

Governance, Risk Management and Financial Sustainability in Islamic Financial Institutions: A Narrative Review

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DOI: <https://dx.doi.org/10.47772/IJRISS.2026.1014MG0120>

Received: 28 May 2026; Accepted: 02 June 2026; Published: 23 June 2026

ABSTRACT

This narrative review synthesizes 56 empirical studies from 2008 to 2025 to critically analyze the interconnections among governance, risk management, and financial sustainability in Islamic Financial Institutions (IFIs). Effective governance depends on smooth coordination between conventional corporate boards and Shariah Supervisory Boards (SSBs). The quality of governance, covering Board of Directors (BOD) independence, director expertise, committee structures, SSB qualifications, and strict compliance, directly boosts financial sustainability and indirectly does so by improving risk management. IFIs contend with a mixed risk profile that includes traditional risks (credit, liquidity) and Shariah-specific exposures (non-compliance, displaced commercial risk), which are often under-managed due to a lack of standardized indicators and costly hedging options. Financial sustainability goes beyond profit metrics (ROA, ROE) to include consistent Shariah compliance, stakeholder trust, and operational resilience. Despite advancements, gaps remain: a shortage of longitudinal studies, limited qualitative analysis of SSB processes, and overdependence on traditional metrics. This review offers an integrated framework with risk management as a mediator, expands Agency theory to a three-party monitoring system (shareholders, managers, SSBs), and suggests key areas for regulators, boards, and researchers.

Keywords: Corporate governance, financial sustainability, Islamic financial institutions, risk management, Shariah governance

INTRODUCTION

The global Islamic finance industry has expanded considerably over the past two decades, with assets exceeding \$4 trillion and operations in more than 75 countries (Rahahleh et al., 2019). IFIs, such as banks, takaful insurers, and investment funds, operate in accordance with Shariah principles, distinguishing them from conventional finance. These principles prohibit interest (Riba), excessive uncertainty (Gharar), and gambling (Maysir), while promoting profit-and-loss sharing (PLS) and asset-backed financing (Reyad et al., 2022). This unique operational framework necessitates governance and risk management systems that balance commercial objectives with religious compliance.

The 2008 global financial crisis revealed vulnerabilities in corporate governance and risk management within the financial sector, including IFIs (Alhammedi et al., 2020). Although IFIs demonstrated some resilience during the crisis, subsequent assessments identified governance flaws and gaps in risk management that could jeopardize their long-term stability (Boubaker et al., 2023). The governance structure of IFIs involves both traditional corporate BODs and SSBs, which can lead to coordination challenges. These issues may impair the efficiency of risk management and threaten the ongoing financial health of IFIs (Elamer et al., 2020).

Recent research highlights a significant gap in understanding how governance mechanisms impact risk management and the sustainability of IFIs. While corporate governance studies often neglect Shariah governance aspects (Aslam & Haron, 2020), research on Shariah compliance usually overlooks broader risk management issues (Khatib et al., 2022). This disconnect impedes the development of comprehensive frameworks essential to strengthening IFI resilience amid rising financial volatility.

This review uses a narrative synthesis approach. Due to variation in constructs (such as governance quality, risk types, and sustainability measures) and differing institutional contexts across the 56 included studies, conducting a formal meta-analysis or systematic review with effect-size pooling is not practical. A narrative review is suitable for highlighting patterns, thematic similarities, and key gaps within this fragmented body of literature.

This narrative review aims to synthesize existing literature on governance, risk management, and financial sustainability in IFIs, highlighting patterns, gaps, and theoretical insights to guide future research and practice. It mainly concentrates on three key research questions:

1. How do governance structures in IFIs influence risk management practices?
2. What are the critical risk types facing IFIs, and what specialized management approaches have been developed to address them?
3. How do governance and risk management practices collectively determine financial sustainability outcomes in IFIs?

This review improves Islamic finance scholarship by addressing these questions and providing practical insights for regulators, practitioners, and Shariah scholars.

LITERATURE REVIEW

Theoretical Perspectives

Research on governance, risk management, and sustainability in IFIs draws on multiple theoretical frameworks. While conventional governance theories provide a starting point, IFIs' unique characteristics, particularly religious compliance obligations, require adaptation and extension of these theories.

