

HALAL GOVERNANCE IN MALAYSIAN COMPANIES

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Abstract

Governance is an important component in Halal industry. Appropriate mechanism should be created to ensure the Halal certified company complies with the Shariah principles. Unlike Islamic finance, Halal industry is less regulated in term of governance. Halal certification is not compulsory and even Halal certificate holding companies do not have clear Shariah governance within the administration to ensure the company fulfil its duty and promise to the stakeholder and the customer. The establishment of proper Shariah governance framework for Halal industry will boosts confidence of the shareholders and the publics that all the practices and activities follow Shariah all the times. Thus, this study investigates current practice of Halal governance in several Malaysian companies. The internal mechanisme in Halal monitoring, controlling, improving and preventing any non-compliance will be assessed. The practice will then be compared to the practice of governance in Malaysian Islamic Financial institutions. The study will help to figure the best practice of Halal governance hence become a proper model to be followed

Keywords: Halal, governance, Malaysian, companies

INTRODUCTION

Halal industry in Malaysia has been growing rapidly since four decades ago. It can be said that the positive development in Halal industry was contributed largely by two main factors; firstly; Muslim needs, awareness and demands and secondly; support from the authority especially in regulating Halal

certification process. Halal certification process is one of the areas which received most attention among industry players in Malaysia. The success story of Malaysia as the pioneer in the Halal industry began in 1974 when the Islamic Affairs Division in the Prime Minister's office started to issue halal certification letters for products (Islamic Tourism Centre of Malaysia, 2017). The establishment of Halal Standards beginning in 2000 was an important milestone and Malaysia becomes the first country to have a documented and systematic Halal assurance system.

One of the importance factors for Halal industry success story is the growing number of Muslim population in the world. Global Muslim population is 1.8 billion, 23% from total world population and it is expected that by 2030, 27% of world population are Muslim (Jamil Bidin, 2016). The Halal economy is huge and diverse ranging from Islamic banking and takaful services to food and consumer products, with the estimated market size of USD 2.3 trillion.

Despite of huge prospect in Halal, the industry is however still new at Halal governance. Halal governance in this research is referring to Shariah compliant corporate governance practiced in Halal companies. Many understands corporate governance as a set of rules, regulations, policies, procedures and process by which a company or industry is controlled. In addition, many researchers have examined the differences and similarities between Shariah governance and conventional corporate governance (Aishath Muneeza and Rusni Hassan, 2011). They argue that governance is:

"Procedures and processes according to which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making".

Other researcher however adds that apart from rules, process and procedures, governance is also defined as set of relationship between a company's board, the shareholders, and other stake holders that provide the structure and mechanism through which the objectives of the company are set and the means for attaining those objectives as well as monitoring performance are determined (Malik M. Hafeez, 2013). Examining literatures that compared between conventional and Islamic corporate governance, it can be said that all researchers agree that Islamic law encourages good conduct in business management including fair, *ihsan*, transparency and honesty (to list a few). As Allah as the ultimate Law Maker, all Muslim must believe that all the company activities must comply with Allah's command. In addition, Malik (2011) adds that the Islamic principles of corporate governance determine the three dimensions of decision making; by whom, for whom, and with whom and to who. He points out that these elements are in line with western

corporate governance that focus on transparency, effective monitoring, efficient management, sound system of internal control and risk management. His idea is also shared by Aishath Muneeza and Rusni Hassan (2011) who state that a corporate governance can be tailored and its compliance to Islamic law depends on the level of compliance of the institution. They also argue that Islamic financial institutions may not need to have separate Shari'ah corporate governance different from general corporate governance, but it is a must for a corporate governance in an Islamic financial institution to include specific rules for the Shari'ah Committee expanding its roles and responsibilities. Therefore, the distinction for any Islamic company is only for having specific Shariah committee or in case of Halal industry, is to have Internal Halal Committee.

The importance of good corporate governance is not only to attract new investment (Malik M. Hafeez, 2013), it also develops public trust in the company. This is because through governance, the company is controlled by appropriate system and it also prevents from any single individual from wielding too powerful influence. Good corporate governance also strongly advocates transparency and accountability (Malik M. Hafeez, 2013). In addition to that, corporate governance also deals with the ways in which suppliers of finances to corporations assure themselves of getting return on their investment although there is a great disagreement on how good or bad the existing governance mechanisms are. (Andrei Shleifer and Robert W. Vishny, 1996).

