Executive Compensation: The Role of Shari’a Compliance

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Abstract

Purpose

The purpose of this paper is to illuminate issues surrounding executive compensation as it relates to current understandings of Islamic business law.

Methodology

We review the emerging bodies of literature in the fields of executive compensation and opinions of stock options under Shari’a law.

Findings

It appears that the trend in offering employee stock options as part of a Shari’a compliant compensation package is acceptable in most cases, yet because of its close association with the more problematic idea of derivative transactions, the company must be vigilant in obtaining the approval from its Shari’a Standards Board before offering it as part of an overall compensation package.

Research limitations

Existing quantitative data in this area is limited. Given the qualitative, exploratory nature of the design, generalizability is not as robust as other designs.

Practical implications

We make recommendations about the inclusion of employee stock options as part of a Shari’a compliant executive compensation package.

Originality/value

This paper advances the extant literature on the ethics of executive compensation in general as well as adding to the extant literature on Shari’a compliance of executive compensation packages.
Key words

Executive compensation

Stock options

Shari’a compliance

Ethics

Islamic finance

Classification of paper

Literature review with case illustrations
There is growing significance of Islam in corporate business decision making and policy development. There is also increasing complexity in global compensation (Dowling et al., 2008; Pucik, 1997). One of the more important corporate decisions is what and how to compensate executives. Jensen and Murphy (2010) assert that a greater emphasis should be placed on how executives are compensated. Extensive published reviews of executive compensation can be found elsewhere (Faulkender et al., 2010; Devers et al., 2010; O’Reilly & Main, 2010). The increasing interest in executive compensation is not limited to academia but also to the public (Southarm & Sapp, 2010). Articles on executive compensation have appeared in The Wall Street Journal, The New York Times, and Barron’s to a name a few.

Critics of excessive executive compensation assert that such a payment arrangement “…reflects a culture of greed and a growing inequality that poses a threat to the viability of the American dream for many middle-class families (Burton and Weller, 2005, page 8).” According to Faulkender et al. (2010), another critique of executive compensation pay packages is “…the size of the pay packages of many employees at failed institutions (page 108).” The public debate surrounding executive compensation and the academic inquiry of executive compensation extends beyond economic theory (Baker et al., 1988), ethics (Chan, 2008), group dynamics (Dorff, 2007), psychology (O’Reilly and Main, 2010) and governance (McConvill, 2005) even in the midst and aftermath of the financial meltdown and the emergence of The Great Recession (Zuckermann, 2010).

The financial meltdown of 2008 and the $700 billion bank bailout package brought to center stage the issue of executive compensation and the ethical aspects of
paying executives stock options despite shareholder losses and companies on the brink of failure (Tuna, January 12, 2009, page B4). As a part of executive compensation, the backdating of options is also under scrutiny given some high profiles cases like United Healthcare and the fact that nearly one in three (29%) of public U.S. companies backdate options (Burrows, 2007).

In spite of these criticisms, the global war for executive talent places executive compensation on center stage in attracting and retaining executive talent (Jensen & Murphy, 2010; Faulkender et al., 2010). It has been argued that the level of pay influences the degree to which executive talent is attracted to a particular organization (Jensen & Murphy, 2010). To this point, a 2009 PriceWaterhouseCoopers Global Equity Incentives Survey describes the link between executive pay and the recruitment and retention of executive talent as follows:

“As organizations navigate the current economy and keep watch on potential government regulation of executive pay practices, they must also attract, retain, and reward key talent to meet employee, organizational, shareholder needs. Of course, this means there is a premium on the design of equity compensation programs that drive earnings as much as or more than the dilutive impact of those programs on earnings per share (page 8).”

This also holds true for multinational corporations (Dowling et al., 2008). This article examines the type of pay, that is, executive stock options, and its impact on attracting executive talent who practice Islam or consider themselves Muslim.

It is estimated that there are between 1.3 to 1.7 billion Muslims across the globe (Zafir al-Shahri & al-Khenaizan, 2005). Within the borders of the United States, there are
seven million reported Muslim-Americans (Walsh 2008). To prevent stereotyping, it is important to know that there is heterogeneity among those who regard Islam as a belief system and rely upon the Qur’an as a way of life. Lewis (1998) refers to this heterogeneity as follows based upon the title of his book- *The Multiple Identities of the Middle East*:

“What I want to convey by this title is something of the complexity and variety of the different identities which can be held at one and the same time by groups, even more than by individuals… (page3).”

