

Management of Shareholder / Stakeholder Conflicts in Takaful Operations¹

By

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Introduction

Conflict is a result of grievance which in turn is created by unmet needs and the understanding of conflict is important because it helps companies to locate profitable niche markets that will be based on meeting those needs.¹ It is defined as the process of ascertaining those unmet needs. Folger defined conflict as “the interaction of interdependent people who perceive incompatibility and the possibility of interference from others as a result of this incompatibility”,² has received a lot of attention from scholars studying corporations in recent years and there are now countless studies dealing with it especially in the past decades where we have seen extensive research on specifically on conflict management³ and a large number of conflict management publications have sprung up in various journals across different disciplines and research findings have been disseminated to academia and practitioners in the form of journal articles, conference papers, books, and other documents.⁴ It was claimed that conflict management research has gained itself a status of a well-established academic

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discipline over the past decades and there is now an invisible network of knowledge production underlying the conflict management literature⁵ especially in the last decade where the most important and the most updated research in the area of conflict management has been conducted.

Freeman defines a stakeholder as "any group or individual who can affect or is affected by the achievement of the organization's objectives".⁶ Based on this definition, the stakeholders, in takaful, among others, would be the participants and their beneficiaries, shareholders, directors, management, employees, intermediaries, suppliers and the public.

Studies and Research in Shareholder / Stakeholder Conflicts in Corporations

Conflict studies in corporations were done due to several factors, one of which is the allegation that that private business brings about a lot of conflicts with corporate stakeholders which the law itself is often unable to settle satisfactorily in the public interest⁷ and it is said that this is bad for business.⁸ It was further suggested that successful conflict prevention is not only sound protection of development investment⁹ but that engaging in the process of deconstructing it or getting to the core issues, allows firms the opportunity to better develop products or services to meet those needs.¹⁰

Depending on how it is managed, conflict can either be productive and unproductive and it was suggested that productive conflict is feasible¹¹ and in order to manage conflicts, one needs to understand how they exist and in this respect several hypotheses were forwarded and that some of the main causes of conflict are:

- value incongruence between individuals and the organization¹²
- people have different ideas about what is important, as well as different answers for something that requires resolution.¹³
- organizations are unclear about their goals, especially the importance of some of the competing goals above others.¹⁴
- misalignment (between ends and means values)¹⁵ and with the mission, strategies and processes of the organization.¹⁶
- misalignment between the diverse interests of managers and shareholders.¹⁷
- the values of the people in the organization are not only misaligned but also incompatible with the values of the organization.¹⁸

In particular the misalignment between shareholder interests and the interests of other stakeholders has resulted in a proliferation of studies in this area and it is exhausting to review all of them, therefore I will stick to a few studies. In the context of takaful, the main stakeholders would be the shareholders, the managers, the intermediaries and the participants as these are the parties that participate directly in the takaful contract.

One study suggested prioritising values as it is important since conflicting values create conflicting strategies and it was emphasized that it is necessary for organizations to prioritize their values into a hierarchical order, explaining that all strategy and goals cannot be equal and that organisations must explicitly identify and define these values¹⁹ as a conclusion it was drawn that there is a connection between values prioritization and reduced conflict²⁰ and this partly, will result in greater success of the organization as it was alleged that for organizational agreements to be sustainable, they need everyone's support.²¹ It was also

alleged that these values and beliefs affect the entire system of organizational strategies, processes and behaviors; an organization will only be as effective as its ability to live its values.²²

In order to be effective in prioritising values, management needs to have a suitable methodology used for identifying values as it was supposed that although many organizational leaders have spent considerable time creating values statements that reflect what they believe the organization represents, yet unproductive conflict still remains a problem because the manner in which values have been identified has not been effective. Many executive leaders of organizations may have spent more time creating values statements they believed to be important rather than time identifying existing values of employees and aligning them with the mission, strategies and processes of the organization.²³ Therefore, management should spend a considerable amount of time on alignment rather than identifying and writing values statements and that a set of core values is made explicit and that the organization is seen to be committed to the values through their consistently congruent behaviour.²⁴

