

ANALYSIS OF LITERATURES ON SHARIAH NON-COMPLIANCE (SNC) IN ISLAMIC FINANCE

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Abstract: Shariah non-compliance is an important topic not only for Muslims who manage businesses but also for Islamic Financial Institutions (IFIs), in order to maintain justice and fairness in transactions. The objective of this study is to conduct an analysis of the relevant literatures on Shariah non-compliance (SNC) in Islamic Finance. Descriptive research that is based on document analysis of prior studies and literatures on SNC that were obtained from online journals has been used as the approach for this study. Journals and publications are obtained via a wide variety of channels, including Google Scholar, Science Direct, and ResearchGate.com. There are a total of 80 articles relevant to this topic that were gathered and reviewed. This study looked at a variety of different characteristics, some of which are subject of article, the number of articles that have been published and type of study. The general conclusion from this study shows that the vast majority of previous research on SNC focused primarily on investigating issues pertaining to firm performance, investment, and risk management and mainly focused on descriptive analysis approach.

Keywords: Shariah, Shariah non-compliance, Islamic Finance

1. Introduction

Islam is religion that adheres to the truth. It is the manifestation of the principle of life that Allah, the Creator and Lord of the universe, has given for the guidance of people in the Quran and the Hadith. Shariah is the Islamic legal system that was given to the Prophet SAW to serve as a guide for behaviour and as a benchmark for determining whether or not something is permissible (*halal*) or forbidden (*haram*) (the path) especially in conducting business operations and commercial dealings (*muamalah*). At the present time, it is necessary to be concerned about commercial dealings and business operations that go against the Shariah. This is because the drive for innovation in order to satisfy the community needs and commercial purposes has caused many companies and Islamic financial institutions (IFIs) to adopt conventional principles and instruments. Islam prohibit Muslim to conduct commercial dealings and business operations that totally involves with usury (*riba*), uncertainty (*gharar*), gambling (*maysir*) and other prohibited element such as dealings with liquors, pork, pornography and selling weapons. On the day of judgement, the Muslim who goes against the Shariah regulations in the way they do business and engage with other people will be punished. As Allah SWT stated in divine revelation (al-Quran):

“And for their taking interest even though it was forbidden for them, and their wrongful appropriation of other people’s property. We have prepared for those among them who reject faith a grievous punishment (4: 161)”.

Therefore, as Shariah is the core principle upon which firms or Islamic financial institutions are built, conformity with Shariah is the most critical part of running a corporation. Companies face the risk of being non-compliant with Shariah principles and values if they do not adhere to them when it comes to managing their finances, running their businesses, and carrying out their operations (Omar, 2019). This paper presents selected analysis of literatures using the online database to determine the research areas related to Shariah non-compliance (SNC) element that involve directly or indirectly in the business operation of the company and Islamic financial institutions. Selected analysis were taken into account in this study of scholarly output such as article counts, type of study and article published.

2. Literature Review

2.1 The Concept of Shariah Compliant

Shariah is the legal system that comes from the teachings of the Quran, which is holy book of Islam, and the teachings of the Prophet Muhammad SAW, which are called Sunnah. Its guide Muslims on how to live in a fair, moral, and righteous way and gives advice on many aspects of life. M. Cherif Bassiouni (2012) asserts that the Quran is the primary source for the Shariah, which is the legal code that governs Muslims. It comprises the laws by which the Muslim world is ruled (or should regulate itself), and it creates the basis for relationships between man and God, between people, whether Muslim or non-Muslim, as well as between man and objects that are part of creation. The Shariah comprises the laws that are used to structure and administer a Muslim community. It also gives the methods to settle issues between people as well as conflicts between individuals and the state.

In the context of the sector, the term "Shariah-compliant" refers to the practise of conducting business in a manner that is in line with Islamic law (Shariah). The Islamic legal system is known as Shariah, and it is based on Islamic principles. These guiding concepts apply to every facet of day-to-day life, including the individual, the family, and society as a whole. A value that is compliant with Shariah can have an influence on the strategic management practise of a company as well as its financial success (Aang Kunaifi, 2019).

