamic and Western Corporate Governance Model with Special Emphasis on Pakistan

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### ABSTRACT

The convergence of western business methods with Islamic law in Pakistan's corporate governance is the topic of this article, which investigates the role that Islamic law plays in the country. Given the current state of the world's financial markets, it is more important than ever to have in place an efficient corporate governance structure. This event made it feasible for there to be an alternative to the financial system that is currently in place in Pakistan. As a result of the worldwide financial crisis, Islamic financing has emerged as a respectable alternative. As a consequence of this, the conventional monetary system will be contrasted with the Islamic monetary system during the course of this essay. In addition to this, it assesses the likelihood of corporate governance mechanisms converging in Pakistan, an aspect that is essential for the efficient administration of any financial system. In Pakistan, the Islamic Financial System (IFS) might be used as a replacement for the country's current financial system and as a mechanism for corporate governance, both of which might share characteristics with western models of corporate governance. On the other hand, using Islamic ideas as a litmus test might not be as problematic as it first appears to be.



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## 1. Introduction

The victory of capitalism over its competitor communism in the last decades of the previous century demonstrates the significance of the capitalist economic system. Since then, the western world with its capitalist financial system has dominated the globe. Classical Muslim jurists were unfamiliar with the current financial system that arose in capitalist nations. However, Islamic money was very popular throughout the early time of Islam. As a practical religion, Islam instructs its adherents in many areas, including financial problems. In Islamic finance, interest is not seen as a legal and lucrative activity, which is the fundamental distinction between Islamic finance and the normal western financial system. Widespread belief is that Islamic banking restricts all contemporary western financial activities. Nevertheless, this is just half the tale. The religion of Islam offers an alternative to debt and loan finance.

One of the key factors that contributed to the most recent financial crisis was excessive use of debt. As a result of the fact that Islamic banking is against the use of leverage, monetary experts, scholars, and researchers have started looking at an alternative financial system that has the potential to respond more efficiently during times of economic strain. The present global financial crisis has given rise to a new kind of financing known as Islamic finance; academics are being pressed to come up with an alternative to this. Recent

industrialization and globalization have sped up the process of convergence, which is when the system of one jurisdiction begins to converge with that of a jurisdiction that performs better. Convergence between one financial system and another that has better attributes is thus feasible.

## **2. Islamic Corporate Financial Model**

Interest treatment is a fundamental distinction between the traditional financial system and Islamic finance. Islamic finance does not regard the debt to be a legitimate or lucrative economic activity (Venardos, 2012). Conventional finance is centered on transactions with interest, but Islamic finance forbids interest on both personal and business loans. It is a common misperception that Islamic finance restricts all contemporary transactions. This is not the whole story. The religion of Islam offers an alternative to debt and loan finance. It bans interest, risk, and unethical commercial practices. Regarding interest, Islam views it as exploitation and the exclusive circulation of money among the wealthy. The Qur'an condemns *riba* by offering a reason for its bad effects: 'it [money] may not [simply] circulate among the wealthiest among you' (Qur'an, 59:7). Interest is, in reality, making money on money, and this may allow wealthy individuals to increase their wealth without engaging in any economic activity. The Islamic financial system is predicated on distributive justice, which refers to the equitable distribution of money, products, and resources between the wealthy and the poor.

In addition, it outlaws companies that it deems immoral, unethical, or religiously forbidden, such as gambling, the manufacturing of alcoholic beverages and their derivatives, pig products, and pornography. Uncertainty is another distinction between conventional and Islamic finance. Some traditional financial operations, such as the futures market, short selling, and gambling, are prohibited under Islamic finance due to their inherent unpredictability. The Islamic financial system is regarded as being morally and ethically oriented. It forbids risk-free returns on financial investments (HMT, 2008).

In this circumstance, "A is being treated unfairly. This is the primary basis for the restriction on interest (*riba*), since it may cause both or one party to suffer an injustice. Islam bans interest because one might benefit without taking risk or participating in profit or loss. Interest-bearing transactions may encourage individuals to make money without engaging in economic activities. Therefore, it promotes equity funding. There may be less unfairness with equity financing since all participants will participate in the profits and losses. Islamic finance offers alternate methods for doing business that may be utilized as alternatives to traditional funding. Modern Muslim and non-Muslim jurists seek alternatives to the traditional financial system. Recent research in Islamic finance has mostly focused on the supply of Shariah-compliant products as an alternative to conventional financial goods. Modern jurists are attempting to synchronize conventional and Islamic finance. Islamic finance and conventional finance may be synthesized to some degree, with the exception of interest, uncertainty, and some industries that are prohibited by Islamic law".

