



UNIVERSITI SAINS ISLAM MALAYSIA  
جامعة العلوم الإسلامية الماليزية  
ISLAMIC SCIENCE UNIVERSITY OF MALAYSIA



كلية الدراسات المصرفية والمالية  
College of Banking and Financial Studies

# e-Proceeding

## THE 7th ISLAMIC ECONOMIC SYSTEM CONFERENCE 2017 (iECONS 2017)

**EXTENDING THE FRONTIER OF ISLAMIC ECONOMICS:  
CULTIVATING A DYNAMIC SOCIAL FINANCE CULTURE FOR  
GLOBAL ECONOMIC SUSTAINABILITY**

12 & 13 December 2017

Sundus Rotana Hotel  
Muscat, Sultanate of Oman

**Organized by**

Faculty of Economics and Muamalat  
Universiti Sains Islam Malaysia (USIM) &  
College of Banking and Financial Studies (CBFS)

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eISBN 978-967-440-428-4

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## **CONFERENCE OVERVIEW**

The main theme for *iECONS 2017* is **Extending the Frontier of Islamic Economics: Cultivating a Dynamic Social Finance Culture for Global Economic Sustainability**

The conference on Islamic Economic System (*iECONS*) 2017 provides a platform for open dialogues and discussions among academicians, postgraduate students and practitioners to address current and pertinent issues, prospects, challenges and opportunities in the Islamic economic system. The conference will bring together researchers who are actively pushing the boundaries of knowledge in various domains of interest from around the world. The subject matter of Islamic Economic System is broad and can be approached from various angles such as Islamic Banking and Finance, Takaful, Islamic Capital Market, Zakat and Awqaf Institutions, Islamic Social Enterprises, and Islamic Cooperatives.

With its brand name as an emerging, preferred Islamic higher education provider in Malaysia, Universiti Sains Islam Malaysia (USIM) has shown a remarkable growth for the past 10 years and Faculty of Economics and Muamalat (FEM) being its Islamic banking and finance arm has contributed undivided supports to the growth. Thus, FEM, USIM and College of Banking and Financial Studies (CBFS) are jointly organizing *iECONS 2017*. The event is dated on 12 & 13 December 2017 and will take place at Sundus Rotana Hotel, Muscat, Oman. This conference will bring together regulators, professionals, industrial experts and scholars engaged in both practical and academic research to discuss and having open dialogues on Islamic economics development related issues.

## **OBJECTIVE OF THE CONFERENCE**

1. To provide a platform for academics and researchers to present their research in the frontier areas of Islamic social economy.
2. To analyze current issues and challenges and to explore further relationship between social finance and the sustainability of Islamic Economic system.
3. To leverage the resources and expertise from cooperation in disseminating information about opportunities and potentials of Islamic banking and finance as stimuli for the dynamic social finance culture.

## ACKNOWLEDGEMENT – CONFERENCE SPONSORS

The 7th Islamic Economic System Conference (iECONS) 2017 is grateful to the following sponsors for their support and contribution towards the success of this conference.

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## CONFERENCE PROGRAMME SCHEDULE

### DAY 1: 12 DECEMBER 2017 (TUESDAY)

8.30 AM	Registration and Arrival of Guests
9.00 AM	Formal Opening and Recitation of Quran
9.10 AM	Welcome Speech: <b>Dr. Ahmed Mohsin Al-Ghassani,</b> <b>Dean</b> <b>College of Banking and Financial Studies (CBFS),</b> <b>Oman</b>
9.20 AM	Opening Address: <b>Prof. Dato' Dr. Musa Ahmad</b> <b>Vice-Chancellor</b> <b>Universiti Sains Islam Malaysia (USIM)</b>
9.30 AM	Speech of the Officiator for iECONS 2017: <b>H.E. Tahir bin Salim Al-Amri</b> <b>Executive President</b> <b>Central Bank of Oman</b>
9.40 AM	Keynote Address 1: <b>Shaikh Dr. Kahlan bin Nabhan Al Kharousi</b> <b>Chair of the High Shariah Supervisory</b> <b>Authority Central Bank of Oman</b>
10.00 AM	Refreshment and Networking
10.30 AM	Concurrent Session 1
11.30 AM	Concurrent Session 2
12.30 PM	Lunch break and Dhuhr Prayer
2.00 PM	Complementary City Tour

**DAY 2: 13 DECEMBER 2017 (WEDNESDAY)**

8.30 AM	Registration and Arrival of Guests
9.00 AM	Concurrent Session 3
10:00 AM	Refreshment and Networking
10:30 AM	Concurrent Session 4
11:30 AM	Concurrent Session 5
12.30 PM	Keynote Address 2: <b>Datuk Dr. Mohd Daud Bakar</b> <b>Chairman, Shariah Advisory Council</b> <b>Central Bank of Malaysia</b>
1:00 PM	Closing Address: <b>Associate Professor Dr. Amir Shaharuddin</b> <b>Dean, Faculty of Economics and Muamalat</b> <b>Universiti Sains Islam Malaysia (USIM)</b>
1:15 PM	Best Paper Award Ceremony
1.30 PM	Lunch break and Dhuhr Prayer
2.30 PM	End of conference

**AN EMPIRICAL STUDY ON AWQAF ENDOWERS PERCEPTION:  
IMPERATIVES FOR AWQAF INSTITUTIONS' SUCCESS**

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**ABSTRACT**

*The success of awqaf institutions are determined by many factors, among others are, good feedback from the endowers either from their contribution and patronage. Thus, this paper investigates the perception of endowers to endow and motivating them to patronage in ensuring the waqf institution success among 366 respondents during year of 2014. The study employs multiple linear regression for quantitative research based on two models. First model analyse the intention to endow among respondents whereas the second model study the internal and external factors influencing the intention to patronize waqf in future. The findings show integrity of waqf institution, religious obligation and access to cash waqf have significant contribution to the endower's perception to endow cash waqf. Whereas the endowers will patronise to endow if they are really familiar with waqf institutions and easy access to cash waqf as these two variables have significant relation to the dependent variable. Thus, in order to motivate the endowers to continue endows the cash waqf, continuous promotion and awareness programs to create more familiarity should be done in parallel with the easy access to cash waqf to encourage repeating endowers.*

**Key words :** *Cash waqf, Islamic Social Finance, external and internal factors, critical success factors*

**INTRODUCTION**

The success of *awqaf* institutions are determined by many factors, among others are, good feedback from the endowers either from their contribution and patronage to endow cash *waqf* to *awqaf* institution. Numerous studies on cash *waqf* behavior among individuals have been carried out. Cash *waqf* is an easy instrument for people to do charity (*Jariah*). Due to the benefits of *waqf*, Muslims have intention to contribute *waqf*



to gain benefits in the hereafter as well as to gain the blessings from Allah. According to Muhammad Ridhwan et al. (2013), Muslims understand that contribution to *waqf* funds will be rewarded by Allah SWT. However, they have very limited possession of tangible assets/properties to be given away (*infaq*). The *waqf* on properties is highly depends on the individual's economic background and capabilities (Antonio, 2002, Amirul Faiz Osman et al, 2012). Therefore, the use of cash *waqf* is more convenience and incurred less cost as compared to *waqf* on properties such as land, buildings etc. Beside that, *waqf* contribution in the form of cash is believed to be a convenience way to Muslims to do this act and it is one of the way to encourage Muslim to contribute *waqf* more frequently.

Chowdhury et al. (2011) explain that cash *waqf* can also help to restructure the current institutional setup of *waqf* institutions and their networking throughout the country with a view of increasing their performances. For example, as mentioned by Muhammad Ridhwan et al. (2013), it can be observed that since the beginning of Islam, in the early seventh century, many educational activities were financed by *waqf* and voluntary contributions. It is a historical fact that Muslim society depended considerably on *waqf* for the funding of education at all levels. This has contributed in producing high caliber scholars and academia as a whole and also contributed to reduce the socio-economic differences by offering education to those based on merit rather than on ability to pay. Therefore, the economically poor people in the society would be supported to reach the socioeconomic pathway swiftly.

Mohd Umar Mohd Marzuki et al. (2012), in his study on solving poverty alleviation in Malaysia, highlighted cash *waqf* as a way to reduce poverty and help the government to save more and create more job opportunities. Even though their study show promising alleviation up to 50% based on simulation this study requires usage of system dynamics methodology for more exploration of the use of cash *waqf*.

According to Amirul Faiz (2012), Muslims are not really aware of the *awqaf* system and its functions in this country, thus *waqf* literacy is very fundamental. As compared to Muslims understanding on zakat and sadaqah, their understanding on *waqf* is too narrow, limited for donation for the purpose of bulding mosques and sites for graveyards. This observation is supported by Siswantoro and Dewi (2002) in Indonesia, Laldin (2005) and

Asyraf (2011) in Malaysia. Moreover, the donors are unaware that *waqf* contribution can be expanded.

