SCHOOL OF ECONOMICS AND MANAGEMENT

Thesis Project

To what extent can Islamic financial principles be used to prevent financial crises? A 2008 Financial Crisis case study

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Abstract

The 2008 financial crisis exposed significant weaknesses within the global financial system which were mostly attributed to the practices of financialization. This thesis explores the potential of Islamic finance principles to prevent financial crises while offering a more stable and equitable financial framework. A qualitative approach was used in order to conduct interviews with various professionals in the Islamic finance field, enabling an exploration of the ethical and practical distinctions between conventional and Islamic finance. Key findings highlight the resilience of Islamic banks during the 2008 crisis, attributed to their adherence to Shariah principles, which prohibit interest (*riba*), excessive uncertainty (*gharar*), and speculative activities (*maysir*). The study underlines the benefits of asset-backed financing and profit-sharing models, which align financial activities with the real economy and therefore promote long-term stability. By suggesting that the ethical framework of Islamic finance offers a practical alternative to conventional financial practices, this research contributes to a more widespread discussion on financial crisis prevention.

Key words: Islamic finance, Financial Crisis, Real assets, Agency theory, Financialization, CSR

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1. Introduction

In July 2007, as the world was on the brink of the most significant financial crisis to date, Charles Prince, the CEO of Citigroup, famously said, “When the music stops, in terms of liquidity, things will get complicated. But as long as the music is playing, you’ve got to get up and dance. We’re still dancing” (Nakamoto & Wighton, 2007). This statement suggested that bankers were aware of the unsustainability of their practices and financial products, which ultimately led to the 2008 financial crisis. Financial crises are not uncommon in today's world. Stiglitz (2003) claims there have been over 100 crises in the preceding 35 years. While some crises are less publicized, others leave a devastating catastrophe of global measure in their wake. One such example is the financial meltdown of 2008, triggered by the bursting of a housing bubble that had been growing over the past decade. Such large-scale crises give rise to many questions, the most pressing being:

“*How could this happen?*”

Initially, the crisis was said to have been caused by regulatory failures, complex financial products, subprime mortgage lending, excessive risk taking by financial institutions, and a lack of ethical behavior (Melvin & Taylor, 2009; Helleiner, 2011). However, recent research delves deeper, suggesting that most financial crises can be linked to interest and subsequently inflation (Crotty, 2009; Kennedy, 1995). When the bubble burst, banks went bankrupt, and people lost their homes, jobs, and life savings, requiring a multi-trillion-dollar bailout by the US government (Lewis et al. 2010; Acharya & Richardson, 2009; Coffee, 2009).
Studies written after the fact criticize the inability of economists to recognize a looming crisis on the horizon (Nelson & Katzenstein, 2014). Consequently, economists and scholars have sought ways to prevent such crises in the future. Historically, all Abrahamic religions forbade or restricted interest (usury) (Looft, 2014). However, today, only Islam remains steadfast in this prohibition. During the 2008 crisis, scholars observed that Islamic banks were not as significantly affected as conventional banks (Baber, 2018; Al-Zumai, & Al-Wasmi, 2016; Farooq & Zaheer, 2015; Hussien et al. 2019; Elasrag, 2010; Diaw, 2015; Kayed & Hassan, 2011). In light of these observations, over the last three decades, Islamic banking has emerged as a viable alternative to conventional banking, gaining credibility and expanding globally (Ahmed, 2010). As of 2020, there are 526 Islamic Banking Institutions operating across 72 countries (Ismail, 2022). The observed resilience of Islamic banks is attributed to

the principles derived from the Quran, the Holy book of Islam and the Sunnah, teachings and sayings of the prophet, upon which Shariah law is based. Hussain et al. (2016) outline the fundamental principles of Islamic finance, which include the prohibition of interest (*riba*), adherence to Shariah (Islamic law), and the promotion of risk-sharing and ethical investment practices.

These principles instill greater discipline within the financial system, potentially reducing the severity and frequency of financial crises (Hassan & Kayed, 2009).

While the 2008 financial crisis has been extensively researched from various perspectives, including to an extent, the Islamic perspective (Hassan & Kayed, 2009). The potential of Islamic finance as a preventive system for future crises is less thoroughly explored. This gap in research presents an opportunity for further investigation.

Therefore, this paper aims to contribute to the existing literature by examining the resilience of Islamic finance during the 2008 financial crisis compared to conventional finance. It seeks to explore the applicability of Islamic finance as an alternative financial system and provide a framework for preventing future financial crises, using the 2008 crisis as a case study. In order to achieve this aim a qualitative study with a case study approach will be utilized. The study will be based on existing literature and semi-structured interviews with professionals from Islamic banks from Bosnia and Herzegovina and Qatar. Additionally, interviews with an Islamic finance expert and a member of a Shariah Supervisory Board will be conducted to assess whether Islamic finance principles can prevent crises and, if so, by what means. This research paper addresses the following question:

'*To what extent can Islamic financial principles be used to prevent financial crises, using the 2008 financial crisis as a case study*?'

The paper is divided into five main sections. Section 2 reviews existing literature regarding the financial crisis, Islamic finance practices and lastly the financial crisis through an Islamic financial perspective. Section 3 describes the methodology used, followed by the results (Section 4), a discussion (Section 5) and lastly the conclusion (Section 6).

2. Literature review

2.1. The Financial Crisis of 2008

When examining the 2008 financial crisis, the literature is extensive as researchers attempt to analyze the crisis from various angles to root out its causes and discuss its consequences. A simple keyword search in Scopus yields 14,800 articles on the subject, highlighting its extensive impact. This crisis is often described as the most detrimental crisis since the Great Depression (Helleiner, 2011; Lewis et al. 2010). The financial meltdown of 2007 - 2009 occurred when the housing bubble in the US burst, leading homeowners to default on their mortgage loans. The bubble had been inflating since the beginning of the 2000's, but when defaults began, financial institutions heavily exposed to these mortgages and the intricate, speculative financial products tied to them were severely affected (Helleiner, 2011). These financial products represent innovative yet risky forms of securitization (Roubini & Mihm 2010).

Privately issued mortgage-backed securities (MBSs), which bundled mortgages including subprime mortgages, had the most significant impact. These MBSs were traded globally, spreading the crisis worldwide (Helleiner, 2011; Acharya & Richardson, 2009; Wignall & Atkinson, 2009). The crisis was further amplified as the MBSs were continuously divided and repackaged into collateralized debt obligations (CDO's), which derived their cash flows from other bonds, and credit default swaps (CDSs), derivatives used to hedge credit risks. However, many CDS buyers did not own the underlying bond, speculating instead on the likelihood of default on specific bonds (Helleiner, 2011).

These derivatives involved over-the-counter (OTC) products, which were privately negotiated between buyer and seller, leading to a lack of transparency with a lot of hidden risks (Helleiner, 2011). Hybrid loans with teaser rates that adjusted after the first few years also played a significant role. The rate adjustments were often unaffordable for subprime borrowers, leading to defaults when the collateral value did not increase as speculated. Essentially, mortgage issuers were betting and speculating on continuously rising housing prices (Acharya & Richardson, 2009). These speculative, complex, and non-transparent

financial products (Coffee, 2009; Helleiner, 2011; Nelson & Katzenstein, 2014; Chapra, 2008; Hassan & Kayed, 2009; Ahmed, 2010) were at the crisis's core.

By utilizing MBSs and CDOs, investment banks significantly increased their leverage. When the financial crisis struck, Lehman Brothers, one of the first banks to go bankrupt, had leverage ratios around 40:1, which left them extremely vulnerable to any deterioration in the collateral backing these securitized assets (Swedberg, 2010). Leverage, the use of borrowed funds to amplify potential returns on an investment, can significantly magnify both gains and losses making leverage a powerful but risky tool in finance. By using leverage, investors can increase their exposure to an asset without having to commit the full amount of capital required to purchase the asset outright. A 40:1 leverage ratio indicates that for every dollar of equity, there are 40 dollars of debt, a substantially high level of leverage.

Banks had highly leveraged business models, borrowing heavily in the short-term money markets to invest in long-term, illiquid assets (Helleiner, 2011). By securitizing loans, banks could reduce required capital reserves, increasing leverage (Acharya & Richardson, 2009). Mortgage lenders, having sold the debt, faced no consequences from defaults, leading to deteriorating loan quality as underwriters failed to verify portfolio quality (Helleiner, 2011; Coffee, 2009). This clearly shows that there was an erosion of market discipline, reinforced by rating agencies' lack of liability and the conflict of interest inherent in the issuer-pays model which accounted for 90% of their entire revenue (Acharya & Richardson, 2009; Coffee, 2009; Helleiner, 2011; White, 2009). This led to overly positive ratings, and the loan quality deteriorated (Berndt & Gupta, 2008; Dell'Ariccia et al. 2012; Keys et al. 2011; Mian & Sufi 2008).

Deregulation and regulatory failures played a crucial role in the meltdown (Acharya & Richardson, 2009; Coffee, 2009; Helleiner, 2011). Inspired by Basel II, the SEC adopted a self-regulation framework for investment banks which allowed them to use internal risk models, often resulting in underestimate risk (Helleiner, 2011; Coffee, 2009; Wignall & Atkinson, 2009). Off-balance-sheet entities were used by banks to keep certain assets and liabilities off their main balance sheets, in order to circumvent regulatory capital requirements (Helleiner, 2011). This permitted investment banks to increase leverage. Self-regulation led to conflicts of interest and fraudulent practices, contributing to Bear Stearns' collapse (Lewis et al. 2010).

Misaligned incentives also played an important role in the crisis (Coffee, 2009; Acharya & Richardson, 2009; Wignall & Atkinson, 2009; Stiglitz, 2003). Managers' compensation schemes were altered to an equity-based system, which incentivized them to focus on increasing short-term earnings, disregarding the long term consequences and promoting high risk behaviors (Nelson & Katzenstein, 2014). Lewis et al. (2010) link the intensity of increased risk taking behavior to a lack of corporate ethics in the banking sector, driven by greed. The speculation undertaken by these bankers was fueled by the fact that they were not bearing the majority of the losses (Lewis et al. 2010).

In summary, the primary causes of the 2008 financial crisis were regulatory failures, complex, speculative financial products and greed (Wignall & Atkinson, 2009; Jickling, 2009; Lewis et al. 2010). These speculative products and tactics were unsustainable and in 2008, the market crashed. The crash was detrimental to the global economy, launching a worldwide recession, forcing banks into insolvency, hedge funds to collapse and the nationalization of American International Group (Luo & Wang, 2023; Wehinger, 2009; Helleiner, 2011; Coffee, 2009) The crisis required a $2 trillion bailout plan (Acharya & Richardson, 2009). Numerous recommendations have been suggested to prevent future crises, including enhanced regulation and a greater emphasis on ethics (Franzoni & Allali, 2018; Lewis et al, 2010). Therefore, this paper will discuss an approach to finance that encompasses all of the recommendations, Islamic finance.

2.2. Islamic Finance and Banking Practices

Islamic finance is rooted in Islamic teachings stemming from the primary source, the Quran and the practice and conduct of the last Prophet, called the *Sunnah* (Hussain et al. 2016). These teachings and thus guidelines are otherwise referred to as *Shariah*. Whilst *Shariah* can be negatively connotated in the west it is simply Islamic law. Etymologically "*Shariah*" stems from a root meaning "*path leading to the watering place*" (Coulson & El Shamsy, 2024).

