

Bridging Halal Industry and Islamic Finance: Conceptual Review on the Internal Governance

Norafni @ Farlina Rahim*

Kolej Pengajian Islam Johor (MARSAH), Malaysia
Email of corresponding auhtor: norafni@marsah.edu.my

Abstract

Halal has become a lifestyle and lucrative business. It is no longer a pure religious issue. Malaysia is a leader in this industry which championing in most of the areas particularly in Halal food, cosmetics and pharmaceuticals and also Islamic finance. Although these industries are under the same umbrella i.e. Halal and lies the under same Shariah principle, the internal governance system are different due to the nature and complexities of the industries. Malaysia Halal Certification has achieve the world standard and become reference from other countries too. The Halal producers and manufacturers are required to comply with Trade Description Act, other Acts related with their nature of business, Malaysia Halal Standard (MS) and Manual for Halal Certification. To ensure the integrity of Halal operation, JAKIM has released the Halal Assurance Management System 2011 (HAS 2011). However, those policies are silent in the internal Halal governance framework. Compared to Islamic finance industry, they are governed by Shariah Governance Framework 2010. Thus, this study tries to review the governance system in Halal industries and Islamic finance and try to integrate them for solid better governance.

Keywords: Halal, Islamic finance, internal governance

1. Introduction

Halal industry is flourishing and thriving. Global Halal economy has generate trillions of sales and it has so much potential. Not only Muslim countries generating their Halal economy, non-Muslim countries also producing Halal products to capture the Halal market (Md Nor Aidi & Ooi, 2014) The growing population of Muslims worldwide has increased the demand for Halal product; which comprises of food, non-food products services (Abdul Raufu & Naqiyuddin, 2014). In addition, the Muslims in the recent years have greater awareness in ensuring Halal for their food, products and services. It becomes a lifestyle and culture for the Muslim community where every single consumer product needs to be legally permitted by Shariah for consumption such as meat, poultry, raw food, cosmetics, pharmaceuticals, hospitality, insurance, finance, banking, tourism, supply chain and many more (Mahiah et al., 2014; Md Nor Aidi & Ooi, 2014). Halal concept in consumption is no more purely a religious issue, rather it is a lifestyle (Norafni Farlina Rahim, Zurina Shafii & Syahidawati Shahwan, 2013), a symbol of quality, assurance, (Abdul Raufu & Ahmad Naqiyuddin, 2014), a source of wealth creation for economy and become a global phenomenon (Md Nor Aidi & Ooi, 2014).

The Halal industry is one of the areas that are currently in attention by Malaysian government. It is due to the impact made by Halal industry player and also the great recognition of the Halal certification from the rest of the world. Malaysia now strengthening its role to be the Global Halal Hub. In June 2015, Malaysian Government has announced its Eleventh Malaysian Plan (RMK11) (2016-2020) toward achieving high-income country and public happiness. In Thrust VI: Re-Engineering Economic Growth, Halal industry is one of the subsectors in Focus Area A in Transforming Services (EPU, 2015, pg.8-18). In RMK11, it mentioned that, "A business-friendly ecosystem and greater collaboration between agencies related to Halal certification and auditing processes will be enhanced" (EPU, 2015, pg. 8-18).

However, there are some cases on the misconduct of Halal management practise such as improper hygienic process and expiration of Halal certification (Hayati, Khairul Anuar & Khairul Rijal, 2008). This has ignited some discomfort feeling and hesitancy of the consumption and confidence on Halal product. Furthermore, there is little information is known whether the food companies practising Halal Assurance Management System (HAS) as stipulated by JAKIM (Muhammad Haziq, Sazelin, S., & Safiah, S., 2014). The standards in Halal industry in insufficient to encounter the *Haram* (forbidden) and *Syubhah* (dubious) issues.

This paper tries to review the recommendations proposed by several researchers in strengthening the internal Halal governance. The objective of this paper is to integrate the Shariah governance that been used in Islamic financial institutions (IFIs) released by Bank Negara Malaysia with the current governance of Halal for Halal-product companies and businesses as stipulated in Halal Assurance System 2011 released by Department of Islamic Development, Malaysia (JAKIM).

2. Literature Review

2.1 Bridging Halal Industry and Islamic Finance

The term of Halal economy has been discussed by Irfan Ishak & Che Man (2011), Irfan Ishak, M. Daud, & Suhaimi (2014), Mohd Ali (2014) and MIFC (2014). Halal economy is the combination of Islamic finance and Halal industries. This is because the values and the principles lies within the industries are similar. i.e. based from Holy Quran, *Ahadeeth* (Sayings of the Prophet Muhammad PBUH), *Ijma'* (Consensus of Muslim scholars), *Qiyas* (Analogy) and *Ijtihad* (Logical reasoning). It means, the Islamic finance and Halal industries are inter-related and a perfect symbiosis nexus (Norafni & Zurina, 2016).

