

Achieving Islamic Social Finance Goals through Zakat, Waqf, and Sadaqa in Selected Countries: Issues and Challenges

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Abstract: Islamic Social Finance is an important area of growth similar to Islamic Finance. However, there has been limited study to discover its potential as it is at its nascent stage. The purpose of this study is to investigate how Zakat, Waqf, and Sadaqa can contribute to the development of Islamic Social Finance. This study utilized content analysis to evaluate the issues and challenges of achieving Islamic Social finance goals from the secondary resources. The results would provide us an opportunity to further develop the potential of Islamic Social Finance in enhancing the society and wellbeing of the Ummah.

1 INTRODUCTION

1.1 Background

Social issues currently have been taken into main consideration by all countries of the world. Despite several programs that have been applied by the countries for many years, there are issues that remain inevitable such as poverty, lack of food and clean drinking water, lack of education and lack of property (UNDP, 2019). World Bank (2019a) also stated that the pertinent climate change has been annoying to various dimensions of lives, namely social wellbeing, sustainable economic and environmental preservation of current and future generations. Furthermore, lack of clean water sources and sanitation are afflicting almost 38.5 million people in Pakistan during 2004-2005 (Khan & Javed, 2007).

Realising the significance in addressing the social issues above, Islamic Social Finance (ISF) is considered as a sector with a vast potential in solving these issues (Zain & Ali, 2018). Moreover, it provides an alternative approach to the Muslim society in improving social welfare and the better environment which is operated based on Shariah compliant (Shahwan *et al.*, 2018). Simultaneously, the awakening spirit of green finance globally as a part of ISF instrument are able to enhance the role of ISF in contributing to the development of social wellbeing (World Bank, 2019a).

The ISF concept has existed since the early days of Islam and its role has developed over time. This sector consists of several institutions based on philanthropy such as Zakat, Waqf and Sadaqa as well as profit and non-profit Islamic microfinance (IRTI, 2014). Later on it developed from its traditional form to be financial instruments such as green Sukuk and Takaful with the goals of overcoming humanitarian crisis at varying dimension (Zain & Ali, 2018).

Importantly, Zakat and Waqf are most widely used as ISF instruments to address the marginalization and vulnerability in the society. For instance, Atah *et al.* (2018) found in their study that Zakat generated significant contribution in achieving SDGs goals, namely no poverty, zero hunger, good health and wellbeing, quality education, decent work, reduced inequality, preserving from environmental pollution and degradation. In addition, the Islamic Development Bank has exhibited that the total Zakat collected is in huge amount approximately between US\$230 and US\$560 billion each year all over the world (UNDP, 2018b). At the same time, as long as generating environmental benefits are concerns, the green bonds globally have proven its potential in achieving ISF goals with the total issuance amounting to around US\$155.5 billion in 2017 (World Bank, 2019a).

Nonetheless, the use of financial instrument for ISF such as Zakat, Waqf, Sadaqa, Sukuk, and Takaful are facing several issues and challenges affecting its effectiveness in achieving ISF goals. It is hampered mostly by the issue of sustainability in the supply of

funds and the absence of comprehensive regulatory and policy frameworks (IRTI,2014).

This paper is organized as follows. The literature review is after the introduction. This will be followed by the statement of the problem. Then, the discussion section ending with conclusion and recommendation.

1.2 Statement of the Problem

The development of Islamic Social Finance has exhibited an impressive advancement in the last decades. Zakat, Waqf, and Sadaqa are the most important instruments with the purpose of achieving ISF goals such as combating social problems and enhancing the welfare of the Ummah in the future. However, despite being a significant tool of ISF, they are facing difficulties of having sufficient funding, comprehensive regulatory and policy frameworks and professional human resources. Furthermore, there are different practices adopted by ISF in various countries. Hence, it is very important to find out the issues faced by ISF. In addition, there is also a need to know the practices that are being adopted in three selected countries such as Malaysia, Indonesia and Pakistan to better understand the involvements of ISF and evaluate the extent to which its goals have been achieved.

1.3 Research Objectives

1. To find out the issues and challenges of Zakat, Waqf, and Sadaqa in contributing to the development Islamic Social Finance.
2. To evaluate the extend of Zakat, Waqf, and Sadaqa has achieved Islamic Social Finance goals.