2.2.1 History of Islamic Finance

Although Islamic banking practices have been fully implemented only in the last century, the theoretical idea can be dated back to as early as the seventh century (De Jonge, 1996). Islamic finance flourished in Malaysia in the mid-1940s and in Pakistan in the 1950s, towards the end of the colonial era. Consequently, Islamic states reevaluated their financial policies to align with *Shariah* ruling (Rammal, 2003). The Egyptian Mit Ghamr Savings Bank was the first successful implementation of Islamic finance, avoiding interest and deriving income from profit-sharing investments (Lewis & Algaoud, 2001). In 1973, the Islamic Development Bank was established (Saeed, 1996). The primary aim of this institution was an expansion of Shariah-compliant financial institutions to Muslims across the globe (Malti, 2022). This institution led the way to the establishment of what is now the largest Islamic Bank in the UAE, as well as the establishment of Islamic financial banks in other countries such as Sudan, Egypt, and Kuwait (ijara CDC, n.d.) Eventually Islamic Banking gained significant momentum, to the point where it is the only permissible financial system in Iran, Pakistan, and Sudan (Chong & Liu, 2009). Thus, Islamic Banks were established to meet a demand for ethical banking brought forward by Muslims around the globe. This demand is not limited to Muslim-majority countries but has currently extended globally, attracting significant interest from non-Muslim investors seeking ethical investment opportunities (Domat, 2024; Malti, 2022).

Islamic Finance has grown to become a $2.5 trillion industry reaching over 80 countries (Domat, 2024). However, as stated in the article by Domat (2024), it is still heavily based in a few countries, with about 95% of the global *Shariah* compliant assets being located in 10 countries around the Middle east and Asia. Therefore, it should be noted that the future prospects of Islamic Banking can be affected significantly by the state of these economies. Nonetheless, , over the past decade, Islamic finance has continued to grow at an exponential annual rate of 10-12% (Domat, 2024). This growth, following the 2008 financial crisis, indicates the sector's resilience to such economic downturns.

2.2.2 Fundamentals of Islamic Finance

Islamic finance theoretically differs from conventional finance through the prohibition of certain practices present in conventional finance and the emphasis placed on ethical investments and risk-sharing.

2.2.2.1 Asset backed financing

An important fundamental aspect of Islamic Finance is that it is rooted in asset backed financing (Usmani, 2002). A significant contrast between Islamic and conventional banking is the definition and use of money. Whilst the conventional approach treats money as a subject-matter of trade, dealing primarily in money and monetary papers, Islamic Finance views money as having no intrinsic value. Money is rather defined as a means of exchange (Usmani, 2002). Thus, Islamic finance must always deal with real/tangible assets.

This point is further stressed in a Washington Post article by Ambah quoting (2008) Amr, al Faisal, a board member of Dar al-Mal al Islami, a holding company that owns several Islamic banks and institutions, "Our dealings have to be tied to actual economic activity, like an asset or a service. You cannot make money off of money. You have to have a building that was actually purchased, a service actually rendered, or a good that was actually sold." Islamic banks diverted great losses in 2008 due to this fundamental pillar.

2.2.2.2 Profit and Risk Sharing

Usmani (2002) illustrates that in capitalist theory, capital and entrepreneurship are viewed as individual factors of production. In contrast, Islamic finance integrates these two elements. Those who invest capital in a business also take on the risk of loss and thus, deserve a share of the actual profit. This means that capital inherently includes the element of entrepreneurship concerning business risk. Instead of receiving a fixed interest return, capital investors earn profit, and higher business profits result in greater returns on capital. This approach ensures that profits from business activities are distributed equitably among all capital investors, regardless of their investment size. Banks and financial institutions, which typically provide capital for commercial activities through depositor funds, can thus distribute actual profits equitably to depositors, helping avoid wealth concentration by a minority. Consequently, contracts in Islamic finance ensure equal profit and risk sharing.

2.2.2.3 Riba (usury)

Charging interest (*riba*), otherwise known as usury, tends to drive the poor further into poverty and create more wealth for the wealthy without doing work or sharing the risk involved in the business undertaking. *Riba*, the charging of interest, further creates wealth without actually being the outcome of productive economic activity or as the result of an increase in commodity supply. Islam therefore considers all interest-based financial

arrangements to be unfair, unjust, and morally unjustifiable and all money generated by such transactions to be passive income (Kayed & Hassan, 2011). Though passive income is not inherently prohibited in Islamic finance, the permissibility depends on the source and nature of the income (AAOIFI, 2017). Usmani (2002) emphasizes that the ban on *riba* aims to promote fairness and equity in financial transactions, ensuring that no party is unfairly enriched at the expense of another. This principle is designed to prevent the concentration of wealth and ensure a more equitable distribution of resources (Usmani, 2002).

In accordance with Shariah, earnings are only acceptable when accompanied by the assumption of associated risks. Thus, any fixed and predetermined, unknown return, guaranteed regardless of the nature or outcomes of the investment, is strictly prohibited. Specifically, *riba*, or usury, arises when there is a predetermined interest rate, positive or negative, tied to the duration and amount of the loan, irrespective of the economic outcomes achieved through the borrowed funds (Franzoni & Allali, 2018).

Analyst with rating agency Standard & Poor's mentions, "Islamic banks were not caught by toxic assets as Shariah law prohibits interest. At the same time, you can create and invest in very risky assets and be Shariah compliant" (Aglionby, 2009). This statement is mentioned in regard to the 2008 financial crisis. Thus, it goes to show the speculative market with interest-based commodity money, is a liability in the face of interest-based crisis, whilst asset-backed financing demonstrates resilience. Thus, asset-backed financing is fundamental to Islamic finance.

2.2.2.4 Maysir (gambling)

Another fundamental pillar of Islamic finance is the prohibition of speculation; *maysir*, otherwise known as gambling. This means that taking excessive risks with potentially extreme outcomes or attempting to become wealthy by gambling on future events, is prohibited (Franzoni & Allali, 2018). Iqbal and Mirakhor (2011) explain that *maysir* leads to wealth creation without productive effort, otherwise known as passive income, resulting in unjust outcomes. Through the prohibition of *maysir* it is ensured that all financial activities contribute to real economic value and discourages speculative behavior that can lead to economic instability.

2.2.2.5 Gharar (uncertainty)

The Quran also prohibits (*haram*) profit based on uncertainty; known as *gharar*. In simple terms, *gharar* can be defined as excessive uncertainty or ambiguity in contracts (El-Gamal, 2006). Thus, in regard to financial contracts, all elements of the contract must be communicated clearly, no elements must be left to chance. The purpose, nature, price and other subjects of the contract must be known and clearly defined. Speculative elements of the subject matter are strictly prohibited (Franzoni & Allali, 2018; Ismail et al. 2020). Interest is a speculative element itself and since the conventional financial system is significantly interest-based it is highly speculative, and thus unreliable and significantly risk bearing (Usmani, 2002). An example of such contracts can be seen in conventional finance with derivatives like options as well as forwards and futures. Due to their uncertainty and speculative characteristics, such contracts are prohibited in IF.

Arm al-faisal (2008) also mentions, “We are more conservative and sober in our investments. That used to be considered a handicap. Now it’s considered the height of wisdom. Successful banks have always been conservative lenders” in The Washington Post article by Ambah. At least such is intended, however, the majority of the world market dabbles in speculative instruments, and such is the definition of money. Thus, it can be argued that the theoretical characteristic of Islamic finance is not applied to its full extent in some cases (Chong & Liu, 2009).

2.2.3 Contracts within Islamic Finance

The following two fundamental Islamic banking principles are of significance to this paper.

1. *Musharakah* means sharing in arabic. In business and trade it’s reflected as a joint enterprise/venture contract where both profit and loss is shared by all partners (Usmani, 2002). In a *musharakah* partnership, partners have a right to engage in management decisions, taking on considerable risk with the potential for significant returns. However, profits are distributed according to predetermined ratios, and any losses incurred are distributed proportionally based on each partner's capital contribution (Hussain et al. 2016; Usmani, 2002).
2. *Mudaraba* is another contract from, specifically a profit-sharing and loss-bearing contract. One party is the financier (as principal) and contributes with funding, whilst

the other party; the mudarib or entrepreneur (as agent) contributes with management competencies and effort, imitating a sleeping partnership in the west, where an investor provides the capital but doesn't take an active role in managing the business. (Hussain et al. 2016: Usmani, 2002). As Hussain et al. (2016) describes, in a *mudaraba* contract profit shares are based on mutual agreement, but in contrast to a *musharakah* contract, losses are carried by the financier only. However, if the losses are caused by the negligence of the mudarib, breach of contract or misconduct, losses will be distributed differently. This type of contract is typically used to raise funds and to manage mutual funds (Hussain et al. 2016; Usmani, 2002).

2.2.4 Regulatory Framework

2.2.4.1 Shariah Supervisory Board (SSB)

A Shariah Supervisory Board (SSB) is composed of Islamic Scholars educated in both finance and *Shariah* to evaluate whether Islamic financial institutions are upholding *Shariah* compliance (Thomas Reuters, n.d.). Financial institutions must run new product or service transaction ideas by the SSB for them to assess whether they are *Shariah* compliant (BankABC, n.d.; Thomas Reuters, n.d.). In addition, the scholars consider different Islamic schools of thought (Hanafi, Hanbali, Shafi'i and Maliki) when assessing the proposals (Thomas Reuters, n.d.). If the proposal is deemed Shariah-compliant, an opinion (fatwah) will be issued, to also serve as potential guidelines for future proposals (Thomas Reuters, n.d.). Different regions and countries have their own SSBs (Aljifri & Khandelwal, 2013; Ahmed & Aassouli, 2022).

2.2.4.2 Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

AAOIFI is a non-profit organization based in Bahrain, creating and reporting standards that are *Shariah* compliant for businesses. It is similar in nature to the conventional International Accounting Standards Board (AAOIFI, n.d.; IFRS, n.d.). The AAOIFI continuously updates their publication, "Shari'ah Standard" to adapt to the changing market, with their latest edition being published in 2017 (AAOIFI, n.d.)

The AAOIFI operates in about 45 countries with 200 members. AAOIFI's standards have been utilized by some countries, however, the members are not obligated to act upon the standards (Thomas Reuters, n.d.; AAOIFI, n.d.; LexisNexis, 2024). Thus, if the standards are not binding, their effectiveness can be debated.