## **3. An Overview of Islamic Finance**

It is a common misconception that Islamic finance was developed during the early stages of Islam and that it is not a flexible system that can adapt to the needs of the modern world. This belief stems from the belief that Islamic finance was founded during these stages. This is a ridiculous presumption to make. The practice of Islamic finance maintains its significance while also undergoing ongoing development. In this regard, the work of Muslim academics is of the utmost importance. It is possible, as a result of the adaptability of Islamic law, for conventionally based financial products that have recently been published to be appraised in light of Islamic law. Academics in the modern era have conducted study on Islamic finance and examined its feasibility in light of the requirements and demands of the modern day. Because of these two factors, Islamic money became an essential component of religious doctrine. To begin, Muslims' day-to-day lives as well as their financial situations are profoundly impacted by their religious beliefs. Second, the Prophet Muhammad (peace be upon him) was a merchant in his own right; as a result, dealings with money were the primary focus of the Prophet's life. Because of both of these factors, the recent focus on Islamic financing has attracted the curiosity of those who specialize in finance. To begin, there

is a strong emphasis placed on Islamic finance in the Muslim world, which makes up a sizeable share of the rest of the world's economy.

This movement got its start in Egypt in 1963 with the implementation of the Mit Ghamr savings project, which was an effort to establish social banking (HMT, 2008). Subsequent developments, such as the founding of the first Islamic bank in the middle of the 1970s, also contributed to the growth of this movement. Second, when there was a worldwide financial crisis and conventional banking institutions did not respond quickly enough to the situation (Warde, 2012).

Pakistan was the first modern Muslim nation to make the proclamation that it will Islamize all of its banks, and it remains the only country to have done so. This took place in the year 1979. Iran and Sudan said in 1983 that they would also follow suit and Islamize their own banking systems. Instead, in 1983, Malaysia established a banking system that ran in parallel (Warde, 2012). In recent years, Islamic banking has emerged as the most dynamic and quickly advancing form of the world's financial systems. It has been used as part of the financial infrastructure of countries that are both Muslim and non-Muslim. The primary focus is on instituting this system concurrently with the one that is in place now for the banking sector (Von Pock, 2007). Due to the fact that conventional and Islamic finance are two separate types of finance that are also, to some extent, competing systems, the growth of two parallel financial systems may be hampered by legal and regulatory restrictions.

#### **4. Can the Islamic Financial Model be a Replacement?**

In Islamic finance, excessive leverage is prohibited, and the building of trust is given a high priority. It places a greater emphasis on the moral aspect of business than the primary financial component of conventional finance does (Rasul, 2010). The present global financial crisis has given rise to a new kind of financing known as Islamic finance; academics are being pressed to come up with an alternative to this. The fact that Islamic finance is a brand-new concept that has not yet been used in modern finance is one of its many advantages (Von Pock, 2007).

Both capitalism and communism are quite different economic systems from the Islamic economic system. A market-based economic system that permits the freedom of private ownership, capitalism, contrasts with communism, which is a regulated economic system in which the state controls all economic activity and restricts private ownership. Capitalism is market-based; communism is a regulated economic system. Capitalism reorganizes the current economic and social structures, adapts in response to the demands of the market, and places a greater emphasis on individual self-interest and logical utility than it does on adhering to traditional moral guidelines (Crone, 2003). Islam has nothing in common with such a worldview (Kuran, 2011).

Pure competition leaves the decision up to the customer. If Islamic finance offers superior alternatives and goods to investors and consumers, it will be advantageous for them. At least in the Western world, the new economic global picture is focused on efficiency and competitiveness, and religion plays a relatively little role. In addition to ethics, non-Muslims may be drawn to Islamic items for other reasons. Ethical finance, such as the restriction on funding alcohol, gambling, and pornographic firms, may attract non-Muslims with similar religious convictions (HMT, 2008).

In the Muslim world in general and Pakistan<sup>3</sup> in particular, where religion dominates the social, political, and economic lives of the majority, Islamic financial transactions may be conducted on a strictly religious basis. Pakistan leads the Muslim world in terms of the Islamization of its economy (Rasul, 2010). It was challenging for Pakistan since there was no successful example to emulate (Masood, 2006).

