

Developing an Islamic-Based Governance Framework for Bumiputera Small and Medium Enterprises (SMEs) in Combating Irresponsible Corporate Board Practice

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Abstract

Small and Medium Enterprises' (SMEs) survival and growth depends on their business leadership and corporate governance, the ability to lead, manage and take full advantage of the resources available. Thus, the aim of this research is to develop an Islamic-based governance framework for SMEs in order to combat irresponsible and ineffective corporate board of directors. Interviews, focus group discussion and a questionnaire survey will be conducted with the management including owners, stakeholders and regulators engaged in SMEs to obtain their views on the current governance and the proposed Islamic-based governance framework. The expected outcome in a form of the framework is to contribute significantly to the country in overcoming SMEs performance weaknesses. Virtuous Islamic-based governance and ethical leadership style will be promoted among corporate board and to support the existing and new waves of discussions in governance of SMEs in helping the policy maker for its effective implementation which complements and strengthens the efforts made by the government to ensure an inclusive and meaningful socioeconomic development through the 12th Malaysia Plan (RMKE-12). At the end of the day, members on the SMEs corporate boardroom will have an accountable and trustworthy leadership with the implementation of Islamic-based governance framework.

Keywords: Islamic-Based Governance, Small and Medium Enterprises (SMEs), Corporate Board, irresponsible practice

1. INTRODUCTION

The Small and Medium Enterprise Corporation Berhad (SME Corp. Malaysia) is the central coordinating agency (CCA) under the Ministry of Entrepreneur Development and Cooperatives (MEDAC) that coordinates the implementation of development programmes for small and medium enterprises (SMEs) across all related Ministries and agencies (smecorp.gov.my). Market access for Bumiputera small and medium enterprises (SMEs) is limited with recent data showing that the size of Bumiputera entrepreneurs is 40 per cent lower than non-Bumiputeras, while income generated from entrepreneurship activities by non-Bumiputeras is double that of Bumiputeras (Daim, 2021). This is because the main, underlying constraint to the growth of Small and Medium Enterprises (SMEs) is a lack of corporate governance structure (Mahmood 2014) and it has further been acknowledged, through prior studies on SMEs that, for a business to be successful, the critical role of leadership and good corporate governance has to be fully understood (Lekhanya, 2015).

This is despite tremendous efforts being implemented by the government to boost the economic growth of Bumiputera SMEs which started with the New Economic Policy, later followed by the National Development Policy, Privatization Policy, Vision 2020 and the New Economic Model, which aims to strengthen the economy and increase Bumiputera community involvement in entrepreneurial activities (Razak, 2013). Recently, New

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Bumiputera Entrepreneurs Scheme (SUPERB) was introduced and the Bumiputera Economic Council (MEB) was established to replace the Majlis Tindakan Agenda Bumiputera as a strategy to strengthen Bumiputera entrepreneur community. In addition to this, High-Performing Bumiputera Companies Program (TERAS) was also launched as a way to identify high-potential Bumiputera companies and help them to achieve sustainable growth through the provision of the RM1.64 billion fund (Unit Peneraju Agenda Bumiputera (TERAJU), 2015). The implementation of an Islamic governance framework in Malaysia is not new, whereby in year 2010, the Central Bank had introduced the Shariah Governance Framework (SGF) which sets out the rules, regulations and procedures to be fully implemented by all Islamic financial institutions operating in Malaysia by 2011, with the purpose of the guideline is to ensure the effective functioning of the Islamic financial system and promoting its integrity. Hence, similar framework can also be applied to Bumiputera SMEs in order to achieve similar outcome. The framework was introduced in supporting robust and orderly developments of the Islamic finance industry in Malaysia. A new SME definition was endorsed at the 14th National Entrepreneur and SME Development Council (NSDC) Meeting in July 2013 as shown in Figure 1.