2.3. Islamic Finance for Crisis Prevention

Islamic finance principles offer a distinctive approach to financial management, emphasizing ethical considerations and risk-sharing mechanisms that can potentially prevent financial crises. The 2008 financial crisis, characterized by excessive risk-taking and speculative activities, highlighted the vulnerabilities of the conventional financial systems (Acharya & Richardson, 2009; Jickling, 2009). In contrast, Islamic finance prohibits the aforementioned *riba*, *gharar*, and *maysir*, which are often recognized as contributing factors to financial instability (Usmani, 2002). A host of Muslim scholars and practitioners strongly argue that Islamic finance "has the potential to become an alternative model for a global system" (Aglionby, 2009; Ayub, 2007; Chapra, 2008). Thus, a systemic analysis of the causes of the crisis and measuring these causes against the intrinsic principles of the Islamic financial system reveals that such a crisis could have been prevented if Islamic financial principles had been prevalent (Kayed & Hassan, 2011). Additionally, when *riba* is prohibited, the financial transactions are based on tangible assets and real economic activities, therefore reducing the possibilities of speculative activities and bubbles being formed. According to Warde (2010), Islamic finance demonstrated resilience during the 2008 crisis due to their adherence to these principles. Moreover, the emphasis on profit-and-loss sharing (PLS) supports both the interests of investors and entrepreneurs. As a result, risk is distributed equally. However, while Warde's thorough analysis emphasizes the stability of Islamic finance institutions, it is also crucial to evaluate the practical implementation of IF principles as well. El-Gamal (2006) argues that many Islamic financial products are structured to imitate conventional financial instruments, potentially undermining their effectiveness in preventing crises. Consequently, this critique highlights the need for a more authentic application of Shariah principles to fully realize the benefits of Islamic finance.

Iqbal and Miakhor (2011) pointed out that Islamic finance's risk management framework is designed to mitigate the moral hazards and conflicts of interests that contributed to the 2008 financial crisis. According to them, the principles of transparency and accountability are

essential to Islamic financial transactions. In addition, according to these principles all parties that are part of a specific financial transaction are conscious of the risk and rewards. In this way, a culture of ethical behavior and responsible risk-taking will always be promoted. However, despite the theoretical advantages, the practical challenges of implementing solid risk management frameworks in Islamic finance cannot be overlooked. Khan and Bhatti (2008) made sure to explain the absence of standardized regulatory frameworks for Islamic finance, which can lead to inconsistencies in risk management practices. This gap opens up the requirement for international regulatory bodies to develop and enforce standards that ensure the effective application of Islamic finance principles.

The comparative resilience of Islamic banks during the 2008 financial crisis provides empirical support for the potential of Islamic finance to prevent future crises. Siddiqi (2009) notes that Islamic banks were less affected by the crisis due to their conservative lending practices and avoidance of speculative investments. This resilience can be attributed to the ethical foundation of Islamic finance, which prioritizes social justice and economic stability over short-term profits. However, it is important to acknowledge that the resilience of Islamic banks during the 2008 crisis may also be influenced by other factors, such as their smaller size and limited exposure to global financial markets.

Moreover, in order to understand Islamic finance better, Elasrag (2010) explains that Islamic finance is not a totally different financial system but rather a different way of structuring financial dealings. In that case, Islamic finance aims to keep finance connected to the real market of production and exchange, avoiding practices that result in shifting wealth without adding value. The concept of financialization, which refers to the increasing dominance of financial motives, financial markets, financial actors, and financial institutions, has been a significant factor in the global economy (Epstein, 2005; Davis & Kim, 2015). Financialization often leads to the prioritization of short-term profits over long-term economic stability, contributing to financial crises (Davis & Kim, 2015). In contrast to conventional finance, Islamic finance, with its emphasis on real economic transactions and ethical considerations, offers a counterbalance to the adverse effects of financialization. By aligning financial activities with real economic outcomes, Islamic finance can mitigate the risks associated with financialization and promote long-term economic stability (Melvin & Taylor, 2009).

The global financial crisis has spiked interest in Islamic finance beyond Muslim-majority countries. As financialization continues to shape global economies, there is a growing demand for ethical and stable financial systems. Non-Muslim countries are increasingly adopting Islamic finance practices as part of broader efforts to reform their financial systems and enhance stability (Warde, 2010). For instance, after recognizing its potential to attract investment and promote financial stability, the United Kingdom, Luxembourg, and Hong Kong have introduced regulatory frameworks to assist the growth of Islamic finance (Wilson, 2009). As a result, the adoption of Islamic finance in non-Muslim countries can present both opportunities and challenges. While the ethical and risk-averse principles of Islamic finance are attractive in theory, the integration of these principles into conventional financial systems requires significant regulatory adjustments and cultural shifts. As noted by Siddiqi (2006), the potential for Islamic finance to contribute to financial inclusion, economic development, and social justice is substantial, but its success depends on overcoming Islamophobia and other socio-political barriers. Additionally, the development of Shariah-compliant financial products that meet the needs of diverse markets is crucial for the widespread adoption of Islamic finance (Hassan & Lewis, 2005).

In summary, Islamic finance principles offer a promising framework for preventing financial crises by promoting ethical behavior, risk-sharing, and transparency. The increasing demand for Islamic finance in non-Muslim countries emphasizes it as a potential alternative to conventional finance. However, the practical implementation of these principles faces significant challenges, including the need for standardized regulatory frameworks and authentic application of Shariah principles. Future research should focus on developing strong governance structures and regulatory standards to enhance the effectiveness of Islamic finance in promoting financial stability and addressing the unfavorable effects of financialization.

2.4 Agency Theory

Agency Theory examines the relationship and conflicts arising from the separation of control and ownership between the owner (principal) and the managers (agent) within an organization, particularly when the agents do not bear the full financial consequences of their decisions.This theory has been applied to analyze the 2008 financial crisis in numerous previous studies (Smith, 2010; Segrestin & Hatchuel, 2011; Conyon et al. 2011).

Eugene F. Fama, a key scholar in this field, discusses in his paper "Agency Problems and the Theory of the Firm" (1980), how the separation of control and ownership can lead to a misalignment of goals between principals and agents. This misalignment often results in situations where the agents may not always act in the best interest of the principal (Fama, 1980, Maxwell, Levesque, 2014).

Fama (1980) conceptualizes the corporation as a nexus of contracts among various stakeholders, such as managers, employees and shareholders. This perspective shifts the view of firms from simple relationships of authority and control to complex interplays of contracts that aim to align diverse interests through incentives and market discipline. Two pivotal concepts that reinforce the existence of agency conflicts are moral hazard and information asymmetry. Moral hazard refers to the opportunistic and self-interested behavior of agents (Ismail, 2013). This occurs when agents take actions that benefit themselves at the expense of the principals, knowing they do not bear the full consequences of their actions. Information asymmetry describes situations where agents have more information than principals, leading to potential conflicts of interest (Jensen, Meckling, 1976). This asymmetry can result in agents making decisions that principals would not have made if they had the same information.

Fama (1980) argues that the discrepancies that arise can be mitigated through various internal and external monitoring mechanisms, including performance-based incentives, capital markets, the role of board of directors and managerial labor markets which by evaluating managers based on their performance affect their future employment opportunities and compensation. These market-oriented solutions to agency problems underscore the importance of external market pressures in maintaining corporate governance and aligning managerial actions with shareholder goals. Fama (1980) thus concludes that by employing a combination of internal and external mechanisms, it is possible to mitigate these conflicts and align the interests of both parties.

Previous studies have pointed to the fact that a lack of a proper incentives system can be deemed one of the root causes of the financial crisis, senior corporate managers (agents) were incentivized to inflate the firm's short term earnings as their compensation system shifted to equity based through stock options, (Coffee, 2009; Lewis et al. 2010; Acharya & Richardson, 2009; Tridico, Pariboni, 2018). As mentioned previously, driven by greed and

the desire to inflate their own personal earnings, managers sold increasing amounts of MBSs and CDOs, paying little attention to the consequences for both their firms and the people purchasing these products. Thus, one major question that arises from the 2008 financial crisis is how do we deal with human nature and greed through agency theory.

2.5 Financialization

In addition to agency theory, financialization literature problematizes the rise of neoliberalism and its associated focus on financial capital at the expense of production capital. Previous papers have used financialization as a theoretical lens to offer an important perspective on the 2008 financial meltdown (Freeman, 2010; Lapavitsas, 2011, Lucarelli, 2012; Deutschmann, 2011; Plys, 2014). Financialization, a historical trend that began in the late 1970's, refers to the increasing dominance of financial motives, markets, actors, and institutions in the economy, profoundly affecting economic and social systems (Epstein, 2005, Davis & Kim, 2015). As financial considerations became increasingly central to the economy's workings, criticisms of financialization grew, particularly following the 2008 financial meltdown, which many attribute to the rise of complex financial instruments like subprime mortgages (Sawyer, 2013).

The shift from traditional economic activities, often referred to as the real economy, to financial activities has been criticized for numerous reasons. Notably, this transition has been linked to increasing income inequality and the creation of financial bubbles that can trigger economic crises (Tridico & Pariboni, 2018; Miah & Suzuki, 2015; Davis & Kim, 2015). Financialization has been blamed for heightening global inequalities and slowing down productivity. Firms shifted from seeking productivity gains to downsizing, significantly impacting income distribution (Tridico, Pariboni, 2018). By 2000, maximizing shareholder value (MSV) had become a dominant ideology, with corporate strategies increasingly influenced by stock market judgments and the need to appeal to investors through compelling narratives (Lazonick & O'Sullivan, 2000). This focus on MSV led to corporate downsizing and layoffs, contributing to income inequality (Davis & Kim, 2015, Lazonick & O'Sullivan, 2000).

An important enabler of financialization is securitization, the process of converting assets with cash flows, such as mortgages, into tradable securities (bonds) (Davis & Kim, 2015).

Leading up to the 2008 financial crisis, banks were making historically high profits through said securitization (Tregenna, 2009). This had a significant impact on rating agencies, which went from break-even firms to exceptionally profitable enterprises. However, this situation gave rise to a conflict of interest, as rating agencies' main income stemmed from issuers who depended on their ratings for their businesses (Coffee, 2009). Thus, securitization and financialization directly contributed to the 2008 financial crisis (Davis & Kim, 2015, Franc-Dąbrowska, 2019). When the housing bubble burst, it triggered a global financial crisis, revealing the vulnerabilities introduced by excessive financialization (Tridico & Pariboni, 2018).

The rise of financialization has also sparked counter movements opposing Wall Street's influence on the everyday economy. These movements advocate for reinstating financial regulations and providing alternative narratives to the ownership society (Davis & Kim , 2015). An alternative system can be found in IF which challenges typical financialization practices (Miah & Suzuki, 2015).

2.6 Ethical finance and Corporate Social Responsibility theory (CSR)

Corporate social responsibility (CSR), an idea that gained traction in the mid-20th century, has become increasingly central in business literature and practices. The concept has evolved from basic philanthropic activities to a more integrated approach within corporate governance and strategic management (Carroll, 2009). Previous studies have used CSR to analyze the 2008 financial meltdown (Berkman et al. 2020; Emeseh et al. 2010). According to Carroll's 2009 paper, CSR can be defined as the ethical obligation of businesses to pursue policies, make decisions, and take actions that benefit society at large while balancing the interests of various stakeholders, including employees, customers, suppliers, communities, and shareholders. Carroll’s work stipulates that CSR has both ethical and business components. A company's CSR activities become a way of reflecting its commitment to operate in a socially responsible manner beyond mere compliance with laws and regulations (Carroll, 2009).

Nonetheless, based on Carroll’s CSR pyramid, economic responsibilities take precedence, followed by legal responsibilities, ethical ones and finally, at the tip of the pyramid, philanthropic ones (Carroll, 1991). Other studies have emphasized the ethical perspective,

suggesting that corporations have inherent ethical responsibilities (Berkey, 2021). Numerous studies have looked at the 2008 financial crisis through an ethical perspective (Lewis et al. 2010; Claassen, 2015; Schoen, 2017). Berkey (2021) states that corporations significantly affect individuals' economic and social conditions, suggesting that business ethics and political philosophy significantly overlap. This solidifies the idea that CSR should not be limited to voluntary actions but should also include ethical obligations that promote justice and social well-being.