In the sector of banking and finance, all IFIs are required to conduct their commercial activities in accordance with Shariah standards in order to minimise Shariah hazards such as *riba* (usury), *maysir* (gambling), and *gharar* (uncertainty) in their transactions. There is a zero-tolerance policy in place for any unethical business practises that may arise inside the banking industry (Satkunasingam, 2006). Other findings (2016) also identify that the other elements such as *Ghubn* (inequality), *Ikra* (duress), *Ghala'* (error), *Taghrir* (deceit), and *Jahalah* (deception) are also prohibited in a Shariah-compliant for commercial dealings. Islamic banks require a thorough understanding of these factors to implement efficient Shariah risk management (Hassan, 2016).

2.2 Shariah Non-Compliance Risk

The outcomes of the research conducted by N. Omar and R. Hassan (2019) demonstrated that SNC risk might originate from a variety of areas, including the structure of the product. Due consideration must be paid to these aspects, as any breach of Shariah law on the terms of the contract may result in SNC. The paperwork must not be in conflict with the principles of Shariah since the nature of Islamic finance is distinct from that of its conventional equivalents. Islamic finance has extra requirements in the terms and conditions of the goods and services it provides. Even if the underlying contract agrees with Shariah rules and principles, a Shariah non-compliance case may nonetheless occur if the product in question is executed incorrectly. Inadequate advertising or questionable and improper marketing may deliver a false image representation of the Islamic bank and the product offered, and it may tarnish the reputation of IFIs in the eyes of the public. N. Omar and R. Hassan (2019) further noted that, a weak system technology will make it more difficult to effectively manage SNC risk.

Apart from that, there is a possibility that SNC risk will have an effect on the amount of income generated by some businesses and IFIs. According to Standard Chartered Bank (2018), Shariah Non-compliant income is defined as income that is generated or received from events that are non-compliant to Shariah rules and principles. Some examples of Shariah Non-compliant income include profit charges from transactions involving invalid Shariah contracts as well as income derived from businesses that do not comply with Shariah. Shariah scholars designate invalid contracts as *batil* or *fasid*. There was little difference between these two words in the eyes of the majority of jurists (Al-Mahalli, 2001). The word "*batil*" signifies "void" in its literal sense. Legally speaking, a *batil* or *fasid* is an agreement when the main terms and conditions have not been met (Al-Shawkani, 2004). According to Shariah law, a null and void contract has no binding force. Therefore, if the parties want to move on with the contract, they will need to re-execute it (Erdem Oz, 2016).

According to Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) (2015) there is significance difference between impure income and SNC income. A certain bank distinguishes between impure and SNC revenues. Impure income is comprised of interest income recognised as such in the statement of financial position, income recognised from Shariah non-compliant financial investments, and income accrued as a result of Shariah non-compliant business sources (products and subsidiaries), whereas SNC income is derived solely from SNC events (AAOIFI, 2015).

In IFIs operation, the potential for SNC to disrupt the business practises of Islamic banks extends far beyond the borders of Malaysia. Shariah non-compliance is a high-priority risk in the management of Islamic financial institutions for two main reasons: first, the vast majority of Islamic financial institution fund contributors recognise that Shariah-compliant services are essential to the institution's continued long-term operations; and second, any uncertainties and inconsistencies in Shariah law will result in the cancellation of a transaction, resulting in loss and an interrupted source of income, annulment of a deal that would have resulted in a loss or invalidated a potential source of income (Amir Husin Mohd Nor, 2019).

3. Research Methodology

This paper performed descriptive analysis based on the body of literature concerning Shariah non-compliance occurrences in firms and IFIs beginning in 2010 and continuing through 2022. For the purpose of the study, a total of 80 publications were gathered from a variety of online sources, including Google Scholar, Science Direct, and researchgate.com, as well as conference papers, journals, and articles. The literatures and articles will be evaluated in order to extract the data including Shariah non-compliance knowledge and issues. This information may be utilised by researchers, academics, and practitioners in banking and finance in order to improve the present issue that is linked to SNC occurrences.