Overall, the awareness level about cash *waqf* in Malaysia is still low (Magna, 2014). Furthermore the awareness towards cash *waqf* in Malaysia is still lagging behind as compared to other countries like Indonesia and Middle Eastern countries (Haslidar *et al.*, 2013). Thus, this study attempts to evaluate the external and internal factors effecting the *waqf* endowers whose intention to endow and patronage in ensuring the *waqf* institution success in Malaysia.

### **FACTORS DETERMINING THE PERCEPTION OF ENDOWERS TO ENDOW FOR AWQAF INSTITUTIONS' SUCCESS: A REVIEW**

In determining the successfulness of *waqf* institution, this research employed the critical success factor (CSF) framework as an underlying principle. The CSF consist of two major elements, internal and external factors. This research suggested that, the contribution made by the endowers to the particular institution is believed due to internal and external factors. Critical success factors (CSF) are the limited area in which satisfactory results will ensure successful competitive performance with the few key areas where “things must go right” as for the manager’s goals to be attained (Rockart, 1981). Pertaining to measuring the *awqaf* institutions’ success, the endowers will have their internal and external CSF. The primary characteristic of internal CSFs is that they deal with issues and situations within the institution’s influence and control. The external CSFs however, pertain to situations generally less under their control and in this study it depends on the *awqaf* institution performance and delivery.

The idea of using “external and internal” factors was based on Lee’s article “Theory of Migration” (1966) in which he describes factors affecting migration with the term “plus” (for factors stimulating migration), “0” (for factors that had no effect to migration) and “minus” (for factors discouraging migration). One of the reasons which raised this theory’s popularity among scientists and researchers was the ability to combine economic, personal, politic, ecological, demographic and all different types of factors that might drive migration (Gurcinaite, 2014). Ever since, researchers refer this theory as “push-pull factors theory”, although the author himself did not give such name to his theory. Thus, this study focusing on the internal (pull) and external (push) factors to

determine the perception of endowers to endow as an imperative for *awqaf* institutions' success. Push factors refer to the external or negative or uncontrollable factors and pull factors refer to internal or positive or controllable factors. For example, research done by Shultz *et al.* (1998) about the influence of external and internal factors on voluntary and involuntary early retirees' retirement decision and adjustment found both push (e.g., poor health) and pull (e.g. leisure interests) factors have influenced the decision to retire and adjustment after retirement.

Some other researchers also used “push-pull factors theory” in their research papers. Some papers which were related to migration studies similar to Lee's paper including studies by Kainth (2009), Min (2011) and Rasool *et al.* (2012). This theory was also applied or based in other research fields. For instance, Norazilawati *et al.* (2009) used the theory to determine satisfactions feeling of urban park visitors. In a study to examine and compare the perceptions of South African health workers, George *et al.* (2013) identified the factors associated with the issue. Shah *et al.* (2014) expose the factors which might drive and restrain internationalization of Pakistani SMEs. Such usages inspired other researchers to implement the theory in studies related to poverty alleviation, including cash *waqf*.

On top of external and internal factors as illustrated in immigrant theory, in Islam the most important aspect in determining action is intention (*al-niyah*). Intention is a very important element to determine individual's actions. Intention may determine action whether it will benefit the actor in this world and the hereafter. Good intention will lead to a good deed. Thus, a good intention will affect continuous attempt to contribute in *waqf* and create sustainable wealth for future generations. Intention has strongly been highlighted in the hadith of Prophet Muhammad SAW as follows:

عَنْ عُمَرَ بْنِ الْخَطَّابِ، رَضِيَ اللَّهُ عَنْهُ قَالَ قَالَ رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ:  
“إِنَّمَا الْأَعْمَالُ بِالنِّيَّةِ وَإِنَّمَا لِأَمْرِي مَا نَوَى.....”

*On the authority of Omar bin Al-Khattab, who said : I heard the messenger of SAW say : “Actions are but by intention and every man shall have but that which he intended .....”.*

(Reported by Bukhari and Muslim)

In fact, in the Quran, there are many verses which discuss and encourage Muslims to endow and give charity such as in Surah al-Baqarah (2: 261), al-Baqarah (2: 271), Ali Imran (3: 92), Ali Imran (3: 134), al-Lail (92: 18-21) and al-Hadid (57: 18). Distribution of wealth is a key issue in the modern economy to make it more dynamic, prejudice free and entrepreneurial (Muhammad Ridhwan Ab. Aziz *et.al.*, 2015).

In the literature review of previous research, intention is outlined under the theory of planned behaviour. According to Conner & Armitage (1998), the theory of planned behaviour that had been developed by Ajzen (1991), suggests that intentions represent a person's motivation in the sense of her or his conscious plan or decision to exert effort to enact the behavior. Intentions and behavior are held to be strongly related when measured at the same level of specificity in relation to the action, target, context, and time frame.

### ***Measuring the Intention in Ensuring the Waqf Institution's Success***

In measuring the intention from perception of the endowers (*waqif*), this study refers to previous research conducted by some of researchers. Among them, Snip (2011) mentioned that the statements used for the construct "intention" was significant measurement represented by Smith and McSweeney (2007) in charitable giving, the effectiveness of a revised theory of planned behavior model in predicting donating intentions and behavior. Six parameters had been used and tested in their studies as good indicators as scientifically measured by acclimating this method as constructed measurements of intention. Thus, this research proposed that intention to endow be measured to observe the pattern of voluntary contribution of cash *waqf* inculcating the Islamic Social Finance among Muslims in Malaysia with some modifications and addition of another parameter that suit *waqf* institution. By adapting this method of measurement, this research proposed that (*Intention to endow and patronage endowing*) was constructed as the dependent variable.

### ***Religious Obligation***

Lammam & Gabler (2012) mention that religious affiliation is an important social determinant of charitable giving. Many religions espouse charitable giving as a moral obligation; some religions even mandate that their adherents endow a specified fixed percentage of their annual income (i.e., a tithe). As a result, religious affiliation is an important indicator of whether people will endow to charity (Jackson et al., 1995). On top

of that, Gittell & Tebaldi's (2006) was cited in Lammam & Gabler (2012) shows that jurisdictions with a greater proportion of the population identifying with a religious affiliation display higher levels of charitable giving (Lammam & Gabler, 2012). Amirul Faiz Osman et al., (2012) estimate the religiosity has a potential that affects cash *waqf* giving, which can be defined as the intrinsic motivation to the *waqif*. Islamic view sees religion as faith "*iman*", action "*amal*", and worship "*ibadah*" triple mandate.

### ***Trust to Waqf Institution and Benevolence (maslahah)***

Sabatini, (2009) and Alina, (2011) were cited in Amirul Faiz Osman et al. (2012) mention that the three determinants for transforming particularized trust (*al-theqah*) into a generalized social trust (*amanah*) should be presented in any community in order to stimulate economic activity namely, the existence of business and corporate ties, reliable and positive public institutions and perception of the community as *umanaa* (plural of *ameen* meaning trustworthy) and safety. The benevolence also been imposed to look at the *maslahah* is taken into consideration. This also been addressed by Babiche Snip (2011) in his research, the trustworthiness of an organization is determined by the perceived benevolence, integrity and ability of that organization. He cited from Gefen & Straub, (2004) and Mayor, Davis & Schoorman, (1995). The more benevolent, honest and able to help beneficiaries the charity organization seems, the more trust people will have in the charity organization. And to conclude, Snip (2011) cited Greiling (2007) and mentioned that trust can be linked to ability, integrity and benevolence.

### ***Familiarity with waqf institution in general***

Amirul Faiz Osman (2012) highlighted *Waqf* literacy is a very crucial part as some Muslims are not really aware of the *awqaf* system and its functions in this country. He cited research done by Siswantoro & Dewi (2002) in Indonesia and Laldin (2005) and Asyraf (2011) in Malaysia, mentioned that the understanding of *waqf* among people in both country is too narrow. Their understanding is only limited to donations for the purpose of building mosque and sites for graveyard. Furthermore, the donors are not aware of diversifying their contribution under *waqf* are wider compared to *zakah* and *sadaqah*.

### ***Access to cash waqf***

Muhammad Ridhwan *et. al.* (2013) stated that access to cash *waqf* is very important as each and every level of income are willing to contribute for *waqf*. The system to be used as method of payment is vital in order to make the process of giving more convenient and easy.

#### ***Affinity cause to endow***

Affinity cause to endow here means the attraction cause to endow. Babiche Snip (2011) in constructing the questionnaires of “affinity with the cause of the organizations” were inspired by the study of Sargeant and Woodliffe (2007), and this study found that affinity with the cause to endow is important aspect to be assessed.

#### ***Opportunism / perceived risk***

Perceived opportunism has a negative influence and action plan should be developed at the end of this study to improve and diminish people’s perceived opportunism of the charity organization.

#### ***Ability of the Waqf Institution***

Amirul Faiz Osman (2012) emphasized on efficient management . He cited works by Beatty, (2007) and Frumkin & Kim, (2001) and mentioned that there was agreement that potential donors to non-profit organization rely on efficiency measures to a certain extent when determining which organization to fund. Individuals would give more to non-profit organizations if more accountability for administrative cost were present and if organizations could better demonstrate the impact of donations.