Banking in accordance with Islamic principles is based on a unique worldview. Its primary concern is morality and ethical conduct. It supplies its residents with strong financial restrictions in order to stop the unrestricted flow of money into a few hands (Nyazee, 2007). It prohibits transactions that are unclear or incur interest costs. It encourages sales agreements, financing based on equity, and leasing contracts (Warde, 2012). Capitalism and Islamic finance are fundamentally separate from one another due to the absence of interest on financial transactions (Venardos, 2012). Islamic finance mandates transactions based on

real assets (Usmani, 1999) and ties financial transactions to the actual economy, which is governed by the principle of profit-sharing. Islamic finance also relates financial transactions to the actual economy. It prohibits interest (riba) and uncertainty (gharrar), and it gives preference to equity loans secured by real estate assets (Warde, 2012).

While capitalism places an emphasis on individual rights that allow for the unrestricted accumulation of wealth, Islamic finance places a priority on the well-being of society as a whole and forbids individuals from profiting off the labor of others (Venardos, 2012). One of the most notable differences is that Islamic banking does not permit reckless risk-taking or undue leverage on customer accounts. In the same vein, paper money is not regarded as a commodity within the framework of Islamic banking. Because it is a means of exchange, it cannot be utilized to increase purchasing power unless a commodity and a socially good productive activity are both involved. This is because it is a medium of trade (Venardos, 2010).

The fall of communism in the 1990s and the economic collapse in the second half of the 20th century and the beginning of the 21st century have brought to light the need of developing an alternative monetary and financial system for the whole world. Significant interest was shown in Islamic financing even during times of economic downturn. In the recent past, it has been the economic system that has been the most dynamic and has had the quickest growth. Both the East and the West have contributed significantly to the body of academic research on Islamic money (Von Pock, 2007). Products based on Islamic banking are being supplied not just in countries where the majority of the population is Muslim, but also in countries that are not predominantly Muslim, such as the United Kingdom<sup>1</sup> and the United States. <sup>2</sup> Because of the West's lack of experience with such a banking system and the religious connotations associated with it, Islamic banking could not be an appropriate financial system for the West. Despite this, those who are not Muslims may use money based on Islamic principles. It is open to all people, even those who do not practice Islam.

Nonetheless, Iran began Islamizing its economy in the early 1980s by introducing Shariah-compliant items. The first phase was amending the Banking Companies Ordinance of 1962 and instituting profit-sharing accounts. Other important procedures included obtaining authorization to do business using the mudarabah structure. The implementation of the Mudarabah Companies and Mudarabah ('Flotation and Control') Ordinance in 1984 made it possible for Islamic financial institutions to conduct business using the mudarabah business structure. To Islamize the economy and industry, the government enacted the Enforcement of Shariah Act, 1991 in 1991. This prepared the path for Islamic mutual funds, Islamic insurance (takaful), leasing (ijarah), and the licensing of Islamic commercial banks (Rasul, 2010).

## **5. Landmark Supreme Court Judgment**

In 1991, "the Shariah Appellate Bench of the Supreme Court issued a ruling declaring riba to be contrary to Islamic injunctions and setting June 2001 as the deadline for the eradication of riba from the economy. The government filed a petition for review. The decision has been delayed and is now pending. This demonstrates a lack of government and institutional interest in eliminating riba and Islamizing the economy. This is a problem for the government".

On the one hand, "it has shown attempts to Islamize the economy, yet on the other, it is unwilling to enforce a decision forbidding riba, a key source of worry in Islamic banking. There might be three potential causes for this choice. First, there have been several government changes in Pakistan. Occasionally the left and occasionally the right dominate the political scene. Furthermore, Islamic parties have a voice in each administration. It is possible that successive governments may not want to adopt pure Islamic financing; rather, these parties may have included it in their manifestos to gain political benefits by using the feelings of the people in order to win votes".

Second, in the current age of the global economy, it may not be possible to outlaw riba unilaterally when nations are saddled with multibillion-dollar debts resulting from global

pressures. However, the domestic abolition of *riba* may not pose a significant challenge. This requires a commitment from the government and the banking sector.

Third, a lack of legal, regulatory, and institutional infrastructure may also have contributed to the Supreme Court's inability to execute its ruling to Islamize the economy (Masood, 2006). The choice cannot be executed without enough preparation. In Pakistan, *mudarabah* commerce grew to some degree, although its operation was not strictly Islamic (Vogel & Hayes, 1998).

