

Corporate Governance and Micro-Banking Stability in Islamic Financial Institutions: Towards an Integrated Approach

Gouvernance et stabilité micro-bancaire dans les institutions financières islamiques : vers une approche intégrée

ALLAFI ISWEESI SAAD Abdulmohsen

Docteur en Sciences de Gestion

Faculté des Sciences Juridiques, Économiques et Sociales Ain Chock

Université Hassan II Casablanca - Maroc

Laboratoire de Recherche en Économie Appliquée et Finance

Date de soumission : 05/07/2025

Date d'acceptation : 10/08/2025

Pour citer cet article :

ALLAFI ISWEESI SAAD. A. (2025) « Corporate Governance and Micro-Banking Stability in Islamic Financial Institutions : Towards an Integrated Approach », Revue Française d'Économie et de Gestion « Volume 6 : Numéro 8 » pp : 772- 793.

Author(s) agree that this article remain permanently open access under the terms of the Creative Commons

Attribution License 4.0 International License



Abstract

In this paper, critical governance levers of micro-banking stability are theoretically and normatively analyzed, with a particular spotlight given to Islamic banks. Moreover, this idea is examined through classical theoretical frameworks, namely, agency theory and stakeholder theory, arguing how governance mechanisms can discipline managerial behavior, lower information asymmetries, and consequently tighten institutional trust. In the case of Islamic banks, governance takes on a specific dimension rooted in compliance with Shariah principles, adding a religious and ethical layer to conventional mechanisms. The paper showcases a hybrid model of attaining institutional resilience and sustainability where internal discipline, risk management, and social legitimacy meet. Islamic finance governance dimension emerges, within this context, as an alternative strategic tool for stability, broadening the financial regulation function from the technical perspective towards an integrated approach of protection and social legitimation.

Keywords : Banking governance, Micro-banking stability, Islamic banks, Agency theory, Stakeholder theory, social legitimacy.

Résumé

Cet article propose une analyse théorique et normative des leviers essentiels de la gouvernance pour la stabilité micro-bancaire, avec une attention particulière portée aux banques islamiques. L'examen s'appuie sur des cadres théoriques classiques, notamment la théorie de l'agence et la théorie des parties prenantes, pour montrer comment les mécanismes de gouvernance peuvent discipliner le comportement managérial, réduire les asymétries d'information et, par conséquent, renforcer la confiance institutionnelle. Dans le cas des banques islamiques, la gouvernance revêt une dimension spécifique fondée sur la conformité aux principes de la charia, ajoutant ainsi une couche religieuse et éthique aux mécanismes conventionnels. L'article met ainsi en évidence un modèle hybride de résilience et de durabilité institutionnelles, où la discipline interne, la gestion des risques et la légitimité sociale s'articulent. Dans ce contexte, la gouvernance de la finance islamique apparaît comme un outil stratégique alternatif de stabilité, élargissant la fonction de régulation financière d'une logique purement technique vers une approche intégrée de protection et de légitimation sociale.

Mots clés : Gouvernance bancaire, Stabilité micro-bancaire, Banques islamiques, Théorie d'agence, Parties prenantes, légitimité sociale.

Introduction

The governance of banking today is at the heart of the stability and confidence dynamic in the financial system. Which Banks, precisely because they are so informationally opaque and so structurally dependent on the confidence of their depositors, assign a decisive role to governance mechanisms. The mechanisms go beyond disciplining shareholders, focusing instead on regulating managerial behavior, reducing information asymmetries, and enhancing institutional legitimacy. Thus, banking governance here is a normative instrument of micro-level stability, assuring the sustainability and robustness of the operating financial institutions. Islamic banks represent a particular case. Founded on the principles of Shariah and the prohibition of interest (riba), they add one more layer to the complexity of governance: the requirement of ensuring that the public's Shari compliance with actions. This dual nature gives them a financial and normative regulation system that is both internal and spiritual. This ties into the strength of conventional mechanisms, as the confidence of depositors and investors thus depends as much on their well-built efficacy as on religious compliance, placing Islamic governance in a class of its own within the banking landscape.

This article seeks to answer the following question: to what extent does governance constitute an instrument of micro-banking stability in Islamic financial institutions? We aim to provide a theoretical and normative reflection based on the main governance theories mobilized, while also considering the specificities of Islamic banks.

The analysis is divided into three parts. The first section of the text focuses on the theories that inform banking governance, emphasizing its roles as a disciplinary, informational, and stabilizing force. The second part investigates the institutional and religious particularities of Islamic banks, looking at their apparatuses and agents. It closes with an integrated reading of governance as a tool of micro-banking stability in Islamic financial institutions, identifying its importance in the management of risk, in protecting stakeholders, and, finally, in the reinforcement of social legitimacy.

1. Theoretical Foundations of Banking Governance

Banking governance lies at the centre of many of the financial analyses because of the unique nature of banks: informational opacity, dependence on depositor confidence, and the systemic role of risk management entities. Instead of being a mere control mechanism for shareholders, it is a comprehensive construct of the broader system that regulates the behaviors of management, ensures transparency, and protects the rights of all stakeholders.

In this sense, governance can be framed in a few complementary angles. First, it serves as a disciplinary mechanism to contain managerial excesses and conflicts of interest. It also helps mitigate information asymmetries and thus enhances the soundness of decision-making and market discipline. The stakeholder theory proposes to take into account the plurality of actors whose interests the stability of banking relies on. Lastly, governance plays a crucial role in maintaining micro-banking stability by fostering resilience and instilling confidence in the continuation of activity.