1.4 Research Questions

1. What are the issues and challenges of Zakat, Waqf, and Sadaqa in contributing to the development Islamic Social Finance?
2. What are the extend of Zakat, Waqf, and Sadaqa has achieved Islamic Social Finance goals?

1.5 Significant of the Study

This study contributes to the literature on the Islamic social finance field which is still in the infancy stages. It also enhances Sustainable Development Goals (SDGs) and Environmental Social Governance (ESG) literatures with new body of knowledge. This study also enables Islamic Social Finance institutions

to renew its strength and improve its weakness by implementing the suggested solutions affecting its operations. Furthermore, the experience of three countries namely Indonesia, Malaysia and Pakistan are shared to benefit researchers.

2 LITERATURE REVIEW

2.1 The Islamic Social Finance Revolution

The concept of ISF begun in the early history of Islam and has grown tremendously since last decade, with its scope becomes broader than the initial sphere. It provided financial assistance in various dimensions of life for achieving ISF goals such as eradicating poverty, providing better infrastructure of school and hospital, preserving communities and the environment (Zain & Ali, 2018).

Subsequently, the ISF revolution begun along with the financial industry revolution. The structure of ISF has been grown rapidly and broadly. It is classified into three main categories (Zain & Ali, 2018):

- i) Islamic traditional instrument that are based on philanthropy such as Waqf, Zakat, and Sadaqa.
- ii) Mutual Cooperative-base foundations such as Qard and Kafala.
- iii) Innovative Islamic instruments that are based on responsible investment, financial inclusion and impact investing such as SRI Sukuk, Islamic microfinance such as Baitul Maal wat Tamwil (BMT) in Indonesia, Amanah Ikhtiar Malaysia (AIM), and Akhuwat in Pakistan and Islamic Crowdfunding

This revolution instrument of ISF is primarily subjected to overcome the social problems at varying dimension rather than focusing on poverty alleviation. The UNDP was collaborating with the National Board of Zakat (BAZNAS) Indonesia, for instance, to organize funds for rescuing the victims and establishing renewable energy projects on the latest earthquakes and the tsunami in Palu, Central Sulawesi and Lombok (Gulf Times, 2018).

2.2 Definition of Islamic Social Finance

Social finance can be defined as a structure of investment strategies with the main objective to produce good impact for both social and environmental outcomes for investors as well as society. Hence, it consists of broad scope such as community investment, microfinance, social impact

bonds, community loan funds and some philanthropic investment programs which is included under this area (VISIZ, 2016).

The Islamic Social Finance definition is akin to social finance in general. However, ISF has salient features that operate to achieve Maqasid Shariah (Objectives of Islamic law). It is social and faith-based financing that provide financial assistance and support people in need in order to alleviate human suffering as well as to preserve environment from the conflict and disaster affected (World Humanitarian Summit, 2016). Accordingly, the approach is to manage and invest funds to solve social challenges and to improve communities and the environment.

2.3 Practices of Islamic Social Finance in Selected Countries

ISF instrument such as Zakat, Waqf, Sadaqa are utilized as instruments in combating the social crisis at various dimension, namely eradicating poverty, assisting proper education and health. In the absence of a good system, the ISF institution cannot manage the flow of funds effectively and efficiently to achieve its goal. In this section, we will describe and evaluate the operations of the ISF institution in selected countries, namely Indonesia, Malaysia, and Pakistan.

2.3.1 Indonesia

Indonesia is the largest country in Southeast Asia. The population of Indonesia approximately was 258 million in 2017, while the Muslim population comprised almost 224.5 million or 87 percent of the total population (Piliyanti, 2010). It is the world's largest island country with the Gross Domestic Product (GDP) in 2017 worth US \$1015.4 billion (World Bank, 2019b). Management of Zakat, Infaq, and Sadaqa (ZIS) in Indonesia utilized dual institutional structure in which ZIS is managed by both government institutions such as BAZNAS, and private organizations such as LAZ, Dompot Dhuafa Republika and Rumah Zakat Indonesia. (Piliyanti, 2010).