Many studies look at the alignment private (profit-oriented) enterprise with that of the public interest and it was argued that it is a necessary step for the justification of private business and the maximization of profits.²⁵ This justification involves corporate ethics which is necessary and sufficient, at least to understand its contribution to the public interest which is aimed to peacefully solve those conflicts between corporations and their stakeholders which follow (or might follow) from corporate strategy and which the (national) law alone cannot settle effectively (any more).²⁶ The other view is that rather than debating whether stakeholders or shareholders matter, corporations should juggle multiple goals and in the

fields of law and ethics, the intellectual struggle between the stakeholder and the shareholder, contracts and communities, and public and private conceptions of the corporation have similarly been manifest in numerous debates.²⁷

The debate on the purposes of the corporation and, in particular, the goal of shareholder value maximization has been reignited following the stock market convulsions and corporate scandals of 2001 and 2002²⁸ has also resulted in another proposition; it was put forward that any company could achieve satisfaction and a balance in stakeholders' conflicting expectations through a value-delivered star model whose needs comprise satisfaction, moral intelligence/ethics, empowerment, communication, and quality corporate governance/leadership which are critical to all stakeholders.²⁹

Still another premise suggests that people's reactions and responses will guide its direction and behavior of individuals will not change until the organizational structure changes. However, this still incorporates the values driven premise and the supposition that if no clear goal is outlined from the beginning and no common understanding of values or strategic priorities exist, everyone will have their own agenda based on what is important to them and if a decision has not been made about "which competing goals are most important, none of the goals will be adequately satisfied or supported resulting in members of the organization not knowing how to address the many critical issues they face and each side will think its approach is the correct one."³⁰ This will cause personal conflict when each stakeholder tries to create their own direction based on their understanding of what the organization is trying to accomplish. It was observed that if a decision has not been made about "which competing goals are most important, none of the goals will be adequately satisfied or supported." This group are of the opinion that members of the organization will not know how to address the

many critical issues they face and the behavior of individuals will not change until the organizational structure changes.

Depending on the cultural, economic, social, legal and political background, some of the above parties gain at the expense of the others. In most cases, although they are agents of the shareholders, and more broadly, stakeholders,³¹ it is the managers who gain the most as they have their own self-interest may be reflected in the choices they make regarding effort, risk exposure, and time horizons³² which may exert a negative impact on shareholder wealth³³ although their duty is to maximise shareholder view as the shareholder is viewed as the most important stakeholder³⁴ as arguments for the primacy of shareholder value maximization as the preferred objective function has been forwarded, albeit subject to certain constraints.³⁵

The primacy of shareholder value maximization is no more reflective in the US where contemporary corporate law is supposed to have as a central objective the protection of shareholder interests in the management-controlled firm, and judges have often affirmed the importance of maximizing shareholder value.³⁶

Therefore, every organization, takaful included, is at risk from abuse by top managers intent on self-aggrandizement at shareholder expense³⁷ as, for example, top managers may entrench themselves by working to redefine the appropriate organizational performance metric and the manager can have redefined the nature of corporate performance to his or her advantage.³⁸ It was also argued that entrenched managers strive to raise their value to shareholders relative to other managers in the labor market making them nonsubstitutable.³⁹

To solve the manager-shareholder conflict, the principle of tying pay to performance is proposed. This principle is thought to be sound but the empirical results of re-search investigating the efficacy of such plans have been mixed and the debate continues but a strong relationship between CEO pay and the pay levels of the outside directors who set the compensation levels was found and this was determined more by the psychology of social comparison than by the economics of corporate performance.⁴⁰ However, this type of plans; first, bonus plans that link compensation to accounting rates of return are thought to be very susceptible to managerial manipulation and managers might be tempted to employ some accounting legerdemain to ensure their bonus at shareholder expense. Furthermore, there are too many forces beyond a manager's control and the motivational potential of rewards diminishes if the goal they are tied to is viewed as impossible to achieve.⁴¹ Finally, it only focuses on outcomes and, indeed, monetary outcomes but say little about the appropriate means to achieve those ends.⁴²