This section will thus elaborate on the theoretical basis of banking governance through these four axes, showing how governance represents both a disciplinarian, informational, relational, and stabilising frame for financial institutions.

1.1. Governance as a Disciplinary Tool

In banking, governance mainly serves the purpose of discipline, to control managers and reduce risks associated with conflicts of interest. The separation of ownership from control (Jensen & Meckling, 1976) results in a direct interest divergence between owners (i.e., shareholders) and executives, leading to the potentially opportunistic mismanagement and maximization of private benefits oriented towards private interest over institutional stability.

The specific aspect of this problem is prominence in banks due to their systemic nature: they own and manage funds that do not directly belong to them (deposits), risks are borne primarily by depositors, investors, and partially by the state (through mechanisms for public guarantees). At the same time, bestowing more power on executives may encourage the adoption of unduly risky behaviors since third parties will bear the losses, and the gains will accrue to the executive through bonuses or reputational gains. This moral hazard phenomenon is at the center of the failures we have seen during banking crises (Caprio & Levine, 2002).

Disciplinary governance addresses these challenges through various mechanisms: The role of boards of directors in providing strategic oversight and constraining managerial discretion is widely accepted. The effectiveness of boards depends on their independence, composition, and genuine ability to exercise control (Adams & Mehran, 2003). Here, more technical and targeted discipline comes in the form of specialized committees (audit, risk, compliance) in the fields of credit risk, liquidity management, and exposure to financial markets. Another disciplinary lever that institutions can pull is incentivizing mechanisms, including executive compensation tied to long-term performance (as opposed to short-run performance).

The regulatory framework also has an external disciplining function, over and above internal discipline. Basel II and Basel III accords impose rigorous regulation of capital adequacy,

liquidity, and risk management. These standards are designed to deter banks from reckless behavior, even where competitive forces or manager incentives would motivate them to act that way.

To sum up, this form of disciplinary governance in banks is not just, or even primarily, a shareholder protection mechanism. It stands for a comprehensive framework to ensure prudential risk-taking, enhance managerial accountability, and protect the long-term viability of the bank. What makes it unique in this regard is that both internal mechanisms (such as oversight, incentives, and committees) as well as external mechanisms (such as regulation and supervision) collectively act to limit the excesses associated with conflicts of interest and moral hazard.

1.2. Governance and the Reduction of Information Asymmetries

One crucial aspect of banking governance is to reduce the information asymmetries that are typical of financial institutions. While this opacity would rarely question the viability of an industrial firm, this is the case for a bank: the quality of assets, the risk profile of credit portfolios, and exposure to financial markets are elements that remain difficult to observe for external parties, particularly depositors and investors. Such opacity leads to the phenomena of adverse selection (Akerlof, 1970), whereby lack of information on borrower insolvency may result in banks financing risky projects, and Moral hazard, which occurs when the behavior of managers or borrowers deviates from the initial expectations, thus threatening the stability of the institution (Stiglitz & Weiss, 1981).

There exist asymmetries of information that create structural uncertainty in depositors since depositors cannot directly measure the value of the balance sheet of a bank. If confidence is diminished, they may even instigate bank runs, massive deposit withdrawals that directly endanger the health of the institution (Diamond & Dybvig, 1983). Hence, governance comes into being as a crucial mechanism for decreasing this ambiguity and creating a stable atmosphere of trust. It works on various levers, such as openness & financial accounting, external audits, and governmental regulation. The Basel accords impose strict disclosure requirements and prudential standards, both contributing to improved stakeholder awareness of the bank's actual situation. Likewise, independent audits or credit ratings send other credibility signals (Bushman & Smith, 2003), though the efficacy of these mechanisms has been challenged, most notably after the 2007–2008 financial crisis.

In decreasing opacity, governance helps not only in enhancing market efficiency but also in solidifying group trust, another pillar of micro-banking stability. Banks have differentiated

levels of correspondence and commitment with different stakeholders, which are primarily based on institutionalized trust mechanisms (Suchman, 1995). Credible by governance transcends the technical function of information disclosure, transforming into a vector of social legitimacy and stability. At the end, this reduction of information asymmetries is not only an operational need but also a normative task, contributing to the long-term survival of banking institutions.

1.3. The Contribution of Stakeholder Theory to Governance

By defining the interests taken into consideration in banking governance beyond just those of shareholders, stakeholder theory (Freeman, 1984) is a truly transformative change for the purpose and structure of banking governance. In a sector characterized by extreme informational opacity and where the realization of ongoing activity relies on the trust of multiple actors, it makes sense to regard the bank as a hub of implicit and explicit bargaining among shareholders, depositors, borrowers, employees, creditors, market counterparties, and public authorities. It is a substantive extension, guiding the design of control, decision, and incentive systems, not just a richly detailed description. However, in practice, governance viewed from this approach aims to balance potentially conflictual claims by organizing deliberation and arbitration procedures, diversifying sources of information, and holding management accountable to various classes of stakeholders.

At a more abstract level, there are two aspects to the contribution. First, it adds to traditional agency theory by acknowledging that managers owe fiduciary duties to a constituency of principals, not just shareholders. The implications of this change are formalized in the stakeholder-agency theory (Hill & Jones, 1992): individual contracts and incentive mechanisms should be designed such that creditor, customer, and employee expectations, and in particular expectations on prudence, service quality, and risk management, are directly internalized to lower aggregate agency costs. The instrumental school (Jones, 1995) takes a second approach whereby trustworthy and cooperative relationships with stakeholders lead to lower transaction costs (Coase, 1937) and monitoring costs, reducing moral hazard, and reducing short-term rent-seeking behaviour. This point of view has implications for managerial remuneration contracts for banks that reward performance that is sensitive to risk (i.e., is structured in relation to risk-adjusted measures), incorporates elements of customer service continuity and protection of depositors in indicators of performance, and builds internal controls that focus on quality of processes rather than solely quality of financial outcomes.