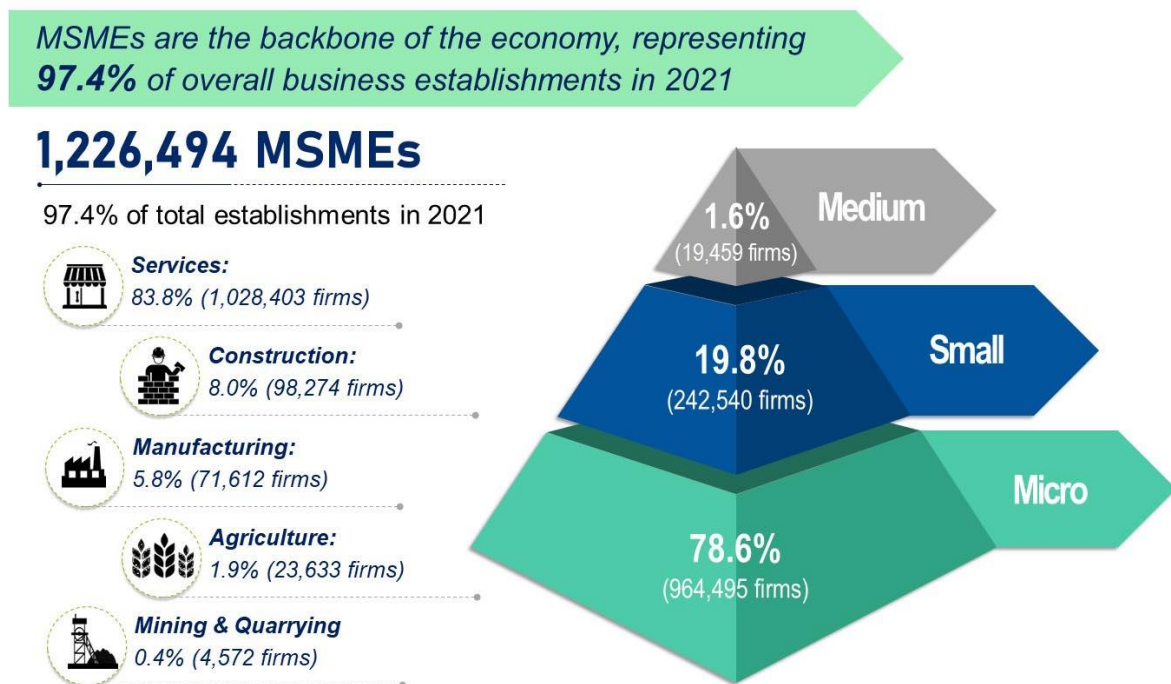


Fig. 1. Types and Proportions of SMEs in Malaysia.

Source: SME Corp. Malaysia

1.1 Problem statement

Various studies on Islamic governance were found to be conducted on financial institutions (Kamaruddin, Hanefah, Shafii, Salleh & Zakaria (2020); Muhamad Sori, Mohamad and Shah, 2015; Ihsan & Ayedh, 2015). However, up to date, there is no specific Islamic governance has been introduced for the SMEs in Malaysia since the genesis of SME Corp. Malaysia dates back to 2 May 1996 known as the Small and Medium Industries Development Corporation (SMIDEC). The growing Malaysian economy since the 1st Malaysia Plan (RMK1) have seen vast involvement and contribution of Muslim businesses owners which are known as Bumiputera. First Malaysia Plan was established with its objectives to govern the citizens' welfare as well as to increase the living standards of those with low-income groups. Accordingly, the principle and strategy of the 12th Malaysia Plan, 2021-2025 will be developed based on three dimensions including the economic empowerment.

The economic empowerment dimension will include new sources of growth, including Industrial Revolution 4.0, digital economy, aerospace industry, integrated regional development as well as growth enablers such as sustainable energy sources and infrastructure connectivity (rmke12.epu.gov.my). Limited market access of Bumiputera SMEs has created a gap of Malaysia socioeconomic between Bumiputerans and non-Bumiputerans.

Differences in types of businesses, productivity and technologies further contribute to the gap. The previous Malaysia Plans (9th, 10th and 11th) in their agendas to achieve balance policy targets were not accomplished. Various unethical issues by the SMEs owners or corporate boards could occur. Among the most recent one is the scam activities. Nevertheless, unethical Bumiputera SMEs owners may have been running a business and claimed their products as Halal but may have used illegal Halal certificates without getting the approval from Jabatan Kemajuan Islam Malaysia (JAKIM). Having said that, unethical activities could have indirectly contributed to weak performances of the Bumiputera SMEs.