Those individuals who were conversant with Islamic finance and those who want to do business in accordance with Islamic principles found themselves to be unsatisfied. Corruption, bad administration, a lack of regulatory framework, and a shortage of human resources were the primary roadblocks to the establishment of Islamic finance in Pakistan. Other barriers were a lack of human resources. The vast majority of businesspeople did not wish to conduct their operations in accordance with *Shariah*; rather, they wanted to profit from the tax breaks that the government offered to *mudarabah* enterprises and take advantage of public sentiment. It was a straightforward way to solicit monetary contributions from members of the general public in the name of Islam (Rasul, 2010).

## **6. Mudarabah Business in Pakistan**

All of this led to the demise of the *mudarabah* sector in Pakistan and cast doubt on the success of Islamic financing in Pakistan. Islamic finance can only be effective if a solid corporate governance system is in place. This would need various actions from the government, regulators, and other organizations. In Pakistan, the Islamic banking system differs little from the regular one. It amounted to a shift in terminology, and most of the transactions undertaken by banks in leasing and *murabaha* were seen as suspect by scholars on the grounds that their purpose was to circumvent the Islamic prohibitions against *riba* (Mansuri, 2005).

These transactions resembled interest-bearing transactions in everything but name. Islamic finance can only be effective if there are real efforts and a mental shift at both the government and entrepreneur levels. Failure in the *mudarabah* sector prompted Pakistani regulators to focus on improving the *mudarabah* industry. To expand the scope of *mudarabah* business, the SECP and *Mudarabah* Association of Pakistan performed research in 2008 to seek *Shariah* board clearance for new *Shariah*-compliant items. They authorized twelve products<sup>4</sup> to expand *mudarabah* and other *Shariah*-compliant enterprises in Pakistan (Rasul, 2010).

This is another institutional endeavor to Islamize the economy. The concern is whether it will alter the current perception of the unsuccessful *mudarabah* enterprise, which was implemented in the early 1990s. The government's modest attempts to Islamize the economy were just the beginning of a lengthy road. This aspect requires further effort. It may be ineffective to simply proclaim something Islamic or non-Islamic. First, an alternative to present financial products must be provided.

In Pakistan, poor governance is a hindrance to the market's and economy's healthy development. Pakistan's system of government must be strengthened. Enforcement is essential to effective government. In order to increase enforceability in the business sector, the judicial, market, and regulatory frameworks must be enhanced. As Islamic finance favors equity financing and restricts interest-bearing transactions, effective corporate governance will be essential to its success. International initiatives have also been undertaken. The formation of the Islamic Financial Services Board (IFSB) in 2002 was a significant step in this direction. It began operations on March 10, 2003.

Rules for regulatory and supervisory agencies engaged in Islamic finance, such as banks, capital markets, and insurance firms, are formulated by the board. These agencies include capital markets. Among these organizations is something known as the Islamic Financial Services Board (IFSB). It is the purpose of this organization to encourage the growth of Islamic enterprises and to push for the creation of new or the acceptance of existing international standards, with the proviso that these standards must first be modified to conform to the injunctions of *Shariah*. In addition to this, the board offers regulatory bodies

guidance on how they may effectively monitor and oversee institutions that are involved in the trade of Islamic commodities. It serves as a conduit for communication between the several groups that are actively engaged in the process of standard-setting. There are now 19 standards, guiding principles, and technical notes that have been released by the board for the Islamic financial services business. These standards and principles include guiding principles on corporate governance for institutions that offer exclusively Islamic financial services (with the exception of Islamic insurance (takaful) institutions and Islamic mutual funds), as well as other standards and principles pertaining to Islamic finance in general.

It is possible to see its distinct recommendations for insurance and mutual funds on its website (<http://www.ifsb.org>). These recommendations may be found on the website. In order to formulate its very own guidelines for Islamic banking and finance, the Islamic Financial Services Board (IFSB) takes into account the guidelines that have been established by the Basel Committee on Banking Supervision and the International Organization of Securities Cooperation (IOSC) for the investment and securities markets (Venardos, 2010). On the other hand, these regulations are only taken into account if the Shariah is not violated in any way by them. The International Financial Stability Board (IFSB) is responsible for the production of guiding principles, which are afterwards open to approval on a national level. There is leeway for worldwide diversity in the implementation of these principles as a result of the fact that they are not legally binding.

