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Setting Shari'a standards: On the role, power and spatialities of interlocking Shari'a boards in Islamic financial services

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ABSTRACT

This paper aims to refine earlier research on the geographies of Islamic financial services (IFS) through a study of how cities are being connected through interlocking directorates in Shari'a advisory boards of IFS firms. The relevance of this analysis is discussed against the backdrop of recent critiques of mainstream 'world cities' research because of structuralist and universalizing tendencies. By applying a network concept to the relationalities of world cities within financial circuits, we explore the nested city/firm/actor structure behind Shari'a board membership, and reassess the connectivity of cities in the IFS network in terms of the role and spatialities of interlocking Shari'a boards. The results show that Gulf cities, most notably Manama, Dubai and Kuwait City are particularly well-connected, while also mainstay financial centres outside the Middle East, such as London and New York are networked by interlocking board memberships of a global Shari'a elite. The dominant position of Manama is traced back to its role as a standard-setting city for Shari'a-compliant investments, which materializes through the enacted presence of an array of highly interlocked regulatory bodies and mediating elites.

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1. Introduction: financial authority in Islamic markets

In November 2007, the Pakistani Taqi Usmani, president of the Bahrain-based Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Shari'a board, pronounced a *fatwa* on Islamic bonds (*sukuk*). Taqi Usmani claimed that *sukuk*, in their aim to compete with interest-based bonds, which generate a guaranteed return, often resemble 'conventional' (that is largely Western) debt-based instruments. Most of the contemporary *sukuk* were therefore considered to violate the principles of Islamic economics, most notably the profit-and-loss sharing idea. As this *fatwa* shook the very fundaments of Islamic financial practices, it immediately launched a shockwave throughout the Islamic financial world: *sukuk* issuance suffered a 40% decline during the first half of 2008 when compared to the US$ 18.3 bn issued in the same period in 2007 (Oxford Business Group, 2008, p. 100). Later in 2008, *sukuk* issuance was held back by the general crisis in credit that affected financial markets at a global scale. Due to a decline in asset valuation, a lack of liquidity, and the general lack of market confidence, total issuance in 2008 fell back to an estimated US$ 20 bn, compared to US$ 47 bn in 2007 (IFSL, 2009, p. 4).

Although Islamic bond markets are operating within an integrated world economy, and have hence been affected by the credit crunch (see Bassens et al. 2010a on Dubai's debt crisis), the controversial *fatwa* ruling elucidates that 'financial authority' in 'Islamic' markets is influenced by extra-economic factors such as the rulings by Shari'a scholars, who stand at the crossroads of financial and religious authority (see Pemberton (2009) for an elaborate discussion of the influence of Taqi Usmani on Islamic discourse, for instance in the field of Islamic finance). For one thing, this reveals that the notion 'international' financial sphere is in practice often implicitly and explicitly equated with practices of Western financial institutions. While 'international finance' has become increasingly conscious of non-financial incentives that drive customers and investors (as exemplified by the rise of ethical or 'green' investments), the Middle East, and the Gulf region in particular, has long been identified for its 'differing' religion-based economic rationale rooted in Islam (Kuran, 1995; Tripp, 2006; Warde, 2000). In fact, while the 'conventional' financial sector is highly sensitive to decisions and measures decreed by large central banks such as the Federal Reserve and the European Central Bank, regulatory bodies such as the Basel II-committee, in addition to leading elites in the sector who primarily operate from the major global cities (Beaverstock, 2004), financial authority within Islamic markets clearly has an additional, often religiously-inclined dimension to its geographies. Building on the Shari'a, the Islamic Law grounded in religious sources (that is Koran and *hadiths*, the sayings of the Prophet), Islamic economics renounces all interest (*riba*), gambling (*maysir*) and contractual ambiguities (*gharar*) that lead to excessive risk taking (Iqbal and Molyneux, 2005). It also

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prohibits investment in certain forbidden products (e.g. pork meat, weaponry, pornography, alcohol, etc.). The prohibition of *riba*, which is often conceived as the prime feature of IFS, reflects the idea that money is not a commodity in its own right, but rather a bearer of risk (Pollard and Samers, 2007, p. 314). According to Islamic economics, the interest-carrying debt-based system is characterized by serious risk asymmetries between financiers and entrepreneurs, since the former can expect a steady flow of interest from its investment, while the latter bears most (or all) of the risk. Profit-and-loss sharing between parties is therefore considered *the* alternative as it prevents such inequalities, which may disrupt social harmony[1] (Ala Hamoudi, 2007). Another notable feature of Islamic economics is its concern with the development of the 'real' economy: in contrast with the highly volatile and detached financial economy which dominates international financial circuits, 'real' growth is to result from the investment in promising projects, from which the profits and losses are shared by investors and entrepreneurs alike (Pollard and Samers, 2007, p. 314). This also explains the 'asset-based' character of many products and practices in IFS, for instance in the *sukuk* financing of large infrastructure and real estate developments in Gulf cities, like the Dubai's government-related property developer Nakheel's US$ 3,5 bn sukuk, which almost defaulted in November 2009 (Bassens et al., 2010a). Despite the recent turmoil around Dubai's debt crisis, the rising influence of Islamic economic discourse is exemplified by the overall growth of the IFS sector, which is especially booming in the Gulf region: in parallel with the steady growth of the 'conventional' interest-based financial sector operating from Gulf offshore centres such as Dubai and Manama, the IFS sector grew by a staggering 27.6% in 2008, in spite of the global financial crisis. Globally, the sector is now worth US$ 822 bn of Shari'a-compliant assets (The Banker, 2009), held by fully-fledged institutions (e.g. Al Rahji Bank, Dubai Islamic Bank) or by Islamic 'windows' within conventional banks (e.g. HSBC Amanah), of which ca. 41% is located in the Gulf Cooperation Council (GCC) states (The Banker, 2008). The growth of the IFS sector highlights the need for a more grounded and versatile perspective in the study of global financial networks, as there are myriad regions where 'Western' corporate spheres do not represent a significant – used here in both statistical and substantive terms – proportion of financial and economic activities and processes (Grant, 2001).