#### ***Integrity of the Waqf Institution, Reputation and Obligation to endow (i.e. wasiat)***

Integrity involves a person’s perception that the trustee adheres to a set of principles that the person finds acceptable (Snip, 2011). Reputation among others, consistency of past actions and congruency between words and actions could positively influence the perceived integrity of a party. This study position this Integrity, reputation and obligation to endow (example through *wasiat*) as push factors that should influence the al-Waqif to contribute cash *waqf*.

#### ***Communication with Stakeholders***

Communication plays a role in how the donor perceives the charity organization and the majority of the donors think that a charity organization should not be too professional and should not engage in too many marketing activities. The more commercial the

communications from a charity organization are the less positive people are on the idea that the organization spends money on those kinds of communication. Therefore, it is important that the communications from the charity organization are effective. This means that the organization should communicate suitably and periodically (Snip, 2011).

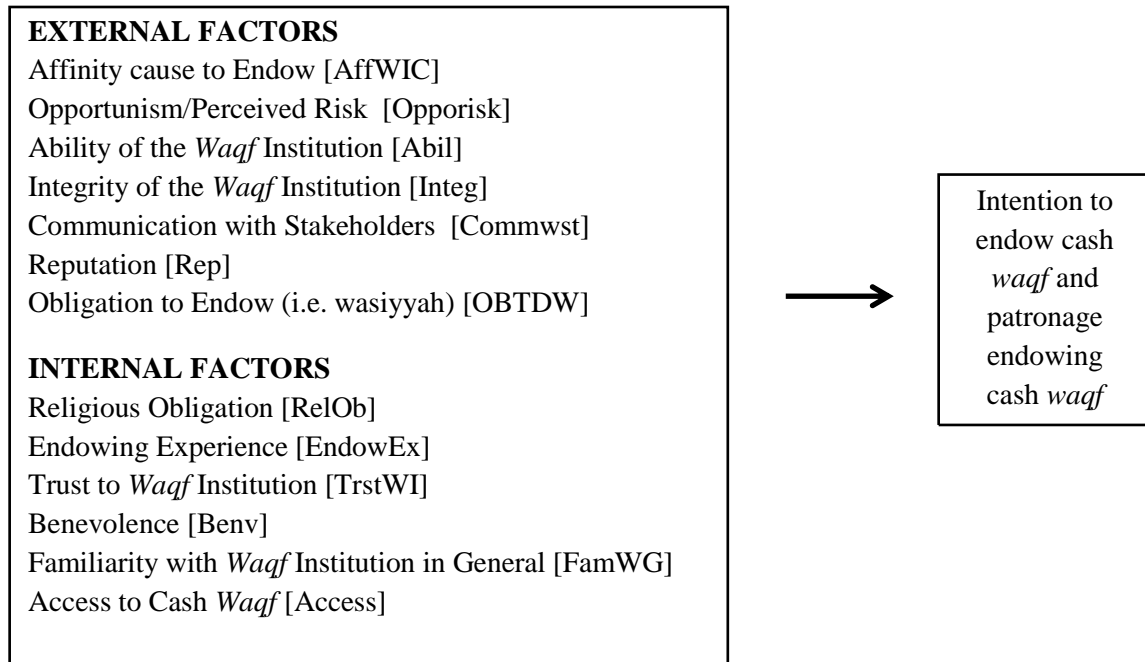


Figure 1 : Framework of the study

### Hypothesis

The hypothesis for the study is as follows:

H<sub>1</sub> : External and internal factors have a significant association with respondents' intention to endow cash *waqf*

H<sub>2</sub> : External and internal factors have a significant association with respondents' intention to patronize endowing cash *waqf* in future.

### RESEARCH METHOD

This study employs a quantitative analysis research method. The first phase of data collection begins with developing suitable variables through literature review research in order to develop conceptual framework as to develop questions which are related to research objectives. The second phase is to test the questionnaires through pilot test and 30 respondents had been involved in this process. The validity and reliability of survey



instrument were indicated by Bartlett's Test of Sphericity and Cronbach Alpha of more than 0.7 (Nunnally, 1994).

The study uses multiple linear regression analysis to learn more about the relationship between several independent or predictor variables and a dependent or criterion variable (Hair, 2010). Two models are tested. The first model analyses the perception of 366 valid respondents on the intention to endow. This model will identify factors that had significant relationship among respondents to their intention to endow to *awqaf* institution in Malaysia. Eight predictor variables were involved which are: Opportunism/Perceived risk, Integrity of the *Waqf* Institution, Reputation, Religious obligation, Trust to *Waqf* Institution, Benevolence (*maslahah*), Familiarity with *Waqf* Institution in general and Access to cash *Waqf*. Model 1 is shown below in equation (1).

Model 1

$\widehat{WIE} = f(\text{Opprisk, Integ, Rep, ReligiousOB, TrustWI, Benevolence, FamiliarityWG, Access})$

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \beta_8 X_8 + \varepsilon_t \dots \quad (1)$$

- Y = Intention to Endow
- X<sub>1</sub> = Opportunism / Perceived risk
- X<sub>2</sub> = Integrity of the *Waqf* Institution
- X<sub>3</sub> = Reputation
- X<sub>4</sub> = Religious obligation
- X<sub>5</sub> = Trust to *Waqf* Institution
- X<sub>6</sub> = Benevolence (*maslahah*)
- X<sub>7</sub> = Familiarity with *Waqf* Institution in general
- X<sub>8</sub> = Access to cash *Waqf*
- ε = Error term

The second model focuses on 217 respondents who had contributed cash *waqf*. This model identify factors that have significant relationship among respondents to continue donating in future. Five new predictor variables are added to the model which are: Affinity cause to endow, Ability of the *waqf* Institution, Communication with stakeholders, Obligation to endow (i.e wasiyyah) and Donating experience. Model 2 is presented in equation (2).

Model 2

$\widehat{WPE} = f(\text{AffWC, Opprisk, Abil, Integ, Coms, Rep, Wasiyyah, ReligiousOB, EndowEx, TrustWI, Benevolence, FamiliarityWG, Access})$

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \beta_8 X_8 + \beta_9 X_9 + \beta_{10} X_{10} + \beta_{11} X_{11} + \beta_{12} X_{12} + \beta_{13} X_{13} + \varepsilon_t \dots \quad (2)$$

Y	=	patronage endowing cash <i>waqf</i> in future
X <sub>1</sub>	=	Opportunism / Perceived risk
X <sub>2</sub>	=	Integrity of the <i>Waqf</i> Institution
X <sub>3</sub>	=	Reputation
X <sub>4</sub>	=	Religious obligation
X <sub>5</sub>	=	Trust to <i>Waqf</i> Institution
X <sub>6</sub>	=	Benevolence (masalahah)
X <sub>7</sub>	=	Familiarity with <i>Waqf</i> Institution in general
X <sub>8</sub>	=	Access to cash <i>Waqf</i>
X <sub>9</sub>	=	Affinity cause to endow
X <sub>10</sub>	=	Ability of the <i>Waqf</i> Institution
X <sub>11</sub>	=	Communication with stakeholders
X <sub>12</sub>	=	Obligation to endow (i.e. wasiyyah)
X <sub>13</sub>	=	Endowing Experience
ε	=	Error term

### **Research Aim**

This paper is aimed to identify external and internal factors associated with endowers' (*waqif*) intention to contribute cash *waqf* and patronize endowing particularly among Muslims in Malaysia inculcating the culture of giving through Islamic Social Finance. The questions for the survey related to intention and patronage were adapted from previous research such as by Snip (2011), Smith *et al.* (1994), Fuadah *et al.* (2013: 2015a & 2015b) & Johari *et al.* (2015) with some modifications to achieve the research objectives. A number of dependent and independent variables were constructed to evaluate the external and internal factors that influence the endowers to contribute cash *waqf* and patronage to *awqaf* institutions in Malaysia.

### **Sample and Data Collection**

400 survey questionnaires were distributed to all respondents randomly for the period 27 October 2013 until 15 September 2014. After the data cleaning process, only 366 questionnaires are usable and valid. For the data collection, two types of survey methods are conducted. First, an online questionnaire through "Survey Monkey" software to obtain wider respondents coverage within Malaysia. The second method appointed 35 enumerators to distribute the questionnaires via face-to-face method. The respondents were Malaysians, including those who have previously endowed to *waqf* institution and had expressed the intention to endow again. The sample size of 400 respondents were estimated since Muslims in Malaysia accounted for approximately 65 percent from the whole Malaysian population of 29.915 million (Malaysian Economic Report 2014/2015).

According to Krejcie and Morgan (1970), the minimum number of allowed sample size based on a population of more than 1 million is 384 respondents.

The measures pertaining to external and internal factors with its relation to the intention to endow again, respondents were asked questions in the form of a 5-point Likert scale, ranging from '1' (strongly disagree) to '5' (strongly agree). Respondents were also asked to provide details on their demographic profile. Respondents' demographic profile is presented in Table 1.