Individual differences are as applicable to Muslim executives as those who practice different faith traditions. However, the role of religion warrants attention. Previous researchers have discussed accommodating religious expression in the workplace (Kelly, 2008) and the need for management training given the increasing religious diversity within the United States (Rollins, 2007). As the number of Islamic executives increases, it will become increasingly important to have pay practices at all levels reflect the values and religious traditions of those that practice Islam whether the organization is considered to be an Islamic organization or not. Our focus will be on executive compensation in general and the use of stock options in particular.

The aim of this article is to describe the nature of Islamic financial institutions (IFIs), present a primer on executive stock options, briefly explore the rise in executive compensation in general, describe executive compensation packages in IFIs, discuss the degree to which options comport with the tenets of Islamic finance, outline *Shari’as* rulings on employee stock options, illustrate how companies actually address *Shari‘a* compliance in their executive compensation plans and offer recommendations for
researchers and practitioners about the convergence of executive compensation and Islamic finance. Our discussion has relevance for all employers in all sectors that are seeking to recruit and retain executive talent in which the executive prefers a Shari’a compliant compensation package. This article contributes to the executive compensation literature, the ethics literature and the international human resources management literature.

The overall purpose of this paper beyond the specific aforementioned aims is to illuminate many of the issues surrounding executive compensation as it relates to current understanding of Islamic law and as it relates to the growth in the number of individuals who practice Islam and the growing dominance of Islamic banking and finance in all parts of the world. We seek to contribute to this emerging body of literature by focusing upon the use of stock options as part of executive compensation packages. This paper also advances the extant literature on the ethics of executive compensation (Angel and McCabe, 2002; Arya and Sun, 2004) as highlighted by Angel and McCabe (2008) who explore the integration of ethics and executive stock options in general. Our perspective will address whether the use of stock options as executive compensation violates Islamic law. This fundamentally reflects a normative approach.

Past research has called the question as to the value of executive stock options from a secular point of view. For instance, Hodgson (2004) writes:

“Stock options and restricted stock awards do not tie executive interests to those stockholders either in the short or the long-term. It has been frequently stated that up to 80 percent of any rise or fall in a company’s stock price is due to the behaviour of the market rather than the
Other research has sought to determine whether extra-financial issues, like environmental stewardship, should be considered when studying stock options in executive compensation packages (Angel and McCabe, 2008). We shall discuss the extra-financial issues of Islamic finance and executive stock options. These extra-financial issues include the ethics of executive compensation from an Islamic perspective and the performance perspective of executive compensation from a human capital management perspective.

This paper extends the body of knowledge on the non-utilitarianism perspective of business ethics (Micewski & Troy, 2007; Fuse et al., 2010) based upon a definition of utilitarian ethics below (Bailey & Porter, 2008):

“...action is ethical depending on the consequences.
In a decision setting, an ethical course of action is one that maximizes the amount of good for the greatest number of people while minimizing the negative consequences (page 24).”

Fuse et al. (2010) in a critique of Western ethical frameworks in public relations writes, “Yet, many Western ethical approaches fall short when applied to the reality of our complex and multicultural world (page 437).” This statement rings true for our discussion on executive compensation with respect to Muslims and Islamic teachings.

The human capital management perspective is best laid out by Rodgers and Gago (2003) who write, “...incentive systems are oriented to motivate decisions that maximize corporate performance (page 190).” Bloom (2004) outlined the ethics of compensation system but did not address it from a religious perspective or international
perspective. Bloom (2004) discusses the linkage between compensation systems and the employment relationship as follows:

“Given the vital role that compensation systems play in employment relationships, it is also very likely that they play an important role in shaping whether people feel they are treated with dignity, trust, and respect and whether they believe the values and culture of the organization are worthy of their fullest commitment and highest efforts (page 149).”

Prior to discussing the applicability of executive stock options, a concise review of IFIs and stock options follows below.

**Islamic Financial Institutions: The Basics**

According to Monger and Rawashdeh (2008), there are more than 300 Islamic financial institutions (IFIs) serving 1.2 billion Muslims or one fifth of the global population. Islamic finance is not restricted to Muslims (Monger and Rawashdeh, 2008) nor to the Middle East or Southeast Asia as evidenced by the 2.5 million Muslims in Great Britain and 19 IFIs in the United States (Shayesteh, 2009).