Agency theory proposes that conflicts of interest between managers (agents) and shareholders (principals) can lead to suboptimal decisions. In IFIs, these agency issues are intensified by the dual governance system. Managers might focus more on financial returns than on Shariah compliance, while SSBs are tasked with acting as religious overseers. Enhancing BOD diversity, independence, and active SSB involvement are seen as ways to lower agency costs by aligning managers' actions with both shareholder interests and religious principles (Umar et al., 2025; Aslam & Haron, 2020). Nonetheless, Agency theory alone does not fully account for the faith-based accountability that SSBs provide.

Stakeholder theory expands the focus beyond shareholders to include depositors, investment account holders (IAH), regulators, and the broader community. IFIs are expected to prioritize societal welfare in accordance with Maqasid al-Shariah (Shinkafi & Ali, 2017). Therefore, effective governance involves balancing the interests of multiple stakeholders rather than solely maximizing shareholder value. Research indicating that BOD diversity and SSB quality enhance environmental, social, and governance (ESG) performance and stakeholder trust supports this view (Islam et al., 2025; Prasajo et al., 2022).

Legitimacy theory suggests that IFIs need to uphold their legitimacy among religious authorities, customers, and regulators. Incidents of Shariah non-compliance can significantly harm an institution's legitimacy, leading to deposit withdrawals, regulatory penalties, and reputational damage (Ghani et al., 2025). Effective governance tools, such as comprehensive Shariah audits and clear compliance reports, help reinforce legitimacy and build stakeholder trust.

Critical Mass theory, originating from gender diversity research, applies to SSB composition. One Shariah scholar alone may have limited sway if outvoted by management or traditional board members. Studies indicate

that SSBs with three or more qualified scholars and cross-institutional independence are more successful in influencing compliance results (Tumewang et al., 2025; Sueb et al., 2022). This nonlinear view questions simple “presence vs. absence” models of Shariah governance.

These theoretical perspectives are not mutually exclusive; instead, they provide complementary viewpoints on how governance structures, both corporate and Shariah, affect risk management and, ultimately, financial sustainability.

Distinctive Institutional Features of IFIs

Islamic finance is based on fundamental principles from the Quran, Hadith, and Islamic law (Fiqh). It prohibits Riba, which includes not only interest but also any guaranteed returns on capital that are detached from actual economic activity (Yaya et al., 2021). The principle of Gharar requires transparency and clarity in contracts, and Maysir is forbidden to prevent speculative transactions lacking economic substance. These principles reflect ethical commitments to fairness, transparency, and social well-being, distinguishing Islamic finance from traditional financial systems (Shinkafi & Ali, 2017).

These principles are embodied in financing structures that prioritize PLS (Mudarabah and Musharakah), trade-based contracts (Murabahah and Ijarah), and equity participation instead of traditional debt. Ideally, PLS arrangements should constitute the majority of IFI portfolios, aligning the institutions' success with their clients' and sharing risks equitably (Yaya et al., 2021).

Empirical evidence shows a persistent PLS paradox: IFIs primarily use debt-like instruments, such as Murabahah, rather than genuine PLS contracts. Hamza and Saadaoui (2013) highlighted this early gap, and newer studies confirm that PLS financing remains limited in most IFIs (Prasojo et al., 2022; Yaya et al., 2021). Reasons include governance issues like poor risk assessment, weak client monitoring, and a lack of specialized expertise. There are regional differences: some Southeast Asian IFIs have made slight progress, while Gulf IFIs still rely heavily on debt-based products. The sustainability implications of this disconnect between theory and practice have not yet been fully examined.

IFI institutional features distinguish them markedly from conventional financial institutions. Their primary characteristic is a dual-governance system, with both a standard BOD and an SSB overseeing operations (Tumewang et al., 2025). IAH are another distinctive element; unlike typical depositors, IAH are expected to share in the bank's performance under Mudarabah agreements (Prasojo et al., 2022). However, competitive pressures often lead banks to smooth IAH returns, transferring risk to shareholders via displaced commercial risk (Hamza & Saadaoui, 2013). Moreover, the ethical and religious responsibilities borne by IFIs further differentiate them, as they are obligated by religious principles to advance societal welfare in line with Maqasid al-Shariah (Shinkafi & Ali, 2017).