3.1 Research Findings

Table 1: Number of Annual Journal Publications

Subject of article	2010	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total
Firm performance		1	1	1	2		2	1	1	2	3	3	17
Investment		1	1	3	1			2	3	1	1	4	17
Islamic banking and finance							1	3	4	1	5	1	15
Risk management	1					1	2	4	6	3			17
Islamic banking product						1	2		2	1			6
Governance						1		1	2				4
SNC reporting											1	1	2
Accounting Management									1				1
Online application												1	1
Total	1	2	2	4	3	3	7	11	19	8	10	10	80

From the years 2010 through 2022, a total of 80 articles relating to Shariah non-compliance were examined. Articles that have been examined throughout the years and which are connected to Shariah non-compliance are outlined in further depth in Table 1. Generally, based on the table, there are nine subjects of article related to SNC that have been published throughout the period namely firm performance, investment, Islamic banking and finance, risk management, Islamic banking product, governance, SNC reporting, accounting management and online application.

There is a comparable number of articles that have been generally related to firm performance, investment, and risk management, and these three subjects of article that have been documented as having the biggest number of articles published in throughout the period of 2010 to 2022. While there are 15 articles that focus with Islamic banking and finance. In addition, there have been recorded articles pertaining to Islamic banking product, governance, and SNC reporting. There are a total of 6 articles pertaining to Islamic banking product, 4 articles pertaining to governance, and 2 articles relating to SNC reporting. Moreover, the subjects that have the fewest number of articles are those that are associated with accounting management and online application; both of these subjects' articles only have one article.

The highest number of articles produced is in 2019 with 19 articles. In 2018, the total number articles produced were 11 articles. Meanwhile, there were 10 articles in 2021 and 2022. In 2020 and 2017, there were a slight difference number of articles in which recorded 8 articles and 7 articles. Meanwhile, there 3 articles published in 2015 and 2016 and 4 articles published in 2014. Both period in 2012 and 2013 had equal number of articles in which both periods published only 2 articles. Last but not least, there is only one article published in 2010 that related to SNC.

Table 2: Types of Study by Journal Articles Publication Year

Publication Year	Data Analysis					Total
	Descriptive	Empirical	Exploratory	Explanatory	Analytical	
2010					1	1
2011						
2012	2					2
2013	2					2
2014	4					4
2015	1	1		1		3
2016		2	1			3
2017	2	2	1	1	1	7
2018	2	5	3		1	11
2019	6	5	4	4		19
2020	2	1	2	2	1	8
2021	5	3	1		1	10
2022	5	1	2		2	10
Total	31	20	14	8	7	80

Analytical, descriptive, empirical, exploratory, and explanatory methods are outlined in Table 2 as the focal points of this analysis. These approaches have been widely used in a variety of previous studies. The descriptive method was used by the majority of researchers, with a total of 31 papers, according to the study that was done on the 80 publications. It was then followed by an empirical approach, which consists of 20 research publications, while 14 journal articles use an exploratory method. The explanatory method, which had a total of 8 articles, was the approach with the second-lowest article count that had been recorded. The number of articles that used an analytical technique is the lowest of any research approach that was documented.

Table 3: List of Journals and Number of Articles Published

No	Title	Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total
1	Oil price volatility and firm profitability: an empirical analysis of Shariah-compliant and non-Shariah-compliant firms	Australia												✓		1