In this paper, we focus on the crucial role of 'parallel' governance networks within the IFS sector, such as the boards that bring together Shari'a scholars. In IFS firms, unlike in interest-based financial institutions, governance through corporate boards is supplemented by these so-called Shari'a boards. We thereby identify at least two major implications for the study of the spatialities of such 'alternative' financial networks. First, 'agents' are a key driver of city networks, as Shari'a scholars who hold highly specialized Shari'a knowledge and skills, lend their services to IFS firms and so doing, boast high levels of authority, since they make and break the rules of Shari'a-compliance. Second, following Pollard and Samers (2007), the concept 'international finance' should be 'decentred' to help steer it away from the focus on practices and products of 'Western' financial institutions, anchored solely in 'conventional' world cities. Addressing both critiques, this paper empirically refines earlier research on the geographies of IFS (Bassens et al., 2010b) through a study of how scholars in interlocking Shari'a boards of IFS firms are networking cities in the Gulf and beyond. This vantage point draws on the observation that through their multiple board memberships, Shari'a scholars can be identified as a source of inter-city connectivity as they link up firms and regulatory bodies across cities. Geographically, the actor-networks created in the process can be read more generally as a proxy for IFS-specific flows of capital, knowledge, and people between its key nodes. In light of this, cities boasting high interlocking levels can also be dubbed 'powerful' places in terms of setting IFS standards on a global scale, because these interlocks allow for the dissemination of Shari'a interpretations through the agency of influential Shari'a scholars. Through this specific analysis, the paper aims to contribute to emerging 'alternative' approaches within world cities research, which has begun rethinking the literature on world cities because of structuralist (Beaverstock, 1996) and universalizing tendencies (Robinson, 2002, 2005). Through our focus on the importance of Shari'a scholar 'agency' in the creation of 'Islamic' financial networks, we aim to contribute to reconceptualizations of *more global* financial and world city geographies that build on a relational perspective. This strand of research analyses IFCs and cities from their role and position in a network, rather than producing hierarchies based on attribute data such as turnover and asset value (e.g. Faulconbridge, 2004). The next section sketches some of the most important critiques voiced against contemporary world cities research, particularly in the field of finance, in more detail. The ensuing sections deal with a description of the globalizing IFS sector and the particular role of Shari'a scholars (Section 3), data collection and methodology (Section 4), and the main insights emerging from of our empirical analysis respectively (Section 5). The paper concludes with an overview of our main conclusions and recommendations for future research.

2. Critique: agency in a 'decentred' transnational urban geography

The most influential contributions within the broad field of what is now commonly called 'world cities' or 'global cities' research put forward that a limited set of large-scale metropolitan areas can now most fruitfully be conceptualized as the key powerhouses in an increasingly networked and globalized economy. More specifically, these cities are said to be the 'command-and-control' centres of the global economy because they harbour numerous corporate headquarters of MNCs and/or a vast array of advanced producer services (APS) firms – that is accountancy, advertising, banking/finance, insurance, law, management consultancy firms – needed to manage increasingly complex production networks (Sassen, 2001). In terms of financial accumulation and intermediation, world cities such as London and New York are thus said to derive their star status from the presence and activities of multinational financial firms, such as investment banks, which have the capability to attract, channel and control transnational flows of commodities, people, knowledge and capital (Castells, 1996; Friedmann, 1986; Sassen, 2001).

Whereas earlier research on financial geographies had been purely hierarchical, recent contributions – echoing world city network conceptualizations – have highlighted the value of a network approach to the study of the global economy in general (Dicken et al., 2001; Faulconbridge and Hall, 2009) and international financial centres (IFCs) in particular (Jones, 2002; Faulconbridge, 2004). Faulconbridge (2004, p. 236) in particular has criticized the study of financial geographies for its preoccupation with attribute properties (e.g. financial turnover, number of banks, etc.) of IFCs, rather than explaining processes behind a centre's growth/decline. By contrast, a reconceptualization of IFCs as being part of a *relational network*, for instance by applying an interlocking world city network model (Taylor, 2004), could prove to be fruitful for a deeper understanding of process and evolution of IFCs, especially when teasing out their interdependencies, as was shown for London and Frankfurt (Faulconbridge, 2004).

[1] In practice, however, an extensive range of mark-up products has moved to the centre of Islamic banking and finance, often imitating interest-based products (loans, bonds, etc.). See Bassens et al. (2010c) for a more detailed description of this evolution.

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