It was also suggested that to ensure non abuse by managers, outside independent directors be appointed but "the ambiguity of the standards of fairness, the difficulty in ascertaining and weighing the relevant facts, the psychological and social pressures on independent directors, and the limited incentives and weak sanctions available suggest that to elicit disapproval from outside directors would take a transaction so grossly overreaching as not often to be proposed by management."⁴³

A meeting of minds proposed the following devices that stakeholders can use to protect their respective interests in corporations :⁴⁴

- Stakeholders protect themselves through contract. Managers negotiate employment contracts, specifying compensation and golden parachutes. Creditors negotiate bond covenants. If employees are represented by a labour union, they may negotiate a collective bargaining agreement, a sort of contract, albeit one that may present particular problems of collective action and face peculiar regulatory obstacles to its negotiation and enforcement.
- Stakeholders may be protected by fiduciary obligations. This is a mixed common law and equitable concept and normally carries with it the idea of judicial enforcement, through an action in law or suit in equity. It is a sort of default rule and may yield to more specific privately negotiated agreement. The general idea of such a fiduciary obligation, owed by managers to the corporation as an entity and to its shareholders, has not been controversial here. This is in fact the outer limit of fiduciary obligation in the law at present. However, fiduciary obligations may be expanding, for example to general creditors. Some have suggested fiduciary obligations owed by managers to other constituencies and some have suggested that the new United States 'stakeholder' statutes point the way to such duties.
- Stakeholders may protect themselves by exit." Shareholders sell shares, employees and managers quit. We have not explored any of the implications of this mode of protection. Fourth, stakeholders may be protected by ownership. This is just a subset of contract; however, the ownership relation is conveniently considered separately, as we have done, because of the thick armature of default rules that surround the rights of 'owners.' Shareholders are thought to 'own' the corporation unproblematically, by

definition; corporate managers, employees, and other stakeholders 'own' it, as we have used the term, just in the case in which they own shares of corporate stock.

- Stakeholders may be protected by legislation, granting them specific rights or privileges in the corporation, or specific public rights or privileges that reduce their dependence on the corporation. Depositors in savings and loan associations may be protected by federal insurance. Shareholders may employ multiple aspects of the regulatory process to discourage institutional stock ownership. Neighbours to corporate facilities may be protected by environmental legislation. Employees may be protected by unemployment insurance or statutory warnings of plant closings. Legislative intervention is better than fiduciary duties.

Guidelines For Managing Conflict in Takaful

Islam recognises that conflict among different people exist as the Quran says, “If your Lord had so willed, He would have made mankind one people, but they will not cease to differ, except those on whom Your Lord and Sustainer has bestowed His mercy, and for this did He create them.”⁴⁵ However, the conflict should be a consequence of selfish desires to the extent of encroaching on other people’s rights as pointed out by the Quran, “Do not then follow your own desires, lest you swerve from Justice.”⁴⁶ The Quran also says, “If the Truth were in accord with their own desires, the heavens and the earth would surely have fallen into ruin, and all that lives in them.”⁴⁷ The Quran further states that following one’s desires will lead one to error as in the verses, “Say: I do not follow your vain desires. If I did, I would stray from the straight path and would not be among those who are rightly guided.”⁴⁸ and “Do not follow vain desire (hawaa) for it will mislead you from the path of God.”⁴⁹