CONCEPTUAL FRAMEWORK

This review presents an integrated conceptual framework, based on combined evidence, that illustrates how governance structures, risk management mechanisms, and financial sustainability in IFIs are interconnected. The framework focuses on three primary constructs: governance architecture, risk management capabilities, and sustainability outcomes, and also incorporates moderating influences and dynamic feedback loops.

The governance framework of IFIs encompasses two interconnected dimensions that act as independent variables in the model. Corporate governance includes BOD factors such as size, independence, expertise, and diversity, as well as committee structures such as audit and risk management committees, and ownership arrangements. Simultaneously, Shariah governance pertains to SSB characteristics like size, independence, scholarly qualifications, and cross-institutional memberships, as well as the effectiveness of Shariah audits and the thoroughness of compliance oversight. Importantly, these governance dimensions interact synergistically rather than function separately (Tumewang et al., 2025).

Risk management skills serve as crucial links connecting governance to sustainability outcomes. This involves an organization's ability across four key areas: comprehensive risk identification, advanced risk evaluation,

Summary of Key Variables

Table 1 clearly summarizes how the main constructs of the conceptual framework have been operationalized across the reviewed studies, highlighting the variety of measurement methods used.

Table 1: Operationalization of Key Constructs in the IFI Governance-Risk-Sustainability Literature

Category	Variable	Dimension	Operationalization (Related Studies)
Dependent	Financial Sustainability	Financial stability	Z-scores (Saadaoui et al., 2025); capital adequacy ratios (Khémiri & Alsulami, 2023)
		Profitability	ROA and ROE (Al Azizah & Haron, 2025)
		Cost efficiency	Cost-income ratio, inefficiency scores (Boubaker et al., 2023)
		Shariah compliance consistency	Maqasid al-Shariah index (Prasojo et al., 2022); Shariah non-compliant income (Hanefah et al., 2020)
Independent	Corporate Governance	BOD characteristics	Size, independence, expertise (Umar et al., 2025)
		Committee structures	Audit committee quality (Umar et al., 2024); risk management committee presence (Umar et al., 2023)
		Ownership structure	Family, institutional, government ownership (Aslam & Haron, 2020)
	Shariah Governance	SSB characteristics	Size, independence, cross-memberships (Kateb et al., 2025)
		Shariah audit	Internal Shariah audit effectiveness (Bouheraoua & Djafri, 2022)
		Compliance monitoring	KRI for Shariah risk (Mohd Noor et al., 2024); AAOIFI adherence (Kateb et al., 2025)
Mediator	Risk Management Capabilities	Enterprise Risk Management (ERM) implementation	Enterprise risk management scores (Alsheikh et al., 2025)
		Risk governance	Risk committee independence, expertise (Umar et al., 2023; Rahim & Mahat, 2015)
		Shariah risk management	Shariah risk management effectiveness index (Ghani et al., 2025)
Moderator	Institutional Quality	Regulatory framework	Regulatory quality index (Rashid et al., 2024); enforcement mechanisms (Elamer et al., 2020)
		Legal system	Legal system strength (Rashid et al., 2024)
	Shariah Governance Quality	Process quality	SSB decision-making transparency (Prasojo et al., 2022)
		Scholar expertise	Depth of scholar financial knowledge (Sueb et al., 2022)
Control	Firm Characteristics	Size	Logarithm of total assets (Umar et al., 2025)
		Leverage	Debt-to-assets ratio (Aljughaiman & Salama, 2019)
		Profitability	ROA, ROE (Aslam & Haron, 2020)
		Age	Years since incorporation (Umar et al., 2024)

METHODOLOGY

This narrative review used a systematic search to find relevant empirical and conceptual studies on governance, risk management, and financial sustainability in IFIs. It emphasizes transparency and reproducibility, noting that narrative synthesis, rather than meta-analysis, is appropriate given the varied constructs, measures, and institutional contexts in the literature.