Table 1: Demographic profile results

Demographic Variables	Category	Sample (n=366)	
		Frequency	(%)
<b>Gender</b>	Male	210	57.4
	Female	156	42.6
	Total	366	100
<b>Age</b>	20-25 years old	55	15.0
	26-30 years old	40	10.9
	31-35 years old	77	21.0
	36-40 years old	62	16.9
	40 and above	132	36.1
	Total	366	100
<b>Marital Status</b>	Single	98	26.8
	Married	264	72.1
	Divorced	4	1.1
	Total	366	100
<b>Occupation</b>	Professional and management	157	42.9
	Self employed	106	29.0
	Administrative staff	60	16.4
	Housewife	7	1.9
	Student	22	6.0
	Others	14	3.8
	Total	366	100
<b>Location</b>	Urban	174	47.5
	Rural	192	52.5
	Total	366	100
<b>Education</b>	SPM or equivalent	95	26.0
	STPM or equivalent	23	6.3
	Diploma or equivalent	60	16.4
	Bachelor degree/Advanced diploma or	132	36.1

Demographic Variables	Category	Sample (n=366)	
		Frequency	(%)
	equivalent		
	Master/Ph.D	38	10.4
	None	18	4.9
	Total	366	100
<b>Formal Islamic Education</b>	Advanced Religious School (Johor only)	68	18.6
	UPKK/ PSRA	54	14.8
	Syahadah sanawi/ SMA	34	9.3
	STAM	14	3.8
	University	132	36.1
	None	64	17.5
	Total	366	100
<b>Informal Islamic education</b>	Mass media (newspaper/ tv/ others)	83	22.7
	Reading from religious book	93	25.4
	Friends/ <i>usrah</i>	32	8.7
	Religious talk/ religious class ( <i>musolla/ mosque</i> )	137	37.4
	Informal religious education	21	5.7
	Total	366	100
<b>Income</b>	Below RM5,000	291	79.5
	RM5,001-RM10,000	59	16.1
	RM10,000 and above	16	4.4
	Total	366	100

Source: Survey Questionnaires.

Based on Table 1, majority of the respondents are male (57.4%) while female constitutes 42.6%. Most of the respondents aged between 40 and above (36.1%); 72.1% are married; 42.9% hold professional and managerial positions; 52.5% from rural areas; 36.1% are degree holders. 36.1% of the respondents reported that they received formal Islamic education in university while 37.4% reported that they received informal religious education from religious talk/ religious class (*surau /mosque*). Majority of the respondents (79.5%) among the B40 group (below 40%) with household income below RM5,000.

**Reliability and Validity test**

Table 2 : Reliability and Validity test

Constructs	KMO	Bartlett's' Test of Sphericity			Total Variance
		Chi Square	df	Significant	
Affinity to <i>waqf</i> institution.	0.878	753.093	10	0.000	76.206
Opportunism perceive risk.	0.779	561.180	6	0.000	66.188
Ability of the <i>waqf</i> institution	0.897	1248.515	15	0.000	80.715
Integrity.	0.880	1330.330	10	0.000	76.371
Communication.	0.875	1560.936	21	0.000	75.745
Reputation.	0.678	429.955	3	0.000	74.040
Obligation to endow (i.e.wasiyyah)	0.936	2685.586	45	0.000	77.621
Religious obligation.	0.500	56.033	1	0.000	68.898
Endowing experience.	0.824	643.163	6	0.000	81.974
Trust to <i>waqf</i> institution.	0.903	1733.643	15	0.000	74.383
Trust propensity.	0.771	486.478	6	0.000	63.900
Benevolence	0.764	961.625	6	0.000	76.275
Familiarity with <i>waqf</i> institution in general.	0.846	1420.842	15	0.000	66.217
Access to cash <i>waqf</i> .	0.689	566.835	3	0.000	78.413
Intention to endow <i>waqf</i> .	0.695	289.617	3	0.000	68.688
Patronage endowing	0.500	121.986	1	0.000	83.756

Table 2 shows results of the Bartlett's test of Sphericity confirming the suitability of the data for factor analysis (Pallent, 2005). In terms of reliability of all fifteen constructs, the Cronbach Alpha values achieved the recommended value of minimum 0.70 after deletion of recommended items as illustrated in Table 3.

Table 3 : Items Accepted and Deleted after modification

VARIABLES	ITEMS ACCEPTED	ITEMS DELETED
Affinity to <i>waqf</i> institution.	5 (Q1,2,3,4,5)	-
Opportunism perceive risk.	4 (Q3,4,5,6)	2 (Q1,2)
Ability of the <i>waqf</i> institution	6 (Q1,2,3,4,5,6)	-
Integrity.	5 (Q1,2,3,4,5)	-
Communication.	7 (Q1,2,3,4,5,6,7)	-

Reputation.	3 (Q1,2,3)	1 (Q4)
Obligation to endow (wasiyyah)	10 (Q1,2,3,4,5,6,7,8,9,1)	-
Religious obligation.	2 (Q3,5)	4 (Q 1,2,4,6)
Donating experience.	4 (Q1,2,3,4)	
Trust to <i>waqf</i> institution.	6 (Q1,2,3,4,5,6)	-
Trust propensity.	4 (Q1,3,4,5)	1 (Q2)
Benevolence	4 (Q1,2,3,4)	-
Familiarity with <i>waqf</i> institution in general.	6 (Q1,2,3,4,5,6)	-
Access to cash <i>waqf</i> .	3 (Q1,2,3)	-
Intention to endow <i>waqf</i> .	3 (Q1,2,3)	1 (Q4)
Patronage endowing	2 (Q 1,3)	3 (Q2,4,5)

### DISCUSSION OF FINDINGS

The linear regression results revealed the total variation associated with intention to endow cash *waqf* was accounted by the eight dimensions of the external and internal factors effecting endowers to contribute the cash *waqf*. Positive regression coefficients explain that any improvement in *waqf* institution's success factors dimensions will increase donors' intention to endow cash *waqf*. In reverse, negative regression coefficients explain that any improvement to *awqaf* institution will decrease the endowers' intention to endow cash *waqf*. The finding shows that all significant result achieved positive regression coefficient.

Table 4 : Linear Regression Model Summary for Model 1

Model	Independent Variables	B	Beta	t	Sig (p)
1	(constant)	.531		1.790	0.74
	Opportunism / Perceived risk	.105	.076	1.750	0.81
	Integrity of the <i>Waqf</i> Institution	.286	.271	3.913	.000***
	Reputation	.114	.108	1.709	.088
	Religious obligation	.207	.188	4.005	.000***
	Trust to <i>Waqf</i> Institution	-.037	-.037	-.607	.544
	Benevolence (masalah)	.009	.008	.128	.898
	Familiarity with <i>Waqf</i> Institution in general	.058	.063	1.362	.174
	Access to cash <i>Waqf</i>	.144	.177	3.789	.000***

\*\*\* Significant value at 1%

$R^2 = 0.309$ ,  $F = 21.913$

Dependent Variable : Intention to Endow

Out of eight predictors, only three predictors had significant relationship with intention to endow cash *waqf*. Those significant predictors variables are Integrity of the *Waqf*

Institution ( $\beta= 0.27$   $t = 3.92$  ,  $p < 0.05$ , Obligation to endow (wasiat) ( $\beta= 0.19$   $t = 4$  ,  $p < 0.05$ , Access to cash *Waqf* ( $\beta= 0.18$   $t = 3.79$  ,  $p < 0.05$ . The overall model equation can be expressed as follows;

$\widehat{WIE} = 0.531 + 0.27$  Integ (external) + 0.19 ReligiousOB (internal) + 0.18 Access +  $\varepsilon_t$   
 Table 5 displays the results for Model 2 in which the dependent variable is “patronage endowing cash *waqf* in future” and 13 predictor variables.