Hence, it can be said that, governance is an important component in Halal industry. Appropriate mechanism should be created to ensure the Halal certified company complies with the Shariah principles. Unlike Islamic finance, Halal industry is less regulated in term of governance. From the survey conducted, Halal certificate holding companies do not have clear Shariah governance framework to ensure the company fulfil its duty and promise to the stakeholder and the customer. The establishment of proper Shariah governance framework for Halal industry will boosts confidence of the shareholders and the publics that all the practices and activities are in compliance with Shariah all the times. Thus, this study investigates current practice of Halal governance in several Malaysian companies. The internal mechanism in Halal monitoring, controlling, improving and preventing any non-compliance will be assessed. The practice will then be compared to the practice of governance in Malaysian Islamic Financial institutions. Islamic finance institutions have a better structure of Islamic corporate governance due to many reasons; one of the fundamental reasons is because this industry is highly regulated by the authority. The stability of the industry depends on the strong well-established governance; fully responsible boards, good Shariah governance and relations with all the stake holders. On the other

hand, the main focus of Halal certified companies is to maintain Halal certificate. Hence, there is no urge to adapt a comprehensive Shariah governance in the company. Thus, it is hoped that this study will help to figure the best practice of Halal governance and suggest a proper model to be followed.

METHODOLOGY

This study compared the practice of internal Halal Committee in Halal products and services Malaysian companies. Questionnaires were distributed to the respondents via emails and few interviews were also conducted. At the same time, the researchers examined the role of internal Halal committee in the companies and compared with the roles of Syariah Committee in Islamic and Finance industry. For the purpose of comparison, reference has been made to Shariah Governance Framework and Guidelines for Halal Assurance Management System by JAKIM.

There are many essential components for Halal corporate governance framework including Islamic accountability and responsibility, independency and objectivity, competency, confidentiality and commitment, consistency, Shariah audit and review, transparency and disclosure, corporate social responsibility and ethicality. This preliminary study however only focused on four components; Islamic accountability and responsibility, independency and objectivity, competency and consistency.

LITERATURE REVIEW

Governance is set of practices, policies, procedures and processes by which a company or industry is controlled. As previously mentioned, Islamic law approves the practice of good Halal governance as long as it does not contradict with fundamental values in Islamic Law. Mansor M Larbsh (2015) also supports the argument that Islamic law improves the corporate governance practice by improving the process of accountability, transparency and disclosure, responsibility fairness, protects the rights of stakeholders. He adds that Islamic corporate governance requires company directors to perform their duties within responsibility and satisfying the needs of the stakeholders and Allah.

Many companies have strived an effort to comply with Halal Assurance Management System. However, as compared to Islamic finance, this industry has a better and well governed governance structure. Corporate governance structure in Halal industry however remains unregulated and is not well documented. The practice of good governance is vary.

Although, governance aspects in Halal industry have received a great attention but the literature carried out on Halal governance was still minimal. Nurulhuda Noordin et al (2009), in their study "Value Chain of Halal

Certification System: A Case Of The Malaysia Halal Industry”, highlighted that halal industry in Malaysia faces complicated governance system. The study also reveals the governance problem related to halal agencies and halal acts of Halal certification system in Malaysia. Many problems occur such as the conflict of authority between federal government and state government. Lack of enforcement and no comprehensive Halal Act also contributed to the governance issue. Among the governance issues is the certification body has no authority in Halal enforcement matters and the enforcement power is given to the various related agencies. It could be suggested that the standardization of Halal governance is required to avoid the confusion among the Muslim. The findings are important in developing Halal Ecosystem and provide motivation for researcher to resolve the issues by providing more focus in niche area (Noordin, Hashim, & Samicho, 2009). In another research (2014) the team also proved that there are many procedures to be followed in the process of obtaining halal certification that will cause delay. However, the halal certification bodies argued that the delay is because of the failure of the applicants to fulfil the requirements needed. Apart from that the delay is also due to the poor understanding of the halal certification procedures, limited manpower at certification bodies, lack of technology used and governance problem. The research argues that poor governance is causing delay in halal certification process (Noordin, Noor, & Samicho, 2014).

Meanwhile, Nornadia Matulidi et al (2016) in their study of “The Needs of Systematic Governance for Halal Supply Chain Industry: Issues and Challenges highlighted the issues and challenges of governance in the Halal supply chain industry. A lot of issues has been discussed including lack of public service delivery needs such as the ambiguity of functions, conflicting roles, poor of job performance, the role of uncertainty and more. By conducting unstructured interview and observation from selected agencies of halal industry in Malaysia, the researchers found that Halal industries need for specific Halal governance to govern the whole supply chain of Halal industries in Malaysia. Thus, the researchers highlight five (5) recommendation elements of governance that can be used in halal governance. First, institutions and actors within government and agencies. Second, roles and responsibilities with clearly define functions. Third, power dependence in relationships between organizations. Fourth is autonomous self-organizing systems and fifth is leading using ‘steer and guide’ rather than command. According to the researchers, to implement halal governance, the company needs three main components namely formulating, implementing and regulating. This formula will enable the sustainable development of all governance in Halal Industry that will promote mutual understanding throughout all agencies. This research can be regarded as the first attempt to

develop Halal Governance structure in Malaysia. (Matulidi, Jaafar, & Bakar, 2016).