## **7. The Islamic International Fiqh Academy (IIFA)**

OIC is a part of IIFA (OIC). The school helps Muslims live a Shariah-compliant life on an individual, social, and worldwide level by identifying Shariah-compliant responses to current difficulties. The academy studies Islamic law and issues legal decisions for the Muslim community (fatwas). The area of research and opinion encompasses Islamic finance so Muslims may change their conventional money. IIFA regulations are simply guidelines and aren't binding. This might cause Muslim splits. Shariah-approved products and market may facilitate Islamic financial convergence throughout the Muslim world. Islamic scholars may agree on this. Once the Islamic business model is nationalized, worldwide consensus will be needed. OIC consensus equivalent to EU projects is also needed. Islamic finance is prone to crises. How financial crises effect Islamic finance is an important topic.

Venardos (2010) cautions that Islamic banking may be indirectly damaged by global unrest. According to him, the slowed economic expansion may have an impact on real estate and asset financing. In addition, he cautions that a decline in real estate values may have indirect effects on Islamic financial institutions, whose economic operations are closely tied to real assets. According to him, this might reduce their assets and negatively impact their company. However, this remark should be qualified by other Islamic financing features. Islamic finance is not only tied to tangible assets. Islamic finance emphasizes ethical business practices. It forbids transactions with interest, undue leverage, and avoiding ambiguity. It supports profit and loss sharing and the continuation of business based on mutual trust and confidence.

Venardos (2010) is also worried that Islamic financial institutions may pursue aggressive speculative investment methods with greater risk and higher projected returns without adhering to basic and solid risk management norms during times of economic hardship. The IFSB is striving to develop rules to prevent similar situations. These issues emphasize the need of implementing effective corporate governance methods to avert such scenarios. In addition, Islamic financing discourages speculative company tactics, which is a crucial factor to consider. Corporate governance under Islamic finance may discourage managers from pursuing extremely speculative methods, regardless of the amount of profit they may generate. A tough and premature issue is whether Islamic finance will be successful and can create an alternative financial system at the world level in general and in Pakistan in particular. However, Islamic finance principles cannot be disregarded since they emphasize ethical corporate practices and emphasize social responsibility (Rasul, 2010).

After the current global financial crisis, Islamic finance has captured the world's interest. The Muslim world has begun the transition from conventional to Islamic finance. Recent study in the Muslim world and the West indicates that Islamic banking has established

itself as an alternative financial system. This is a demanding endeavor that needs substantial field investigation. Regarding the current financial crisis, it is generally acknowledged that Islamic finance, which focuses on asset-backed financing, may have adapted more effectively than capitalism (Warde, 2012).

Without a shadow of a question, this system is gaining significance in the world of Muslims on the basis of religion; but, it also has potential because of the fundamental features that it has. However, in order for it to be taken seriously in the world that is not dominated by Muslims, it must first overcome the religious barrier and establish that it is superior to the established methods of money management. It is feasible for use throughout the whole of the Islamic world, with a special focus on Pakistan. After it has shown its legitimacy and viability in the Muslim world, the rest of the world may turn to it as a means of escaping the inherent unpredictability of conventional financial systems. As a result of globalization, markets are now linked; yet, the availability of commodities that can compete with one another is crucial to the survival of any system (Vogel & Hayes, 1998). Therefore, in order for Islamic banking to be a viable option, its shortcomings must first be rectified. Otherwise, it will not be able to compete in the global economy. In particular, academics and legal professionals will find this to be a challenging project.

## **8. Stock Exchange and Islamic Economic Model**

There are stock market indices operating inside the boundaries of a number of countries, including those that are not Muslim. The Dow Jones Islamic Market Index in Bahrain, the FTSE Global Islamic Index in the United Kingdom (Von Pock, 2007), and the Shariah-compliant index of the Karachi Stock Exchange (KSE) are a few examples of indices that were created in non-Muslim countries in order to attract Muslim customers residing in their jurisdiction. Other examples include the Islamic Market Index of the Karachi Stock Exchange (KSE), which was developed in Pakistan (Franzoni, 2018). On the Karachi Stock Exchange (KSE; <http://kse.net.pk/>), there are now 112 companies that comply with Shariah law. There is not much of a correlation between the total number of businesses and these particular companies. This indicates that Islamic funding has not yet been entrenched in Pakistan. [Citation needed] The expansion of Islamic finance in Pakistan has significant challenges, the most significant of which are a lack of legal, regulatory, and institutional infrastructure as well as insufficient governance. As a result, the establishment of an appropriate governance structure is essential to the accomplishment of the goals set by Islamic financial institutions.