2	The Influence of Islamic Governance on Minimizing Non-Compliance with Sharia	Indonesia										✓						14
3	Shariah vs non-shariah IPO under-pricing: evidence from Indonesia Stock Exchange	Indonesia															✓	
4	Sharia vs non-sharia compliant: which gives much higher financial-based brand equity to the companies listed in the Indonesian stock market?	Indonesia															✓	
5	How uncertainty and firm characteristics determine the capital structure: Evidence from Indonesia's sharia- and non-sharia-compliant firms	Indonesia															✓	
6	<i>Mitigasi sharia non-compliance risk pengembangan produk keuangan syariah di Bank Pembiayaan Rakyat Syariah</i>	Indonesia										✓						
7	Identification of non-sharia compliant activity in conventional insurance	Indonesia												✓				
8	Do sharia and non-sharia listing security a listing security invest ties investors respond different respond differently to tax avoidance?	Indonesia															✓	
9	Comparison analysis of determinants on firm performance in sharia and non-sharia compliant firms listed in Indonesia stock exchange	Indonesia															✓	
10	Voluntary Disclosure and Company Characteristics of Indonesian Listed Companies: Comparison of Shariah and Non-Shariah Companies	Indonesia				✓												
11	<i>Aspek syariah non-compliance pada mekanisme transaksi saham syariah jakarta</i>	Indonesia															✓	

	<i>Islamic index (jii) Bursa Efek Indonesia</i>																
12	Corporate governance and shariah noncompliant risk in Islamic banks: Evidence from Indonesia and Malaysia	Indonesia										✓					
13	<i>Mitigasi sharia non-compliance risk pengembangan produk keuangan syariahdi bank pembiayaan rakyat syariah(studi kasus : Pt. Bprs Mandiri Mitra Sukses</i>	Indonesia										✓					
14	<i>Perbandingan kinerja perusahaan berbasis keuangan syariah (sharia-compliant) dan perusahaan berbasis keuangan non-syariah (nonsharia compliant)</i>	Indonesia												✓			
15	Determinants of Capital Structure: A Comparison between Sharia-Compliant and Sharia Non-Compliant Firms in Indonesia	Indonesia											✓				
16	Management of Shariah Non-Compliance Audit Risk in the Islamic Financial Institutions via the Development of Shariah Compliance Audit Framework and Shariah Audit Programme	Malaysia	✓														48
17	Corporate governance and Shariah non-compliant risk in Islamic banks: evidence from Southeast Asia	Malaysia										✓					
18	Internal control, risk and Sharī'ah non-compliant income in Islamic financial institutions	Malaysia										✓					
19	Survey on Sharī'ah non-compliant events in Islamic banks in the practice of tawarruq financing in Malaysia	Malaysia											✓				
20	Sharī'ah non-compliant assets as rahn (pledge) in Islamic banking	Malaysia								✓							

	products: a fiqhī perspective																	
21	performance of Shari'ah compliant and non-Shari'ah compliant listed firms: a case study of Malaysia	Malaysia										✓						
22	External and internal determinants of performances of Shariah and non-Shariah compliant firms	Malaysia							✓									
23	Measuring Shariah non-compliance risk (SNCR): claw-out effect of al-bai-bithaman ajil in default	Malaysia							✓									
24	Shari'ah non-compliant income disclosures and the moral legitimacy strategies of Islamic banks	Malaysia											✓					
25	Performance of Shariah and Non-Shariah Compliance F&B Firms in Malaysia: Is there any Difference?	Malaysia											✓					
26	Shariah Non-Compliance Treatment in Malaysian Islamic Banks	Malaysia									✓							
27	The role of key functions in managing and reporting the Shariah non-compliant income (SNCI) in Malaysian Islamic banks	Malaysia											✓					
28	<i>Pengurusan pendapatan tidak patuh syariah di Bank Muamalat Malaysia Berhad</i>	Malaysia									✓							
29	Shari'ah non-compliance risk management in takaful industry	Malaysia									✓							
30	Potential shariah non-compliance practices in e1bidding: observation from e-bidding platforms in Malaysia	Malaysia														✓		
31	The Disclosure of Shari'ah Non-Compliance Income: Comparative Study	Malaysia										✓						