Although Halal industry and Islamic finance are under the same principles and values, both industries somehow lack of nexus (Norafni & Zurina, 2016). The current scenario looks like both main industries are somehow separated and independent (Irfan Ishak, Daud, & Suhaimi, 2013; Mariatul Aida & Rosidah, 2013; Mariatul Aida & Rosidah, 2014; Nurul Aini, Nathasa, Sumaiyah & Nor Asiah, 2014; Purnomo, Rosidah & Faridah, 2015). There are many studies done theoretically and empirically in both fields but very few crossing the paths between them. In another realm, Rahman, Tareq and Mahdzir (2016) propose to integrate the performance measurement in Islamic banking into the Halal industry based on *Maqasid Shariah* (Objective of Shariah).

In the matter of governance, the studies by Zurina & Siti Noradibah (2015), Nurul Aini, et al., (2014), Irfan Ishak et al., (2013) are among few who tries to look at the integration in between these two sectors. Zurina & Siti Noradibah proposed the Shariah Governance Framework (SGF 2010) in Islamic finance sectors into the Halal assurance system. Nurul Aini et al. (2014) and Irfan Ishak et al. (2013) look the governance system in both industries in which we can surmised that there still a room for integration for example in research, training and development.

2.2 Governance System

Corporate governance is defined as a system on how firms are directed and controlled (Muhammad Rizky & Mohamad Ali, 2016). Corporate governance in Islamic perspective should have *Tawhid* as the episteme and Shariah board at the top of the governance (Choudury & Ziaul Hoque, 2006). Although there is no perfect governance system, the good corporate governance should have clear defined responsibilities and expectations for board members, disclosure, transparency, description on shareholder rights, compliance and mechanism for both internal and external governance system (Samra, 2016).

2.3 Shariah Governance in Islamic Finance Institution

Shariah Governance Framework (SGF 2010) has been introduced by Bank Negara Malaysia as a governance standard for Islamic Financial Institutions (IFIs) in the aspects of governance structures, process and arrangements comprising of Shariah review, Shariah audit, Shariah risk management and Shariah research. The SGF 2010 structure and their functions is as follows:

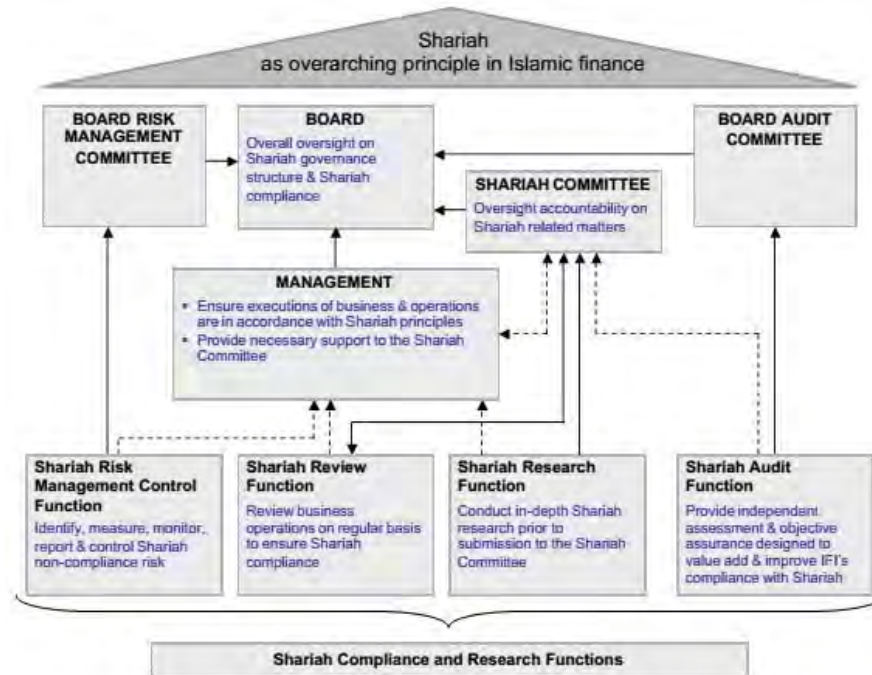


Figure 1: Shariah Governance Framework (2010)
Source: Bank Negara Malaysia

2.4 Halal Governance

In the field of Halal industry, the governance and regulatory framework is quite complex due to the nature of the industry. Halal industry consisting several industries with different natures of businesses which tied with different Acts and legal framework. The unity of these industries are bounded by Halal certification and Halal Assurance Management System 2011 (HAS 2011) which need to be complied by all businesses in Halal industry. Most of the studies in Halal governance are hovering in Halal certification (Sri Nor Haslina, Fadilah & Azlina, 2016; Nuruhuda, Nor Laila & Zainal, 2014; Nornadia, Harlina & Ahmad Naqiyuddin, 2016) but very few studies emphasizing the internal Halal governance. Furthermore, the current Halal assurance system is emphasizing around the Halal certification; pre-Halal certification, during Halal certification and post-Halal certification.