The growing industry of Islamic Banking and Finance (IBF) is the manifestation of attempts to apply Islamic law (*Shari’a*) and Islamic economic theory to financial dealings. *Shari’a* law governs financial and other business transactions (Walsh, 2008). Islamic law does not allow for individuals or institutions who lend or borrow money to charge or pay interest on that money, or to participate in gambling or unnecessary risk taking without the corresponding sharing of responsibility for potential losses, among other prohibitions including those against illegal consumer goods: pork, alcohol, weapons
or illicit drugs. The size and the importance of IBFs (Smolarski et al., 2006) as well as the size and importance of Islamic capital market products and services (Sadeghi, 2008) are growing.

Islamic financial institutions include Islamic banks and Islamic “windows” as well as companies providing other financial services such as venture capital, private equity, mutual funds, real estate financing and Shari’a compliant insurance (Takaful) companies. IFI’s may be distinguished from conventional financial institutions by three primary elements (Bahrain Monetary Agency 2002):

1. Prohibition of prohibited financing arrangements and business practices. The most important prohibition in Islamic finance is the prohibition of *riba* (interest or usury). This means not only that financing transactions are structured differently than in conventional finance, but also that the asset structure of the institution is based entirely upon tangible assets and partnership arrangements instead of on interest-based financial assets. *Gharar* (speculation) and *maysir* (gambling) are prohibited, as well as trading in *haram* (forbidden) goods such as alcohol, pork, and owning equity in *riba*-based institutions (Lewis and Algaoud 2001).

2. Integration of religious practices into daily life by governing business under Islamic law.

3. Existence of a *Shari’a* Standards Board (SSB) composed of Islamic scholars. The SSB’s purpose is to insure that Islamic law is being followed accurately in the business practices and financial arrangements of the IFI. A member of the SSB (called a “Shari’a Scholar”) has been trained formally in Islamic law, but has not necessarily been trained in finance. A separate financial standards board evaluates the efficacy of financial transactions, just as it does in a conventional institution, and the two boards often work together.

Ideally, an IFI should combine the elements of Islamic financial practices with some effort to uphold Islamic daily life practices (Lewis and Algaoud 2001).

**Executive Stock Option: A Primer**

The dominant rationale for offering stock options to executives arises from agency theory. The argument suggests that stock options align the interests of the agent
(executive) and the principal (shareholders). Other benefits include reducing cash outlays, attracting executives with a degree of entrepreneurial risk-taking behavior, and promoting retention of key talent.

Stock options are contracts, which give the individual receiving them the right to buy stock at a pre-determined or “exercise price.” When a stock option can be exercised, then the option is said to be “vested.” According to Angel and McCabe (2008), one of the basic tenets of compensation is as follows:

“…the compensation should not be based on random events outside the control of the employee (page 226).”

Given this basic tenet, Angel and McCabe (2008) argue that there is a lack of alignment between the performance of an executive and the stock option as part of the executive compensation package that also violates agency theory. Jensen and Murphy (2010) recommend an approach to counter this lack of alignment as described below:

“CEOs should own substantial amounts of company stock. The most powerful link between shareholder wealth and executive wealth is direct ownership of shares by the CEO (page 66).”

Even given this strong endorsement of compensating CEOs with company stock, a review of stock options is warranted given the aim of this article and the increasing use of executive stock options over the past 20 years (Faulkender et al., 2010; Hall & Murphy, 2003).

There are three types of stock options: incentive stock options; nonstatutory stock options; and discount stock options. Incentive stock options “…entitle executives to purchase their companies’ stock in the future at a predetermined price (Martocchio, 2006,
Nonstatutory stock options “...do not qualify for favorable tax treatment (Martocchio, 2006, page 423).” Lastly, any executive with a discount stock option plan “…immediately receives a benefit equal to the difference between the exercise price and the fair market value of the employer’s stock (Martocchio, 2006, page 423).”

Regardless of the type of stock option, the basic mechanics remain the same. Lansing and Knoedgen (2007) point out that risk is minimized when using stock options as part of the compensation package as described below:

“In the case the stock price plunges the executives need not exercise the options; often enough, corporations will re-price the options or issue new stock options. However, if the price for stocks rises, executives are able to harvest huge returns. This is clearly a cost factor for the corporation because the use of stock options requires the issuance of new shares, which dilutes the value of existing shares. Furthermore, stock options are not expensed and thus, do not affect the corporation’s bottom line (page 71).”