## **9. Islamic Financial Institutions and Corporate Governance in the Muslim World**

The recent development of using Islamic finance as an alternative to or parallel to the traditional financial system in Muslim nations in general and Pakistan in particular has produced a variety of concerns. There is a risk that various nations' funding methods may collide with one another in terms of their respective forms and circumstances. This assumption is grounded in the Islamic law's basic essence. The difficulty with Islamic law is that the Qur'an only gives broad principles, despite the fact that Islamic law offers a degree of adaptability to accommodate current demands and requirements. The book does not provide specific regulations. The Prophet Muhammad (peace be upon him) and his companions demonstrated and articulated these ideas. The second issue was that the collection of the Sunnah of the Prophet occurred quite a long time after his death, which allowed for its falsification. This resulted in divergent opinions among Muslim jurists on the Sunnah's acceptability and the degree of influence it may have on the development of laws.

The second problem is the standards of interpretation that are held by the jurists of the different Muslim sects. The Islamic legal system gives jurists the ability to analyze modern problems in light of previously established principles. This leverage for understanding essential passages is provided by other sources of Islamic law in addition to the Qur'an and the Sunnah. This might result in a number of different interpretations, which could then give birth to a number of different sorts of business and governance practices, which could then hinder the Muslim world's ability to converge on a single model. Globalization has resulted in the convergence of a wide variety of corporate governance concepts as a consequence of the interrelated interests of the countries, competition, and investment across international

borders. This practice has generated concerns over the implementation of corporate governance policies.

The Islamic world is aware of this difficulty, and as a result, it established the Islamic Financial Services Board (IFSB) to ensure that Shariah-compliant products and rules are followed. On the other hand, the most significant factor that has contributed to the proliferation of divergent interpretations of fiqh throughout the Muslim world is jurists' tendency to adhere to a literal reading of Islamic legal texts. Because of this, there may be difficulties associated with the production of Shariah-compliant items, the market, and the governance of corporations. It is for this reason that jurists are required to exhibit flexibility while interpreting Islamic law books. Jurists of today have come up with strategies that may be used to circumvent this difficulty. The phrases "option and selection," "amalgamation or patching," "necessity," and "ruses" are all examples of these types of methods (Ahmed, 2012). These may be used in the process of redefining fiqh in conformity with the requirements of current society. It is possible that this will contribute to the unification of the many different interpretations of Islamic law as well as the convergence of corporate governance and corporate finance throughout the Muslim world. This would also make Pakistan's shift toward Islamic banking throughout the rest of the Muslim world easier to accomplish.

## **10. Distinctions between the Two Models**

The Islamic and Western financial systems are very different from one another in basic ways (Alam et al, 2019). Within the context of corporate law and corporate governance, Islamic finance places a strong emphasis on moral principles and places primary focus on the objectives of Islamic law. It takes into account the interests of investors in addition to a number of other aspects, though. In addition to safeguarding religious practices, it works toward achieving the objectives of society as a whole. On the other hand, the Western model of corporate governance puts a premium on individual rights while also catering to the requirements of the market (Istrefi, 2020). In terms of business and corporate governance, it places an emphasis on society, despite the fact that this may not be the highest priority when compared to individual private interests. 5 It is possible that managers working under the Western model of corporate governance will not be required to maintain religion, despite the fact that this need is an essential part of Islamic law. This mismatch between Islamic banking and the Western financial system may be reduced if the goals are adequately articulated, and if Muslim jurists are allowed certain leeway in their interpretational criteria.

It is imperative that modern Western business methods, company law, corporate governance aims, and share trading in Pakistan be brought into harmony with Islamic beliefs. The primary contrast that can be made between Western forms of business and Islamic financial practices is the prohibition on the charging of interest. The majority of traditional business forms are Islamic, but there are a few that are forbidden by Shariah and must be avoided in order to construct a system that is compliant with Shariah. For instance, businesses that involve gambling, the production of alcohol, or pornography may be prohibited by Shariah. Investing in stock markets is at its core consistent with Islamic principles. Dealing in loans, debt securities, forward and future contracts, short selling, and other risky financial activities should be avoided at all costs. When it comes to matters of corporate governance, protecting the interests of investors is just as important in Islam as it is in Western corporate governance. Greater importance than is placed in any other nation on having sound corporate governance may be seen in Pakistan. To begin, there is an urgent need to address the widespread weak governance. In order for Pakistan to successfully transition to Islamic finance, effective corporate governance would be absolutely necessary because of the emphasis that Islamic finance places on equity financing. Thirdly, despite the fact that Islamic finance is very young in comparison to other modern methods of financing, it has not yet established any safeguards or rights for investors (Ahmed, 2012).