Table 5 : Linear Regression Model Summary for Model 2

Model	Independent Variables	B	Beta	t	Sig (p)
1	(constant)	1.120		2.255	.025
	Opportunism / Perceived risk	-.160	-.100	-1.592	.113
	Integrity of the <i>Waqf</i> Institution	.106	.085	.911	.363
	Reputation	-.018	-.014	-.155	.877
	Religious obligation	.149	.118	1.722	.087
	Trust to <i>Waqf</i> Institution	.046	.041	.454	.650
	Benevolence (masalahah)	-.158	.132	-1.198	.232
	Familiarity with <i>Waqf</i> Institution in general	.328	.306	4.614	.000***
	Access to cash <i>Waqf</i>	.185	.196	2.878	.004***
	Affinity cause to endow	.091	.079	.859	.391
	Ability of the <i>waqf</i> institution	-.008	-.007	-.055	.956
	Communication with stakeholders	.180	.172	1.491	.137
	Obligation to endow (i.e. wasiyyah)	-.043	.109	-.397	.691
	Endowing Experience	-.036	-.034	-.346	.730

\*\*\* Significant value at 1%

$R^2 = 0.291$ , F-test = 6.401

Dependent Variable: patronage endowing cash *waqf* in future

Based on Table 5 shows that, out of thirteen predictor variables, only two predictors had significant relationship with dependent variable as to patronizing to endow cash *waqf* in future. The significant predictors variables Familiarity with *Waqf* Institution in general ( $\beta= .306$   $t = 4.62$ ,  $p < 0.05$ ) and Access to cash *Waqf* ( $\beta= .196$   $t = 2.878$ ,  $p < 0.05$ ). The overall model equation can be expresses as follows;

$$\widehat{WPE} = 1.12 + 0.31 \text{ FamiliarityWG}^{***} + 0.19 \text{ Access}^{***} + \varepsilon_t$$

### CONCLUSION

The finding shows that the integrity of *waqf* institution, religious obligation and access to cash *waqf* had significant contribution to the perception to endow cash *waqf*. Whereas the endowers will patronage to endow if they are really familiar with *waqf* institutions and



have an easy access to cash *waqf* as these two variables have significant relation with dependent variable. Thus, in order to motivate the endowers to continue giving cash *waqf*, continuous promotion and familiarity should be done in parallel with the easy access to cash *waqf* to encourage repeating endowers. The awareness towards cash *waqf* in Malaysia is still lagging behind compared to other countries. The awareness level about cash *waqf* in Malaysia is still low. Thus, identifying to what extent the external and internal factors affecting the *waqf* endowers are vital and significant to the policy makers. If we can tackle this situation, the solutions provided will not only encourage those who have the intention to endow but also patronage to endow cash *waqf* in future. The enhancement awareness and patronage will ensure *waqf* institutions' success as the third sector to complement the government and private sector and the impact will benefit the community and *ummah* at large in Malaysia.

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## **LIQUIDATING *WAQF* ASSETS AND FUTURE FRAMEWORK OF AL-TAWRIQ**

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## ABSTRACT

*Lack of financial resource had led Waqf assets / land development to remain idle or unproductive. Thus, a new solution and an innovative approach should be varies to be used as to provide an effective alternative. After much consideration of fiqh discussion, the liquidation of Waqf asset through the instrument of al-Tawriq is deemed suitable to be one of the solutions. However, the main issue in question is the method of its implementation and whether this option would be accepted by the executors or the Mutawalli. Thus, this paper will explore the future framework of al-Tawriq which can be employed as solution to the Waqf financing and its development problem. A focused group discussion was conducted to gather the necessary information and feedback on these options and the feasibility in adapting the future framework. The focused group discussion (FGD) was held on 19 September 2017 involving a total of seven participants. In this discussion, three sets of situations and future model were required to be developed as the al-Tawriq model for Waqf asset in future. The future model 1 is selling part of Waqf assets to get liquidity, the future model 2 : Qard al-Hassan and lastly, the future model 3 : Waqf Mu'aqat (temporary Waqf). This study concluded that participants were not ascertained regarding the feasibility of future model 1, they had doubt on the sustainability of future model 2 but were really optimistic for future model 3. Thus, al-Tawriq is a new dimension and innovation on top of the normal practice of cash Waqf and other models in enhancing the third sector of economy (Economy Ijtima'i) and enhancing the development of the ummah.*

**Keywords:** *Liquidating of Waqf assets, Waqf financing , Islamic Social Finance.*

## INTRODUCTION

The idea was firstly mooted by YTI- USIM Professorial chair holder Y.Bhg. Datuk Dr Mohd Daud Bakar during a special session of YTI's research and publication projects held on 27 April 2016 at Faculty of Economics and Muamalat, USIM. An academic discussion was held on 12 July 2017 in YTI's brown bag meeting entitled "*al-Tawriq for Waqf assets*" which resulted to a number of projection of the conceptual *al-Tawriq* and the proposal of further research on the future framework of liquidating *Waqf* assets. Thus, the chance to explore the conceptual future framework in the liquidation of *Waqf assets which would eventually benefit the ummah* and provide solution to the current problem became the main motivation for this paper. The motivation of this paper is to explore the conceptual of future framework of liquidating *Waqf assets* for the benefit of ummah as solution to current problem.

There are two scenarios in the problems related to *Waqf* asset. Firstly, the situation in which the unproductive *Waqf* asset (that is unattended?) with idle, either those with lack of maintenance and development budget or ones that provide no commercial value and benefit lowly in the return of *Waqf* asset or *Waqf* land. For example, in the case of

Mukim Panchang Bedena, Sabak Bernam, Selangor, 25 acres of *Waqf* land has been standing idle and not cultivated due to the lack of financial resources. The Surau committee of the district was supposed to make use of the land for oil palm cultivation at a cost of RM 26,000.00. However, due to the committee's lack of funds to start on the development project, the proposed project has to be inevitably delayed. On top of that, another project worth RM 1.5 million involving the construction of rented houses also left unattended due to lack of capital. This project was under the purview of a mosque's administration in the area of Meru and is considered to be as the most viable in the way that it can potentially benefit the society (Razali Othman, 2015). The second scenario in discussion is the insufficient fund for renovation / maintenance / repair cost, as the *Waqf revenue* is inadequate to cover the repair cost.

The main issue in these methods of development is focused on the protection and the security of the *Waqf assets*. Since the ownership of *Waqf assets* are regarded to be retained by Allah SWT or by the beneficiaries (in accordance to different opinions of Islamic jurists), the application of liquidating *Waqf* asset using the instrument *al-Tawriq* is still considered as new and questionable. Thus, this paper will explore the future framework of *al-Tawriq* which can be employed as the solution to the *Waqf* financing and development's problem.

## **THE ORIGIN AND EVOLUTION OF AL-TAWRIQ : THE LEXICONS AND TERMINOLOGICAL ANALYSIS**

### ***Al-Tawriq derive from a root word of Waraqa and Awraq al-Mal***

There is no word of *al-Tawriq* found in Arabic Dictionary of Lisan al-Arab written by Ibnu Manzur (1983), which indicates the rarity of the word in the communication of Arabic among Arab's people. The same outcome is found from the reference of the Dictionary of Modern writing Arabic (Arabic – English) by Hans Wehr (1976). However, the root word that *al-Tawriq* stemmed of which are *waraqa* or *waraqa naqdi*, are interpreted by this dictionary as paper money. Another root word, *Awraq al-Mal*, describes another interpretation of the word which means securities, bonds or banknotes paper money. This definition is further detailed by Muhammad Abdul Halim (2007) in which he defines *Al-Tawriq* as an extract from *al-waraqa* that means 'a paper' that can be written on it and on the paper tree. Ila' Aziz al-Jaburi (undated) states that *Al-Tawriq* is



taken from the word *al-waraqah*, meaning money from silver while Yusuf Ali & Yuzian Rahman (2009) believed that *Al-Tawriq* is rooted from the word *al-Awraq*. Later, Abdul Karim Aiyuni (2011) also mentions the phrase *Waqf al-Awraq al-Maliyah* in his writing, and emphasizes that *Al-Awraq al-Mal* is recognized as one of the instrument that can be use in *Waqf*. In the literal sense, there is no summary of the word *Tawriq* in Arabic dictionary up until 1980's but only the association with a root word of *al-Awraq al-Mal* can be inferred. The word *al-Tawriq* only appears in the dictionary around year 2000's and above. Thus, chronologically, the word of *al-Tawriq* is only mentioned in the Arabic dictionary later in the year of 2007, indicating acknowledgement of the rise of study on the field of Islamic Finance.

### ***Literal meaning of Al-Tawriq as a Security***

The modern Arabic dictionaries, specifically in the area of Economics and Finance, has mentioned the word *al-Tawriq*. For instance, *Mu'jam al-Mustalahat al-Iqtisadi wa al-Mal wa Idarah al-Mal* (2009), which is an Arabic Economic Dictionary has described *al-Tawriq* with the phrase *Waraqah Maliyah* which carries the meaning of security. The *Investment and Finance Encyclopedia*, (2016), defines *Tawriq* as the Arabic term for securitization. Interestingly, *Mu'jam al-Ma'ani al-Jami'*, (2016), interprets *Tawriq* in its literal meaning that is "issuing paper" as the *masdar* (derivation of the verbal noun) for *warraqa* means paper.

In addition, there are several academic papers that touch briefly on *al-Tawriq* in their research. Khairuddin (2012) states that *al-Tawriq* carries the definition of securitization. Making the deferred debt in the liability of others in the period which between its credit and the matter of the deferred certificate (*Sukuk*) and transferable in secondary market. Muhammad Ahmad (2009) and *Majallah Majma' al-Fiqh al-Islamiy al-Dawli* (2009) also acknowledge that, *al-Tawriq* can be defined as securitization. *Al-Tawriq* (securitization) is an innovative financial instrument that shows how a financial institution can mobilize a group of homogeneous and secured debts as an asset and puts it in one single debt consolidation before presenting it to the public through a specialized facility to subscribe in the form of securities for liquidity in a form of cash for a bank. Thus, the terminology of *al-Tawriq* is an innovative word, discussed by scholars in the early 2000s and has been endorsed by OIC Fiqh Academy in the year 2009. These lexicon

and terminological analysis will later be constructed to an applied terminologies as follows.