Malaysia Standard (MS), Manual Procedure for Halal Certification (MPPH) and HAS 2011 has required the top management of organization to establish Internal Halal Committee (IHC) which include Halalan-Toyyiban Leader, Halalan-Toyyiban Committee, Halal Executive Officer and Halal Auditor.

In Clause 3.2.2.1 of MS2400:2010-1(P) Halalan-Toyyiban Assurance Pipeline – Part 1: Management System Requirements for Warehousing and Related Activities and MS 2400:2010-2(P), Halalan-Toyyiban Assurance Pipeline – Part 2: Management System Requirements for Transportation for Good and Cargo Chain Services mentioned that the top management shall appoint Halal-leader, committee and advisor. In clause 3.2.2.2, a Halalan-Toyyiban leader should ensure the Halalan-Toyyiban management system is

established, implemented and maintained in accordance with the standard. Their responsibility include organizing and coordinate the Halalan-Toyyiban activities such as verifying the Halalan-Toyyiban Assurance Pipeline. Halalan-Toyyiban leader reporting the effectiveness of management standard for management review.

In clause 3.2.2.3 in the same MS, Halalan-Toyyiban Committee was set up to develop, maintain and review the Halalan-Toyyiban risk management. The committee should know the Halal principles and reporting to the Halalan-Toyyiban leader. In clause 2.1 of HAS 2011, Internal Halal Committee (IHC) should be established to preserve the Halalan-Toyyiban effectiveness by controlling, monitoring and developing the HAS. It should have at least four members comprise of chairman, internal Halal executive and officer to manage Halal matters of the company. In clause 3.1 of MS1500:2009-1(P): Halal Food- Production, Preparation, Handling and Storage, Halal Executive Officer are functioning as workforce that to guarantee the viability of internal Halal control framework. In Manual of Halal Certification, in clause 9.1, the Halal auditor is independent and not involving in Halal certification. Halal auditor have privilege on access all the crude material for test, documentation, storage, company profile, and all necessary documents for auditing.

2.5 Research Gap

SGF 2010 is considered so far as the most comprehensive framework for internal governance. (Zurina & Siti Noradibah, 2015). It is so because it addresses the focal issues in assurance system. In the study by Nurulhuda et al. (2016), the focus group has voice out the issue of unstandardized of governance system in Halal industries, in which the respondents has gave example of SGF 2010 as the best practice to unify the process of whole Halal supply chain.

According to Zurina and Siti Noradibah (2015), although the Halal Assurance System 2011 (HAS 2011) improve the management standards of Halal organization, it still lacks authority and clear reporting structure to the higher authority; the Shariah Committee and top management i.e. Board of Directors (BOD). It also lacks of coherent term in practicality and accountability to ensure the Halal integrity. The researcher has proposed the adoption SGF 2010 into the Halal assurance system.

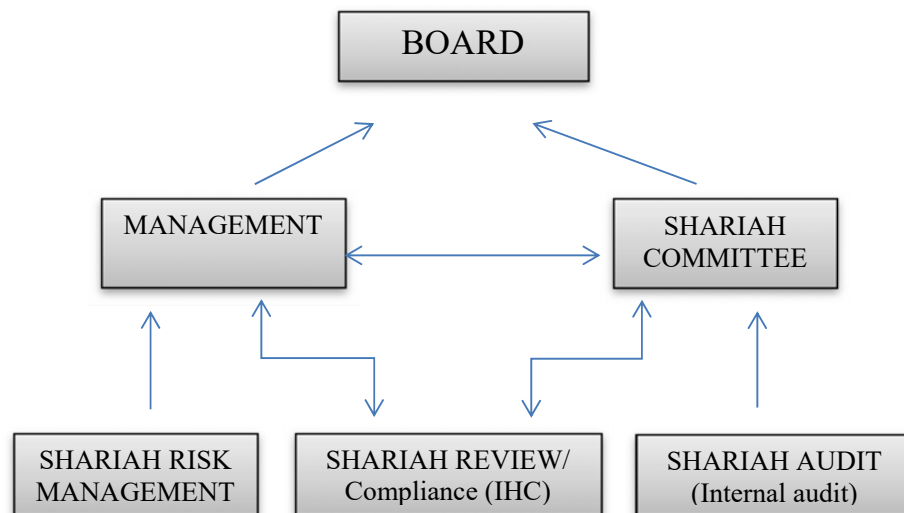


Figure 2: Proposed Governance Framework of Halal Industry.
Adopted from SGF 2011 by Zurina & Siti Noradibah (2015)