From the governance perspective of SMEs, the Islamic-based governance framework has the potential to change and reshape the unethical corporate boards. in three key aspects: accountability, transparency and reporting. The Islamic-based governance framework appears as a new avenue in combating unethical corporate boards of Bumiputera SMEs. An unethical corporate board could significantly affect the balance of power between management, directors, stakeholders and regulators. Thus, this research believes it is important to understand the Islamic-based governance implications on the corporate boards or owners of Bumiputera SMEs and it needs strong governance framework to operate effectively.

1.2 Research questions and objectives

In order to achieve the research objectives, the current study attempts to address the following research questions as presented in Table 1.

Table 1. Research Questions and Research Objectives.

Research Questions	Research Objectives
What is the current governance framework for Bumiputera SMEs corporate boards?	Examine the current governance framework in Bumiputera SMEs Muslim corporate boards.
Why does Islamic-based governance framework significant for Bumiputera SMEs in contributing to Bumiputera SMEs performance?	Investigate the significance of Islamic-based governance framework for Bumiputera SMEs in combating unethical corporate owners.
How do Bumiputera SMEs strategize the promotion of Islamic-based governance framework to corporate boards?	Identify strategies that can be taken by Bumiputera SMEs to promote Islamic-based governance framework to corporate boards.
How do Muslim directors view the Islamic-based governance framework for Bumiputera SMEs in combating unethical corporate owners?	Examine the views of Muslim directors on Islamic-based governance framework in Bumiputera SMEs corporate owners.

2. LITERATURE REVIEW

2.1 Small and medium enterprises (SMEs)

SME is defined under the SME Corp. Malaysia which can be located at www.smecorp.gov.my. The definition of SME covers all sectors, namely services, manufacturing, agriculture, construction and mining & quarrying due to various development in the industry such as price inflation, structural changes and change in business trends. Following to that, the new SME definition was endorsed at the 14th National SME Development Council (NSDC) Meeting in July 2013. To be qualified as a SME, two (2) criteria used are sales turnover and number of full-time employees as follows:

- 1) For the manufacturing sector - SMEs are defined as firms with sales turnover from RM15 million and not exceeding RM50 million OR number of full-time employees from 75 and not exceeding 200.
- 2) For the services and other sectors - SMEs are defined as firms with sales turnover from RM3 million and not exceeding RM20 million OR number of full-time employees from 30 and not exceeding 75.

2.2 Shariah governance of Bank Negara Malaysia

Shariah Governance is vital to Islamic financial system stability to strengthens and secure public confidence in the integrity, management and business operations of the Islamic financial institutions. Bank Negara Malaysia or BNM (The Central Bank of Malaysia) has first introduced the Shariah Governance Framework for Islamic

Financial Institutions in 2010 and required it to be implemented by all Islamic institutions in 2011 (Bank Negara Malaysia, 2019). The Shariah Governance deliberates on the board, Shariah committee, senior management, control functions, Shariah compliance culture and remuneration as well as transparency and disclosures.

The Islamic paradigm is driven by the objectives of ‘Shari’ah Islami’iah’ or Islamic Shariah. It includes

- * Al-adl and Al-ihsan (social justice and compassion for fellow human)
- * Barakah (Allah’s blessings)
- * Al-Falah (Realise benefit for the people in this world and hereafter)

Figure 2 illustrates the Shariah Governance Framework for Islamic Financial Institutions by Bank Negara Malaysia.