The second aspect addressed by the stakeholder approach is an insight into the banking sector-specific route of the external discipline. The disciplinary pressure of market forces exerted by uninsured depositors and creditors, interbank counterparties, rating agencies, and regulators supplements the internal controls. According to the market discipline literature, it is the structure of a bank's liabilities (redeemable debt and deposits, public information) that can impose discipline on managerial risk-taking (Calomiris & Kahn, 1991; Flannery, 2001). Basel, Pillar 3, Organizes and provides a framework for information that clearly communicates the necessary details to external stakeholders. This approach embeds intuition into the International Prudential Framework, ensuring transparency that operates independently of stakeholder control but serves multiple audiences in varying degrees by predicting and policing forbidden behavior.

On an institutional scale, this means the establishment of formal mechanisms: boards with composition and functioning focused on the need for risk management competency and diversity of views; risk, compliance, and audit committees with a mandate covering the quality of the information delivered to depositors and creditors; compensation policies aligned with the time horizon of the institution's funding source and clientele; and formalized communication mechanisms (complaint channels, satisfaction surveys, ad hoc products) for the capture and transmission of faint signals. It further implies that stakeholder mapping is treated as a management tool: those who put the most economic or reputational risk are highlighted, the information rights of each of these are clarified, the relevant performance metrics are defined for each of these, and specificity is utilized in making decisions when objectives clash (e.g., short-term profitability vs. service continuity).

Finally, placing the bank in a stakeholder ecology enables to account for micro-stabilizing effects without the need to invoke external foundations: with expectations of funders (depositors and creditors), clients, and regulators being incorporated into the objective function and incentives, the chances of excessive risk taking diminishes, the quality of the information that is disclosed improves, and the bank becomes less susceptible to confidence shocks. Put differently, stakeholder theory adds to banking governance, in that the problem facilitates the transformation of a one-dimensional problem (the shareholder needs to be protected against the agent) into a problem of designing mechanisms that minimise collective agency costs and protect intermediation continuity.

1.4. Governance and Micro-Banking Stability

First, it is critical to differentiate between macro-banking stability and micro-banking stability. The first is related to the robustness of the entire financial system to aggregate shocks, interdependencies, procyclical amplifying effects, and negative externalities (the everyday problems of contagion, fire sales, "common exposures"). The deficient macroprudential regulation of credit has been the problem, this being the domain of macroprudential policy, which is supposed to avoid the accumulation of systemic risks (Crockett, 2000; Borio, 2003). The latter relates to the stability of a single institution: its ability to satisfy its commitments, the effectiveness of risk management, the sufficiency of capital and liquidity, continuity of operations, and the confidence of stakeholders in its management. Micro-stability is the objective of microprudential supervision and internal governance mechanisms. Micro-stability cannot guarantee macro-stability, but it is a necessary condition because when banks are fragile individually, systemic events become more likely.

Governance is then a key micro-stability lever, working through several complementary channels within the framework. By defining risk appetite, allocating limits, and monitoring independent exposures, it minimizes the chances of managerial error and excessive risk-taking. An efficient, and genuinely independent board of directors with appropriate risk and audit committees and risk management achieves better decision quality, reduces agency costs, and increases bank credibility (Macey & O'Hara, 2003; Caprio & Levine, 2002). Second, governance internalizes costs of risk through risk-adjusted performance evaluation and horizons commensurate with commitment maturities. It prevents moral hazard and risk shifting (characteristic of limited liability structures (Laeven & Levine, 2009) by reducing short-termist incentives.

It also adds micro stability as it enhances the quality and asymmetry of information. First, transparency and market discipline, mainly stemming from the disclosure requirements of Pillar 3 of Basel, reduce balance sheet obscurity and favor external risk assessment and thereby enhance the dispersed monitoring role of depositors, creditors, and counterparties (BCBS, 2015). Naturally, a relative opacity is necessarily less so, and therefore less likely to be self-fulfilling panic and thus less likely to cause large withdrawals (Diamond & Dybvig, 1983).

The other channel concerns loss-absorbing capital. Governance increases distance to insolvency (Berger et al., 1995) through both enforced discipline over capital and liquidity policies (conservation buffers, term funding, ALM consistency). It thus enhances resilience against firm-specific risk (idiosyncratic shocks).

Ultimately, governance protects the trust capital that is the foundation of any bank's viability. It influences the heart of micro-stability, confidence, and the avoidance of loss of confidence, by stabilizing depositor and creditor expectations (through transparency of managerial behavior and predictability of action and accountability). Governance, in this sense, is an intangible asset; it does not show up on the balance sheet, but it decreases the likelihood of adverse events (defaults, fraud, litigation) and mitigates the riskiness of funding flows. If conceived in this way, governance does not stop at "monitoring"; it assesses the bank's ability to withstand shocks, remain liquid and solvent, and continue to provide its core services without interruption.

2. Specificities of Governance in Islamic Banks

Governance in Islamic banks is characterized by the additional requirement, namely that Islamic banks must comply with the banking control and discipline standards at the global level (International standards) as well as existing Shariah requirements regarding Islamic finance products and services. Such specificity has resulted in hybridism of Islamic governance in both technical and religious aspects, as durable institutions would require sufficient managerial rigour as much as spiritual legitimacy.