### ***Applied Terminologies of Al-Tawriq***

*Tawriq* is a unique product of Islamic securitization model within the Islamic financial system. It is the conversion of Shariah compliant deferred debt that originated from the contract of exchange of the Shariah compliant assets into a tradable paper that can be traded in the secondary market (Razi Pahlavi Abdul Aziz & Anne-Sophie Gintzburger, 2009). *Al-Tawriq* (securitization) is an innovative financial instrument to mobilize a range of secured assets of debt, by converting it from debt to enhanced credit, and then presenting it to the public through a special way for subscription in the form of securities in order to minimize risks and to ensure the continued flow of liquidity (Ajil Jasim al-Nasyami, (undated). On top of that, *al-Tawriq* is (securitization) in the conversion of loans into marketable securities for trading i.e transfer of debt from the primary lender to other lenders (Muhammad Ahmad Ghanim, 2009). Thus, *al-Tawriq* is the liquidation of unmovable (real property) asset's debt through the creation of new financial instrument (certificate) in the sense of transferring financial assets from the original lender to others, which is largely through the financial institutions and the stock exchange.

Thus, in the concept of practical and applied definition, *Al-Tawriq* is defined as the capacity of an individual or a company to convert assets into cash or the immediate ability to meet one's financial obligation. Subsequently, this definition gives the impression that liquidity is a process of converting assets into cash or cash equivalents and the process must not lead to significant loss. However, liquidity varies according to the different purposes. In the sector of finance for example, liquidity is the bank's ability to meet any unexpected demands for cash from its depositors. Thus, liquidity is perceived as a parallel to the term 'solvency' i.e. the ability to meet debts due to a situation where a bank's current assets exceeding its current liabilities, (Mohd Daud Bakar, 2008; 2017).

## **TERM OF AL-TAWRIQ FROM THE AL-QURAN AND FIQH DISCUSSION**

### ***Al-Tawriq in al-Quran***

The term *Tawriq* was an inspiration from verse 19 of Surah al-Kahfi in al-Quran :

قَالُوا رَبُّكُمْ أَعْلَمُ بِمَا لَيْتُنْتُمْ فَابِعْتُوَا أَحَدَكُمْ بِوَرِقِكُمْ هَذِهِ إِلَى الْمَدِينَةِ فَلْيَنْظُرْ أَيُّهَا أَزْكَى طَعَامًا فَلْيَأْتِكُمْ بِرِزْقٍ مِنْهُ

***“Allah (Alone) Knows Best How Long Ye Have Stayed Here. Now Send Ye Then One Of You With This Money Of Yours To The Town: Let Him Find Out Which Is The Best Food (To Be Had) And Bring Some To You...”***

The word of “*wariq*” according to Yusuf Ali is translated as money in general, while according to the translations of Shah International and Shakir and the majority of Tafser scholars, it means silver; either official currency (coins or just silver that could be accepted to be traded and exchanged in the market). Thus, it can be implicitly referred that the word “*wariq*” means giving something in the form of cash (Khairun Najmi Saripudin, 2013).

***Fiqh Discussion on Al-Tawriq***

Table 1 : *Fiqh Discussion on Al-Tawriq*

Source	Opinion / View	Citation / reference
Abi Bakar Muhammad (undated)	<p>The unmovable assets (العقار) are allowed to be to use Tawriq. Unmovable assets are absent from “possession”(يقبض) and therefore cannot be transferred (ولا ينقل) as the assets are well-known and unmovable.</p> <p>In other words, unmovable asset does not fulfill the prohibition condition which is no liability with possession (لا يضمن بالقبض).</p> <p>Note : Unmovable assets are allowed to become assets in Tawriq transactions. Thus, Tawriq is suitable and permissible to be applied in relation to the <i>Waqf assets</i>.</p>	Imam Abu Hanifah
Ajil Jasim al-Nasyami, (undated),	<p>Debt that is based on deferred payment in currency, is prohibited and not permissible (على عدم جواز).</p>	the whole Fiqh Scholar

	<p>1.1.1.1.1 Still, debt based on commodity is allowed. Thus, issuing <i>Tawriq</i> for commodity items is allowed.</p>	<p>Imam Ahmad.</p> <p>This opinion was also agreed by Ibn Taymiyyah and Ibn al-Qayyim.</p>
	<p>Mentioning that selling debt with deferred payment with deferred price to avoid the <i>riba</i> is allowed.</p>	<p>Imam al-Syafie</p>
	<p>1.1.1.1.2 Agreeing on the permission of the trading as long as the items sold are not food items.</p> <p>Another criteria is the trading must be free from <i>gharar</i>, <i>riba</i>, and some of other prohibitions, restriction and must be Shariah compliance.</p>	<p>Imam Malik</p>

Source : Abi Bakar Muhammad (undated) & Ajil Jasim al-Nasyami, (undated)

Based on Table 1, it is shown that Abi Bakar Muhammad (undated) who narrated the opinion of Imam Abu Hanifah, mentions that the unmovable assets (العقار) are allowed to apply *Tawriq* as the unmovable assets are absent from “possession” (يقبض) issues and cannot be transferred (ولا ينقل) since they are well known and unmovable. In other words, unmovable assets do not fulfil the condition of prohibition which is no liability with possession (لا يضمن بالقبض). This opinion confirms the fact that unmovable assets are allowed to be considered as assets in *Tawriq* transactions. Thus, *Tawriq* is suitable and permissible to be applied in the association of the *Waqf assets*.

According to (Ajil Jasim al-Nasyami, undated), there are two types of application in the principles of *Tawriq*. The first is securitizing debt based on currency and secondly, securitizing debt based on commodity. On discussing the debt that is based on deferred payment in currency, the whole Fiqh Scholars agree that this is prohibited and therefore is

not permissible (على عدم جواز). The only option by which it is permitted is the second type of application which is securitizing debt based on commodity. Commodity is the best-selling characteristic in disclosure, the possession with specific characteristic and value identified; such as agriculture product, animal, derivatives or industries such as metal (iron or steel), cement, automobile, aircraft or product from raw materials like natural gas or semi-processed oil etc. Imam Ahmad expresses that issuing *Tawriq* for commodity items is allowed to be done. This opinion is also acknowledged by Ibn Taymiyyah and Ibn al-Qayyim. Imam al-Syafie also says that the act of selling debt with deferred payment from non-debtor invaluable with deferred price in avoiding the *riba*. Imam Malik also agrees that it is permissible to conduct the trading as long as not the items in question are not food items. Another necessary criteria are the absence of *gharar*, *riba*, and some of other prohibition, restriction and must be Shariah compliance.

### ***The Permissibility of Liquidating Waqf assets***

As a general rule, it is stated that the private alienation, temporary or absolute, by mortgage or otherwise, selling of *Waqf* lands, even if such are for the repair or other benefit to *Waqf*, is illegal according to Islamic law. However, where it is necessary for the purposes of the *Waqf*, the qadi and the authorization of a sale, or the variation of the rules of management of the *Waqf*, even when this has been expressly forbidden by the founder, the qadi may

- 1) authorize contracting debts for repairs of the property, or for the payment of taxes when there is no income or means of paying them out of the *Waqf*
  - 2) mortgaging the dedicated land of its produce by way of security for debts so contracted
  - 3) sell part of the dedicated land for the purposes above mentioned
- (Mohd Zain Othman, 1982).

Thus, the permissible in liquidating of *Waqf assets* can be summarised with some special characteristic as follows;

1. *Maslahah or general good and daruriyah in allowing the liquidity of Waqf assets*
2. *Madhahib Thought of provisions which permits for the sale, exchange/and or lease of Waqf property.*
3. *Permissible of Sell and the need for order of the court*

(Fuadah et al, 2017)

Mohd Daud Bakar, 2008 conducted an in-depth analysis on the research of liquidating (*al-Suyulah*). One interesting precedent discovered is that the concept of liquidating the *Waqf assets* has been documented in the history of Islamic commercial activities in the case of *mursad* or *khulu'* loan in the area of *Waqf* (endowment) law. This finding has shed light on the application of ways in solving the problem of *Waqf* financing and its development which subsequently provide solution in the current and modern world. Thus, this paper will explore the preliminary of conceptual *al-Tawriq* in three different options of future framework. A focused group discussion was conducted to gather information and feedback on these options and the feasibility of future framework that can be adapted.