**Rise of Executive Compensation**

There has been a documented rise in overall executive compensation from 1993-2003 with a particular growth in equity-based compensation (Bebchuck and Grinstein, 2005). Furthermore, the increase in executive compensation cannot be accounted for by parallel increases in market capitalization (Bebchuck and Grinstein, 2005). Another investigation found that executive compensation increased by 276 percent adjusted for inflation (EPI, 2005). Glimsted, Lazonick, and Xie (2006) discuss the internationalization of stock options for both executives and non-executive employees. Lansing and Knoedgen (2007) go one-step further and describe how stock options as a component of
executive compensation are on the rise in Europe. London is regarded as one of the centers of Islamic finance by many (National Bureau of Asian Research, 2008).

**Executive Compensation in IFIs**

The question of employee compensation is posed within a wider critique of the inherent obstacles to conducting business in Islamic nations or companies that follow the tenets of Islamic teachings (Wilson, 2006). It has been established that an employee in an IFI should earn a just and equitable wage according to the market rate (Beekum, 1997). Contemporary conventional executive compensation packages include stock options; therefore, if stock options are deemed to be *Shari’a* compliant, it is preferable that they be included in an employee compensation package. In other words, if employee compensation packages in IFI’s are to be equitable according to market standards, employers must strive to include employee stock options. *Shari’a* scholars must determine whether stock options are acceptable components of that package and implement that decision.

According to Clarke (2008), this has been a controversial issue in IFI’s: “Rules forbidding the issue of stock options to expats in the Middle East is a major deterrent to foreign talent, so are the banks offering any alternatives?” Given some of the apparent limitation to issues stock options to expats in the Middle East (Clarke, 2008); other executive compensation alternatives may include Employee Stock Ownership Programs or ESOPs. However, in many Gulf nations, it is illegal for expats to have ownership in Gulf companies. Other alternative to options may include discretionary bonuses, and phantom stocks.
A distinction must be made in terms of the legal and organizational structure of the particular company in question regarding the permissibility of executive stock options. Wilson (2006) asserts that multinational corporations in general do not consider religion in corporate decisions. In fact, in some nations like the United States, there are laws forbidding religious discrimination (Title VII, 1964). However, Wilson (2006) argues that the discussion of the intersection of Islam and business ought to be investigated and discussed as illustrated below:

“It is preferable to have a dialogue with those who wish to see Shari’a law applied to commerce and finance rather than trying to oppress Muslim businesses and Islamic finance (2006, page 121).”

In the next section, we shall focus our discussion on the application of Islamic teachings on options in general and executive stock options in particular.

**Islamic Teachings: A View on Options**

In order to understand how Islamic law informs Islamic finance, it is necessary to know something about how law and authority are positioned in Islamic thought. The tenets of IBF are derived from Islamic legal thought; however, as we will see, not every aspect of Islamic finance is found in classical Islamic sources. Although practitioners assert that IBF is banking (or finance) following the manner set forth by the Prophet Mohammed, it is more realistic to think of Islamic finance and business as encompassing some basic codes from classical sources enhanced by needs and realities of life in the twenty-first century. It is extremely important to note that in Islam there is no single human who has been granted the authority to make decisions about religious matters. Islamic law (also called Shari’a law or fiqh) is the source of authority designed
to guide Muslims in their daily practices, according to Allah’s (God’s) will. Allah holds the ultimate authority in Islam, and His word is manifest in all of the texts and traditions. Textual and traditional authority in Islam is derived from one of three sources. First, the Qur’an is the holy text of Islam. Its words are believed to be the exact words that Allah revealed to the Prophet Mohammed. Many of the stories and ideas in the Qur’an are recognizable as the traditions of the other two Abrahamic religions: Judaism and Christianity. For example, the Qur’an includes the stories of Noah and Moses, as well as the story of Jesus’ birth.