Search Strategy and Databases

The search was performed on February 1, 2026, using the Scopus database, chosen for its extensive coverage of peer-reviewed journals in business, management, accounting, economics, econometrics, and finance. The search query was refined through an iterative process to include both corporate and Shariah governance aspects, as well as risk management terms. The final Boolean search string was:

TITLE-ABS-KEY (("Islamic financial institution*" OR "Islamic bank*" OR "Shariah-compliant bank*" OR "Islamic finance institution*") AND ("governance" OR "corporate governance" OR "Shariah governance") AND ("risk management" OR "financial risk" OR "enterprise risk management"))

Inclusion and Exclusion Criteria

Articles were included if they met the following criteria:

- Publication period: 2008 to 2025. The start date marks the post-global financial crisis era, when governance and risk management in IFIs received heightened academic attention. The end date includes articles published or available online before the February 1, 2026 search (i.e., 2025 was the last complete calendar year; any 2025 articles with early view or final publication prior to the search date were included).
- Subject area: Business, Management and Accounting OR Economics, Econometrics and Finance.
- Document type: Peer-reviewed articles or reviews (excluding conference proceedings, book chapters, editorials, and dissertations).
- Language: English.
- Source type: Academic journals only.
- Publication stage: Final published versions (not "in press" or "accepted manuscript" without volume/issue information).

No formal quality appraisal tool, such as a critical appraisal checklist, was used, which is typical in narrative reviews focused on synthesizing themes rather than calculating effect sizes. Nonetheless, articles had to be from peer-reviewed journals, ensuring a basic level of scholarly quality.

Screening and Selection Process

The initial search retrieved 89 documents. After filtering by subject area, document type, language, source type, and publication stage, 56 articles fulfilled all inclusion criteria. No manual searches of reference lists were performed, which is recognized as a limitation in Section 5.0.

Geographic and Temporal Coverage

The final sample of 56 articles encompasses research from diverse geographic contexts, including:

- Southeast Asia: Malaysia, Indonesia
- Gulf Cooperation Council (GCC) countries: Saudi Arabia, UAE, Qatar, Kuwait, Bahrain, Oman

- Middle East and North Africa (MENA): Egypt, Jordan, Tunisia, Morocco
- South Asia: Pakistan
- Cross-country studies covering multiple regions

The temporal distribution spans 2008 to 2025, with a notable concentration of publications after 2018, reflecting growing academic interest in IFI governance and risk management.

Data Extraction and Synthesis

Each of the 56 articles was read in full. Key information was extracted into a standardized coding sheet, including:

- Author(s), year, journal, geographic setting
- Theoretical framework(s) used
- Research design (quantitative, qualitative, mixed methods)
- Key independent, dependent, mediating, and moderating variables
- Measurement approaches for governance, risk, and sustainability
- Main findings and reported effect directions
- Acknowledged limitations

The synthesis used a thematic analysis approach. Data were organized into themes related to the three research questions: (1) governance's impact on risk management, (2) types of risks and their management strategies, and (3) governance, risk, and sustainability pathways. For each theme, agreements and disagreements were identified, methodological trends were observed, and gaps were documented.

The analysis was more focused on critical evaluation than just description. It included examining the quality of evidence, such as whether studies accounted for endogeneity and selected appropriate samples, questioning underlying assumptions, such as the linearity of governance effects, and detecting contradictions among studies. The five combined findings in Section 4.0 (Findings) resulted from repeated readings and comparisons of the collected data.

Limitations of the Review Methodology

Several methodological limitations should be acknowledged. Firstly, relying solely on the Scopus database may have excluded relevant studies indexed exclusively in Web of Science, PubMed, or regional sources. Secondly, excluding non-English articles could introduce language bias. Thirdly, grey literature, such as working papers, theses, and industry reports, was not included, even though it may contain valuable practical insights. Fourthly, no formal quality weighting was applied, meaning that studies with weaker designs, such as small samples or cross-sectional studies, were given the same consideration in the synthesis. Lastly, the search was performed on a specific date (February 1, 2026), so any articles published or indexed after that are not represented.

These limitations are addressed in the future research recommendations (Section 5.3) and are acknowledged in the Conclusion section.

FINDINGS

The review of 56 articles uncovers a developing and detailed body of research. The main insights are summarized into five core themes.

Finding 1: The quality of dual-governance structure, not just its presence, is essential for IFI effectiveness.

Governance quality, encompassing both corporate and Shariah factors, is essential for effective risk management and sustained success. As operationalized in the conceptual framework (Section 2.3 and Table 1), governance quality encompasses both corporate and Shariah dimensions, spanning board composition, committee structures, SSB scholarly credentials, and the rigor of compliance monitoring.