	between Full-fledged and Subsidiaries Malaysian Islamic Banks																
32	Sustainability-disclosures and financial performance: shariah compliant vs non-shariah-compliant Indonesian firm	Malaysia										✓					
33	Capital Structure Determinants of Shariah and Non-Shariah Companies at Bursa Malaysia – Dynamic Approach	Malaysia										✓					
34	Impact of Firm Leverage to Performance: Evidence from Shariah and Non-Shariah Compliant Companies in Malaysia	Malaysia							✓								
35	The Practice of Reporting Shariah Non-Compliant Income in the Annual Financial Report of Islamic Commercial Banks in Malaysia	Malaysia											✓				
36	Managing and reporting of shariah non-compliant income in Malaysian Islamic banks	Malaysia												✓			
37	Initial Returns of Shariah versus Non-Shariah IPOs: Are There Any Differences?	Malaysia							✓								
38	Non-shariah compliance of Islamic banks and customers commitment: trust as mediator	Malaysia													✓		
39	A Comparative Analysis Between Shariah-compliant & non-Shariah compliance	Malaysia										✓					
40	Effective Organizational Communication and Its Roles in Mitigating Shariah Non-Compliance Risks for Malaysian Takaful Operators (TOs)	Malaysia									✓						

41	Corporate Social Responsibility Reporting in Malaysia: A Comparison Between Shariah and Non-Shariah Approved Firms	Malaysia					✓											
42	The Need for Credible Reporting of Shariah Non-compliance Event by Islamic Banks in Malaysia	Malaysia										✓						
43	Islamic finance, Sharia non-compliance and the standardisation of Sharia governance	Malaysia							✓									
44	Impact of Macroeconomic Volatilities on Shariah Compliant and Non-Compliant Equities in Turkey	Malaysia						✓										
45	Determinants of capital structure - Evidence from Shari'ah compliant and non-compliant firms	Malaysia								✓								
46	Shari'ah Non-Compliant Income in Accounting Studies	Malaysia										✓						
47	Impact of Working Capital Management on the Profitability of Shariah-compliant and non-shariah firms: The Case of Malaysia	Malaysia						✓										
48	Performance of Initial Public Offerings (IPOs): Shariah and non-Shariah Compliant Companies	Malaysia																✓
49	Potential Shariah Non-compliance Determinant Factors: A Guidance for Shariah Control Function of Islamic Financial Institution in Malaysia	Malaysia																✓
50	Shariah non-compliance risk in Bank Islam Malaysia Berhad	Malaysia										✓						
51	Impact of dividend policy on the shareholders' wealth: shariah vs non-shariah companies listed in bursa malaysia	Malaysia						✓										

52	Property rights and shariah non-compliance risk	Malaysia											✓			
53	Prudence in Managing and Reporting the Shariah Noncompliant Income by Malaysian Islamic Banks	Malaysia													✓	
54	Ratification of Shariah non-compliance issues: solutions and its implementation in Islamic financial institutions - with specific reference to tawarruq-based products and services	Malaysia										✓				
55	Shariah non-compliance risks in shared and outsourced services of takaful operators	Malaysia									✓					
56	Shariah non-compliance issues and defense of illegality in Islamic finance litigation	Malaysia								✓						
57	Does religious philosophy affect investor behaviour in the COVID-19 times: Evidence from herding in non-Shariah compliant energy firms	Malaysia											✓			
58	Impact of Investment Efficiency on Cost of Equity: An Empirical Study on Shariah and Non-Shariah Compliance Firms Listed on Pakistan Stock Exchange	Malaysia										✓				
59	Shariah Non-Compliant events in Islamic Banks in the practice of Tawarruq Financing in Malaysia	Malaysia									✓					
60	The capital structure decisions of Shariah compliant and non-compliant firms: Evidence from Malaysia	Malaysia										✓				
61	Challenges Faced by Malaysian Islamic Banks in Treating Shariah Non-compliance Events	Malaysia											✓			
62	Management of Shariah noncompliance risk in Maybank Islamic Berhad	Malaysia										✓				