The second source of Islamic authority is the sunna. The sunna are collections of stories called haditha (singular, hadith) attributed to the Prophet Mohammed and recorded by trusted sources close to him. Haditha are parables meant to clarify or supplement the teachings of the Qur’an and are based on real life situations from the life of the Prophet. The third source of authority is a set of rulings made as results of qiyas, or analogical interpretations of Islamic laws (Shari’a) in all areas of life. Expert jurists (mujtahid) make rulings on matters of Islamic law using the intellectual process known as ijtihad. It is preferable that a community of scholars come to a consensus (ijma’) on legal rulings, but ijma’ is not required for people to use that ruling to make decisions (Waines 1998).

Individual jurists or other learned people can offer opinions on a given situation, but it is always preferable to have a consensus of scholars. Some individuals appear to have more authority than others do; however, that is due to the reality of human society and power structures, and is not built into the religion itself. When a moral decision arises, it is incumbent on each individual Muslim to think through the situation in his or
her own personal process of *ijtihad* and to conclude that this is consistent with his or her understanding of the religion. Many of the debates about financial matters happen because of different interpretations of central ideas and the meaning of specific practices.

Although ownership of stocks in a corporation is perfectly acceptable under Islamic law (Usmani 2007; Iqbal and Mirakhor, 2007) to date, there is no agreed upon consensus regarding the permissibility and use of conventional options (Smolarski et al., 2006). There are two verses from the Qu’ran regarding the permissibility and use of options based upon two agreed upon prohibitions: (1) interest (riba) and (2) gambling (maysir). These two verses are below:

“Those who devour usury will not stand except as stands one whom the evil one by his touch hath driven to madness. That is because they say: Trade is like usury, but God hath permitted trade and forbidden usury (Qu’ran 2:275).”

“They ask thee concerning wine and gambling. Say: In them is great sin, and some profit for men; but the sin is greater than the profit (Qu’ran 2:219).”

The permissibility of conventional options is not limited to hermeneutics. *Fatawa* (plural of *fatwa*: scholarly ruling on a matter of Islamic law) are issued by religious authorities declaring the permissibility of various behaviors in society including options. *Shari’a* scholars determine whether a particular banking, financial, and/or investment product, service, process, or practice meets the standards outlined within a particular Islamic
principle (Walsh, 2008). If it is determined that the product, service, process, or practice is Shari’a compliant, then it is referred to as “halal” (Walsh, 2008). A company’s Shari’a advisor or Shari’a Standards Board will issue a fatwa declaring the transaction acceptable. Within the financial sector, there exists the Accounting, Auditing and Governance Standards for Islamic Financial Institutions (AAOIFI), which determines, maintains and updates regularly Shari’a accounting standards (Walsh, 2008).

Based upon a review of fatawa regarding options for hedging purposes, it was concluded that “…equity options are allowed in Islamic finance for the purpose of hedging (Smolarski et al., 2006, page 440).” Other investment vehicles forbidden under Islamic law are conventional credit cards, day trading, futures contracts, and currency hedging (Walsh, 2008). Naughton and Naughton (2008) present evidence suggesting that equity options are allowed by some and forbidden by some.

An interesting issue raised by Naughton and Naughton (2008) is that “…a simple call option strategy is extremely difficulty to justify from an Islamic perspective (page 156).”¹ Several types of conventional financial transactions fall under the category of speculation because of their uncertain nature. Most common derivative transactions, including options, are either decisively prohibited or are contested under the rules of Islamic finance. These transactions are thought to be extremely risky because the buyer and seller are hedging the value of the contract against an unknown point in the future. Shari’a law requires that delivery of a sales contract must be taken without regard to movements in prices (Ayub 2007). By definition, a conventional option utilizes movements in price to create a profit-making opportunity for the option holder.

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¹ Although recent scholarship has discussed the permissibility of forward, futures, swaps and options contracts (Al Amine 2009), this discussion refers to more complex hedging instruments and still recognizes the highly speculative nature of derivatives.
Moreover, the conventional option holder purchases the *right* to exercise a purchase (call option) or sale (put option) without incurring the corresponding responsibility for potential losses: i.e., if the price to exercise the option is unfavorable, the option holder does not have to exercise the option. Both circumstances—price movement and creating a right without responsibility—contradict *Shari’a* teachings. The question is, then, are stock options acceptable means of compensating executive employees in an Islamic Financial Institution and Muslim employees in other types of organizations?