Such particularities can be analysed through three complementary axes. The first emphasizes the institutional and religious particularities that support the uniqueness of this model. The second aspect compares actors and governance mechanisms related to Islamic banks with those of conventional banks. The third examines the ethical and normative challenges that Islamic governance faces in terms of its liability for trust and stability.

2.1. Institutional and Religious Specificities

The dual anchoring, one financial and the other religious, endows governance in Islamic banks with an institutional originality. They cannot rely on a classical governance architecture based on a board of directors, an audit committee, or risk management systems, unlike conventional banks. They must necessarily have a body, the Sharia Supervisory Board (SSB), which assures that the activities and products are compliant with the principles of Shariah. These characteristics profoundly alter the logic of governance, as they introduce a third normative power, distinct from the influence of shareholders or managers, grounded in moral and religious principles. In this respect, Islamic governance is structurally hybrid: it fuses a financial rationality towards performance with a religious rationality with respect to spiritual and social legitimacy (Archer & Karim, 2007).

The dual institutional anchoring is demonstrated in the evaluation and validation of strategic and operational decision-making. The role of the Shariah board is not just to undertake a

ceremonial validation of the transactions; it executes an active policing function which could have direct implications on the type of arrangements, the approach to financing that is pursued, and indeed the policy of the institution as a whole. As a result, one will prefer to develop instruments like *mudaraba* (profit-sharing financing contract) or *musharaka* (partnership based on profit-and-loss sharing) instead of instruments similar to *riba* (interest) bearing loans that are banned by the general principle of *riba* prohibition. In addition, the financing must be backed by tangible assets, which fulfills the condition of being grounded in the real economy and imparts a less speculative character to the operations, and perhaps a more sustainable one. This implicit moral dimension added by imposing a specific discipline in addition to the economic framework serves to restrict reckless behaviour and encourages stability (Chapra & Ahmed, 2002).

In addition to the financial legitimacy based on the viability and profitability of the institution, the Sharia Supervisory Board (SSB) also adds religious legitimacy to the institution based on adherence to Shariah law. Both these types of legitimacy underpin stakeholder confidence. Deposit security is not merely a nominal value derived from formulas based on profits and losses; it also serves as an assurance that operations will adhere to their religious and ethical values. Here, governance acts as a means for comfort in which the moral authority of the *ulama* lends extra legitimacy to the managerial choice, thereby lowering the danger of a client withdrawal in the event of uncertainty in terms of religious compliance. Such specificity, therefore, plays a vital role in improving Islamic bank resilience against confidence shocks, an important element of micro-banking stability (Dusuki, 2008).

Consequently, Islamic governance is not just a replacement of a generic model with an Islamic one but a specific model in which institutional and religious dimensions converge and form a distinctive nexus of enforcement and legitimation. By adopting this model, some managerial discipline is preserved, but ethical compliance can be assured, enabling the bank to cultivate reputation (trust) with stakeholders in the long term. Islamic governance, in turn, becomes an unusual force for economic stability and social legitimacy, as even the imposition of greater scrutiny over types of activity and internalizing these norms into a moral frame of decision-making extends well beyond the economic domain and is rooted in a vision of finance as total. Thus, the governance of Islamic banks is part of the legitimacy and protection of stakeholders so that trust, which is needed for the stability of the banking sector, can be maintained (Baig, 2024).

2.2. Actors and Mechanisms of Governance in Islamic and Conventional Banks

The structure of governance in banking relies crucially on several actors and mechanisms that help regulate, control, and legitimate the actions of the institution, regardless of whether they are Islamic or conventional banks. Although the principles of transparency, accountability, and internal discipline are common to both systems, the excellent specificity of Islamic banks is the necessity of religious compliance. This duality, both financial and ethical, not only defines the characteristics of the actors but also the governance instruments that are used.

In traditional banks, governance is organized around classical bodies: the board of directors, specialised committees (audit, remuneration, risk), shareholders, and regulators. Particularly, these actors serve supervisory and strategic roles intended to regulate managerial behavior, protecting investors and enhancing the market discipline. These are: accounting transparency, standardized information production and dissemination, rating agencies, and last but not least, the discipline of the financial market (Shleifer & Vishny, 1997).

Along with these conventional instruments, the Islamic banks employ specific processes to ensure Shariah compliance. Perhaps the most iconic of these features is the still-nascent Shariah Supervisory Board (SSB), comprised of Islamic finance jurists and specialists whose task is to certify the religious validity of banks' products and practices. This board plays a supervisory role that is not limited just to the financial regulation but endows it with moral and spiritual legitimacy, which helps the depositors and investors in their belief (Chapra & Ahmed, 2002; Archer & Karim, 2007). This creates a special niche for SSBs within governance, because they coordinated and reconciled religious imperatives with contemporary constraints on banking management.

The Islamic banks' governance complexity is presented through the complementarity between the classical and Islamic mechanisms. They are thus doubly obliged: in addition to upholding risk management, transparency, and the prudential conformity to international standards, they must also observe the religious prescriptions upon which their identity and social legitimization rest. This reinforces a dual institutional form, which is a combination of traditional bank governance bodies and specialized institutions for compliance with religious rules (Lewis, 2005). Although this architecture provides confidence, it may also create tensions when managerial and religious authorities interpret the architecture differently.

Thus, actors and instruments of governance in Islamic and conventional banks are based on a standard set of principles, but the religious dimension is a heavy difference. While traditional banks mainly depend on disciplinary and informational tools, Islamic banks offer an additional

normative and spiritual dimension, adding a unique layer of legitimacy and trust (Safieddine, 2009). This specificity, which entitles the Islamic governance to a technical and religious dual character, is also distinct within the global banking sector.