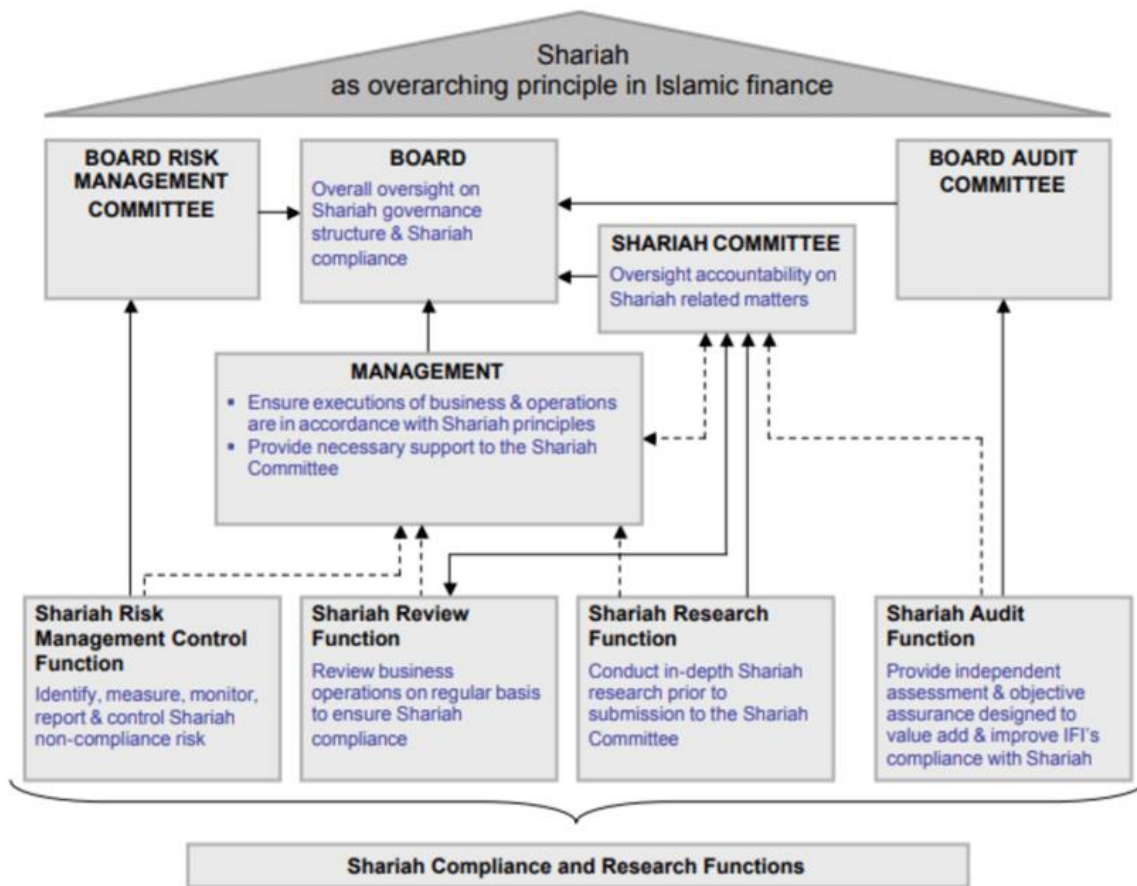


Fig. 2. Shariah Governance Framework Model for Islamic Financial Institutions

Source: Bank Negara Malaysia 2010

It governs every aspect of a Muslim’s life, be it relationship with Allah or with others including politics, economics and social. Haniffa and Hudaib (2002), in their seminal paper on Islamic perspective of accounting contended that the Western conventional accounting is in conflict with the Islamic paradigm. The self-interest perspective of wealth maximisation in a classical Adam Smith model does not sit well with the encompassing objective of Islamic Shariah (Ali and Owaihan, 2008). Thus, corporate governance in Islamic perspective constantly and closely associated to the moral and behavior in business governance with spiritual matters as a consequence of the belief of a Muslim to Allah. Lewis (2005) provided an overview of the differences between conventional and Islamic corporate governance.

In Malaysia, all Islamic financial institution had to implement the Bank Negara Malaysia or BNM (The Central Bank of Malaysia) Shariah Governance Framework for Islamic Financial Institutions. It was introduced in 2010 and was required to be implemented by all Islamic institutions in 2011 (Bank Negara Malaysia, 2019). The Shariah Governance Framework deliberates on the board, Shariah committee, senior management, control functions,

Shariah compliance culture and remuneration as well as transparency and disclosures. This shows how vital is the Shariah Governance to the Islamic financial system. It may strengthen and secure public confidence in the integrity, management and business operations of the Islamic financial institutions. However, the focus of this Shariah Governance Framework is on financial institutions. Unlike Malaysia, it was found that the implementation of Islamic corporate governance in Islamic banks in Indonesia have not been standardized and optimal (Indrawaty and Wardayati, 2016). Another important corporate governance framework in Malaysia is the Malaysian Code of Corporate Governance (MCCG).