In the case of the conflicting interests of the various stakeholders of takaful, one must apply the principle of equity⁵⁰ and must give proper due to the various competing stakeholders. In this respect the Quran says, “Give full measure and full weight, in justice. We task not any soul beyond its scope. And if ye give your word, do justice thereunto, even though it be (against) a kinsman; and fulfil the covenant of Allah. This He commandeth you that haply ye may remember.”⁵¹ Indeed the Quran gives lessons from the examples of previous Prophets who observed this principle in their dealings with other people. For example the Quran says, “And unto Midian (We sent) their brother, Shueyb. He said: O my people! Serve Allah. Ye have no other God save Him. Lo! a clear proof hath come unto you from your Lord; so give full measure and full weight and wrong not mankind in their goods, and work not confusion in the earth after the fair ordering thereof. That will be better for you, if ye are believers.”⁵² In another place the Quran says, “O my people! Give full measure and full weight in justice, and wrong not people in respect of their goods. And do not evil in the earth, causing corruption.”⁵³ Indeed the Quran considers those who are not equitable and liken them to defrauders and warned them thus, “Woe unto the defrauders: those who when they take the measure from mankind demand it full, but if they measure unto them or weigh for them, they cause them loss.”⁵⁴

Muslim jurists have detailed out the principles in conflicting interests and I have summarised these principles in an earlier paper.⁵⁵ For the purposes of our discussions, I list down the legal maxims that are relevant here. These are :

- Putting precedence of the *indispensables* over the *necessities* and also the *needs*.
- Putting precedence of the *necessities* over the *needs*.
- Putting precedence of the certain *benefit* over the uncertain *benefit*.

- Putting precedence of the big *benefit* over the small one.
- Putting precedence of the *benefit* of the group over the individual *benefit*.
- Putting precedence of the *benefit* of the many over the *benefit* of the few.
- Putting precedence of the lasting *benefit* over the temporary or intermittent *benefit*
- Putting precedence of the fundamental and basic *benefit* over the marginal and subsidiary *benefit*
- Putting precedence of the potent future *benefit* over the immediate weak *benefit*.
- Priority of the lasting action over the temporary action
- Priority of the action that brings long term benefits over short term ones
- Priority of the fundamentals over the peripherals; and
- Priority of the rights of the group over the rights of the individual

The above principles are applicable in the absence of a clear contract to effect. However, in the case of takaful, the rights of each of the directly participating stakeholders are quite clear in most circumstances. The shareholders interests are covered under the wakalah and or mudharabah agreement(s). The employees interest and needs are met with a comprehensive scheme of service. The intermediaries too, are paid according to the wakalah or ju'alah contract entered into with the takaful company and the participants welfare are covered by the takaful contract. The only remaining party that may be subject to differences in interpretation is the manager. In this respect, the guidelines inherent in the Quran and the Sunnah, coupled with decrees issued by bodies like the OIC Fiqh Academy, the Islamic Financial Services Board, the Accounting and Auditing Organisation of Islamic Financial Institutions and the respective authorities will help in reducing the potential conflicts.

However, the interest of those stakeholders that are not parties to the takaful contract such as the beneficiaries of participants and the community are not fully protected. In this respect, more could be done such as appointing shariah advisors as members of the Board. This way, the shariah advisor may be fully aware of the intricacies of the takaful business. In addition, the shariah managers in takaful companies should be involved in technical aspects of the takaful operations to enable them to present a proper and accurate proposal for the shariah advisors to adopt. The legal infrastructure should also be instituted to protect them. In Muslim countries laws should be enacted to streamline the different schools of thought such as the status of the takaful benefits.⁵⁶ In non-Muslim countries a special law such as that of the Administration of Muslim Law Act⁵⁷ may be enacted to reduce any conflicts in interpretation.

Conclusion

Shareholder/stakeholder conflicts in takaful can be resolved by incorporating the spirit of the shariah through its objectives with proposals and suggestions forwarded by conflict scholars in various capacities. However, there is still a need to provide a fairly comprehensive legal infrastructure for these conflicts to be managed well.