The management of Zakat in Indonesia has exhibited an increasing trend in which the total Zakat collection has been increased by 32 times over the last decade or almost US\$231.6 million in 2012. Those Zakat funds, according to BAZNAS are distributed in four main programs, namely education program, humanitarian aid, health program and economic program. Furthermore, the success story of the zakat management in Indonesia is managed by Dompot

Dhuafa Republika. It is a philanthropic institution mobilizing donated assets to help the poor through an excellent program known as Zakah-based microfinance and community empowerment project approach (IRTI, 2014).

Simultaneously, Indonesia as the predominantly Muslim country along with large progressive Waqf potential which are regulated under Badan Wakaf Indonesia (BWI). The beneficiaries of Waqf disbursement through Ibadah (worship) and public welfare programs, such as religious activities, provision of education and health services, aid the indigent, orphans, scholarship students, another economic and community development in accordance with Shariah rules (IRTI, 2014).

In addition, Baitul Maal wat Tamwil (BMT) is the prominent Islamic Microfinance Institution (MFI) established based on Islamic cooperative in Indonesia. It comprise of Baitul Maal which manages social funds and Baitul Tamwil which operates the business function under the Islamic cooperative system (Ascarya, 2017). However, Abdullah *et al* (2018) found in their study that its role in improving social welfare is still not effective because of the internal and external issues affecting the operations.

Subsequently, for maximizing the distribution of Islamic charities, BAZNAS has collaborated with UNDP in 2017 in implementing social enhancement program in Jambi. This project started with renewable projects with local population comprise almost 5,000 people from 803 households in four villages in Jambi province benefiting the electricity assistance. In addition, the value Waqf land and property alone in Indonesia has accounted almost US\$27 billion or estimated around 4.4 billion squared meters. This huge amount has the vast potential in assisting the government in achieving their social goals such as reducing poverty and lessening inequality (UNDP, 2018b).

Furthermore, Islamic Research and Training Institute and Bank Indonesia had established principle framework for Waqf sukuk in 2018 in order to further develop the positive impact of ISF on social wellbeing and environmental preservation globally (Gulf Times, 2018). However, it was reported that climate change caused massive loss approximately US\$320 billion loss globally (UNDP, 2018a).

Therefore, to assist in preserving the planet and its people, the Ministry of Finance of Indonesia have introduced new financial instruments of ISF in March 2018 namely green sukuk in US dollars. Surprisingly, the success stories of green sukuk begins in which the total funds increased up to US\$1.25 billion over five years (UNDP, 2018a).

2.3.2 Malaysia

Malaysia is a federal constitutional monarchy comprises 13 states and the federal territories of Kuala Lumpur, Putrajaya, and Labuan. The estimated population of Malaysia is 31.1 million in 2017 with the Muslim population approximately 19.3 million in 2017 (Index Mundi, 2018a). Zakat mobilizations and management has been increasing over 20 years in which it increased 28 times or US\$547 million in 2011 (IRTI, 2014). In addition, Malaysia is the new industrialised market economy which has the Gross Domestic Product was worth US\$314.7 billion in 2017 (World Bank, 2019b).

Zakat institutions are managed by the State Islamic Religious Council (SIRC) under offices such as Baitul Maal, Zakat department and Zakat Committee (Ahmed, 2004). Aziz et al (2015) also stated that the institutional structure of Waqf and Sadaqa are under the jurisdiction of SIRC of each state in order to ensure the Islamic law and regulation on the Waqf and Sadaqa management practices and to achieve efficiency of Islamic religious programs. In addition, Amanah Ikhtiar Malaysia (AIM) has the largest Islamic microfinance established in 1987 as the replica of Grameen bank which primary source of funds subsidized by the government (Mokhtar *et al.*, 2012).

All SIRC maximised the mobilisation of Zakat, Waqf, and Sadaqa funds for resolving the social and welfare needs. Johor Islamic Council, for instance, has collaborated with Waqf An-Nur Corporation Berhad (WANCorp) in maximizing role of Waqf in several flagship programs, namely Management of Mosque, Healthcare, Start-up capital for microenterprises and disaster relief (IRTI, 2014).