Research using comprehensive governance indices (Umar et al., 2025) reveals stronger links to risk-taking and performance than studies examining individual governance factors, such as BOD size. When corporate BODs and SSBs collaborate effectively, their combined oversight enhances risk detection and mitigation (Jallali & Zoghalmi, 2022). However, poor coordination between these bodies can impede decision-making and create governance gaps (Alhammadi et al., 2020). The key factor is the quality of integration, including formal joint meetings, clear role definitions, and mutual information sharing, rather than merely having both governance structures existing.

Finding 2: Risk management serves as a key mediating factor linking governance to financial sustainability.

Research using mediation analysis (Jallali & Zoghalmi, 2022; Rahim & Mahat, 2015) demonstrates that governance quality affects financial performance, in part, through improved risk governance and management effectiveness. This suggests that governance by itself is insufficient; its success depends on translating it into robust risk management practices.

None of the reviewed studies provided standardized effect sizes, such as indirect effect coefficients or the proportion of the total effect mediated, in a manner that allows for comparison across studies. Nevertheless, the mediation analyses consistently indicate that the indirect effect through risk management is both statistically significant and economically relevant. For instance, Jallali and Zoghalmi (2022) demonstrated that risk governance partially mediates the relationship between governance and performance, with the mediated pathway contributing a considerable share of the total effect (exact percentage unspecified). The characteristics of the Risk Management Committee (RMC) are vital for effective risk oversight, with standalone RMCs and greater qualified representation associated with reduced risk-taking behavior (Umar et al., 2023).

Finding 3: IFIs encounter a hybrid risk profile that demands tailored management strategies beyond standard frameworks.

IFIs face both traditional financial risks and distinctive Shariah-related exposures. Although credit risk remains the most prominent, its nature varies depending on asset-backed financing needs (Othman & Gabbori, 2024). Liquidity risk is intensified by the absence of interest-based interbank markets and the limited access to Shariah-compliant liquidity tools (Rahahleh et al., 2019).

The literature shows that handling these specialized risks remains underdeveloped in various ways.

- Shariah non-compliance risk lacks standardized key risk indicators (KRIs); although Mohd Noor et al. (2024) proposed KRIs such as transaction review coverage and fatwa adherence rates, adoption remains uneven.
- Displaced commercial risk (DCR) is recognized as unique to IFIs, but no formal DCR management framework has been widely adopted; most IFIs rely on discretionary smoothing of returns to IAH rather than proactive risk transfer mechanisms (Hamza & Saadaoui, 2013).
- Shariah-compliant hedging instruments (e.g., Islamic profit rate swaps, currency forwards) are available but suffer from lower liquidity and higher costs compared to conventional derivatives, leaving IFIs at a competitive disadvantage (Rahahleh et al., 2019).

Although progress has been made in risk identification, the tools and governance processes for mitigating Shariah-specific risks are still in the early stages.

Finding 4: The link between governance and risk-taking is complex and context-dependent.

Traditional views hold that stronger governance lowers risk-taking. However, evidence from IFIs paints a more complex picture. Some governance enhancements, like qualified RMC representation, are associated with reduced risk (Umar et al., 2023). Others, such as audit committee financial expertise, have mixed effects depending on the type of risk (Umar et al., 2024). BOD financial expertise generally decreases insolvency and credit risks, though SSB characteristics affect risk-taking in diverse ways (Sueb et al., 2022).

Importantly, none of the studies reviewed directly examined non-linear (e.g., quadratic) effects of governance on risk-taking. This suggests that the relationship is better described as complex and context-dependent rather than purely “nonlinear.” The effects of governance vary in both direction and strength depending on moderators like institutional quality, board culture, and the specific type of risk. This shows that governance mechanisms influence different facets of risk in distinct ways, underscoring the importance of sophisticated analysis beyond basic linear or universal models.

Finding 5: Financial sustainability in IFIs is a complex concept not fully captured by traditional metrics.

Most current research relies on conventional banking metrics like ROA, ROE, and Z-scores to assess the sustainability of IFIs (Al Azizah & Haron, 2025; Saadaoui et al., 2025). However, these indicators might not comprehensively capture IFI-specific sustainability qualities, such as Shariah compliance, stakeholder trust, and alignment with Maqasid al-Shariah objectives (Prasojo et al., 2022).