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- ² Folger, Poole. and Stutman, R.K. (2005), *Working Through Conflict: Strategies for Relationships, Groups, and Organizations*, 5th ed., Allyn & Bacon, Boston, MA. Quoted in Boonsathorn, Understanding Conflict Management Styles Of Thais And Americans In Multinational Corporations In Thailand, *International Journal of Conflict Management*, Vol. 18 No. 3, 2007, 197
- ³ Ma, Lee and Yu, Ten years of conflict management studies: themes, concepts and relationships, *International Journal of Conflict Management* Vol. 19 No. 3, 2008, 234
- ⁴ *ibid*
- ⁵ *Ibid*, 235
- ⁶ Sundaram and Inkpen , The Corporate Objective Revisited, *Organization Science*, Vol. 15, No. 3, 352
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- ⁸ *ibid*
- ⁹ Annan, K, *Prevention of armed conflict: Report of the Secretary-Genera*, United Nations Press, New York.
- ¹⁰ Fotino, 82
- ¹¹ Fitzpatrick, 287
- ¹² F Fitzpatrick, 296
- ¹³ Fitzpatrick, 287
- ¹⁴ Fritz, quoted In Fitzpatrick
- ¹⁵ Fitzpatrick, 298
- ¹⁶ *ibid*
- ¹⁷ Walsh and Seward, On the Efficiency of Internal and External Corporate Control Mechanisms, *Academy of Management Review*, 1990, Vol. 15, No. 3, 421
- ¹⁸ *ibid*,286
- ¹⁹ *ibid*, 294
- ²⁰ *ibid*,295
- ²¹ *ibid*,297
- ²² *ibid*,298
- ²³ *ibid*,298
- ²⁴ *ibid*,298
- ²⁵ Steinmann, 136
- ²⁶ *ibid*
- ²⁷ Sundaram and Inkpen , The Corporate Objective Revisited, *Organization Science*, Vol. 15, No. 3, 350
- ²⁸ *ibid*
- ²⁹ Salie, A, *Servant-Minded Leadership And Work Satisfaction In Islamic Organizations: A Correlational Mixed Study*, A Dissertation Presented in Partial Fulfillment of the Requirements for the Degree, Doctor Of Business Administration, University Of Phoenix, November 2008,93
- ³⁰ Fitzpatrick, 291
- ³¹ Sundaram and Inkpen, 350
- ³² Jensen and Smith quoted in Walsh and Seward, 422
- ³³ *ibid*
- ³⁴ *Ibid*, 423
- ³⁵ Sundaram and Inkpen, 351
- ³⁶ *Ibid*, 351
- ³⁷ Walsh and Seward, 434
- ³⁸ *Ibid*, 432
- ³⁹ *ibid*
- ⁴⁰ Walsh and Seward, 428
- ⁴¹ *ibid*
- ⁴² *ibid*
- ⁴³ *Ibid*, 433
- ⁴⁴ Ownership, Contract, and Politics in the Protection of Employees against Risk Author(s): Alan Hyde Source: *The University of Toronto Law Journal*, Vol. 43, No. 3, Special Issue on Corporate Stakeholder Debate: The Classical Theory and Its Critics (Summer, 1993), 723-724
- ⁴⁵ Quran, 11: 118-9
- ⁴⁶ Quran, 4: 135
- ⁴⁷ Quran, 23: 71).
- ⁴⁸ Quran, 6: 56
- ⁴⁹ Quran, 38: 26
- ⁵⁰ The equity principle has been discussed substantially by the writer in another paper at this summit. See, "Theory and Practice of Takaful Surplus Distribution" by the same writer for further details

⁵¹ 6:152

⁵² 7:85

⁵³ 11:85

⁵⁴ 83:1-3

⁵⁵ Ismail, Azman, *Fiqh Aulawiyat* in *Retakaful* - Between RBC (Risk-Based Capital) Standards and Islamic Institution, a paper presented at the ISRA Islamic Finance Seminar, Kuala Lumpur November 2008

⁵⁶ See for example a paper by the same writer, "Nominations and Shariah Issues in Takaful", a paper presented and the ISRA Shariah Schoars Dialogue, Kuala Lumpur, 2009.

⁵⁷ Administration of Muslim Law Act, Singapore