Malaysia is considered as world's Islamic finance marketplace. Hence, the development of Islamic social finance in this country was remarkable in the past few years. It is marked by the world's first issuance of SRI sukuk in July 2017 by Tadau Energy in Malaysia. Subsequently, the five issuances of green sukuk in April 2018 with the total amount approximately RM3.7 billion in which RM2.4 billion has been utilized to assist renewable energy programs and green building (World Bank, 2019a). Moreover, HSBC Amanah Malaysia is the world-first private bank which offered sukuk related to social finance at a big amount of about \$120 million. The funds will be utilized for poverty assistance and sustainable energy generation for the deserving communities (Gulf Times, 2018).

2.3.3 Pakistan

Pakistan is a federal republic consists of four provinces, namely Balochistan, Punjab, Sindh, and

the North-West Frontier Province and two federally administered territories, namely Islamabad and Azad Kashmir. Pakistan is the sixth most populated country with a population of 204.9 million. For the total population, the highest percentage of religion is Muslim at 96.4 percent or 197.5 million in 2017 (Index Mundi, 2018b). It has Gross Domestic Product approximately US\$304.9 billion in 2017 (World Bank, 2019b)

Zakat and Waqf institutions in Pakistan are operated by the government, individuals, and private voluntary organizations (Ahmed, 2004). Overall, the accumulation of Zakat in Pakistan is generally indicating an upward trend which is increasing by almost 40 percent over 3 years or US\$105 million in 2011. In addition, released data from the Ministry of Religious Affairs stated that the zakat allocated by several schemes such as rehabilitation and safety net, social welfare, education and skill enhancement, health care and administrative expenses (World Bank, 2019a).

Waqf institutions in Pakistan are run by the independent waqf administration in each province, namely Punjab, Sindh, Baluchistan, and Khyber-Pakhtunkhwa. All these four administrations headed by a chief waqf administrator known as Central Waqf Council (IRTI, 2014). Ahmed (2004) deliberated the example of Waqf disbursement in Punjab province that it is classified into four main programs such as administration, religious affairs, social welfare, healthcare and national development budget. In addition, Akhuwat Pakistan acts as Islamic microfinance institution founded on the spirit of brotherhood in improving social welfare through the interest-free loans, Qardhul Hassan (Jaafar, 2018).

Inspiringly, the fabulous practices of Zakat management operated by Shaukat Khanum Memorial Cancer Hospital & Research Centre in Pakistan were established in 1994 in Lahore. This is the first and only cancer hospital in Pakistan based on International standard with the purpose of eradicating the suffering of patients with cancer irrespective of their ability to pay. Moreover, the hospital utilized Zakat funds is one the sustainable sources for resilient charities projects with mixed beneficiaries. It has an annual budget around PKR 5.8 billion (World Bank, 2019a).

2.4 Comparison of Islamic Social Finance Model

Islamic Social Finance has great potential in promoting development of social wellbeing and sustainable environments. Its role and contribution through utilization of its tools and instruments. This study measured the extent of contribution of ISF

Table 1: Comparison of Zakat, Waqf, and Sadaqa.

No	Type	Indonesia	Malaysia	Pakistan
1	Population	258 million	31.3 million	204.9 million
2	Muslim Population	224.5 million	19.3 million	197.5 million
3	GDP (US\$)	1015.4 billion	314.7 billion	304.9 billion
4	Zakat Collection (US\$)	231.6 million	547 million	105 million
5	Institutional Structure	Zakat & Sadaqa Waqf Government and Private organization Badan Wakaf Indonesia (BWI)	State Islamic Religious Council (SIRC) State Islamic Religious Council (SIRC)	Government & Private organization Province Waqf administration
6	Islamic Microfinance	Baitul Maal Wat Tamwil (BMT)	Amanah Ikhtiar Malaysia (AIM)	Akhuwat Pakistan
7	Success project practices	Dompot Dhuafa Republika	Waqf An-Nur Corporation Berhad	Shaukat Khanum Cancer Hospital

Source: Authors' own work

institutions in selected countries, namely Indonesia, Malaysia, and Pakistan.