**Shari’a Ruling on Employee Stock Options**

Sheikh Yusuf Talal DeLorenzo is one of the foremost *Shari’a* Scholars in the world today. In the questions section of muslim-investor.com (last accessed 2-13-10), Sheikh DeLorenzo addresses the permissibility of employee stock option plans as part of a compensation package. He concludes that employee stock options are permissible under Islamic law under the following conditions:

1. The strike price of the option is fixed.
2. The employee has an option to buy or not buy the stock.
3. The company itself is *Shari’a* compliant.

To our knowledge, this is the only clear pronouncement on employee stock options by a *Shari’a* scholar. Andreas Jobst (2008) of the International Monetary Fund considers the problem of *Shari’a* compliant derivatives in general and declares:

“[T]he issuance of stock options to employees would be an ideal candidate for a *Shari’a*-compliant derivative. By setting incentives for higher productivity firm
owners reap larger corporate profits that offset the marginal cost of greater employee participation in stock price performance.” (page 43)

It appears that the trend in offering employee stock options as part of a Shari’a compliant compensation package is acceptable in most cases, yet because of its close association with the more problematic idea of derivative transactions, the company must be vigilant in obtaining the approval from its Shari’a Standards Board before offering it as part of an overall compensation package.

Illustrative Case Studies: Executive Compensation and Shari’a Compliance

The five illustrative case studies below describe how actual companies throughout the world address Shari’a compliance with regard to executive compensation. The analysis of these case studies is based upon grounded theory (Glaser & Strauss, 1967). In essence, grounded theory recommends that researchers conduct an analysis of the data without any pre-conceived notions (Glaser & Strauss, 1967). This is particularly the case in an emerging area of research with little empirical data and theoretical models. Fendt and Sachs (2008) suggest that research should continue to use a grounded theory approach.

Gulf Investment Bank (GIB)

The (GIB) is a financial services group based in an Arabian Gulf country. Its business lines include asset management, real estate, corporate finance, and private equity. All business lines are 100% Shari’a compliant. The company is privately held. No stock options are provided as part of the compensation package; however, the company provides its senior management with share grants to provide incentives to remain with the
company and/or cash bonuses. The SSB approves the general compensation package for management.

*IBF Newsservice*

The IBF Newsservice is the Islamic finance-reporting desk of an international financial industry newsservice. Stock options account for approximately 25% of an executive’s compensation package. The Shari’a Board approves and monitors the overall compensation package, but there is no evidence that a fatwa has been issued specifically for stock options. The company offers cash bonuses if an employee does not accept stock options for religious reasons.

*U.S. Private Equity Group (USPEG)*

The USPEG is the U.S. private equity office of a Gulf-based investment bank. This private equity company offers Shari’a compliant private equity investments on behalf of overseas investors. The company is privately held, and does not offer stock options to its executives. However, investments are required to adhere to Shari’a standards, including the target company’s compensation package, even if the investment was not originally Shari’a compliant. The SSB approves and monitors the general compensation package.

*Islamic Investment Fund (IIF)*

IIF is a mutual fund. This organization runs a Shari’a compliant stock portfolio as a subsidiary of a conventional investment firm. Stock options comprise approximately 10%
of an executive’s compensation package. The package is monitored by the SSB to ensure Shari’a compliance. No specific fatwa has been issued for stock options.

**IF Consulting Firm**

IF Consulting Firm advises IFIs on structuring Shari’a compliant financial products. The company does not offer stock options, and its compensation package is approved and monitored by the SSB. A fatwa has been issued for general compensation packages.

**IF Research Service**

IF Research Service is a company that provides consulting services to advise clients on corporate governance issues in IFIs. The service is particularly focused on ensuring that companies adhere to their own Shari’a Board’s policies. The company’s compensation package is neither approved nor monitored by its SSB. No stock options are offered as part of executive compensation.

Data from case studies reveal that the management of IFI’s are cognizant of Shari’a compatibility of executive compensation packages. In all except one case the Shari’a Standards Board structures and monitors compensation packages for Shari’a compliance, usually issuing a fatwa to assure employees and investors of that compliance. This is the case whether the IFI is part of a conventional institution or not: i.e., even if the parent company does not follow Shari’a requirements, the IFI subsidiary does. In two of the cases, stock options are offered as part of that package; whereas specific fatwa were not issued for the case of stock options, overall Shari’a monitoring ensures that the options will be Shari’a compliant. Executives of companies located in
the Arabian Gulf states prefer compensation in the form of cash bonuses, and this is likely due to the fact that the consumer economy has historically been (Bamyeh 200X) and is still largely cash based (Rehman 2008). No executive or company policy in this study objects to offering stock options for executive compensation because of Shari’a requirements. In sum, compensation packages are structured and monitored for Shari’a compliance and stock options exist and are Shari’s compliant as executive compensation. However, at this time, cash bonuses are more prevalent than stock options to incentivizing executive performance in IFIs.