2.3. Ethical and Normative Issues in Islamic Governance

In addition to its institutional specifics, the governance of Islamic banks is characterized by a profound ethical and normative component that shapes not only the governance structure but also the ultimate purpose of the banking activity. In contrast to typical models, which consider governance primarily through the narrow principles of shareholder value maximization and mitigating agency conflict, Islamic governance is guided by a wider set of religious, social, and moral imperatives. It is predicated on a particular notion of finance as a socially oriented activity (in service of the ummah), in which the quest for profitability must be balanced out with adherence to Shariah and attainment of the goals of justice and equity. In this view, governance is not only how we discipline managers or protect controlling stakeholders' rights to wealth; it is also a mechanism of social legitimation and trust — the decisions we make seem legit in part because they are consistent with ethical norms which all actors in the same context share (Suchman, 1995).

This normativity is woven into a set of expectations that extends beyond simply disclosure of financial information. Islamic governance broadens managers' moral jail: they not only answer shareholders or regulators, but they also answer to God and the community. This multiplicity of accountability establishes a regime of discipline that is as much a formal *modus operandi* as an institutionalized ethos. Hence, managers are required to refrain from anything that resembles excessive speculation (*gharar*) or exploitation (*zulm*). As such, financial options extend an ethical dimension that rationalizes financial in decision-making beyond market logics (Chapra, 2011).

Thirdly, Islamic governance plays a role in reinforcing the resilience of micro-banking through a sustainable and trustworthy atmosphere with stakeholders. Transparency and religious compliance are also crucial in a sector with high information asymmetries: the risk of massive deposit withdrawals or credibility loss is a serious one. This means that not only is the depositors' money invested in permissible and socially responsible activities, but it also ensures that Islamic banks enjoy better customer loyalty in crisis times. Collectively, then, these religious and social bases of legitimacy thus comprise a form of symbolic capital that serves to supplement and strengthen both the established risk management measures. Berger et al. (1995) argue that the stability of a banking system is mainly guaranteed by the confidence of depositors

and their perceptions of the safety of their deposits, enhanced in the case of Islamic banks by the moral and religious character of this trust.

Thus, the moral-normative aspect of Islamic governance goes beyond mere adherence to the law to the fact that it is used to safeguard common interests and serves as the vehicle of social legitimacy. It presents a different paradigm of banking governance, where a reliance on market-driven discipline for stability is supplemented with adherence to a standard moral and religious order. From this perspective, Islamic governance is a type of endogenous regulation in which ethical principles provide a form of regulation that is exogenous only in relation to and often more effective than external regulatory systems. Given this mechanism that ensures banking stability beyond classical economic logic (integrating social, moral, and spiritual dimensions), this model provides Islamic banks with a unique feature that should receive special attention among the professional and academic world.

3. Towards an Integrated Approach to Governance and Micro-Banking Stability in Islamic Financial Institutions

Micro-banking stability forms one of the core complexities of governance in Islamic financial institutions. This equilibrium is even more precarious than in traditional banks: it relies on the discipline of managers, on reliance on informed risk aversion, on the policing of depositors, and finally on social legitimacy. Hence, Islamic governance should not be regarded solely as a mechanism of control but viewed as an architecture that links diverse, institutional, religious, economic, and social facets to maintain the resilience and continuity of the banking activity under the umbrella of Sharia-compliant long-term objectives.

In this light, Islamic governance appears as a structuring lever of micro-banking stability, both by curbing opportunism, reducing information asymmetries, and enhancing the confidence of stakeholders. It therefore follows a bundled logic where internal discipline, risk management, and ultimately social legitimation are not separate mechanisms, but complementary elements that maintain the sustainability of the institutional shell.

3.1. Islamic Governance, Risk Management, and Internal Discipline

Micro-banking stability forms one of the core complexities of governance. Islamic banks are exposed to various financial, operational, and religious risks owing to their specificity, which cannot be handled without a solid governance framework. In this sense, governance does not appear as an external instrument of compliance or control, but an embedded mechanism of management and prevention. It enables the anticipation of vulnerabilities linked to the participatory nature of contracts, the limitation of opportunistic managerial behavior, and the

strengthening of depositor confidence. This axis presents two key functions of Islamic governance: its role in the sphere of risk management on the one hand and its ability to maintain long-lasting internal discipline on the other hand.

3.1.1. Islamic Governance as an Instrument of Risk Management

Risk management and prevention in banks are fundamentally defined by the particularities that characterize Islamic banks, especially the nature of their institutional work. Hence, the governance of Islamic banks occupies a prominent position. In fact, an Islamic bank cannot be considered merely a traditional bank exposed to traditional financial risks such as credit, liquidity, market, or operational risk. Therefore, the bank must also consider another significant non-traditional risk: non-compliance with Shariah principles. In fact, should a financial transaction or product be declared non-compliant by religious leaders or authorities, then it can quickly lead to a crisis of confidence amongst depositors and investors, and in most cases, massive withdrawals or disengagement from the market. This specificity implies that Islamic governance plays a significant preventive role, ensuring that banking practices align with religious prescriptions while also managing the financial risks associated with banking activities.

In this scope, the Sharia Supervisory Board (SSB) takes a critical position: an independent party monitoring the religious compliance of banking products and operational processes, as well as assisting in the elimination of uncertainty. Has it given an advanced credibility to Islamic Banks, where clients can have peace of mind that their deposit or investment will be administered based on the values of Islamic principles? As noted by Archer and Karim (2007), this is an innovation at the institutional level because this religious supervision gives Islamic banks their relative advantage in terms of assurance and legitimacy. In addition, it also acts as an instrument to mitigate information asymmetry. Since depositors are usually not capable of determining whether the product complies, the existence of the Sharia Supervisory Board serves to assure that the product being offered is indeed compliant, hence reducing the opportunity for managers to engage in opportunistic behavior.