CSR aligns with Rawlsian principles (Sacconi, 2010). Thus, according to Rawlsian theory, principles of justice apply to the basic structure of society, which in today's world includes corporations. This view suggests that corporations have justice-based reasons to promote social welfare directly, countering the idea that they are only responsible for generating profits for shareholders. The 2008 financial crisis serves as a reminder of the consequences of neglecting ethical principles in business. The crisis was caused by various unethical behaviors, including a lack of transparency, excessive risk-taking, greed, and exploitation. A significant aspect of the crisis was the widespread issuance of subprime mortgages, bundled into complex financial products. These products were often interest-bearing loans. As Looft (2014) notes, borrowing money at interest without risk-sharing between the lender and borrower creates an exploitative relationship. In such scenarios, borrowers, who are often in need, can be easily exploited by more powerful lenders.

The crisis underscored the importance of proper ethical frameworks and CSR in financial institutions, highlighting the necessity for companies to adopt policies that align with principles of justice, ensuring fair opportunities and reducing inequalities (Carroll, 2009). By incorporating these principles, businesses can help prevent the kind of systemic failures that led to the financial crisis, promoting a more ethical and equitable financial system.

3. Methodology

3.1 Research approach

A qualitative case study analysis using an inductive approach was conducted to explore the significance of Islamic finance on crisis prevention in interest-based economies. In contrast to quantitative research, qualitative research underscores words instead of quantifying the

collection and analysis of data (Bell et al. 2019). Furthermore, a qualitative approach allows researchers to delve into relatively unexplored areas, generating insights and understanding where research is limited (Bell et al. 2019). An exploration of previous studies revealed limited research on Islamic finance as a solution to crisis prevention. Thus, enabling the researchers to facilitate a more nuanced perception of how Islamic principles and practices intersect with broader economic and financial dynamics. Consequently, offering valuable insights about how Islamic finance can contribute to crisis resilience by examination of its specific mechanisms.

As stated by Bell et al. (2019), qualitative studies primarily apply the inductive approach, which is most suitable when exploring the relationship between theory and research. Thus, an inductive approach allowed the researchers to stay open to new ideas and emergent themes that arose during the data collection process. Such flexibility showed to be crucial as the data collected did open up to new, interesting perspectives that contributed significantly to the research.

Throughout the process of generating questions and conducting the semi-structured interviews, the researchers have been aware of their own biased perspectives, striving to remain objective in their analysis.

3.2 Research Design

As the aim of the study was to decipher whether Islamic finance is a suitable alternative to prevent crisis prevention, a case study approach uncovering the 2008 financial crisis was utilized. The case study approach enables in-depth examination of real-life experiences, deeming it suitable to understand the nuanced phenomena of the 2008 financial crisis (Bell et al. 2019). Interviews were chosen as the preferred data collection method, as it allows for in depth understanding of the phenomena, in this case the 2008 financial crisis, from a primary source, in addition to the secondary data found in existing literature.

The data gathered was analyzed through a systematic approach. Systematic analysis aids digestion of deep insights of nuanced data (Strauss, 1990). This approach ensures thorough, reliable, and valid analysis, contributing to a deeper understanding of the topic. The 2008

financial crisis is multifaceted with several interpretations of the root of the problem, thus indicating the need for a nuanced analysis method for such complex data.

Once all data was collected, it was organized through the approach of axial coding. Axial coding focuses on identifying relationships between themes and potential subthemes, deeming it suitable for systematic data analysis (Strauss, 1990). Since systematic analysis uncovers how components interact, grouping into themes and categories aids this analytical approach.

3.3 Data Collection Method

3.3.1 Selection of Population

To uncover the extent of effects of the 2008 financial crisis on Islamic finance and prevention methods used, Islamic financial institutions that were in operation during the crisis and continue operation today were selected. To gain broader insights, Islamic financial institutions in geographically and politically different countries were selected, thus including respondents from institutions in Bosnia and Herzegovina, Qatar, and the broader Middle East. It should be noted amongst the Islamic financial institutions, the governing bodies of the main institutions (SSBs) were also interviewed. Moreover, an Islamic financial expert was interviewed twice to gain further insight into the topic and to help assess responses from interviewees.

However, as all respondents are still active in their respected institutions and currently pursue careers within Islamic finance, their names and institutions will be anonymized. The respondents will be referred to as ‘respondents’ and occasionally their respected countries.

3.3.2 Primary Data Collection

The primary data collection method of this paper was semi-structured interviews. After determining which Islamic financial institutions to look into, LinkedIn and personal connections were used to identify interviewees and reach out to them. Each interviewee’s background and experience were carefully assessed and taken into consideration during the selection period to fit the sample requirements. These requirements included respondents

with at least 10 years of experience within Islamic financial institutions and they had to have been actively employed in an Islamic bank during the crisis. Moreover, this experience had to be from before to the 2008 financial crisis and significantly reach years after the crisis.

All interviews were conducted via zoom due to geographical distances. The meeting times and dates were determined based on the interviewee's availability. Semi-structured interview questions, with some structured background questions to ensure validity of the interviewee, were formed (Appendix 1). The questions remained open-ended to an extent to not limit potential interesting perspectives. The questions were organized in themes as visualized in Appendix 1. The themes included regulatory questions, strategy questions and questions about the impact of the crisis. In consensus with the interviewees, all interviews were recorded via Zoom to ensure points were not misunderstood or wrongfully transcribed to cause misinterpretations. The interview was transcribed based on the recordings and other personal notes taken during the meetings.

Snowball sampling was utilized to reach other interviewees. The experience requirement also contributed to the interviewees having significant networking, enabling the researchers to reach other experienced respondents. Most respondents were willing to help.

3.4 Data Analysis

The interviews were transcribed using the AI software TurboScribe. However, to ensure the interviews had been transcribed accurately, the transcripts were proofread with the zoom recordings. The transcripts were also altered with punctuation and notes, to fit the tone and intensity of the respondents that the AI was unable to capture. The transcripts were read several times more to gain familiarity with the data and discover similarities and differences. Several categories were identified along with subcategories. The relevant parts of the responses were then placed within the relevant categories, to aid analyses of the data. As mentioned previously, the data was then analyzed with a systematic method.

3.5 Validity and Reliability

Validity reflects the accuracy and truthfulness of the study's results. It shows if the researchers successfully measure what is intended to be measured (Bell et al. 2019). Firstly, the interview questions were designed to closely align with the theory and address the

research question. This resulted in a large number of questions to ensure consistency between the chosen theories, data, and the research question. Even before feedback indicated there were too many questions, adjustments were made to directly tackle the issues. However, since the interviews were conducted individually with representatives from different demographic and geographic backgrounds, the interview data might reflect subjective interpretations, potentially introducing bias. Bias could in turn reduce the validity of the results. However, the data provided was confirmed by the researchers by running it by an Islamic finance expert and secondary sources found online. Thus, through triangulation, cross verification of the data, the validity of the research was enhanced (Bell et al. 2019).

Reliability assesses the consistency and reliability of the data attained. Consequently, reliability is enhanced by replicability and consistency (Bell et al. 2019). Amongst question types, semi-structured interview questions are generally considered to be of the less reliable type compared to structured interviews (Bell et al. 2019). The data can be subjected to more bias due to the subjectivity of the researchers. With structured interview questions, the researchers are limited to the strict non-flexible responses. However, semi-structured interviews allow for deviation of the intended questions to explore different perspectives peaked by the interest of the researcher. The researchers were willing to keep this risk of lower reliability compared to structured interviews, to ensure rich and fulfilling data was collected. However, reliability was enhanced through an interview guide presented in Appendix 1, that was used for all interviews to ensure replicability as much as possible. Moreover, the consistency was ensured through inter-observer consistency (Bell et al. 2019). Each researcher coded the data individually, to then compare their results and ensure they did not present significant differences but instead significant similarities.

4. Results

After transcribing all the interviews, a systematic analysis was conducted to codify the answers from each section of the interview transcriptions. This careful analysis revealed several recurring themes and concepts, which enhanced our understanding of the 2008 financial crisis from the perspective of Islamic finance principles. The interviews mainly highlighted the stabilizing role of Islamic finance principles, the ethical and social responsibility in Islamic banking, and the regulatory environment that is supported by Shariah law. The majority of the answers underpin that Islamic finance principles could have

played a significant role in mitigating the effects of the 2008 financial crisis and hold promise for promoting financial stability in the future.

As explained in the previous sections, the 2008 financial crisis, characterized by the collapse of major financial institutions and severe market downturns, highlighted significant vulnerabilities within the conventional financial system. This section presents the findings from the interviews conducted with professionals in Islamic finance, focusing on how the principles and practices of Islamic finance could prevent future crises. The interviews were coded and analyzed to identify key themes and insights, which are discussed in detail below.

4.1 Key Themes from Interviews

The interviews conducted with experienced professionals from various Islamic financial institutions revealed several key themes that provide valuable insights into the IF response to the 2008 financial crisis. One leading theme was the emphasis on ethical and asset-backed financing, which contrasts sharply with the speculative practices found in conventional finance that played a crucial role in the crisis. Interviewees highlighted the importance of profit-sharing models and risk-sharing mechanisms inherent in Islamic finance, which promote financial stability and equal wealth distribution. Moreover, another recurring theme was the role of transparency and accountability in fostering trust and resilience within financial institutions. The results from the interviews also emphasized the significance of adhering to *Shariah* principles, which guide financial transactions and also implement a sense of moral responsibility among practitioners. All of these themes collectively illustrate how Islamic finance principles can offer a potential framework for mitigating financial crises and promoting sustainable economic growth.

4.1.1 Ethical and Asset-Backed Financing

Prohibition of Riba and Gharar

One of the most important themes that emerged from the interviews was the prohibition of *riba* (interest), *gharar* (excessive uncertainty) and *maysir* (gambling) in Islamic finance. Participants consistently emphasized that these prohibitions naturally reduce speculative activities and promote financial stability. The prohibition of *riba*, which refers to any guaranteed interest on loans, ensures that financial transactions are based on real economic

activities rather than speculative gains. This principle is deeply rooted in Islamic finance and is designed to foster a more equitable and stable financial system (El-Gamal, 2006). As one participant noted:

"*The prohibition of riba ensures that financial transactions are based on real economic activities rather than speculative gains, which was a significant factor in the 2008 crisis.*"

This way of thinking was also mentioned by other interviewees as well, who highlighted that the absence of interest-based transactions in Islamic finance reduces the likelihood of debt accumulation and financial bubbles to a great extent. By eliminating *riba*, Islamic finance encourages investments in productive assets and real economic activities, thereby aligning financial practices with the real economy (Chapra, 2008). This alignment is crucial for maintaining financial stability since it prevents the kind of speculative behavior that led to the 2008 financial crisis.