Within the framework of the Western style of corporate governance, certain rights and safeguards have emerged through time. Since Pakistan inherited the British legal and regulatory framework, its policymakers and lawmakers may benefit from the Western model of corporate governance in general and the system of corporate governance in the UK in particular. Pakistan inherited the legal and regulatory framework from the British. It is



imperative that Islam play an important part in Pakistan's commercial sector. Injunctions based on Islam have the potential to obstruct any eventual transition to a corporate governance model more typical of the West. There is a possibility that the barrier between Islamic finance and Western corporate governance is not as insurmountable as it first seems to be.

In addition, "Islamic law is not nearly as stringent as it seems to be. It has a natural capacity for adjustment. Some Islamic legal sources and concepts, such as the "presumption of continuity," "ruses," and "necessity," could be able to help bridge the gap between Islamic and Western forms of corporate governance. The Western model of corporate governance may be implemented in Pakistan after it has been adapted to take into account the aforementioned principles and subject to the Islam-centered goals described in this chapter. However, this will only be possible if the model is first implemented in accordance with the principles".

## **11. Financial System Islamic and Pakistan**

Islam is the official religion. It guides followers in all areas of life, including money. Globalization, competition, and intertwined financial interests have pushed more developed to less developed countries. Pakistan's foreign governance influences its development. Pakistan's adoption of a Western corporate governance element must pass the Islamic litmus test. Two elements must be considered for Pakistan's corporate governance to meet international norms.

First is the Islamic world's unprecedented convergence on Islamic finance and business governance. Pakistan will also be affected. Islamic finance among Muslims may vary as a result of the development of several schools of thought within the Muslim world. This divergence may be resolved, but Muslim jurists must demonstrate some degree of interpretive flexibility. In Islamic law, there are a variety of methods for bridging the gap between divergent interpretational standards and achieving agreement.

The second element is Pakistan's increasing adherence to the corporate governance model prevalent in Western nations. Pakistan is an Islamic country, but since it was a British colony in the past, it has adopted the conventional banking system that is based on the British model. In view of the Islamic character of Pakistan and the desire of its population for Islamization, the government launched efforts to Islamize the country's economy. It has not been effective, however, for a variety of reasons, including poor governance, a weak enforcement mechanism, a lack of human resources and a lack of governmental commitment, the absence of a legislative and regulatory framework, and institutional incompetence. All of these factors contributed to its failure. The fact that Islamic finance has never been implemented in modern times presents Pakistan with a problem when it comes to implementing it. In addition, there is hardly another Muslim country that can serve as a successful example for Pakistan. Ancient Muslim jurists believed that the conventional and Islamic banking systems were fundamentally different from one another because their goals were fundamentally different.

Modern jurists are attempting to transform Islamic banking into an alternative monetary system. In order to compete in the global economy, these attempts to provide an alternative financial system may only be effective if the holes in Islamic finance are addressed. Globalization has necessitated the convergence of several corporate governance characteristics, where the supply of competitive goods is essential to the survival of any system. In order to strengthen corporate governance in Pakistan, western corporate governance practices must be used within the Shariah's constraints. First, since a sudden overnight transition from the conventional financial system to the Islamic financial system is not practicable, the system must be modified using a pragmatic approach. Instead of overhauling the whole system, it is necessary to align it with the Islamic financial system.

## **12. Conclusion**

Conventional financial systems and the Islamic Financial System are sometimes considered as competing systems; yet, it is feasible to create a synthesis of the two. However, Muslim legal academics need to be adaptable in their interpretation of Islamic law in order to

accommodate the requirements and expectations of the modern world. Muslim academics in the modern era have already achieved a certain level of success, yet there is always room for improvement. Both the Islamic Financial System as an alternative financial system and corporate governance systems that might be convergent with Western corporate governance norms may be implemented in Pakistan. The Islamic Financial System is an option. In spite of this, Islamic norms might be used as a litmus test, which might not be as problematic as it seems at first glance.

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