The structural orientation of Islamic banking towards the real economy is another fundamental aspect of Islamic governance in risk management. Islamic banks are not permitted to participate in derivative instruments that have a significant degree of complexity, as well as speculative transactions that exhibit a high degree of volatility due to the prohibition of *riba* (interest), *gharar* (excessive uncertainty), and *maysir* (speculation). Such normative incentives drive managers towards investments that are productive and real, thus lowering the risk of exposure

to systemic financial collapses. In this regard, Islamic governance serves as an ex-ante filter to prevent institutions from including high-risk products in their portfolios that are short-term profitable but will be detrimental to the long-term sustainability of the institution.

In contrast, risk management in Islamic banks encompasses not only financial and religious aspects but also an ethical and moral dimension, which is both specific and integral. Managers have a moral obligation, which is, of course, to protect the interests not only of shareholders but also of depositors, clients, the community, and ultimately God. This ethical obligation provides a strong motivation for cautious and open management of resources. It plays out as an endogenous regulation that supersedes formal risk management practices and reinforces institutions' behavioral discipline. Thus, as Chapra and Ahmed (2002) note, this element of ethics constitutes a unique blend of financial regulatory instruments and religious imperatives that endows the bank with greater stability against confidence crises and internal imbalances. From this perspective, Islamic governance plays an essential role in enabling both the expectation and specification of the unique risks of participatory finance through the scaffolding of disclosure and sanctity (Alshehri, 2024).

In the end, Islamic governance is far more than an ex-post risk management tool. It is a proper integrated system of prevention, supervision, and legitimation that merges religious beliefs, institutional schema, and moral incentives. By doing so, it diminishes the financial risk proneness of partner Islamic banks and shields depositors from the reality of non-conformance risk. It helps upgrade financial sector stability through the persistent aura of trust. It thus demonstrates how the interplay between distinctive religious norms and contemporary practices of governance can yield a risk management regime that is functional, authoritative, and robust.

3.1.2. Islamic Governance as a Tool of Internal Discipline

Islamic governance does not merely aim to prevent and manage risks, but also form a discipline of self-regulation to discipline managers through aligning their behaviors with standard practices to mitigate failures due to information asymmetries. These asymmetries are especially severe in banking, where depositors and investors (who tend to be dispersed and ill-informed) are left in a position of disadvantage, relative to managers with privileged access to financial and operational information. The above situations are fertile ground for opportunistic behavior, which will result in higher agency costs, or worse, directly endanger banking veracity. The participatory nature of contracts such as *mudaraba* or *musharaka* in Islamic banks makes this problem even worse, as depositors carry part of the risk directly. This has made a compelling

case for a firm disciplinary structure so that the interests of stakeholders are safeguarded and the institution survives.

Islamic Banks primarily deploy both formal measures and normative values as disciplinary mechanisms. At the institutional level, external control bodies, such as audit committees, risk management committees, and boards of directors, monitor the alignment of managerial decisions with strategic and normative goals. Here, the Sharia Supervisory Board holds a special position, because apart from its role as a religious watchdog, it serves as an additional regulatory body that constrains managerial freedom and puts pressure on top managers to rationalize their decisions in both economic and moral and religious terms. Mandating both gives internal discipline another boost, narrow windows for opportunistic behavior are reduced, and the same higher-order principles of justice and transparency now legitimize tighter supervision.

This organizational discipline is complemented by a moral discipline inherent within the governance model of Islam. The responsibility of Islamic bank executives transcends that of their counterparts elsewhere: they must answer not just to shareholders or regulators, but also to the community of believers, and therefore also directly to God. This kind of accountability is rooted in what we refer to as transcendent accountability, and it alone is a potent stimulus for honesty, prudence, and transparency, where any infraction could be viewed as not simply a professional failing, but even a moral and religious violation. Such an embedding of the banking relationship contributes to a climate of increased trust among the different stakeholders, since it encompasses a shared horizon of values, far beyond the profitable transaction.

3.2. Islamic Governance, Stakeholder Protection, and Social Legitimacy

The governance of Islamic banks, apart from its disciplinary and risk management functions, is foundational in the protection of stakeholders as well as in the consolidation of their social legitimacy. Trust is the foundation of micro-banking stability from all points of view; therefore, governance is not only about managing the behaviour of its members but also protecting the interests of depositors and situating the bank in an everyday ethical and religious context. This duality of protection and legitimacy within Islamic governance plays a vital role in enhancing the resilience and sustainability of institutions over time.

3.2.1. Islamic Governance as a Mechanism for Stakeholder Protection

Within the underlying principles of the governance of Islamic banks, one of the key elements is stakeholder protection. For conventional banks, deposits are usually secured under some public insurance scheme. However, Islamic investment accounts are not secured and are based

on contracts where the depositors and the bank enter participatory contracts like *mudaraba* or *musharaka*. The risk is then in part passed onto depositors who stand to lose their funds via these contracts. This uniqueness amplifies their vulnerability and makes a strong governance structure a necessity, one that governs fund management and mitigates the risk of managers engaging in opportunistic behavior.