In addition to the prohibition of *riba*, the *gharar* is also strictly forbidden in Islamic finance. *Gharar* refers to any transaction where the terms are ambiguous or uncertain, which can lead to disputes and financial instability (Iqbal & Mirakhor, 2011). By prohibiting *gharar*, Islamic finance ensures that all financial contracts are transparent and clearly defined, reducing the risk of misunderstandings and disputes (Iqbal & Mirakhor, 2011). This principle, at its core, promotes trust and confidence in financial transactions, which are essential for a stable financial system. Additionally, participants in the study emphasized that the prohibition of *gharar* plays a critical role in mitigating risks associated with financial transactions. One interviewee explained:

"*By eliminating excessive uncertainty, Islamic finance promotes transparency and trust in financial transactions, which are key to maintaining financial stability*."

The combined effect of prohibiting *riba* and *gharar* creates a financial environment that is less prone to the speculative and risky behaviors that characterized the conventional financial system leading up to the 2008 crisis. This approach not only promotes financial stability but also aligns with the ethical and moral values of Islamic finance, which prioritize fairness, transparency, and social justice (Siddiqi, 2006).

In summary, the prohibition of *riba* and *gharar* in Islamic finance appeared as a significant theme in the interviews, highlighting their role in reducing speculative activities and promoting financial stability. These principles ensure that financial transactions are grounded in real economic activities and are conducted with transparency and fairness, thereby contributing to a more resilient and equitable financial system.

Emphasis on Asset-Backed Financing

Another crucial aspect highlighted was the emphasis on asset-backed financing. Islamic finance principles mandate that all financial transactions be backed by tangible assets, and all contracts must involve real, existing assets fully owned by at least one party, which inherently limits excessive risk-taking. This approach contrasts sharply with the conventional financial system's reliance on complex derivatives and speculative instruments. A participant explained:

"*Islamic finance's requirement for asset-backed transactions ensures that financial activities are grounded in real economic value, thereby reducing the likelihood of financial bubbles.*"

The underlining on asset-backed financing, promotes financial stability and also aligns financial activities with the real economy. This alignment is crucial in mitigating the risks associated with financialization, where financial motives and speculative activities often overshadow real economic activities (Miah & Suzuki, 2015). By ensuring that transactions are tied to tangible assets, Islamic finance can permanently reduce the exposure to speculative risks and financial shocks, which were significant contributors to the 2008 financial crisis.

Moreover, asset-backed financing fosters a more ethical and socially responsible financial environment. As one interviewee noted:

"*Shariah compliant products are very secure and safe for the economy and the world.*"

This statement emphasizes the broader impact of Islamic finance principles on market stability and ethical behavior. Moreover, the requirement for tangible asset backing ensures that financial transactions contribute to real economic growth, rather than merely generating speculative profits (Miah & Suzuki, 2015). In addition, the asset-backed nature of Islamic finance transactions promotes transparency and reduces information asymmetry between

parties (Siddiqi, 2006). This transparency is vital in building trust and ensuring that all parties are fully aware of the underlying assets and associated risks. As another participant highlighted:

"*Islamic finance must be a socially responsible player in the market*", supporting the idea that ethical and socially responsible thinking is central to Islamic banking and finance.

Overall, the emphasis on asset-backed financing in Islamic finance not only limits excessive risk-taking but also promotes a more stable, transparent, and ethical financial system. This approach offers a practical alternative to conventional financial practices, which often prioritize short-term gains over long-term stability and ethical considerations.

4.1.2 Profit-Sharing Models

Mudarabah and Musharakah

The interviews also noted the importance of profit-sharing models such as *Mudarabah* and *Musharakah*. These models promote risk-sharing between parties, aligning their interests and building a more stable financial environment. One expert stated:

"*Profit-sharing mechanisms like Mudarabah and Musharakah align the interests of investors and entrepreneurs, reducing the incentive for excessive risk-taking that was prevalent in the conventional system during the 2008 crisis.*"

As explained in the previous sections of this paper, *Mudarabah* is a profit-sharing and loss-bearing contract where one party, the financier (*rabb-ul-mal*), provides the capital, while the other party, the entrepreneur (*mudarib*), contributes expertise and management (Hussain et al. 2016). Profits are shared according to a pre-agreed ratio, but any losses are borne solely by the financier unless they result from the entrepreneur's negligence or misconduct (Hussain et al. 2016). This structure encourages cautious management and diligent effort from the entrepreneur, as their compensation is directly tied to the venture's success.

Similarly, *Musharakah* is a joint venture where all partners contribute capital and share profits and losses in proportion to their investment (Hussain et al. 2016). This model

promotes a collaborative environment where both parties are equally invested in the venture's success. As one participant noted:

"*Musharakah ensures that both investors and entrepreneurs have skin in the game, promoting a balanced approach to risk and reward.*"

The profit-sharing nature of these models inherently discourages speculative behavior and excessive risk-taking. By aligning the interests of all parties involved, *Mudarabah* and *Musharakah* create a more stable financial environment. This alignment is particularly significant in the context of the 2008 financial crisis, where misaligned incentives and excessive risk-taking were major contributing factors (Hussain et al. 2016).

Again, these models promote ethical and socially responsible investing. The requirement for transparency and mutual agreement on profit-sharing ratios ensures that all parties are fully aware of the terms and potential risks (Hussain et al. 2016). This transparency reduces information asymmetry and builds trust between investors and entrepreneurs. Additionally, another interviewee highlighted:

"*The ethical foundation of profit-sharing models in Islamic finance builds a culture of trust and mutual benefit, which is essential for long-term financial stability*."

In summary, the profit-sharing models of *Mudarabah* and *Musharakah* play a crucial role in promoting risk-sharing, aligning interests, and fostering a stable and ethical financial environment. These models offer a potential replacement to conventional financial practices, emphasizing collaboration, transparency, and mutual benefit.

4.1.3 Regulatory Environment

Shariah Compliance and Oversight

The role of Shariah compliance and oversight was another recurring theme in our interviews. Islamic finance operates under strict regulatory frameworks that ensure adherence to ethical principles. Participants highlighted that this regulatory environment could have mitigated the crisis by preventing the proliferation of high-risk financial products. As one interviewee mentioned:

"*The rigorous Shariah compliance and oversight in Islamic finance create a robust regulatory environment that could have prevented the widespread adoption of high-risk financial products seen in the 2008 crisis.*"

Financial products and services must be structured in a way that aligns with Shariah principles, ensuring that all transactions are ethical and socially responsible (El Tiby, 2010). This strict adherence to ethical guidelines creates a financial environment that prioritizes stability and long-term sustainability over short-term gains.

The oversight mechanisms in Islamic finance are designed to ensure that all financial activities comply with Shariah principles. This includes the establishment of Shariah boards, which are composed of scholars who review and approve financial products and services (Ahmed, 2010). These boards play a crucial role in maintaining the integrity of Islamic financial institutions by ensuring that their operations are in line with ethical standards (Ahmed, 2010). As one participant noted, *"The presence of Shariah boards adds an additional layer of scrutiny, which helps in maintaining ethical standards and preventing the introduction of high-risk financial products."*

Moreover, the regulatory environment in Islamic finance is characterized by a high degree of transparency and accountability. Financial institutions are required to disclose detailed information about their operations and financial products, which helps in building trust and confidence among stakeholders. This transparency is essential in preventing the kind of opaque and complex financial products that contributed to the 2008 financial crisis (Acharya & Richardson, 2009). As another interviewee highlighted,

"Transparency and accountability are cornerstones of Shariah compliance, ensuring that all financial activities are conducted in a fair and ethical manner."

The emphasis on ethical behavior and social responsibility in Islamic finance also extends to corporate governance. Islamic financial institutions are required to adhere to strict governance standards, which include the fair treatment of all stakeholders and the promotion of social welfare. This focus on ethical governance helps in creating a more stable and

resilient financial system, as it reduces the likelihood of unethical practices and excessive risk-taking (Aglionby, 2009).

In conclusion, the rigorous Shariah compliance and oversight mechanisms in Islamic finance play a crucial role in promoting financial stability and preventing the proliferation of high-risk financial products. By adhering to ethical principles and ensuring transparency and accountability, Islamic finance offers a robust regulatory framework that could have prevented the adverse effects of the 2008 financial crisis.

Need for Regulatory Harmonization

However, the interviews also revealed a need for harmonizing regulatory standards across different jurisdictions to ensure consistent application of Islamic finance principles globally. One participant noted:

"*While Islamic finance principles are effective, there is a need for harmonizing regulatory standards to ensure their consistent application across different countries.*"

The diversity in regulatory frameworks across various jurisdictions poses a significant challenge for the global Islamic finance industry. Each country has its own set of regulations and Shariah interpretations, which can lead to inconsistencies in the application of Islamic finance principles. This lack of uniformity can create barriers to cross-border transactions and hinder the growth of the industry (Ahmed, 2010). As one expert explained:

"*The absence of standardized regulatory frameworks can lead to differences in Shariah compliance, making it difficult for Islamic financial institutions to operate seamlessly across different regions.*"

Harmonizing regulatory standards would involve creating a unified set of guidelines that can be adopted by all jurisdictions. This would not only ensure consistent application of Islamic finance principles but also facilitate smoother cross-border transactions and enhance the industry's global competitiveness. A standardized regulatory framework would provide clarity and certainty for investors and financial institutions, thereby promoting greater confidence in the Islamic finance sector (El Tiby, 2010). Additionally, another participant highlighted:

"*A unified regulatory framework would eliminate ambiguities and create a level playing field for Islamic financial institutions worldwide.*"

Moreover, regulatory harmonization would enhance the credibility and integrity of the Islamic finance industry. By adopting a common set of standards, financial institutions can ensure that their operations are in line with globally accepted best practices. This would help in building trust among stakeholders and attracting more investors to the sector. As one interviewee noted:

"*Harmonized regulatory standards would enhance the credibility of Islamic finance, making it more attractive to both Muslim and non-Muslim investors.*"

The process of harmonizing regulatory standards would require collaboration among various stakeholders, including regulatory authorities, Shariah scholars, and industry professionals. International organizations such as the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) can play a pivotal role in this regard. These organizations can facilitate dialogue and cooperation among different jurisdictions, helping to develop and implement standardized regulatory frameworks (Aglionby, 2009).

In conclusion, the need for regulatory harmonization is crucial for the consistent application of Islamic finance principles globally. By creating a unified set of guidelines, the industry can overcome the challenges posed by diverse regulatory frameworks and enhance its global competitiveness. This would not only promote greater confidence in the sector but also contribute to its long-term growth and stability.

4.1.5 Systemic Resilience

Inherent Resilience of Islamic Finance

Furthermore, the inherent resilience of Islamic finance, derived from its risk-averse and ethical principles, was also a recurring theme. The interviewees stated that these principles promote long-term stability. One interviewee stated:

"*The inherent resilience of Islamic finance, with its emphasis on ethical practices and risk aversion, promotes long-term stability and could have mitigated the impact of the 2008 financial crisis.*"

Islamic finance operates on a foundation of risk-sharing and ethical guidelines, which inherently promote a more stable financial environment. This risk-averse approach minimizes the likelihood of speculative bubbles and financial instability, which were significant factors in the 2008 financial crisis (Ahmed, 2010). As one participant noted,

"*The avoidance of interest and excessive uncertainty in Islamic finance creates a more predictable and stable financial system.*"

Moreover, the ethical principles of Islamic finance mandate that financial activities must contribute to the real economy and societal well-being.. As another interviewee highlighted:

"*The ethical framework of Islamic finance not only promotes financial stability but also ensures that financial activities are aligned with societal values and sustainable development goals.*"

This focus on ethical investments and social responsibility ensures that Islamic financial institutions engage in activities that are beneficial to society and sustainable in the long term (El Tiby, 2010).