Based on the literature reviewed, this analysis suggests that future studies should explore alternative or additional metrics, such as:

- Maqasid al-Shariah performance index (as developed by Prasojo et al., 2022), which measures institutional contributions to faith, life, intellect, lineage, and property.
- Shariah compliance consistency score (e.g., number of compliance violations per year, proportion of Shariah audit findings remediated within a specified period).
- Stakeholder trust indicators (e.g., depositor retention rates, IAH withdrawal patterns, customer satisfaction surveys related to Shariah confidence).
- Displaced commercial risk exposure (e.g., the ratio of smoothed returns to actual investment performance).

Governance quality (Kateb et al., 2025), risk management (Aljughaiman & Salama, 2019), and ESG factors (Islam et al., 2025) are key drivers of sustainability. Nevertheless, regional variations and inconsistent findings regarding specific mechanisms, such as SSB effects on performance, highlight the need to develop more tailored, context-sensitive sustainability metrics.

DISCUSSION

Theoretical Implications

The five findings of this review carry several theoretical implications that advance Islamic finance scholarship beyond prior single-theory applications.

The review proposes an expanded view of Agency theory: in IFIs, the principal-agent relationship involves not only shareholders and managers but also religious authorities (SSBs) who oversee Shariah compliance. This forms a tripartite agency structure where managerial opportunism might prioritize commercial gains over religious commitments. SSBs serve as a separate monitoring mechanism, distinct from traditional agency models. Likewise, Stakeholder theory is enriched by considering IAH, regulators, and the broader Muslim community as stakeholders, whose interests span both financial profits and religious legitimacy. The finding that SSB quality impacts performance supports a broader, multi-fiduciary stakeholder approach.

Second, the review shows that risk management acts as a key intermediary connecting governance to sustainability. This clarifies the causal routes that were previously unclear in the literature. Rather than directly impacting financial results, evidence suggests that good governance improves sustainability by strengthening risk identification, assessment, mitigation, and monitoring. Viewing this as a mediation process implies that future governance studies should explore not only direct effects on performance but also the indirect effects through organizational capabilities and processes.

Third, the review emphasizes the importance of context-specific theories in Islamic finance. Relationships seen in one institutional, regulatory, or cultural setting should not be blindly applied to others. For instance, the impact of SSB on performance varies between Malaysia, which has a strong regulatory framework, and Pakistan, where enforcement is weaker. These results question the universal assumptions underlying some governance theories and indicate that contingency approaches, in which governance effectiveness depends on fit with the institutional environment, are likely more suitable for understanding IFI governance.

Fourth, the suggested conceptual framework, linking governance architecture to risk management capabilities and ultimately to financial sustainability, all moderated by the quality of institutional and Shariah governance, serves as a basis for future theoretical advances. By explicitly treating Shariah governance as equivalent to corporate governance and acknowledging feedback loops between sustainability and governance, this framework offers a more holistic view of IFI dynamics than earlier models.

Finally, the review highlights a unique theoretical concept specific to IFIs: religious accountability as a governance mechanism. Unlike traditional firms that rely primarily on legal compliance and financial results for legitimacy, IFIs must uphold religious legitimacy by consistently adhering to Shariah principles. This indicates a need to expand legitimacy theory to include a faith-based aspect.

Practical Implications

This review highlights the importance of regulators and standard-setters establishing comprehensive governance frameworks that address both corporate and Shariah aspects. Simply mandating SSB presence through regulatory standards is insufficient. Regulators should:

- Mandate SSB quality criteria, including minimum scholarly qualifications (e.g., recognized Islamic jurisprudence certification), limits on concurrent SSB memberships (e.g., no more than three institutions per scholar to ensure attention), and independence safeguards (e.g., scholars cannot be executives of the same IFI).
- Require Shariah audit and compliance monitoring systems with regular external reviews.
- Facilitate development of Shariah-compliant risk-mitigation instruments (e.g., liquidity management tools, profit rate swaps) to address current disadvantages IFIs face relative to conventional competitors. This could involve central banks issuing Shariah-compliant sukuk to manage liquidity.
- Align with existing standards from AAOIFI (Governance Standards) and IFSB (Guiding Principles on Risk Management), while strengthening enforcement mechanisms.