### RESEARCH METHOD

This research was a qualitative study in nature which engaged with content analysis. Based on the review of literature, this paper will explore and identify the few underlying and important themes towards the establishment of *al-Tawriq's* future framework. A focused group discussion was conducted to gather the necessary information and feedback on these option and the feasibility for future framework to be adapted. Thus, the focused group discussion (FGD) was conducted on 19 September 2017. There were seven persons participated in this FGD and named with Haji, Ahmad, Developer, Ali, Abu, Lynn and Omar (all the respondents' real name were not stated). The profile of all respondents are as follows;

Table 2 : Profile of Respondents

Residential	No	Education	No
Kuala Lumpur	4	Degree	2
Nilai	2	Master	2
Johor	1	PhD	3
Total	7	Total	7
Age	No	Occupation	No
30 - 39	2	Lecturer	4
40 – 49	2	Officer	1
50 - 69	2	Pensioner	1
70 and above	1	Vice President	1
Total	7	Total	7
Gender	No	Status	No
Male	6	Single	1
Female	1	Married	6
Total	7	Total	7

Race	No	Religion	No
Malay	7	Islam	7
Total	7	Total	7

### FOCUS GROUP DISCUSSION ANALYSIS

Three set of situations were asked to be developed as *al-Tawriq* model for *Waqf* asset in future. Future model 1 is the selling part of *Waqf assets* to get liquidity, future model 2 : Qard al-Hassan and future model 3 : *Waqf Mu'aqat* (temporary *Waqf* ). This paper will only analyse future model 1.

#### ***Future model 1: Selling Part of Waqf assets to Get Liquidity***

The question was asked whether the selling part of *Waqf assets* to get liquidity was suitable to be applied in Malaysia. Most of the respondents displayed uncertainty on whether or not the selling part of *Waqf assets* to get liquidity was suitable to be executed in Malaysia, but were certain of the practice's existence in Singapore.

*Ahmad : I am unsure of this practice occurring in Malaysia, I have not seeing it taking place in Malaysia. But this concept of selling part of the asssets is practiced in Singapore*

*Developer: It is different in Singapore.. because they use MUIS as the landmark. They are utilising their own Sukuk*

*Ahmad : In Singapore, the sighah is for the mosque itself, there must be a mosque involved, but it is renovated with the components of different buildings as an addition to the already existng (mosque). Thus, the mosque itself remains but the back part is utilised for other purposes, not only the land. Therefore, it means that the new component is the apartment. The apartment is not part of the original waqf, it is the improvisation (of the mosque). Hence the selling part involved is the improvised part. The mosque is still of used, it is still a facility. Only some (involved) part is sold*

Then, they were be asked regarding the motivational factors that should be applied on the selling part of *Waqf assets* to get liquidity in Malaysia. One of the respondent said that as long as the *Waqf* land was held by the sole trustee, the idea of *al-Tawriq* in selling part of *Waqf assets* to get liquidity can be executed. However, from the developers perspective, the selling of the *Waqf* land was limited to certain banks only. There were limited bank available that were allowed to give financing facility to the developer to develop the *Waqf* land.

*Ahmad : As long as the (waqf) land is under the ownership of the sole trustee, it is possible to be executed.*

*Developer : Based on the previous waqf land in Penang, only ar-Rajhi bank was willing to give us financial support. (We have) loans from two banks, Islam Bank and Muamalat Bank. If we are the developer, from 2018 to 2020, we have..have 2,000 units houses to lease. As for Yusuf's, (we have) about 1,000 units, around more than 800 units for Siti Aishah. And in Ipoh, we have about 144 units and 296 units in Kedah.*

However, according to the experience of the developer in developing the *Waqf* land, the decision varied according to the states and authority. The developer came up with 3 states as an example. For instance, in Pulau Pinang, the Mufti stated that *Waqf* land were not allowed to be sell. Selling were not allowed and the only way for it to be permissible was through the status of 'pajakan' (lease). With 'Pajakan' (lease), Kedah only allowed for the land to be sold to the Malays Muslim, as this land was treated as Malay Reserve. Meanwhile, Selangor opted to remain on the fence regarding the fatwa, showing no sides on whether or not one can sell the *Waqf* land.

*Developer: In Pulau Pinang, the Mufti specified that not even an inch of the land can be sold. Thus the lease route is used. For example, (we can see) how the developer did it in Penang.. the Mufti said the land.. not even an inch of the land can be sold, (hence) in Penang, the term 'selling' doesn't exist (not used)*

*Developer: As for Kedah, the issue is the reserved land.. that the land is reserved only for Malays, the Malay Muslims that is. But there, the person leasing must be a Malay.. a Malay Muslim.. unless it says (fatwa).. only*



*the Siamese buyer is allowed, the Siamese Muslims that it.. the rest are not allowed to buy.*

*Developer: Recently, Selangor is still on the fence. But the fatwa still permits this.. so the PPT can still access the land.*

Next, the discussion was continued by inquiring the question on what were the obstacles in selling part of the the *Waqf assets* / land. The most important point to be made was that, whether or not the title of the particular *Waqf* land was written as not to be sold or pawn its automatically put under leasing title (*pajakan*). Furthermore, with the status of *Waqf* land or its lease label, it is definitely not an easy feat to convince a bank to provide financing facilities. As for now, only two banks (both are foreign banks) showing cooperation in providing financing facilities. Hence, the main obstacle in this was to find the suitable buyer or the financing provider for particular *Waqf assets*.

*Developer :It is written there on the title that the waqf land cannot be sold, cannot be on leased. If the issue is on leasing, the main issue is that he (seller?) is using the 15A form. The youth..they often seek for loan aren't they? But the bank at the time.. there is not even one bank that is willing to provide financial facilities .. for those using the 15A form . Most of the waqf lands are 'free hold' but when they cannot be leased, cannot be used as a down payment and be sold, it is downgraded to the 99 years lease. That's why it (land) is put on lease. But even the bank has limit on providing financial facilities. And we only have two banks at that too. So the issue is that, it is possible to be flexible... but we need people to take the lease for the houses. The Islamic bank.. the cooperation... the so-called Islamic bank is what we are lacking in assisting us to develop the waqf land.*

Following the question, the participants were then asked on the solution of this problem (selling and financing project). The respondent, particularly the developer, was optimistic on the resolution for this matter. One of the solution suggested was through collaboration. Banks, Islamic Religious Council and Developer must collaborate hand in hand to develop the *Waqf* land. The collaboration should be in the context of commercial, by which the selling *Waqf* land were not targeting the benefit of individual but institution. The *Waqf* product should be developed through the commercial office and would then be

sold to the big institution such as KWSP, Tabung Haji etc. with the condition of first buyer only not for the purpose of second buyer. Thus, the trustee should conduct a profiling for each of the *Waqf* land to be further advanced with the suitable *Waqf* project.

*Developer :Now, I think there is a need for collaboration. All must be present.. you cannot make up your part only. The bank should partake, the developer as well, and the Majlis Agama Islam.. now that is the true collaboration.*

*Ahmad :When we discuss this in the context of commercial, it means the office.. office is not sold to the public but to institutions. It may be the issue of financing.. but dealing with bank may already require a different kind of arrangement. It is possible that the institutions.. for example KWSP which has a large fund..it (KWSP?) may lead us to financial support.. to buy the building. In my opinion, (the land) can still be sold.. can be possible if we make a little bit of adjustments..*

*Abu : The developer can provide some financing. developer itu boleh bagi financing.*

*Developer : An auction may be accepted by Majlis Agama Islam. (but) the land, the land belongs to him (owner?). He owns it. But only for the first buyer. As for the second buyer, [dia boleh on off that state] So it basically depends on the lease, not based on the land. This is what bank fails to understand, the issue regarding the lease. The land.. it originally does not have any title. But as for the 'free-hold' 14A form (land) with 99 years of lease, those kinds do have a title.*

*Lynn : The trustee needs to do some research in the profiling of waqf lands. There is a suggestion from Dr. Shamsiah Abdul Karim regarding the execution of asset allocation or spending policy, a discussion on the most suitable weightage in asset allocation.*

Based on the discussion, it was deducted that the importance of al-Tawriq execution was to unlock the value of *Waqf* land or assets. This is because without liquidity, it's difficult to prosper the *Waqf* land / assets. The respondents agreed that by liquidating the *Waqf* land in order to further develop the land will uplift the value.

*Ahmad :The land, if left unattended can worth only thousands, but if it is developed, its worth can reach up to millions. Hence.. the justification is that.. one portion intended to be developed does need a financial support even when sold by only a part, but what should be the focus is the increasing worth, not the low value of its physical worth. The focus needs to be on its worth. So if it is not perceived in such way, the worth can never increase rapidly.*

An example on how to resolve the value was by developing the unproductive area of mosques and integrated them with apartments. These apartments would be sold as to get feasible return that could be utilised to maintain, renovate or repair the original mosque to the new building which is bigger, better and highly benefited to the ummah.

*Ahmad : For instance, let's say that there is one area of the land with a mosque, but the mosque is unattended and already ruptured. So we should have plan to develop the land, the back part (of the land) should be built apartments and more and then be sold. The profit gained from the apartments then can be the source to repair and renovate the mosque to be bigger and better as to bring more benefit.*

### ***Future model 2 : Qard al-Hassan***

Next, the question was asked on whether liquidating *Waqf assets* through Qard al-Hassan was suitable to be applied in Malaysia?. This model has been doubt on its suitability especially in keeping the *Waqf* asset sustained and maintained. This concern was shared by the respondent particularly with the payback record behaviour. The difficult part was on encouraging the *Waqf* managers to pay back to the lender. This failure in the system also occurred during the Ottoman period. Even though the initiative was good, but the committee member had mentioned that the possibility of failing in paying back is high, as observed by the difficulties faced by Majlis Amanah Rakyat (MARA), Tabung Nasional (TEKUN) and Amanah Ikhtiar Malaysia (AIM) be it from the entrepreneurs or students. Thus, awareness of implementing Qard al-Hassan should be clear, so that the prosperities of *Waqf assets* can be achieved smoothly. On top of that, there are some cases where the tenant did not pay the rent due to the perception that *Waqf assets* should be free, even though the rent is as lower as RM 3.00 per month.