The profit-and-loss sharing mechanisms in Islamic finance also contribute to its inherent resilience. By aligning the interests of both the financier and the entrepreneur, these

mechanisms encourage financial behavior and risk management to be more careful.As one expert explained,:

"*Profit-and-loss sharing arrangements in Islamic finance create a more resilient financial system by promoting responsible risk-taking and aligning the interests of all parties involved.*"

This alignment reduces the likelihood of defaults and financial distress, thereby enhancing the overall stability of the financial system (Aglionby, 2009). Moreover, the strict regulatory oversight and Shariah compliance requirements in Islamic finance further enhance its resilience. Islamic financial institutions are subject to rigorous scrutiny to ensure that their operations adhere to Shariah principles. This regulatory framework promotes transparency, accountability, and ethical conduct, which are essential for maintaining financial stability (El Tiby, 2010). As one participant noted:

"*The Shariah board has authority to terminate the venture's contracts regardless of the stage of the business. Accordingly, these strict regulatory and Shariah compliance requirements in Islamic finance ensure that financial institutions operate in a transparent and accountable manner, thereby enhancing their resilience.*"

In conclusion, the inherent resilience of Islamic finance, derived from its risk-averse and ethical principles, plays a crucial role in promoting long-term stability. By avoiding interest and excessive uncertainty, focusing on ethical investments, and implementing profit-and-loss sharing mechanisms, Islamic finance creates a more stable and resilient financial system. These principles not only mitigate the impact of financial crises but also contribute to the overall sustainability and ethical conduct of the financial industry.

Post-Crisis Adaptation and Learning

Lastly, the interviews also noted that there was minimal direct impact of the crisis on Islamic banks, reinforcing the effectiveness of Shariah-compliant practices. This has led to increased interest and adoption of Islamic finance principles in the post-crisis period. As one participant noted:

"*The minimal impact of the 2008 crisis on Islamic banks has reinforced the effectiveness of Shariah-compliant practices, leading to increased interest and adoption in the post-crisis period.*"

The resilience demonstrated by Islamic banks during the 2008 financial crisis has led to a reevaluation of financial practices globally. The crisis underscored the vulnerabilities within the conventional financial system, characterized by excessive risk-taking and speculative activities (Chapra, 2008). In contrast, the stability of Islamic banks, rooted in Shariah-compliant principles, has gathered significant attention and interest from both financial institutions and regulators seeking more sustainable financial models (Iqbal & Mirakhor, 2011).

The post-crisis period has seen a growing interest in the ethical and risk-averse principles of Islamic finance. Financial institutions and policymakers are increasingly recognizing the potential of these principles to enhance financial stability and prevent future crises. This has led to the adoption of Islamic finance practices in various regions, including non-Muslim-majority countries, as part of broader efforts to reform the financial system (Warde, 2010). As one participant noted:

"*The effectiveness of Shariah-compliant practices after the crisis has spiked interest in Islamic finance globally, leading to its adoption in diverse financial markets. I'm working on a company where we're trying to implement some banks which follow Islamic finance principles in non-muslim countries*"

Moreover, the crisis has prompted Islamic financial institutions to further refine and strengthen their practices. The increased investigation and high interest have led to innovations in Shariah-compliant financial products and services, aimed at meeting the evolving needs of the market while adhering to ethical and risk-averse principles (Siddiqi, 2009). Accordingly, another interviewee emphasized:

"*The post-crisis period has been marked by significant innovation in Islamic finance, with institutions developing new products that align with Shariah principles and address market demands.*"

The regulatory environment has also evolved in response to the crisis, with greater emphasis on compliance. Since Islamic financial institutions are subject to strict regulatory frameworks, they ensure adherence to Shariah principles and promote transparency and accountability (Hassan & Lewis, 2005). This regulatory rigor has further reinforced the stability and resilience of Islamic banks, making them an attractive model for financial reform. In addition to this, another one expert stated:

"*The strong regulatory oversight in Islamic finance has been a key factor in its resilience, and this has been increasingly recognized in the post-crisis period.*"

Lastly, it can be confirmed that the post-crisis period has seen significant adaptation and learning, with innovations in financial products, enhanced regulatory frameworks, and a growing recognition of the potential of Islamic finance to promote long-term stability and prevent future crises (Siddiqi, 2009).

4.1.6 Summary of the Results

The systematic analysis of the interviews with experts in Islamic finance have contributed significantly to the potential of Islamic finance principles in preventing financial crises and fostering long-term economic stability. A prominent theme that emerged from our discussions is the emphasis on ethical and asset-backed financing. Unlike the speculative practices that played a major role in the crisis within conventional finance, Islamic finance principles focus on ethical investments and transactions backed by tangible assets. The prohibition of *riba* (interest), *gharar* (excessive uncertainty), and *maysir* (gambling) ensures that financial activities are built in real economic value and ethical considerations. This approach not only mitigates the risks associated with speculative bubbles but also encourages a more stable and resilient financial system.

Our interviewees also highlighted the importance of profit-sharing models and risk-sharing mechanisms inherent in Islamic finance. These models promote financial stability by aligning the interests of all parties involved and ensuring a more equal distribution of wealth. Therefore, by sharing profits and losses, Islamic finance institutions create a more balanced and sustainable economic environment, reducing the likelihood of systemic failures.

Another significant theme is the role of transparency and accountability in fostering trust and resilience within financial institutions. Adherence to Shariah principles instills a sense of moral responsibility among practitioners, ensuring that financial transactions are conducted with integrity and transparency. This ethical framework enhances the credibility of Islamic finance institutions and contributes to the overall stability of the financial system.

The strong regulatory oversight in Islamic finance has also been recognized as a key factor in its resilience. The post-crisis period has seen significant adaptation and learning, with innovations in financial products and enhanced regulatory frameworks. The minimal impact of the 2008 crisis on Islamic banks has reinforced the effectiveness of Shariah-compliant practices, leading to increased interest and adoption of Islamic finance principles.

In conclusion, the resilience of Islamic finance, derived from its risk-averse and ethical principles, plays a crucial role in promoting long-term stability. By avoiding interest and excessive uncertainty, focusing on ethical investments, and implementing profit-and-loss sharing mechanisms, Islamic finance creates a more stable financial system. Lastly, the findings from the interviews highlight the potential of Islamic finance to offer an effective framework for mitigating future financial crises and promoting sustainable economic growth. As the global financial landscape continues to evolve, the principles and practices of Islamic finance hold promise for facilitating a more stable and ethical financial system.

5. Discussion

In this section, the themes from the interviews will be analyzed and discussed in relation to past literature. Additionally, this section will include the key themes found from the interviews in relation to the agency theory, financialization and ethical implications.

5.1.1 Relationships Built on Morals and Ethics

As seen in conventional finance, IF investors (principals) use control rights to ensure that agents act in the principals best interest (Ahmed & Aassouli, 2022). However, IF operates on principles distinct from conventional finance, incorporating ethical, moral, and religious dimensions derived from Shariah law, which profoundly impact the structure and operation of

financial contracts, particularly in addressing agency problems. This means that IF has mechanisms that differ from their conventional counterparts.

This study set out to assess the impact of Islamic finance on crisis prevention in interest-based markets. Previous studies highlight the evidence of misalignment of moral hazard and information asymmetry during the 2008 financial crisis. Conventional finance practices, driven by short-term gains and speculative activities led to a systematic failure (Coffee, 2009; Lewis et al. 2010; Acharya & Richardson, 2009; Tridico & Pariboni, 2018). Furthermore, Islamic Finance, being grounded in Shariah principles, demonstrated resilience, and did not suffer from the same consequences during the crisis (Hussien et al. 2019). None of the Islamic banks interviewed suffered direct losses due to the 2008 financial crisis as they " have zero investments that are subprime" (All respondents). However, as the 2008 financial crisis affected the world economy, the Qatari respondent mentioned: "*it affected our market, because, when that crisis hit real estate, it reflected on the whole sectors, in all the globe. We have assets in the local market. So the market value of the real estate impacted from that.*" The respondent noted that the 2008 financial crisis significantly impacted the Qatari Islamic financial institution, primarily through its effect on the local market. Since the institution deals with "real assets," this market disruption directly affected its operations. However, this effect was not significant enough to cause the bank serious liquidity issues.

Extensive research on the topic (Zhu et al, 2019) and all the respondents highlighted that greed is in the nature of man and, as mentioned by previous literature (Ahmed & Aassouli, 2022), a fundamental root of the crisis. The respondents stressed that if this greed is not contained by ethical and moral standards, a misalignment of interests' is only a question of time. Problems outlined in agency theory are bound to arise, as individuals will act in their own favor if their actions have no consequences. Although a regulatory framework exists within conventional banking, it has proven inadequate in preventing speculative practices, "*(...) unfortunately, human beings are greedy. And if you show them benefits, they will do whatsoever to get that benefit. He doesn't care about that, unfortunately, as long as there is no ethics and there is no government governance and there is no something that will stop them from doing it (talking about leading the market with misleading products)*". All respondents made this same point. Islamic Finance being rooted in Shariah principles, encompasses morals and ethics based on halal (permitmitted) and haram (sin/not permitted) (Aljifri & Khandelwal, 2013). Moreover, all respondents stressed how the belief in the

afterlife and the Day of Judgement act as a moral compass as they do not want to commit acts that they cannot defend in front of God. They stressed that the basics of Islamic finance is rooted in such beliefs. However, a Qatari respondent mentioned human beings are forgetful by nature, "*And unfortunately, people, they have a short memory, because in a couple of years, he will forget and will do it again. By nature, human beings are too greedy*". Thus, the internal moral compass is not sufficient enough to make people act in ethically and morally correct manners.

Therefore, the system of Islamic finance is built around these considerations. All respondents explained how the concept of moral hazard is mitigated through Profit-and-Loss sharing contracts like *Mudarabah* and *Musharakah*. IF also stresses the importance of benefit maximization for the maximum of stakeholders, here the profit and loss sharing (PLS) nature of IF contracts plays a pivotal role by dissauding agents and principles from acting in a dishonest way as they share both rewards and failures on a pro-rata basis (Ismail & Ahmad, 2006). A Bosnian respondent mentioned, "*The other aspect of Islamic finance principles is there must be some profit sharing.*" Furthermore, all respondents mentioned that Islamic finance utilizes "real assets". IF mandates that all financial transactions must be backed by tangible, real assets. When the outcomes are shared, both parties tend to be more cautious and collaborative in their decision making, as mentioned by the Islamic finance expert interviewee:

"*Profit-sharing mechanisms like Mudarabah and Musharakah align the interests of investors and entrepreneurs, reducing the incentive for excessive risk-taking that was prevalent in the conventional system during the 2008 crisis.*"

While performance based contracts are no stranger to conventional finance, the almost omnipresence of the PLS concept that one finds in IF sets Islamic banks apart from conventional ones.