For IFI boards of directors and management: The review highlights the importance of coordination between the BOD and SSB. Key practices include:

- Formal joint BOD-SSB meetings at least quarterly to review strategic decisions with Shariah implications.
- Mandatory SSB reports to the BOD on compliance findings and recommended remedial actions.
- Conflict-resolution protocols when commercial and Shariah considerations diverge.
- Investing in director expertise through training programs (e.g., certification in Islamic finance risk management) and recruiting individuals with dual competence in finance and Shariah.

RMCs should operate independently of audit committees and comprise members with expertise in both financial and Shariah risks.

For Shariah scholars serving on SSBs: The review highlights the importance of having financial expertise alongside religious knowledge. Scholars are encouraged to pursue ongoing professional development in areas such as:

- Contemporary financial instruments (derivatives, structured products) to understand their Shariah implications.
- Risk management techniques (credit scoring, stress testing, value-at-risk).
- Banking operations (liquidity management, capital adequacy).

Furthermore, scholars must carefully manage potential conflicts of interest arising from holding multiple board memberships by ensuring each institution receives proper attention, for example, by restricting concurrent memberships and fully disclosing all positions.

For investment account holders and stakeholders: Stakeholders must insist on governance transparency, which includes disclosure of:

- SSB qualifications, meeting frequency, and key decisions.
- Shariah audit findings and remediation status.
- Compliance monitoring outcomes and any Shariah non-compliant income.

Engaging stakeholders actively in governance oversight, such as through annual general meetings where SSB reports are shared, can enhance accountability.

Boards and regulators should also treat the governance of digital transformation as an immediate practical priority rather than a future concern. IFIs are increasingly deploying AI-based Shariah compliance screening tools, blockchain-anchored audit trails, and algorithmic credit and liquidity risk systems. Each of these introduces governance risks that existing BOD and SSB oversight structures were not designed to address. Cybersecurity vulnerabilities, including data breaches, ransomware exposure, and third-party cloud infrastructure dependencies, constitute operational risks with direct implications for the integrity of Shariah compliance; for example, a compromised Shariah compliance monitoring system may unknowingly allow non-compliant transactions to proceed at scale.

Regulators should require IFIs to conduct technology-specific risk assessments as a formal component of ERM frameworks and to include cybersecurity risk disclosures in annual governance reports. At the board level, RMCs should include at least one member with demonstrable expertise in information security or digital systems governance. For SSBs, the key challenge is explainability: AI-driven product structuring or compliance verification tools must be auditable and interpretable by Shariah scholars, not simply accepted as black-box outputs. AAOIFI and IFSB are encouraged to develop specific governance standards for AI-enabled compliance and fintech operations in IFIs, a gap that currently leaves institutions without authoritative guidance on how to fulfill their dual governance obligations in a digitally transformed operating environment.

Recommendations for Future Research

Based on the gaps identified in the literature, future research should address the following areas in order of priority:

Longitudinal and causal studies:

Most current research relies on cross-sectional or short-panel designs, which cannot establish causality or examine how governance-risk-sustainability relationships evolve over time. Future studies should:

- Conduct long-term panel studies (10+ years) tracking IFIs through economic cycles to assess whether governance effects persist during crises.
- Use natural experiments (e.g., regulatory changes introducing SSB independence requirements) to identify causal effects.
- Employ instrumental variable approaches or difference-in-differences designs to address endogeneity.

Shariah governance quality (beyond presence):

Existing research predominantly examines SSB presence, size, or independence: structural characteristics that may not reflect actual effectiveness. Future research should:

- Develop and validate Shariah governance quality indices capturing scholars' expertise depth, decision-making processes, stakeholder engagement, and compliance monitoring rigor.
- Conduct qualitative case studies examining SSB deliberations, dissent, and interactions with management. Ethnographic research or in-depth interviews with SSB members could reveal how Shariah decisions are actually made.
- Use mixed methods: quantitative quality scores combined with qualitative process tracing.