The paper of “Jurisdiction and Prosecution of Halal Related Matters in Malaysia: Challenges and Prospects” by Che Rosmawati Che Mohd Zain et al (2015) highlighted conceptual arguments on prosecution and jurisdiction, particularly its challenges and prospects in strengthening halal related matters in the country. The findings show that undeniably, there is no mother law which can be a supreme law of halal related matters in Malaysia. It is needed to formulate a so-called Halal Act or whatsoever name could be to be a single roof and paramount law for all those scattered halal laws under those many kinds of agencies. This paper suggests that the government to consider a legal transformation of halal related matters in the country as a vehicle to drive Malaysia to be a great country in promoting the goodness of halal related matters internationally. (Zain, Rahman, Ishan and Aziz, 2015).

In Islamic literature, good governance is strongly advocated although the mechanism was quite different with current practice. During Abbasid period, there were officials called *mushrif* literally means supervisor and controller. The office of *ishraf* (supervision) seems basically to have been a financial one. The supervision of financial operations was in the first century or so of the ‘Abbasid caliphate (Bosworth, C.E. and Burton-Page, J. 2012). In addition, there was also a *hisbah* practice where the entrusted person with the hisbah was called the *muhtasib*. *Hisbah* is a non-Quranic term refers to a duty of every Muslim to promote good and forbid evil. On the other hand, the function of *muhtasib* who is effectively entrusted in a town with the application of this rule in the supervision of moral behaviour and more particularly of the markets (Cahen, Cl., Talbi, M., Mantran, R., Lambton, A.K.S. and Bazmee Ansari, A.S. (2012). Although the role of *mushrif* and *muhtasib* were slightly different with the internal Shariah committee members and Halal committee, however they share the common roles and functions within the institution; to ensure justice, fair treatment and avoidance from corruption.

GOVERNANCE AND HALAL ASSURANCE SYSTEM

It can be said that the implementation of Department of Islamic Development Malaysia (JAKIM) Guidelines for Halal Assurance Management System (HAS) of Malaysia Halal Certification is a pre-requisite programme for obtaining Halal Certificate from the authority. Based on this requirement, in order to maintain Halal certificate, the Halal certificate holding company must fulfil the minimum score of implementations of the said HAS. Examined the Malaysian HAS, governance aspect has been described briefly, and only minimum requirements have been set in this standard.

The main purpose of Malaysian HAS is to ensure and preserve halal integrity of products throughout the supply chain. The manufacturers are responsible for developing and managing the Halal assurance system to ensure compliance of the entire supply chain. Hence, the main focus of Malaysian HAS is to ensure 100% halalness of the products. On the other hand, comprehensive corporate governance is not only focusing on products, it includes process of appointing controllers, development of the structure of rights and responsibilities of all stakeholders, and set of mechanisms that protect external investors against expropriation by corporate insiders (Mohammad Al-Suhaibani and Nader Naifar, 2014). Although some researchers argue that Shari'ah corporate governance has different perspective and methodology, but it can be argued that the conventional corporate governance does not contradict significantly with Shariah corporate governance. Shari'ah corporate governance primary is based on the tenets of Islam as the primary law and then on other positive laws, such as laws regulating the interest of the directors and the stakeholders (Aishath Muneeza and Rusni Hassan, 2011).

Malaysian HAS only requires the establishment of Internal Halal Committee that responsible for developing, monitoring and controlling the halal assurance system to ensure its effectiveness including discussing issues related to the development, implementation, maintenance and review of Halal Assurance System. Apart from this, the main purpose of HAS also covers other important areas; documentation, control measure, corrective action, non-compliance, contamination, traceability, Halal critical point and verification. The basis of the implementation of HAS is to minimize and eliminate non-conformance of Halal requirement.

It can said that HAS does not describe clearly the responsibilities of the board, Shariah committee (if applicable), audit and review process in the company. These all aspects are not monitored in Halal certified holding companies. It also can be said that only partial halal governance framework is documented in Malaysian Halal Assurance Management System.