However, the MCCG did not include the Shariah principles into it. Alnasser and Muhammed (2012) argued that it is very important to take into consideration the corporate governance in Islamic banks because it might help to draw the right image about the organization. Previous studies had attempts to map the relationship between country religiosity, their religious moral code and unethical corporate practices. Dyreng, Mayew and Williams (2012) and Mc Guire, Omer and Sharp (2012) had shown companies based in highly religious countries had less aggressive financial reporting. This shown that faith matters in a corporate environment.

2.3 Leadership style

Ali and Owaihan (2008) in their review of the concept of Islamic work ethics showed that there were implications of the Islamic faith and the progress of economic and organizational activities. They identified that moral principles, hard work and commitment to the community helped Islamic economy thrived before being impeded by colonisation. These values would need to be re-iterated in an Islamic corporate governance framework. Empirically, Rahman, Omar, Rahman and Muda (2017) in their study of Islamic ethical values of corporate leaders in top 100 firms in Bursa Malaysia found that there were significant and negative associations between ethical values and proxies of Real Earnings Management (REM). Another important finding was that Muslim CEO and Muslim Chairman greatly exert control in negating REM especially in family-controlled firms. Elias, Yaacob and Othman (2018) claim that religiosity leaderships style made significant contribution to SMEs in a form of increasing business performance at a certain market segmentation. Elias, Yaacob and Othman (2018) claim that religiosity leaderships style made significant contribution to SMEs in a form of increasing business performance at a certain market segmentation.

Nevertheless, a study by Umrani and Johl (2016) evidenced that family owners of SMEs in Malaysia expropriate minority shareholders' rights and perform illegal activities. Recent study was conducted on leadership style on innovation capabilities of Islamic school teachers in organizational learning perspective during the Covid-19 pandemic (Fadillah, Surur, Elfrianto, Roziqin, Suhaili, Handayani, Mufid, Purwanto, Muhajir and Fahmi, 2020). Corporate governance in Islamic perspective constantly and closely associated to the moral and behavior in business governance with spiritual matters as a consequence of the belief of a Muslim to Allah SWT. These findings stressed on the need of the implementation of Islamic-based governance framework for Malaysian SMEs.

2.4 How Islamic corporate governance framework works for Bumiputera SMEs

A major gap in prior studies on Islamic perspective is the excessive focus on its cloud over financial institutions (Daud, 2019; Lassoued, 2018; Lai and Samers, 2016). Optimal implementation of Islamic corporate governance can enhance public confidence and give good image for Islamic banks and ultimately impact and support performance of Islamic banks (Siswanti, Salim, Sukoharsono and Aisjah, 2017). While aiming at the gap left unmet, by the previous researchers, Islamic-based governance framework for Bumiputera SMEs is the concept which is still at its infancy stage if it is to be discovered as no proper definition has emerged. Extensive efforts need to be taken to derive at developing the framework.

To ensure the efforts taken are effective, it would be beneficial to understand the perception of existing Muslim directors of Bumiputera SMEs on the current governance practice of their corporate boards. The viewpoints from the management, stakeholders as well as regulator will ultimately support the views of the directors. There is a need to understand the challenges and strategies that may have to be taken to promote the Islamic-based governance and support the board of directors' leadership style. It would definitely a new exposure to be able to help the policy makers to discover and promote the Islamic-based governance among the corporate boards of Bumiputera SMEs.

3. METHODOLOGY

3.1 Research design

Based on the SWOT (strengths, weaknesses, opportunities, and threats) analysis of risk management of SMEs in this proposal as shown in Figure 3, the scope of the current research will focus on a number of Bumiputera SMEs in geographical area of Kedah and Perlis. The opportunity of having the current Shariah Governance Framework (SGF) introduced by the Bank Negara Malaysia is that it may be used as a basedor benchmark in developing the Islamic-based governance framework for Bumiputera SMEs in Malaysia.

Additionally, the Islamic-based governance framework will complement and strengthen the efforts made by the government to ensure an inclusive and meaningful socioeconomic development through the 12th Malaysia Plan (RMKe-12). Although the Covid-19 pandemic has not allowed most of the research activities being conducted as planned, the development of the Islamic-based governance framework for Bumiputera SMEs is expected to assist in combating the irresponsible corporate owners and strengthen the confidence and trust of stakeholders on Bumiputera SMEs.