The mechanisms of Islamic governance are prominently realized through financial transparency, the dissemination of reliable information, the existence of an internal and external audit system, and a transcendental role of the Sharia Supervisory Board (SSB). The latter not only guarantees operational compliance from a religious perspective but also provides a supervisory authority that enhances client trust. Islamic governance ensures that depositors and investors become familiar with risk management by reducing information asymmetries, thus implicitly guaranteeing security. Berger et al. (1995) emphasize that the stability of the banking sector will depend on depositor confidence, as any concerns about the security of the deposits would result in mass withdrawals, which in turn would directly endanger the survival of a financial institution in the form of a bank run. On this premise, Islamic governance serves as a bastion of safety not only for depositors but also for investors, employees, regulators, and the community. The alignment of internal management with stakeholder expectations and religious values adds to the credibility of Islamic banks and thus reinforces their resilience against internal or external shocks.

3.2.2. Islamic Governance as an Instrument of Social Legitimacy

The mechanisms of Islamic governance are prominently realized through the governance of Islamic banks, which is not limited to mere contractual protection but takes on a larger dimension in terms of social legitimation as well. In fact, the Islamic bank is not just a financial intermediary but also a social entity, even further a moral institution that has the responsibility to take part in the realization of collective welfare (*maslahah*). Hence, it owes accountability not only to its shareholders and clients but also to society, which expects it to maintain ethical, fair, and Shariah-compliant behaviour.

This legitimacy reaffirmation process is centered around the Sharia Supervisory Board. Beyond the strictly economic realm, its monitoring and review of operations affords the bank the religious and moral legitimacy it needs. This religious legitimacy is fundamental to maintaining client and public confidence, in that it ensures that the bank adheres to the principles of justice, transparency, and fairness. Indeed, as Suchman (1995) has noted, while legitimacy is a critical resource for the survival of an organization, no institution can expect to remain stable

indefinitely without continuous investment in its legitimacy. For Islamic banks, this legitimacy rests on two pillars: a religious compliance that ensures the operations of the banks are moral, plus modern governance mechanisms that ensure discipline and transparency.

This unique combination presents Islamic banks with a distinct positioning in the financial landscape. Value-based governance is driven not only by the need to meet expectations of regulators or shareholders but also by the desire to address the social and ethical expectations of communities. This means that for micro-banking stability, it cannot be detached from social legitimacy; the more a bank is considered to be honest, equitable, and committed to its religious principles, the more it engenders trust, reduces massive withdrawals, and fortifies institutional durability. Islamic governance thus operates as a vector of legitimacy that diffuses beyond the financial sphere to embed itself in a social logic wherein stakeholder protection and the consolidation of social trust emerge as mutually constitutive prerequisites of stability.

3.3. The Governance of Islamic Banks as a Lever for Micro-Banking Stability

The governance of Islamic banks should not be based on conflicting control mechanisms, but rather on a holistic structure that fosters micro-institutional stability. It forms a structuring lever that articulates multiple dimensions: internal managerial discipline, preemptive risk management, stakeholder protection, and the accumulation of enduring social legitimacy. This distinctive blend uniquely qualifies Islamic banks as different from conventional ones and gives the former the benefits of resilience against distress.

Governance, in the first place, provides a protection layer against failures attributed to opportunistic managerial behavior and agency conflicts. Islamic banks, as a system based on participation contracts such as *mudaraba* or *musharaka*, are directly subject to financial risk that arises from both investors and depositors. This uniqueness increases the need for internal discipline, but also greater transparency, to maintain trust. Islamic governance reduces information asymmetries in such regards by virtue of making management more accountable and reducing incentives to over-leverage by reducing risk-taking incentives.

Second, Islamic governance serves as a mechanism of integration between religion and economy. This articulation is best illustrated by the role of the Sharia Supervisory Board, which, in ensuring that its operations are compatible with Shariah principles, reinforces the bank's religious legitimacy and its credibility among society. This dual legitimization, religious and social, constitutes a micro-banking stability factor, as it reinforces stakeholder confidence in the robustness and rectitude of the institution.

Last but not least, the Islamic governance also helps in securing the long-term stay of banks within its socio-economic setting. It does more than ensuring stability inside it, but also enables institutional sustainability through establishing the alignment between the banking practices and the ethical and social expectations of the community. Islamic banks manage to gain trust and become less vulnerable to crises by portraying themselves as responsible, moral actors. Their governance is a forceful lever with the promise of enduring micro-stability, simply on account of how the articulation of discipline, transparency, and legitimacy renders it.

In short, Islamic governance is not just one tool in the toolbox; instead, it comes through the pivot of the micro-banking stability framework. In reconciling cautious risk management, stakeholder protection, and social legitimization, it endows Islamic banks with institutional robustness and a capital of trust, without which no sustainable stability is to be dreamt of.

Conclusion

This analysis, performed in this article, identified the structuring role of banking governance as a normative and conceptual instrument of micro-banking stability. Using the theoretical contributions relating to governance, specifically agency theory and stakeholder theory, it has been demonstrated that internal discipline mechanisms, lowering information asymmetries, and protecting relevant stakeholders reinforce the stability and robustness of banking institutions. The quality of governance frameworks thus seems inextricably tied to the perceived stability of micro-banking, the bedrock of continuity and trust.

The study of Islamic banks has emphasized their institutional and religious peculiarities that give a dual aspect to their governance: on the one hand, the introduction of classical mechanisms of control and risk management, and on the other hand, the introduction of normative (using Islamic principles) and spiritual (using shari'ah supervisory boards) legitimacy. It is this hybridity that is both a limitation and a resource as it forces a consideration of ways to balance managerialism and religious adherence, at the same time, expanding governance into the ethical and social domains.