**Recommendations**

Given that the evidence to date supports the idea that executive stock options are *Shari’a* compliant, this begs the question as to what advice should be offered to compensation committee of a board, to senior human resources professionals, to executive compensation consultants, to executive search practitioners, and to Muslim executives who regard executive compensation as not being in compliance with Islamic law. The following recommendations are set forth below:

1. Structure the compensation committee of the board in a way that preserves independence from undue influence by the CEO and compensation consultants. Others share this view (Faulkender et al., 2010). Be sure that the compensation committee is appropriately staffed and has adequate financial literacy (Faulkender et al., 2010).

2. Formulate an executive compensation philosophy and an executive compensation program that is managed by the appropriately trained professionals in the
company yet reports to an appropriate committee of the board. This policy may address executive compensation for all executives regardless of whether they are practicing Muslims or a policy that has enough discretion on the part of senior management to offer two types of executive compensation packages—one for practicing Muslims and one for individuals who are not practicing Muslims.

3. Review the equity mix award mix as it comports with the compensation philosophy and total rewards mix. According to Price Waterhouse Coopers in their 2009 *Global Equities Incentives Survey*, an increasing proportion of responding companies used the financial meltdown to conduct this review of the equity award mix.

4. Consider the role of shareholders and their impact on the design of executive compensation packages due to the increasing involvement of shareholders in such decisions (Morgan et al., 2006).

5. Offer common stock as part of the executive compensation package. According to Naughton and Naughton (2000), common stock are “…acceptable securities within Islam (page 148).” Moreover, Angel and McCabe (2008) argue as it relates to executive compensation in general that to align the interests of the executive and the company that the solution “…is to grant shares in the company to the executive (page 227).” Others (Jensen & Murphy, 2010) share this point of view.

6. In areas in which expatriates are not allowed ownership in a company, alternative arrangements must be offered in order to make compensation packages equitable in the market.
7. According to Sheikh Yusuf Talal DeLorenzo, a Shari’a Scholar, offer employee stock options so long as they meet the following requirements: (1) the strike price of the option is fixed; (2) the employee has an option to buy or not buy the stock; and (3) the company itself is Shari’a compliant.

8. Regard the design and delivery of executive compensation as a measure of fairness among diverse stakeholders including CEOs who have been shown to be concerned with fairness as well as self-interest (Wade, O’Reilly & Pollock, 2006).

9. Cash bonuses and share grants may be more attractive to executives from the Middle East than stock options.

10. The design of executive compensation packages can be customized at the level of the organization and the individual executive given that there is no “one size fits” all model of executive compensation (Subramaniam, 2009).

Any of these aforementioned recommendations must be framed with the recognition that compensation practitioners often prefer universal pay systems due to the ease of administration (Dowling et al., 2008). However, recent evidence strongly suggests that pay systems should reflect local factors (Festing et al., 2007; Bloom et al., 2003). In this article, local factors focus upon Shari’a compliance with regard to executive stock options. Moreover, compensation practitioners ought to heed the advice of Dowling et al. (2008) citing the work of Engle et al. (2001):

“Firms may provide a person with personal ‘choice’ in pay and pay for his/her skills or competencies (page 176).”

One element of choice is to compensated based upon one’s religious beliefs and practices.
Future research ought to describe the differences in executive compensation packages across different regions of the world among IFIs and different types of IFIs. This research would be both descriptive and qualitative with regard to finding out the strategic and religious rationale for adopting specific executive compensation packages. This line of research could use similar a methodological approach as utilized in other comparative executive compensation studies (Southam & Sapp, 2010) in which the variable of interest was country of origin rather than religion. In addition to focusing upon IFIs, future research could also examine executive compensation packages among a more diverse set of companies in countries that adopt Shari’a law as a governing business and governance principle.

In closing, executive compensation is critical to organizational performance in all types of organizations. Boards, compensation committees, compensation consultants, and executives need to heed the admonition of Faulkender et al. (2010): “Flawed compensation schemes can lead to value destruction (page 109).”
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