STRENGTHS (S)			WEAKNESSES (W)		
<i>Before</i>	<i>Current</i>	<i>After</i>	<i>Before</i>	<i>Current</i>	<i>After</i>
It was evidenced there is no Islamic-based governance framework been introduced for Bumiputera SMEs in Malaysia.	The Islamic-based governance framework for Bumiputera SMEs in Malaysia will assist in combating the unethical corporate owners.	The Islamic-based governance framework for Bumiputera SMEs will assist in combating the unethical corporate owners and strengthen the confidence and trust of stakeholders on Bumiputera SMEs in Malaysia.	Very few research was conducted on Bumiputera SMEs governance framework.	Current research only cover a limited number of Bumiputera SMEs in geographical area of Kedah and Perlis.	May not be able to include the whole Bumiputera SMEs in Malaysia as population of a research.
OPPORTUNITIES (O)			THREATS (T)		
<i>Before</i>	<i>Current</i>	<i>After</i>	<i>Before</i>	<i>Current</i>	<i>After</i>
Bank Negara Malaysia has introduced Shariah Governance Framework for Islamic institutions in 2011.	The Islamic-based governance framework for Bumiputera SMEs in Malaysia is currently developed and will support the Shariah Governance.	The Islamic-based governance framework for Bumiputera SMEs in Malaysia will complements and strengthens the efforts made by the government to ensure an inclusive and meaningful socioeconomic development through the 12th Malaysia Plan (RMKe-12) and is expected to contribute to new insights for the agency theory.	The Covid-19 pandemic has not allowed most of the research activities being conducted as planned.	Most research activities such as data collection interviews and cademic conferences are conducted virtually.	Similar threats from Covid-19 pandemic could still be threatening.

Fig. 3. SWOT Analysis for Risk Management

3.2 Conceptual framework

A primary function of the conceptual framework is to lead to hypotheses relevant to the research problem. The conceptual framework of the current study is based on views of participants and issues gathered. The framework in Figure 4 serves as the conceptual framework.

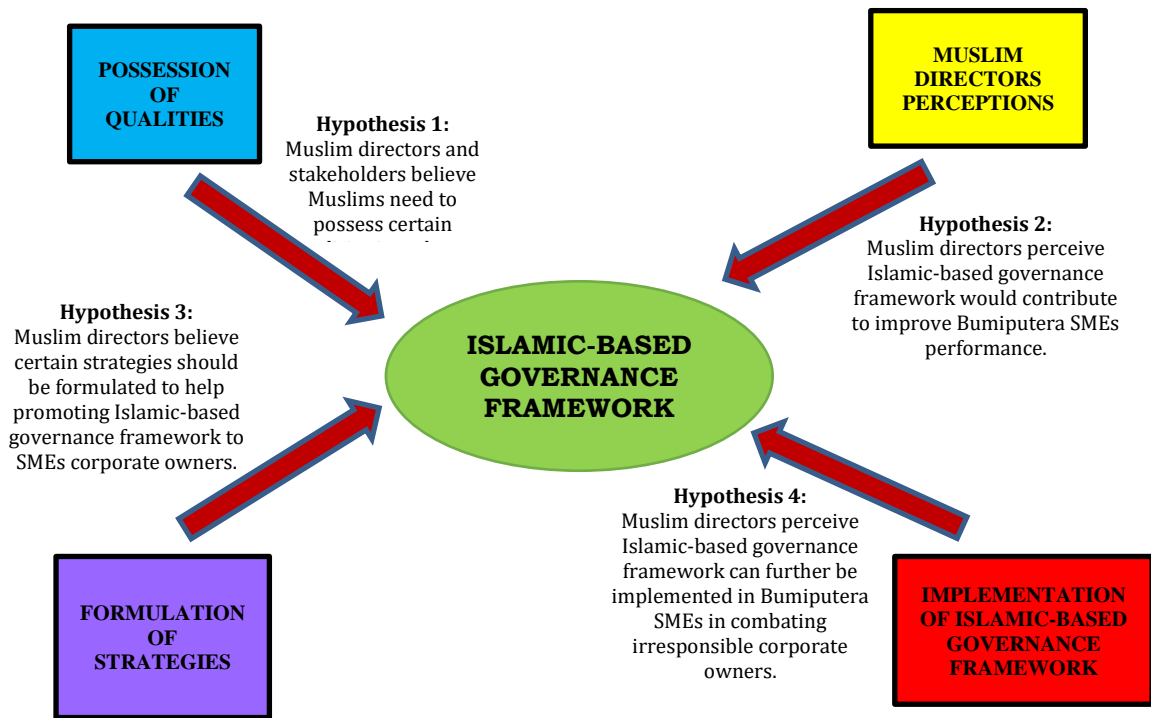


Fig. 4. Conceptual Framework

3.3 Hypotheses development

Based on the literature review as discussed in section 2, the following hypotheses have been developed in responding to the research questions:

- Hypothesis 1: Muslim directors and stakeholders believe Muslims need to possess certain qualities in order to sit on Bumiputera SMEs corporate board.
- Hypothesis 2: Muslim directors perceive Islamic-based governance framework would contribute to improve Bumiputera SMEs performance.
- Hypothesis 3: Muslims directors believe certain strategies should be formulated to help promoting Islamic-based governance framework to SMEs corporate owners.
- Hypothesis 4: Muslim directors perceive Islamic-based governance framework can further be implemented in Bumiputera SMEs in combating irresponsible corporate owners.

3.4 Data collection and estimation approach

In achieving the above objectives, the research proposes to conduct systematic interviews, focus group discussion and a questionnaire survey. Research data will be collected and divided into three stages as presented in Table 2.

Table 2. Research Method.

Method/Stage	Description
Stage 1: Interviews	Stage 1 will focus on the actual practices of the current governance framework for Bumiputera SMEs. The data in this stage will be gathered through face-to-face, in-depth, closed and open-ended interviews with the management and Muslim directors of 20 Bumiputera SMEs around Kedah and Perlis. The aim of the interview is to gain the directors' views and experience on the practice of the current governance framework for Bumiputera SMEs. Besides, the interview is important in the formation of an Islamic-based governance framework that integrates the views of respondents in ensuring that the proposed framework be able to combat unethical corporate board of Bumiputera SMEs in the country.

- Stage 2: Focus Group Discussions The focus groups discussion will focus on the management of the SME Corp Malaysia and the group discussion will be made to further understand the development of Bumiputera SMEs and to look more closely at the impact of current governance framework on the Bumiputera SMEs. The collection of data based on the focus group can benefits this research since there will be more information and suggestions from the party that governs SMEs in Malaysia and to have their input in formulating the questionnaire. Having an expert review on the developed Islamic-based governance framework.
- Stage 3: Questionnaire Survey The questionnaire survey will focus on getting the input from the interviewees. The questionnaires will be pilot-tested and subsequently sent to a sample of 200 respondents consisting of the management, stakeholders and regulators of the selected Bumiputera SMEs in Kedah and Perlis and the SME Corp Malaysia.
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4. EXPECTED RESULTS AND BENEFITS

Developing Islamic-based governance framework can be introduced and recommended to Bumiputera SMEs in combating irresponsible corporate boards in the context:

- *Society*: Running a business with strong customer engagement with the intentions to increase the living standards of those with low-income groups. The economic empowerment dimension will include new sources of growth, including Industrial Revolution 4.0, digital economy, aerospace industry, integrated regional development as well as growth enablers such as sustainable energy sources and infrastructure connectivity.
- *Academia*: To introduce Islamic-based governance framework which sets out the rules, regulations and procedures to be fully implemented by all SMEs operating in Malaysia, with the purpose of the guideline is to ensure the effective functioning of the Islamic corporate system and promoting its integrity.
- *Government*: To understand the Islamic-based governance implications on corporate boards or owners of Bumiputera SMEs and it needs strong governance framework to operate effectively.
- *Industry*: SMEs survival and growth depends on their business leadership and corporate governance, the ability to lead, manage and take full advantage of the resources available. Potential to change and reshape the irresponsible SMEs corporate boards in three key aspects: accountability, transparency and reporting.

5. CONCLUDING REMARKS

In conclusion, this research is expected to support the existing and new waves of discussions with regard to governance of Bumiputera SMEs in helping the policy makers for effective implementation of related policies which complements and strengthens the efforts made by the government to ensure an inclusive and meaningful socioeconomic development through the 12th Malaysia Plan (RMKe-12). The development of the Islamic-based governance framework for Bumiputera SMEs in combating irresponsible corporate board is also expected to contribute to new insights for the agency theory.

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