In the case of Islamic financial institutions, the articulation between governance and micro-banking stability thus uncovers an original model, one in which the confidence of depositors and investors rests as much on the solidity of conventional mechanisms as on adherence to religious rules. This dual exigence renders Islamic governance an important prop of stability, which goes beyond mere internal control to underpin the social legitimation of the institution itself.

In this sense, banking governance, when put into the context of Islamic banks, becomes an instrument of regulation, coverage, and confession in a more strategic approach. More than a technical thing, it has to be perceived as a normative structure, where discipline, transparency, and legitimacy coalesce. This observation reveals potential conceptual investigation around the junction of governance, ethics, and stability, especially as Islamic finance becomes more important at the international level.

Despite this analysis developed previously, some limitations of this research should be noted. While the proposed analysis is primarily conceptual and normative, it has not been empirically validated using quantitative data or field studies, which limits its generalizability and applicability. Furthermore, such conclusions presented must be interpreted with a more nuanced lens, as the institutional and regulatory contexts across Muslim-majority countries are diverse. However, these limitations present opportunities for future research through comparative empirical studies, in-depth analyses of specific Islamic banking governance cases, and interdisciplinary approaches that integrate economic, legal, and sociological perspectives to understand better the nexus of banking governance and micro-banking stability in the context of Islamic financial institutions.

BIBLIOGRAPHIE

Adams, R. B., & Mehran, H. (2003). Is corporate governance different for bank holding companies? *Federal Reserve Bank of New York Economic Policy Review*, 9(1), 123–142.

Akerlof, G. A. (1970). The market for lemons: Quality uncertainty and the market mechanism. *Quarterly Journal of Economics*, 84(3), 488–500.

Alshehri, M. (2024). Corporate governance reforms in banking: Emerging conceptual frameworks. *Journal of Banking Regulation*, 25(2), 145-163. <https://doi.org/10.1057/s41261-024-00234-5>.

Archer, S., & Karim, R. A. A. (2007). *Islamic finance: The regulatory challenge*. John Wiley & Sons.

Baig, A. (2024). Risk management and governance mechanisms in Islamic banks: Towards micro-stability. *Journal of Financial Stability*, 68, 101234. <https://doi.org/10.1016/j.jfs.2024.101234>.

Basel Committee on Banking Supervision. (2006). *International convergence of capital measurement and capital standards: A revised framework*. Bank for International Settlements.

Basel Committee on Banking Supervision. (2015). *Corporate governance principles for banks*. Bank for International Settlements.

- Berger, A. N., Herring, R. J., & Szegö, G. P. (1995). The role of capital in financial institutions. *Journal of Banking & Finance*, 19(3–4), 393–430.
- Borio, C. (2003). Towards a macroprudential framework for financial supervision and regulation. BIS Working Papers No. 128.
- Bushman, R. M., & Smith, A. J. (2001). Financial accounting information and corporate governance. *Journal of Accounting and Economics*, 32(1–3), 237–333.
- Bushman, R. M., & Smith, A. J. (2003). Transparency, financial accounting information, and corporate governance. *Economic Policy Review*, 9(1), 65–87.
- Calomiris, C. W., & Kahn, C. M. (1991). The role of demandable debt in structuring optimal banking arrangements. *American Economic Review*, 81(3), 497–513.
- Caprio, G., & Levine, R. (2002). Corporate governance in finance: Concepts and international observations. In R. E. Litan, M. Pomerleano, & V. Sundararajan (Eds.).
- Chapra, M. U. (2011). The Islamic vision of development in the light of maqasid al-shariah. Islamic Research and Training Institute.
- Chapra, M. U., & Ahmed, H. (2002). Corporate governance in Islamic financial institutions. Islamic Development Bank, Islamic Research and Training Institute.
- Coase, R.H. (1937). The Nature of the Firm. *Economica*, 4(16), 386-405.
- Crockett, A. (2000). Marrying the micro- and macro-prudential dimensions of financial stability. BIS Speeches.
- Diamond, D. W., & Dybvig, P. H. (1983). Bank runs, deposit insurance, and liquidity. *Journal of Political Economy*, 91(3), 401–419.
- Dusuki, A. W. (2008). Understanding the objectives of Islamic banking: A survey of stakeholders' perspectives. *International Journal of Islamic and Middle Eastern Finance and Management*, 1(2), 132–148.
- Freeman, R. E. (1984). *Strategic management: A stakeholder approach*. Pitman.
- Hill, C. W. L., & Jones, T. M. (1992). Stakeholder-agency theory. *Journal of Management Studies*, 29(2), 131–154.
- Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4), 305–360.
- Jones, T. M. (1995). Instrumental stakeholder theory: A synthesis of ethics and economics. *Academy of Management Review*, 20(2), 404–437.
- Laeven, L., & Levine, R. (2009). Bank governance, regulation and risk taking. *Journal of Financial Economics*, 93(2), 259–275.

- Lewis, M. K. (2005). Islamic corporate governance. *Review of Islamic Economics*, 9(1), 5–29.
- Macey, J. R., & O'Hara, M. (2003). The corporate governance of banks. *Federal Reserve Bank of New York Economic Policy Review*, 9(1), 91–107.
- Safieddine, A. (2009). Islamic financial institutions and corporate governance: New insights for agency theory. *Corporate Governance: An International Review*, 17(2), 142–158.
- Shleifer, A., & Vishny, R. W. (1997). A survey of corporate governance. *The Journal of Finance*, 52(2), 737–783.
- Suchman, M. C. (1995). Managing legitimacy: Strategic and institutional approaches. *Academy of Management Review*, 20(3), 571–610.