GOVERNANCE AND THE ESTABLISHMENT OF HALAL PROFESSIONAL BOARD

Malaysian authority has taken a step further in monitoring Halal industry by the establishment of Halal Professional Board (HPB). This board was established by the virtue of the 58th meeting of Malaysian National Council for Islamic Affairs (Mesyuarat Majlis Kebangsaan Bagi Hal Ehwal Ugama Islam) on 15th December 2014. However, the responsibility of the board is however only to develop training modules and assessing the competency of Halal training providers and trainees. The board was officialy officiated just recently on 18th May 2017. The main objective of this board is to ensure that

key players in Halal industry receive a standard and comprehensive training in Halal. This will not only minimise the risk of Halal non compliance issues, but to create awareness that Halal is not merely a certification process, but maintaining high quality of Shariah compliance management, practicing good conduct, transparency and well establish plan for auditing and review.

As the establishment of Halal Professional Board is very new, it is not comparable with the establishment of Shariah Advisory Committee of Bank Negara Malaysia that have wider responsibilities in monitoring Islamic Banking and Takaful industry.

HPB is responsible for developing a comprehensive training module and evaluating any person involved directly in the control of halal integrity to ensure the level of quality and competence of Halal professionals (Halal Professional) and the preparation of Halal training service providers (Penyedia Latihan Halal) are reserved for public benefit.

HPB is chaired by the chairman of JAKIM and consists of 13 members:

- I. Director of Ministry of Health
- II. Director of Department Of Standards Malaysia
- III. Director of Ministry Of Higher Education
- IV. Deputy director-general of Department of Skills Development
- V. Senior director of the Ministry of International Trade and Industry
- VI. Seven experienced and expert representatives having halal affairs

The Board functions are:

- I. To establish any plans and policies related to halal trainings
- II. To set the application requirements for training exercises by Halal Training Provider (Penyedia Latihan Halal)
- III. Responsible for approving training modules related to Halal Professionals (HP) and Halal Training Provider (HTP), considering appeal by PH and HTP, cancelling registration PH and PLH which fail to meet the conditions stipulated by the council
- IV. Establish any subcommittee that deems necessary for the performance of its functions and to do such other matters as it deems fit for the performance of its functions effectively

HPB has established two sub-committees:

1. Halal professional certification panel
2. Halal professional board curriculum development committee

At the moment, according to Manual Prosedur Pensijilan Halal Malaysia MPPHM 2014 (Malaysian Halal Certification Procedure Manual, the authority requires two skilled officers in Halal certificate holding company; Halal executive and Internal Halal Auditor. Halal Executive must be a

Muslim personnel with Islamic studies education background and having a valid Halal Executive Certificate. The authorities as defined in the manual are; JAKIM and State Religious Authorities. This manual clearly defines 7 Halal areas that are monitored in the process of Halal certificate application; foods and beverages, consumer products, food premises, slaughtering houses, logistics, pharmaceutical and cosmetic products.

Examined this MPPHM, it can be said that the manual covers the aspects that need to be addressed by the company with regards to Halal certification process and procedures. Only little governance aspects have been highlighted in the MPPHM. It does not specify the responsibilities of the boards, responsibilities of internal Halal Committee within the company. Only it does mention the duty of Halal Executive. Hence, it is up to the company in which direction they wanted to bring Halal governance within the company. Whether they want to develop a comprehensive governance framework or vice versa. In addition, the MPPHM2014 also distinguished the requirement for setting up Internal Halal Committee between sizes of the company. Only multinational and medium sized companies are required to established internal Halal Committee. It is sufficient to mention that this internal Halal Committee only responsible for the halalness of the products, traceability, recall process any matters related to the products and Halal certification. It can be said that majority of the companies only concern about obtaining and maintaining Halal certification rather than implementing the comprehensive Halal governance in the company.

MPPHM2014 clearly outlines the responsibilities of Halal Certificate holders are related to the certificate such as the responsibility to notify the authority if there any changes in term of details of the company, missing or damage certificate.

HALAL ASSURANCE MANAGEMENT SYSTEM OF HALAL CERTIFICATION

The guideline was established to promote the adoption systems when developing, implementing and improving the effectiveness of controlling Halal purity and genuineness. It must be used by certificate Halal holder companies to fulfil Halal Standards, regulations, and requirements in Halal certification. The objective of this systematic process is to be as an internal mechanism in halal monitoring, controlling, improving and preventing any non-compliance in producing Halal products. It can be said that the guideline is intended to ensure Halalness of the product. As compared to Islamic finance, Shariah governance framework was developed not only to ensure the legality of the 'product' but to ensure almost all activities of the IFI is Shariah compliance including daily operations, non-banking activities and company images