Zurina and Siti Noradibah (2015) has outlined the functions and role of each organ. Shariah Committee for example is proposed to internal Halal governance to observe the entire operation to comply with Halal requirement, as well as approving all the legal documentation needed in Halal operation. Management is the intermediaries of the internal governance system, where it supplying the manpower, providing training and responsible to implement the policy made by Shariah Committee and Board. Board of Director must supervising the whole structure toward Halal compliance and responsible for the internal governance system and framework. Shariah Risk Management functioning as the one who deal with non-compliance issues and control the recurrence of risk. Shariah Review on the other hand assesses the activities and operation that should not contradict with Halal principles. This include the evaluation of premises and operation of whole Halal supply chain. Shariah Audit, as it name implies auditing the whole operation, structure, procurement of Halal ingredients, and whole management system (Zurina & Siti Noradibah, 2015).

3. Conceptual Model of Integration for Internal Halal Governance

The previous subtopics have explain briefly the need for internal Halal governance system. Thus, this paper tries to integrate the Shariah Governance Framework (SGF 2010) currently practiced in Islamic financial institution, which also been proposed by Zurina & Siti Noradibah (2015) into the existing Halal assurance system. This will ensure the robustness of internal Halal governance system and empowering the Halal integrity. Halal governance system not only strengthening the assurance system, but also saving time, minimizing the risk for non-compliance or non-conformities, improve the effectiveness of the whole Halal operational system.

The functions and role of each organ is similar as in Malaysian Standards and what has been proposed by Zurina and Siti Noradibah (2015) which is adoption from SGF 2010, only that this framework include Halalan-Toyyiban leader as the reporting organ under Halal Advisory and Management. This is to equip the role of Halalan-Toyyiban leader in make the internal Halal governance smooth and effective.

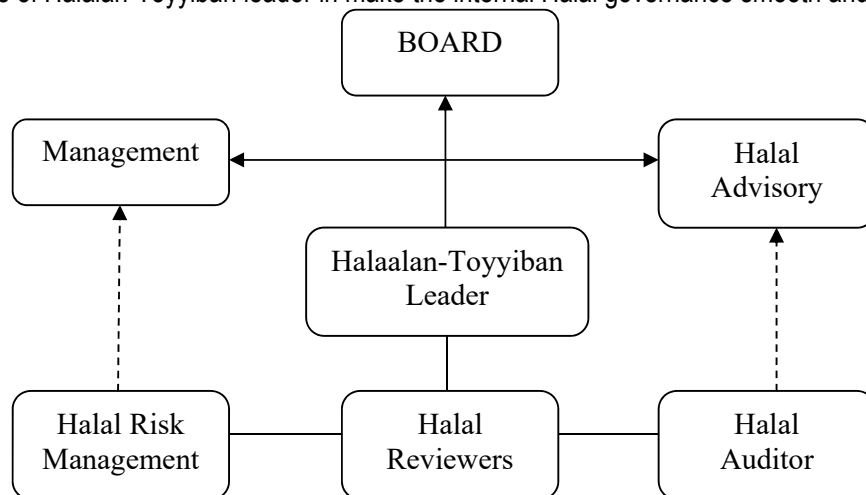


Figure XX: Conceptual Integration framework of Internal Halal Governance

- ▶ Direct reporting
- - -▶ Indirect reporting

Conclusion

Halal is not only a matter of lawful and forbidden in Shariah view, but it has become the lifestyle and a symbol of quality assurance. The practice of Halal covering all aspects of life and transaction. This include Islamic finance, food, cosmetics and pharmaceuticals, supply chain, warehouse, tourism, and all. Thus, the assurance of Halal is needed to preserve the integrity of Halal, as well as strengthening Malaysia as a Global Halal Hub. As Halal industry and Islamic finance seems lack of nexus and integration, several proposals been made by few researchers to make these industries to have a unity in governance to achieve the good standard in quality assurance. Although Halal industries is quite complex with various legal framework to cater different nature of industries, there is lack in internal governance. The internal Halal governance should be geared up to ensure Halal integrity.

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