Geographic diversification and comparative studies:

Research is focused on Malaysia, Indonesia, GCC, and Pakistan. Underrepresented regions include:

- Africa (e.g., Nigeria, Sudan, South Africa), where Islamic finance is growing, but governance research is scarce.
- Latin America (limited Islamic finance presence but potential for comparative insights).
- Post-Soviet states (e.g., Kazakhstan, Kyrgyzstan) with emerging Islamic finance sectors.
- Comparative studies across these regions examining how institutional contexts (regulatory frameworks, legal systems, cultural norms) moderate the relationship between governance performance and outcomes would be especially valuable.

Intersection of governance with technology and innovation:

Digital transformation impacts IFI operations, yet research on fintech, AI, and blockchain in governance remains in early stages. Future studies should explore:

- Whether digital tools (e.g., AI-based Shariah compliance monitoring, blockchain audit trails) enhance governance effectiveness or introduce new risks (e.g., algorithmic bias, cybersecurity).
- How governance configurations enable or constrain product innovation while maintaining Shariah compliance (the control-creativity tension).

Stakeholder perspectives beyond shareholders:

IAH represents a unique stakeholder group, but research on their perceptions of governance quality, risk management, and trust remains limited. Future research should:

- Conduct survey-based studies measuring IAH confidence, withdrawal intentions, and responsiveness to Shariah compliance disclosures.
- Use experimental designs to test how governance transparency affects depositor behavior.

Develop IFI-specific sustainability measures:

Relying too much on traditional metrics (ROA, ROE, Z-scores) might overlook aspects unique to IFIs. Future research should create and validate:

- Maqasid al-Shariah performance indices (building on Prasojo et al., 2022) with standardized sub-components.
- Shariah compliance consistency scores (e.g., proportion of transactions audited as compliant, time to remediate violations).
- Stakeholder trust metrics tailored to IFIs.

Methodological diversification:

Over 90% of reviewed studies rely on quantitative archival methods, treating boardroom dynamics as a black box. Future research should utilize:

- Qualitative comparative analysis (QCA) to identify configurational pathways to high sustainability.
- Process tracing within case studies to understand how governance translates into risk decisions.
- Action research collaborating with IFIs to implement and evaluate governance interventions.

Limitations of the Review

The methodological limitations of this review are documented in detail in Section 3.6. In summary, reliance on a single database (Scopus), restriction to English-language sources, exclusion of grey literature, and absence of formal quality weighting represent the primary constraints on the comprehensiveness and generalisability of findings.

Two additional limitations bear reflection at this stage. First, as a narrative review, this study does not provide pooled effect sizes or statistical tests of heterogeneity across the 56 included studies. This means that statements about the direction and strength of governance–performance relationships are based on qualitative synthesis and the weight of consistent findings across studies, rather than on meta-analytic precision. Second, the review focuses exclusively on IFIs; comparisons with conventional financial institutions are referenced only where individual studies explicitly examined them, and no systematic comparative synthesis has been conducted. Future systematic reviews with meta-analytic methods and deliberate IFI–conventional comparative designs would substantially advance on the evidence base established here.

CONCLUSION

This review of 56 studies (2008–2025) shows that effective governance in IFIs depends on seamless coordination between corporate BODs and SSBs. Governance quality, measured by BOD expertise, committee structures, SSB qualifications, and compliance thoroughness, improves financial sustainability both directly and indirectly through better risk management. IFIs face a mix of risks (credit, liquidity, Shariah non-compliance, displaced commercial risk), with the latter being under-managed due to limited frameworks and tools. Financial sustainability goes beyond traditional metrics like ROA and ROE, encompassing consistent Shariah compliance and stakeholder trust. The review expands Agency theory to include a tripartite monitor: shareholders, managers, and SSBs, and proposes a mediation framework for regulators (setting SSB criteria, promoting Shariah-compliant instruments), boards (formal BOD-SSB coordination, dual expertise), and scholars (financial education). Limitations include reliance on a single database, language bias, lack of quality weighting, and cross-sectional designs that prevent causal conclusions. Future research should focus on longitudinal studies, qualitative research on SSB processes, geographic expansion to Africa and Latin America, and the development of sustainability metrics tailored to specific IFIs. Strong governance and specialized risk management are essential to IFI resilience, though causality remains unproven; improving these systems requires coordinated efforts among regulators, standard-setters (AAOIFI, IFSB), boards, scholars, and researchers.

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