63	Analysis of Syariah quantitative screening norms among Malaysia Syariah-compliant stocks	Malaysia			✓													
64	Shariah non-compliance risk and its effects On Islamic financial institutions	Not Stated							✓									3
65	Managing Shariah Non-Compliance Risk via Islamic Dispute Resolution	Not Stated										✓						
66	A Comparative Analysis Between Shariah-compliant & non-Shariah compliant Stocks	Not Stated										✓						
67	Does Shariah Compliance lead to Managerial Trustworthiness? Evidence from empirical analysis of Capital Structure of Shariah and Non-Shariah Firms in Pakistan	Pakistan						✓										9
68	Capital structure dynamics of Shariah-compliant vs noncompliant firms: evidence from Pakistan	Pakistan															✓	
69	Do Shariah stock market indices perform better than non-Shariah stock market indices? A case study of Bangladesh and Pakistan stock markets	Pakistan															✓	
70	Research study of sharia noncompliance risks in the perspective of banking murabaha	Pakistan										✓						
71	The study of possible Shariah non-compliance Risks of Ijarah with their risk management Mechanism	Pakistan										✓						
72	Governance Indicators and Firm Value: Evidence of Non-Sharia Compliant firms from Pakistan	Pakistan										✓						
73	The Study of Potential Shariah Non-Compliance Risks in Murabahah Along	Pakistan										✓						

	with their Risk Management																
74	Are top managers important for firm performance and idiosyncratic risk? Evidence from sharia vs non-sharia-compliant firms in the UK and Pakistan	Pakistan								✓							
75	Non-Shariah Compliant Income Sources, Treatment, And Its Impact On Customers Trust And Commitment of Pakistan Islamic Banks: A Qualitative Approach	Pakistan											✓				
76	Dividend policies of Shariah-compliant and non-Shariah-compliant firms: Evidence from the MENA region	Saudi Arabia				✓											3
77	Free Cash Flow, Agency Cost and Dividend Policy of Shariah Compliant and Non-Sharia-Compliant firms	Saudi Arabia									✓						
78	The determinants of corporate cash holdings: evidence from Shariah-compliant and non-Shariah-compliant corporations	Saudi Arabia											✓				
79	Monitoring Shariah non-compliance risk in Islamic banking institutions	UK								✓							1
80	Legal and Shariah non-compliance risks in Nigerian Islamic finance industry: a review of the literature	Nigeria											✓				1
	Total																80

According to the publications in the aforementioned journals, there are seven countries that have published a total of 77 articles relating to Shariah non-compliance. The publication location of the remaining three articles is not indicated. A total of 80 publications from a variety of indexed journals were found to be associated with all of the published studies. A significant number of them came from Malaysia.

4. Discussion

After going through the analysis, the finding of the study that has been acquired from 80 articles examined within 2010 to 2022 is that the increasing number of articles published each year demonstrates that research related to Shariah non-compliance is depicted as being very relevant and continues to be a topic of discussion. This finding was acquired from the study that was done in order to acquire the information that was acquired during the analysis. There are nine different aspects of the article that have been highlighted by earlier researchers. The findings indicate that the most researched topics in relation to SNC are firm performance, investment, and risk management; specifically, those three areas registered the highest frequency of publishing.

In terms of type of study, the descriptive analysis is the most approach that has been utilised to a large extent by previous researchers in order to delve more into SNC from its beginnings to its place in the modern day. In comparison to the analytical approach that marked the lowest type of study on SNC. In the meantime, the research shows that the highest number of articles were published in 2010 in Malaysia with regards to management of SNC in IFIs. Malaysia is the country that has provided the greatest number of articles concerning SNC. This is due to the fact that the majority of Malaysia's population is Muslim, and the problem concerning SNC presents ongoing difficulties in satisfying the needs of the Muslim community.

5. Conclusion

General findings discovered that there is a lack of studies pertaining to SNC over the course of the period with regards to global literatures. The study pertaining to SNC should be developed in order to meet the needs of the Muslim community in order to carry out commercial dealings in a just and equitable manner and become a solution to the problem pertaining to SNC. In this regard, the researchers of the future need to maintain their focus and keep their research up to date regarding the current problem and solution of SNC in order to assist the *ummah* in avoiding Shariah non-compliance element in conducting commercial dealings for the purpose of a better improvement in economic sectors as well as reference to the generation that comes after them.

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