The Table1 above described the comparison of Zakat, Sadaqa, and Waqf feature in selected countries in which all three countries have several similarities and differences in the practices. The results illustrated that the highest number of populations was Indonesia 285 million in 2017 followed by Pakistan 204.9 million. The lowest is Malaysia with approximately 31.3 million. Another major difference is that Indonesia has the biggest Muslim population among three selected countries with 224.5 billion, whereas the Muslim population of Malaysia and Pakistan are around 19.3 million and 197.5 million respectively (World Bank, 2019b).

In the Gross National Product (GDP), Indonesia has the highest GDP with US\$1015.4 billion in 2017. This is followed by Malaysia and Pakistan with US\$314.7 billion and US\$304.9 billion respectively in 2017. Surprisingly, Malaysia is the highest rank in the term of total Zakat collected even though it has the smallest number of populations, it was approximately US\$547 million in 2011. The total Zakat collected in Indonesia and Pakistan, on the other hand, were US\$231.6 million and US\$105 million respectively in 2011 (IRTI, 2014).

Moreover, from the institutional structure viewpoint, the management of Zakat and Sadaqa in Indonesia are managed by both the National Board of Zakat (BAZNAS) and private agencies of Zakat such as private institutions for Zakat (LAZ), Rumah Zakat Indonesia, Dompot Dhuafa, and Republika. Whereas in Pakistan, the mobilization of Zakat and Sadaqa are administered also by the government and private organization. However, unlike Indonesia, Pakistan specified the compulsory sadaqa or zakat has to be collected to the governmental institutions. On the other hand, the management of zakat in Malaysia is

under the jurisdiction of the State Islamic Religious Council of each state (IRTI, 2014).

According to the type of innovative Islamic instruments in selected countries, namely Baitul Maal wat Tamwil (BMT) in Indonesia, Amanah Ikhtiar Malaysia (AIM) and Akhuwat in Pakistan. BMT collects the fund from several sources such as members' deposits, Islamic charities and borrow funds from an Islamic financial institution when there is lack of fund (Ascarya, 2017). Whereas, Amanah Ikhtiar Malaysia is funded mainly from the government subsidies (Mokhtar *et al.*, 2012). On the other hand, Akhuwat Pakistan generated the funds mostly from the donation and Islamic charities (Jaafar, 2018).

2.5 Issues Affecting Islamic Social Finance Institutions

ISF as important growth areas able to turn up a significant role in combating social crisis at varying dimension since its inception. Hence, there are limitations currently faced by ISF affecting its effectiveness and efficiency in achieving the ISF goals (UNDP, 2018b), namely lack of standards of governance, lack quality of human resources, lack of disclosure and transparency, lack capital structure of funding.

2.5.1 Lack Standards of Governance

The governance system of an institution is very substantial for the success and sustainability of institutions. According to Zain & Ali (2018) who studied on "An analysis on Islamic Social Finance for protection and preservation of Maqasid Shariah", they found that management of ISF instruments, including Zakat, Waqf, and Sadaqa, lack of

standardization of governance. Huda (2014) also found in his study that the current Indonesian regulation Law No 23/2011 related to Zakat Management is still in debatable issues among stakeholders.

Pursuing standardization of Waqf governance is very in need in order to maximize the utilization and end the issues. (Puad *et al.*, 2014) found that several challenges highlighted in Waqf practices in Malaysia, namely the legal framework of the Malaysia land Administration system cannot be applied on Waqf land, and lack of Waqf standardized application procedures and Waqf management issues. Noor *et al* (2014) was also found on their study on the Waqf governance framework in Malaysia is under the supervision of each state's SIRC. Hence, there are differences in the management of Waqf properties governance such as disbursement because each state adopted different methods in mobilization of Waqf properties. This is further supported by Abdullah *et al* (2018) that the external issues of Waqf management in Indonesia also lack in regulation and the governance support of the Waqf management.

2.5.2 Lack Quality of Human Resources

The good quality of human resources is a pivotal part of any business management, including ISF in order to pursue the success and sustainability of institution. Zain & Ali (2018) found in their study that one of the serious problems of ISF is lack of human resources in both quantity and quality. In addition, the issue of quality of human resources still becomes critical problem in implementing the proper system and regulation. Puad *et al* (2014) also found that lack of professional of human resources in managing the Waqf assets were part of the challenges facing by Majelis Agama Islam Selangor MAIS.