IF reduces the risk of information asymmetry through the role of the Shariah Supervisory Boards (SSB). A significant difference between conventional finance and IF is the existence of the Shariah Supervisory Board (SSB). The SSB is fundamental in mitigating agency problems in IF through two key functions. First, the SSB serves as an important monitoring entity, which aims to reduce information asymmetry and enhance transparency by requiring access to the same level of information as managers (Ahmed & Aassouli, 2022). The access

to information is of utmost importance as, secondly, the SSB also oversees all activities to ensure compliance with Shariah principles. In order for an activity to be Shariah compliant, it cannot go against the ethical framework traced by the islamic principles, such as those of fairness and justice, this aims to reduce problems of moral hazard (Aljifri & Khandelwal, 2013; Ahmed & Aassouli, 2022).

Some respondents have experience within such boards. One respondent was especially in favor of the SSB, as they act as a strict governing mechanism that can nullify a contract during any period of its life cycle, if it is deemed incompliant with Shariah standards (Ayub, 2007). This idea could work as a factor to keep agents and principles in check as they can suffer great economic losses in the case of nullification of their contracts. Conventional banks are usually bound by regulatory frameworks of the countries or areas in which they operate, similarly different countries have their own SSB boards.

Moreover, a mechanism mentioned by all our respondents is the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). The AAOIFI works as an additional regulatory framework, on top of the SSB, much like auditing in conventional finance. Extra means of regulation aid at ensuring minimization of moral hazard and information asymmetry.

A critique by the Islamic finance expert is that the SSBs currently operates under few different standards in various countries, but there is an increasing need to unify these regulatory frameworks. Achieving such harmonization can improve the stability and resilience of the global financial system. IF has stronger regulatory frameworks in place compared to conventional financial institutions. Whilst the SSBs and AAOIFI showed significant crisis resilience in 2008 specifically, it could be enhanced through harmonization. Moreover, enhancement of the regulatory framework within conventional banking, as a start, could be deemed plausible as it already has it in place to some extent. As narrated by an Islamic finance expert, "*Harmonized regulatory standards would enhance the credibility of Islamic finance, making it more attractive to both Muslim and non-Muslim investors.*"

Nonetheless, moral hazard is a concern in IF because of the leniency often shown to debtors who are struggling to repay their loans. This leniency is rooted in the ethical and compassionate principles of Islamic law, which aim to help those in genuine financial

difficulty. However, it can also be exploited by those who might pretend to be in trouble to avoid repayment. The challenge is being able to distinguish between debtors who truly deserve help and those who are trying to cheat the system (Hassan & Kayed, 2009).

In conclusion, a systemic analysis of agency theory in the context of both conventional and Islamic finance, during the 2008 crisis, highlights the potential benefits of incorporating ethical and risk-averse practices into the broader financial system. Islamic Finance (IF) is not immune to agency conflicts, but it incorporates its own mechanisms to address these issues, with its emphasis on Shariah compliance, ethical investments, PLS contracts, and real asset-backed transactions. These mechanisms offer a resilient model for preventing financial crises. The integration of moral and ethical dimensions into financial practices, as exemplified by Islamic finance, provides a pathway to a more stable and sustainable financial system. Consequently, the insights gained suggest that adopting similar principles in conventional finance could promote long-term stability and prevent future crises.

5.1.2 Financial Stability through IF

The 2008 financial crisis serves as a very important case study for examining the implications of financialization and the potential stabilizing role of Islamic finance (IF). Financialization as a trend that gained momentum in the late 1970s, has profoundly reshaped economic and social systems by prioritizing financial motives, markets, actors, and institutions over traditional economic activities (Epstein, 2005; Davis & Kim, 2015). This shift has been criticized for contributing to income inequality, creating financial bubbles, and ultimately leading to economic crises (Tridico & Pariboni, 2018; Miah & Suzuki, 2015). The findings from our study, which involved detailed interviews with experts in Islamic finance, provide a nuanced understanding of the resilience of Islamic financial institutions during the 2008 financial crisis.

Our study highlights that Islamic banks manifested a remarkable degree of resilience during the 2008 financial crisis. Most of the interviewees noted that the resilience of IF can be attributed to its core principles as mentioned previously. According to Islamic finance experts we interviewed, these principles promote a more stable and risk-averse financial environment. Additionally, the literature also supports this view, highlighting that Islamic financial institutions were less affected by the crisis compared to their conventional

counterparts (Luo & Wang, 2023). As a result, during the 2008 crisis, the prohibition of *riba* prevented Islamic banks from engaging in the high-risk mortgage lending and securitization practices that were central to the crisis (Jickling, 2009; Lewis et al., 2010).

The theory of financialization, which describes the increasing dominance of financial motives, financial markets, financial actors, and financial institutions in the economy, played a significant role in the 2008 crisis (Archarya & Richardson, 2009). The results section supports the aspect that excessive financialization contributed to economic instability. In contrast, Islamic finance principles emphasize asset-backed financing and risk-sharing, which essentially limit the extent of financialization and its associated risks. This alignment with real economic activities and the avoidance of speculative practices provided a shield against the financial shocks experienced during the crisis.

Our study also found that Islamic financial institutions responded differently to the challenges posed by the 2008 financial crisis compared to conventional banks. Islamic banks focused on maintaining liquidity and supporting their clients through asset-based and equity-based financing methods. This approach contrasts with the conventional banks' reliance on government bailouts and monetary interventions. The literature confirms these findings, noting that Islamic banks' emphasis on real economic transactions and risk-sharing mechanisms contributed to their relative stability during the crisis (Hasan & Dridi, 2010).

Furthermore, by adopting certain Islamic finance principles, such as risk-sharing, ethical investment, and asset-backed financing, conventional banks could enhance their stability and resilience against future financial crises. This perspective is also reflected in the literature, which calls for a reevaluation of financial practices and a move towards more sustainable and equitable financial systems (Melvin & Taylor, 2009). The integration of ethical considerations and the alignment of financial activities with real economic outcomes could mitigate the adverse effects of financialization and promote long-term economic stability.

Looking ahead, the ongoing global economic challenges and the rise in Islamophobia present both opportunities and challenges for the growth of Islamic finance. Additionally, one interviewee specifically noted that one of the projects he was part of was shut down precisely due to the existing hostility towards Islam. However, our study suggests that the inherent stability and ethical foundation of Islamic finance could position it as a viable alternative to

conventional finance, particularly in regions seeking to mitigate the risks of financialization. The literature supports this view, highlighting the potential for Islamic finance to contribute to financial inclusion, economic development, and social justice (El-Gamal, 2006; Siddiqi, 2006).

In conclusion, the integration of our study's results with the literature and financialization theory emphasizes the potential of Islamic finance principles to prevent financial crises. By promoting ethical, transparent, and risk-averse financial practices, Islamic finance offers a powerful framework for achieving long-term economic stability. The lessons learned from the 2008 financial crisis highlight the need for a more balanced and ethical approach to finance, one that aligns financial activities with real economic outcomes and prioritizes the well-being of society as a whole.

5.1.3 Ethical Implications in Islamic Finance

The results from the interviews and the literature review support the idea that Islamic finance (IF) is a more ethical approach to conducting business. This ethical framework aligns with the theory of Corporate Social Responsibility (CSR) as outlined by Carroll (2009) and further supported by Berkey (2021). The convergence of CSR and IF is essential for understanding how ethical frameworks can be effectively applied in financial practices. Our systematic analysis reveals that Islamic finance principles inherently reflect CSR dimensions by prohibiting interest (*riba*) and excessive uncertainty (*gharar*), promoting asset-backed financing, and emphasizing profit-sharing mechanisms. IF also embodies the goals that Berkey put forward in his 2021 paper, in which he stated that corporations should adopt policies aligning with principles of justice, including ensuring fair opportunities and reducing inequalities. These principles ensure that financial transactions are grounded in real economic activities, fostering long-term stability and ethical behavior, which are critical components of CSR.

One of the main themes from the interviews was the emphasis on real asset-based investments, which left Islamic banking institutions less exposed to speculative risk. This stands in contrast to conventional banks, which were heavily involved in speculation and thus more unstable and vulnerable due to high leverage and speculative activities. An interviewee highlighted this by stating, “Shariah compliant products are very secure and safe for the

economy, to the world". The integration of real asset-based investments, combined with the ethical framework imposed by Shariah law, lead to market stability through cautious practices, limiting exposure to financial shocks and systemic risks. Another interviewee noted, "Islamic finance must be a socially responsible player in the market," reinforcing the idea that ethical and socially responsible thinking is central to Islamic banking and finance.

This ethical framework aligns with Carroll's (2009) CSR model, which encompasses economic, legal, ethical, and philanthropic responsibilities. The commitment of Islamic finance to ethical practices provided a buffer against the 2009 financial crisis's impacts, as speculative activities were minimized. One interviewee mentioned, "The banks which were exposed, were highly speculative in nature." This demonstrates how profit motives in Islamic banking cannot be separated from ethical and socially responsible thinking.

The role of the Shariah Supervisory Board emerged as another critical theme. Strict adherence to its guidelines ensures that Islamic finance operates according to Islamic law and the principles of Islamic moral economy, which emphasize fairness, transparency, and the avoidance of harm. Additionally, IF does not allow any business to be conducted surrounding activities which are considered harmful such as alcohol, pornography and weaponry (Oxera, 2007). An interviewee stated, "Islamic finance operates according to Islamic law and principles of Islamic moral economy, which emphasizes fairness, transparency, and the avoidance of harm, such as avoiding interest (usury) and investing in businesses that provide social benefit while avoiding those that are harmful or unethical."

As theorized by Carroll, Islamic finance demonstrates that adding an effective layer of corporate governance significantly enhances the sustainability of CSR initiatives. The Shariah board's oversight reduces excessive risk-taking and unethical behavior, creating a stabilizing effect contrasting with the speculative nature of the conventional finance system that contributed to the 2008 financial crisis. Another interviewee emphasized, "We need ethics and values, Shariah compliance values, to keep the environment and business safe."

The ethical aspect of IF principles was also a focal point. Ethical banking practices in Islamic finance emphasize social welfare and customer well-being, contributing to overall financial system stability by avoiding practices that could harm individuals or communities. An interviewee explained, "Islamic banks must pay attention to the well-being of their clients. It

should not compromise on those to achieve profitability." This reflects the CSR objective of balancing stakeholder interests and ensuring fair opportunities, as emphasized by Carroll (2009). The emphasis on social justice in Islamic finance aligns with the broader CSR objectives of promoting fairness and reducing inequalities (Hassan & Kayed, 2009).

IF aspires to promote an economy that sustains all members of society, similarly to CSR, which aims to maximize benefits for a maximum of shareholders. One way this can be observed is through the importance placed on philanthropy for IF institutions. Mechanisms such as Zakat, a compulsory financial act that promotes charity for the needy and Sadaqah, a voluntary action of various kinds - not necessarily financial - that encourages the help towards others; ensure wealth distribution and support for the needy (Hassan, Abdul Latiff, 2009).

The principle of Profit and Loss Sharing (PLS) in Islamic finance ensures that profits are earned only if risk is also borne, reducing the potential for exploitation and promoting equitable wealth distribution. This principle resonates with CSR's goals of fairness and ethical conduct. Another interviewee stated, "Islamic banks and finance are much better at implementing social justice principles than other banks. The overall general principle for Islamic bank and finance is to consider this responsibility for social justice and ethical framework as a basis for all dealings."