DISCUSSION AND FINDINGS

This study surveyed various Malaysian companies which have annual turnover ranging from RM25 millions to RM800 millions. The study also involved two type of business that are food/beverages and pharmaceutical companies. All the company surveyed have already established their own internal Halal Committee. As mentioned earlier, the establishment of internal Halal Committee is a requirement by Malaysian Government under Guidelines for Halal Assurance Management System (HAS). Although the practice is different between companies surveyed, at least the companies managed to establish the Committee for the purpose of developing, monitoring and controlling the halal assurance system to ensure its effectiveness. Not all company surveyed have specific criteria for the appointment of internal Halal Committee. This maybe due to the absence of this requirement in the HAS itself. As compared to Shariah Governance Framework for Islamic Banking and Takaful industry, the qualification of a Shariah committee is clearly defined. The majority of members in the Shariah Committee shall at least hold Bachelor Degree in Shariah, which includes study in Usul Fiqh or Fiqh Muamalat from recognised university. The Shariah Committee members are also expected to demonstrated strong proficiency in written and verbal Arabic, English and Malay. On the other hand, HAS only requires that the Internal Halal Committee shall consist of at least four members where only two of them must be Muslim at management level, without requiring their Islamic education background level. They only required to be knowledgeable and well trained in Halal standards and Halal certification requirements. Although the are Muslim representative in the Committee, the functions, responsibilities or terms of reference for all Halal Internal Committee in the company surveyed also differed. Surprisingly, one company surveyed does not have any Muslim member in the Internal Halal Committee.

In term of ferquency of meeting of internal Halal Commitee, majority of the companies surveyed conducted the committee meeting only four times in a year, while some company conducted more frequently and one company only conducted the meeting once in a year. It can be said that they have less frequent meeting as compared to Syariah Committee meeting in Islamic Finance industry where the meeting is normally conducted at least 8 times per year.

In term of training, all the companies surveyed provide sufficient Halal Training for the Internal Halal Committee Members. There are numbers of Halal Training provided such as training for Halal Executive and Auditors by Institute of Halal Research and Management Universiti Sains Islam Malaysia. As mentioned above, the establishment of Halal Professional Board is to

control the management of Halal Training in Malaysia including verifying the curriculum, the appointment and the approval of Halal Training Service Provider and the appointment of Halal Trainers.

All the company surveyed also provide adequate resources and manpower to support the function of Halal Committee. The IHC roles and functions in the companies surveyed including matters pertaining to Halal Audit, Halal risk management, establishment of appropriate measure to deter any non-compliance, establishment of corrective action to deter any non-compliance, establishment of proper Halal documentation and record and establishment of product recall. However, the internal Halal Committee in most of the companies surveyed does not perform duties on Shariah matters in non product or non operational issues. Therefore, they are not accountable for other activities, such as financial activities and marketing especially to ensure whether these activities are Shariah compliance or vice versa. They only responsible on operation related activities only that have direct impact with the Halal certification requirements.

CONCLUSION

Although the implementation of Halal governance in Halal industry is still at its infancy stage, it is not obvious to state that it is not impossible to the Halal companies to practice it. The surveyed companies are still lacking in Halal governance structure and the documentation on how the company should be properly governed. The governance areas examined including accountability and responsibility, independency and objectivity, competency and consistency are still far from satisfactory. Hence, it can be concluded that all the companies surveyed mainly focus on Halal certification process, Halal audit, monitoring and prevention from any Shariah noncompliance events that will affect their 'halal' status. However, the awareness and knowledge to implement true Halal Governance is there. In this regard, it is not obvious to restate that Halal governance mechanisms can be better altered through the political move. The authorities should implement clear guidelines on Halal governance in order to build the confidence of stakeholders of Halal industry. Halal industry is not only about the halalness of the products or services, but should also focus on how the company is managed according to true Shariah spirit.

Government initiative should be given to Halal companies that practice true Shariah corporate governance. Directors and managers of Halal company can also make a significant contribution to Shariah corporate governance especially in providing training to inculcate a culture at every level of the company. The company must have goal setting and committed to achieve the targets. Good Shariah governance are combination of many different things, the board, the management, stakeholders and last but not least the authorities.

Halal companies must aware that sound corporate governance will further boost customers' and stakeholders' confident, and most importantly will increase the likelihood of long-term success. It is timely for Halal industry players to implement Halal corporate governance as the government has recently introduced the Shariah compliant governance framework (Berita Harian, 16/07/2017). Hence, the Halal industry players have to take the challenge to prove that their company does not only produce 100% halal products and services, but is also well managed and governed through the implementation of Shariah corporate governance structure.

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