Abdullah *et al* (2018) in their deep analysis of internal problem found that the five internal challenges facing the management of Waqf in Indonesia such as low quality and professionalism of *nadzir*, lack attractiveness of *nadzir* profession. Hamzah *et al* (2013), in addition, found in their study on Analysis Problem of Baitul Maal Wat Tamwil (BMT) Operation in Pekanbaru, Indonesia that the issues of BMT is the Islamic microfinance is lack quality of human resources which affecting the sustainability and effectiveness.

2.5.3 Lack Transparency and Disclosure

Transparency of financial institution is very important in order to build public trust and

confidence. As ISF is still at its nascent stage faces issue in public confidence due to this set back. This has affected the collection of Zakat as the obligation due to lack of disclosure and transparency in management. The problem of integrity, transparency and professionalism in managing of social funds affecting negatively to the level of public trust and credibility which determined a sustainability of social funds (IRTI, 2014). This is further supported by Zain & Ali (2018) who found out that absence of standard of governance, including transparency and disclosure inducing the issue of corruption and embezzlement. Hence there is a need to improve the accounting standard and transparency to address the issues facing ISF in this context.

2.5.4 Lack Capital Structure of Funding

The capital structure of an institution is very crucial and plays an important role in every business sustainability in the long-term. Ascarya (2017) studied on Baitul Maal wat Tamwil (BMT): an Islamic Social and Commercial Financial Institution in Indonesia revealed a structural problem of funding caused by higher demand for financing compared lower amount of deposit available. As a result, BMT has to rely on funds placement from banks which bear a higher cost. In addition, Abdullah *et al* (2018) found also in their study that the issue lack structural of funds hampers the institution in conducting the training to enhance the quality and skill of staffs.

3 DISCUSSION

Mobilization of Zakat, Sadaqa and Waqf in selected three countries has been playing an important role in the achieving the ISF goals since its establishment even though there are several differences in the practices. One of the major differences is that the total zakat collected in Malaysia is highest although its total Muslim population is less than the total Muslim in Indonesia and Pakistan with about eleven-fold and ten-fold respectively.

According to the institutional structure, Zakat and Sadaqa funds in Malaysia are disbursed to the beneficiaries by respective SIRC of each state. Mobilization of Zakat and Sadaqa in Indonesia and Pakistan, in contrast, is managed by, either through the governmental committee or by several voluntary institutions.

Another difference can be seen from the type of Islamic microfinance institution. BMT in Indonesia faces shortage of funding in which its sources of

funding such as members' deposits and Islamic charities is considered as fluctuated with lowest proportion. Similarly funding for Akhuwat Pakistan is also affected as its funds are mostly generated through Islamic charities and the donation from both individual and institution. Both incomes of Akhuwat are fluctuating funds and not fixed overtime. AIM, in contrast, is subsidized by the government in which the issue of structure problem of funding can be resolved.

Furthermore, maximization of zakat disbursement is necessary to be supported by the good governance and systems. The lack standard of governance will result in inefficient and misappropriation of zakat distribution. Zakat, Sadaqa and Waqf management in Malaysia, for instance, has different standard of governance in each state. Hence the practices also differ between the three countries in the study namely Indonesia, Malaysia and Pakistan. Thus, there is a need for a global standard to address this issue. The lack of transparency and disclosure of institution affected the trust of Islamic charities payers who prefers to pay directly to the beneficiaries rather than contributing to philanthropic institutions.

4 CONCLUSIONS

Zakat, Waqf, and Sadaqa instruments have been contributing significantly in achieving the ISF's goals to mitigate poverty, provide better infrastructure of school and hospital, and preserve life and the environment. Moreover, ISF also moves forward together with Sustainable Development Goals (SDGs) and Environmental Social Governance (ESG) in the same direction. However, it has to address the need of standard of governance globally in order to improve its role and effectiveness. Equally important is having quality of human resources in this field in order to ensure the proper mobilization of ISF funds and practiced in the line of Shariah compliance. Hence, ISF's management has to improve the skill and ability of their staff through several training and seminar. There also needs to increase the transparency and disclosure in order to build higher confidence and public trust towards the institution.

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