The systematic analysis provides comprehensive insights into how Islamic finance principles, regulatory environments, and market behaviors align with the theoretical framework of CSR. The emphasis on ethical practices, asset-backed transactions, and strict regulatory oversight in Islamic finance not only promotes financial stability but also reflects a commitment to social responsibility and ethical governance. Integrating these principles into the broader financial system can enhance overall stability and resilience, underscoring the potential benefits of adopting CSR practices in financial institutions. The interviews conducted confirm the ideas presented by Carroll and Berkey, who argue that businesses need to be more ethical. Increasing the integration of Islamic finance principles into the broader financial system could enhance overall stability and resilience. The practical implications of these findings are significant for the banking industry. Following the Islamic framework, financial institutions can adopt asset-backed financing and profit-sharing mechanisms to enhance stability and ensure fair wealth distribution. Additionally, incorporating

Shariah-based governance frameworks can improve transparency and accountability within financial markets.

Furthermore, IF's approach to fiance aims to free future generations from debt, extending the traditional definition of sustainable development—'meeting the needs of the present without compromising the ability of future generations to meet their own needs' (Brundtland Commission, United Nations, 1987)—by emphasizing economic sustainability (Hassan & Kayed, 2009).

6. Conclusion

This final section will serve to summarize the main points of the paper and will discuss to what extent our research has been capable of answering our research question.
Following that, limitations and generalizability will be elaborated further. Lastly, to conclude the paper, recommendations for future research will be introduced.

To sum up, after thoroughly researching the existing literature and conducting the interviews with Islamic finance experts, it can be clearly stated that Islamic finance principles can undoubtedly be used in financial frameworks so that future financial crises can be significantly prevented.

6.1 Summary of main points

While emphasizing the potential of Islamic finance principles in forming a more resilient and ethical financial system, this paper has contributed in exploring the diverse implications of the 2008 crisis. Our research began by identifying the sensitive global finance practices, vulnerable to excessive financialization and speculative activity. By comparing conventional banking practices with those of Islamic finance, this paper highlights the distinctions between the two systems. It examines how these differences contribute to the resilience and stability of Islamic financial institutions.

The first part of the paper contains information which is useful to understand main Islamic finance principles and practices and how they managed to maintain stability during the 2008 financial crisis. These principles, which prohibit interest (*riba*), excessive uncertainty

(*gharar*), and speculative activities (*maysir*), inherently promote risk-sharing and asset-backed financing (Siddiqi, 2006). Moreover, with detailed insights from the practical applications and benefits of these principles, the semi-structured interviews with experts in Islamic finance contributed to a great extent in the enhancement of our study. Since we conducted semi-structured interviews, we were exposed to exploring various perspectives from each interviewee. Therefore, this has led to a rich and more comprehensive data set. Additionally, the systematic analysis of the data allowed us to observe recurring themes and subthemes, which were explained in the results section in detail. The key findings highlighted different themes of Islamic finance, which contrast sharply with the debt-driven nature of conventional finance. Accordingly, the themes we have found from coding were carefully analyzed in how they relate to one another and how they compare with conventional finance practices, therefore, supporting the idea that the IF principles can reduce the risks of financial crisis to a great extent.

In conclusion, this thesis contributes to the academic discourse on financial crisis prevention by offering an understanding of how Islamic finance principles can provide a more stable and uniform financial framework. Our study advocates for a shift towards more ethical banking practices, aiming to create a more resilient financial system capable of enduring economic shocks.

6.2 Limitations

Due to a matter of time restraint, the sample size of the research was limited to a number of Islamic financial institutions. The research could have been even more comprehensive if more Islamic financial institutions around the globe were accessed. Furthermore, respondents only agreed to partake in the research if their names and any other indicators of their identities were kept anonymous. All respondents participating in the research are still employed in Islamic financial institutions and planning on continuing their career in that direction, meaning they do not wish to jeopardize their careers by openly being critical. Such hesitance showed to be a recurring obstacle when finding respondents in general. However, the promise of anonymity diminished such reluctance, and all respondents answered the questions to the best of their abilities.

Furthermore, the researchers wished to interview several representatives from each institution to enhance validity and reliability in turn, however, this was not possible for all institutions. Thus, the method of cross-examination through triangulation of the respondents' answers was possible with most but not all respondents. However, the Islamic financial expert was especially utilized to cross-examine singular respondents from some institutions.

Moreover, it can be argued that the data collection method hinders accuracy of results. The preferred data collection method was interviews, which are limited to the statements of the respondent and respondents could potentially be recalling some aspects incorrectly or forgotten it all together. Thus, triangulation could be further emphasized if time allows for more interviews. However, secondary data was used to enhance accuracy of statements and triangulation of the respondents was conducted, but with respondents from different financial institutions.

Additionally, bias is a limitation brought forward by both the researcher and the respondents. Researcher bias might be present in paper. The researchers asked their peers to read the research and provide feedback to minimize researcher bias.

6.3 Generalizability

The research method employed, qualitative case study approach, is described as non-generalizable by Bell et al (2019), as the case study approach makes the results subjective to one specific case, if longitudinal approach is not utilized. However, it can be said that these research papers' results are not limited to the 2008 financial crisis only. In essence, it is a critique of the capitalistic financial system as a whole. The conclusion drawn from the research indicates that the capitalist financial system is insufficient and unsustainable. Whilst, IF is posed as a sustainable alternative to be employed. Thus, the data and results can be utilized to assess previous financial crises and other situations that call for alternative financial systems.

6.4 Wider Implications and Future Research

Based on our research, several key recommendations have emerged to foster a more stable and ethical financial system. Firstly, to prevent financial crises driven by greed, ethical practices need to be emphasized and promoted. Integrating the ethical and socially

responsible frameworks present in Islamic finance into conventional banking can be a significant step forward. Although Corporate Social Responsibility (CSR) already exists, it should take on a more central role. Emphasizing risk-sharing and transparency can further promote economic stability.

Secondly, banks should shift their focus away from interest-based practices towards the real economy. These principles can contribute to a more stable and crisis-resistant financial system. Regulators should enhance oversight mechanisms; existing ones like the SEC should be strengthened to ensure greater transparency and accountability.
The growing demand for ethical banking and a return to the real economy highlights the need for innovation. Adopting the proven principles of Islamic finance can serve as an effective strategy. Education plays a crucial role in this transition, as there is often apprehension about anything labeled "Shariah" due to a lack of understanding. Educating finance students about Islamic finance principles can bridge this gap. By adopting these recommendations, stakeholders in the financial sector can leverage the principles of Islamic finance to build a more stable, ethical, and resilient global financial system.
Future research should examine the acceptance and integration of Islamic finance in non-Muslim-majority countries to reveal the potential for broader adoption and the challenges that may arise. Additionally, detailed case studies on how Islamic financial institutions manage the impact of financial crises can provide practical lessons and strategies for crisis prevention and management. Finally, researching long-term economic impacts of widespread adoption of Islamic finance principles in various regions can help to evaluate its sustainability and scalability as a global financial system.

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Appendix

Appendix 1

The table below shows the interview structure of the questions that were asked during our interview process.

Theme	Question
Background and Experience	1. To begin, can you briefly introduce yourself, what you currently do and what motivated you to pursue a career in this area?
Perceptions of the 2008 Financial Crisis	1. What were your initial reactions to the unfolding events of the 2008 financial crisis? 2. To what extent did the 2008 financial crisis impact your bank or the Islamic banking sector in general? 3. What strategies or measures did the Islamic bank implement in response to the 2008 financial crisis to ensure financial stability and business continuity? 4. Did Islamic financial institutions respond differently to the challenges posed by the 2008 financial crisis compared to conventional banks?
Role of Islamic Finance Practices	1. In your opinion, could Islamic finance principles/tools have alleviated the effects of the 2008 financial crisis, and if so, to what extent?

	2. Do ethical and socially responsible banking practices play a role within Islamic finance ?
Response Strategies and Adaptations	1. Did the crisis prompt any changes in the Islamic banking sector?
Regulatory Environment and Oversight	1. Do regulatory and governance frameworks within Islamic banking institutions significantly differ from those of conventional banks? 2. How did regulatory frameworks and oversight mechanisms governing Islamic finance institutions influence the response to the 2008 financial crisis?
Lessons Learned and Future Outlook	1. Reflecting on the 2008 financial crisis, what are the most notable lessons learned within the Islamic banking sector? 2. Looking ahead, what do you foresee as the trajectory of Islamic finance, especially considering ongoing global economic challenges and the rise in Islamophobia? 3. From your viewpoint, what lessons can other financial institutions, both

	Islamic and conventional, gain from the 2008 financial crisis?
Personal Reflections and Insights	1. Do you believe islamic banking principles could have prevented the crisis? 2. What personal insights or experiences from the 2008 financial crisis or any other financial crisis over the past couple of years have shaped your perspective on Islamic finance and its role in promoting financial stability? 3. Is there anything else you would like to share or discuss regarding your experiences during the crisis and their implications for Islamic finance?
Theories	1. Given the ongoing debate surrounding **financialization**, what role would you attribute to financialization in contributing to the 2008 financial crisis? Specifically, how do you perceive the impact of excessive financialization on economic stability during that period? 2. In your view, how effectively do Islamic finance principles address **agency problems** inherent in

	financial institutions, such as conflicts of interest and moral hazard?

Appendix 2

Authorship Statement

This thesis is the original work of us, conducted under the guidance and supervision of Liesel Klemcke, at Lund University. The research, analysis, and writing were carried out solely by us, ensuring the integrity and authenticity of the work presented here.
The conceptualization of the research topic, formulation of research questions, the literature review and development of the methodology were independently undertaken by us. Data collection, including the design and execution of semi-structured interviews, was meticulously performed by us, following ethical standards and academic rules. Furthermore, the analysis of the collected data, including the systemic coding and thematic exploration, was conducted by us. The insights and conclusions drawn from this analysis are the result of our critical thinking and academic interpretation.

While the AI tool ChatGPT was used for inspiration and refinement purposes, as detailed in the AI Usage Statement below, all intellectual content, including the synthesis of literature, interpretation of results, and formulation of conclusions, was independently developed by the author. The AI's role was limited to only enhancing the clarity, coherence, and grammatical accuracy of the text.

AI usage Statement

When writing this thesis, the AI tool ChatGPT was used to enhance various aspects of the writing process. ChatGPT was used as a source of **inspiration** when determining the overall structure of the paper and identifying the main points that should be included. This was useful in organizing the content in a coherent and a logical structure. Additionally, AI was helpful in **improving** parts of sentences to ensure better grammar and readability. This included finding more appropriate synonyms and enhancing the overall flow of the text.

ChatGPT also provided valuable inspiration on how to approach the analysis of the results. The suggested structure included identifying important points and principles from the data, making the sections more distinctive by using clear titles and subheadings, following these points and principles with direct quotes from the interviews to provide evidence and context, analyzing whether the themes identified in the literature review support these quotes, and summarizing each section with a paragraph to ensure a clearer understanding of the subheadings. The entire results section, particularly the key themes, was **structured** following this approach. This methodical structure facilitated a comprehensive and systematic analysis of the data, ensuring that the findings were presented in a clear and organized manner. Furthermore, at no point did AI contribute in writing paragraphs and sentences. Again, it is important to note that it was used solely for inspiration and refinement purposes, and **all intellectual content and analysis were conducted independently by us, the authors.**

Furthermore, AI software TurboScribe was utilized to transcribe the video interviews conducted. The transcripts were thoroughly checked through and modified to ensure all information was valid and true.