*Lynn : I think this is difficult to be sustained.*

*Ahmad : Take a look at Cash Waqf Turki . In previous period, there was the concept of borrowing Waqf cash, but failed at the end, even though it was a well-thought system. Cash Waqf Turki.*

*Developer : This system.. even if executed... Islam's economy is still underdeveloped*

*Dr.Fuadah : What is the obstacle?*

*Lynn : Behaviour. This is the problem of mentality. As I'm saying this, I still fear my possibly unfair judgement. But.. as of now.. even when it is executed, without any interest, whether to entrepreneurs or students, it still has this kind of.. even though we are helping the Malays, as waqf should be an aid to Muslims.. God knows better. I fear to this kind of mentality. Even now the public perception is that waqf should be free. I fear, with the execution of qard hassan,[ satu in term of dia punya strive pun dia tidak] , he doesn't have the liability to payback. Behaviour.*

*Ahmad : There is a doubt on the context of Muslims' behaviour themselves when it comes to paying back.*

*Developer : Awareness among the Muslims.*

*Ahmad :Not only MARA, but Pinjaman Tekun, Amanah Ikhtiar Malaysia and more mostly experience non-fulfilment..*

*Developer : As if the waqf land is free. Even up till now, with rent of a mere RM 3.00, RM 3.00 and yet still unpaid. When we start an organization to assist the debt collector, in terms of collecting the rent, we try to make the shops work like a night market, but.. as the awareness fails to reach the targeted people, up till now (the rent) remains unpaid.*

The following question was focused on how to solve this problem. The essential part of *Waqf assets* were to ensure the *assets* were developed to get the return. From the return gained through *Waqf asset*, the profit could then be used to revive the *Waqf assets*

through al-Qard al-Hasan. However, the most important crucial matter was that all decision should be firstly consulted to the Islamic Religious State Council.

*Developer : That's why if possible we need to firstly have the assets. When the assets are available, we can develop the lands. For example, the Siti Aisyah waqf, where we gain 350,000 per month. How much can we get if we are to follow the deal that split the 12% percent to other places. But (it needs to be observed) under the question of why? Where does the money go to? That is what we need to know. That is why we portion [in-kind aset] to Majelis Agama Islam. We put it (profit?) in a fund, a fund that we can further generate, generate and generate.*

### ***Future model 3 : Waqf Mua'qat (Temporary Waqf)***

Compared to the first and second model, the third model was agreed by most of the respondents to be suitable to be executed in liquidating the *Waqf* land / assets. In fact, the respondents also showed agreement to the idea of contributing the *Waqf* land for temporary.

*Is this model suitable to be executed in order to reach flexibility, to develop the land and the waqf assets?*

*Developer: Suitable.*

*Omar : In 2004, (the Mufti) came up with a fatwa that allowed sub-contract? in the leasehold interest of property, that is the sub-contract for waqf owners. For me personally, we can observe this leasehold.. in terms of a certain period of time. This leasehold is a contrast to primehold. The leasehold interest, for me, is possible to be executed in this context. If the context of land ownership has a certain period of time, why can't the same be done to the waqf land ownership.*

*Abu : Let's say an agreement granted (waqf) the land for only a period of 10 years. When it reaches the agreed time, the owner wants his land back.. what would happen then?*

*Developer : No problem. It can be done the usual way shops are rented.*

*Omar : But if we look at the leasehold with an agreed period of time, the duration may vary. It can reach up to 60 years, maybe 90 years, maybe even 10 years.*

Another option was to execute temporary *Waqf* for some period of time. Meanwhile, the developer will get a financing and develop some unit of houses, for example 10 unit of houses from the land. The houses would be rented to the tenant and the *Waqf* house will obtain the rent as its manfaat / benefit. After 10 years, the *Waqf* land would then be return to the owner. The best possible period of temporary *Waqf* is the longer time of years as to temporary *Waqf* status.

*Developer: Let's have a situation where you want to grant (waqf) 5 acres of the land, and you would want it back after 10 years. It's fine, it can be done for you. The 10 units mentioned by your family, the profits are all kept for you and can be used when you desired. By then, let's say the 20% we gain from the 10 units, the portion of rent that you want to grant (waqf), in my opinion, is not necessarily needed to be granted as a whole. I think that it would be better for you to grant the amount that would want to earn back. The rest of the waqf belongs to the Muslims. So the matter is that, you grant how much you want, and we give you back in the form of 10 units of shops which you initially state you do not want in the present time. But you will take it back.. let's say 10 or 20 years later.. maybe the worth of 200,000 can double up to 2 or 3 millions.*

## CONCLUSION

The commitment to raise Bumiputera's capabilities through equity possessions is the main agenda in enhancing the progress of the ummah in Malaysia. *Waqf* has been identified as an excellent instrument to be explored. However, due to the lack of financial resources, the *Waqf* land development has been neglected. *Al-Tawriq* is found to have the capacity for an individual or a company to convert assets into cash or the immediate ability to meet one's financial obligation This definition gives the impression that liquidity is a process of converting assets into cash or cash equivalents and the process must not lead to a significant loss. Liquidity varies in purpose. In the finance sector for example, liquidity is the bank's ability to meet any unexpected demands for cash from its depositors. On top of that, *Al-Tawriq* (securitization) is an innovative financial instrument

that can mobilize a range of secured assets of debt by transforming it from debt to enhanced credit, and then presenting it to the public through a specialized way for subscription in the form of securities, in order to minimize risks and to ensure the continued flow of liquidity. Three set of situations and future model were asked to be developed as al-Tawriq model for *Waqf* asset in future. Future model 1 is selling part of *Waqf assets* to get liquidity, future model 2 : Qard al-Hassan and future model 3 : *Waqf Mu'aqat* (temporary *Waqf*). This study discovers that the chosen participants are not entirely certain on the feasibility of future model 1, have doubt regarding the sustainability of future model 2 but are optimistic for future model 3. History has proven that liquidating of *Waqf assets* can be executed and with proper documentation, obtaining cash is permissible and these can be applied in the attempt to solve the *Waqf* financing and development problem. Thus, al-Tawriq is a new dimension and innovation on top of normal practice of cash *Waqf* and other models in enhancing the third sector of economy (Economy Ijtima'i) and enhancing the development of the ummah.

#### ACKNOWLEDGMENTS

Special appreciation to Faculty of Economic and Muamalat, Universiti Sains Islam Malaysia (USIM) and Yayasan Tun Ali Berdaftar for grant research entitle : “*Exploring the Principle of Tawriq in Liquidating Part of Waqf Assets for Maintenance and Development*” (USIM/YTI/FEM/052002/40817). FRGS research grant entitle “*Kaedah Mencairkan Tanah Wakaf untuk Membiayai Projek Pembangunan Wakaf di Malaysia* (USIM/FRGS/FEM/055002/50817)”

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## **INDONESIA-YEMEN BILATERAL TRADE RELATIONS: A PRODUCT COMPETITIVENESS MAPPING ANALYSIS**

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### **ABSTRACT**

*This study discusses efforts to boost Indonesia's exports by formulating Indonesian product competitiveness mapping analysis with Yemen as the counterpart. Based on the product competitiveness mapping analysis, it could be concluded that in general the Indonesian exports products has higher competitiveness than the Yemeni export products. At the same time, however, the two countries can be said still have a low level of competitiveness of their respective export products. The study suggests both countries should pursue a bilateral FTA.*

**Keywords:** *Economic Diplomacy, Product Mapping, Competitiveness, Foreign Policy, Indonesia, Yemen.*

### **INTRODUCTION**

Indonesian diplomatic relations with the Republic of Yemen have been cordial and positive over the years. In fact, the two nations have historically closed emotional connection. It started in the 9<sup>th</sup> Century, in which Sayyid Ali bin Muhammad Dibaj bin Ja'far Shadiq, a Hadhrami people from Yemen migrated to East Aceh, Indonesia and married with a younger sister from the King Perlak Syahir Nuwi. Several centuries after, Syekh Jamaluddin Akbar and his families, from Gujarat, India but descendant from Hadhramaut region migrated to Southeast Asia to spread the religion of Islam. In Indonesia, he went to East Java and he actively perform Islamic missionary endeavour to the Indonesian society in Java, and thus, he was known as Walisongo.

The third waves was in the 17<sup>th</sup>-19<sup>th</sup> centuries in which many Hadhrami people (particularly the Alawiyyin Hadhrami) to spread Islamic religion and do trade for living in Indonesia. Further, in the period 1870-1888, there were significant number of Hadhrami people migrated to Indonesia. Apart from performing Islamic missionary endeavour and conduct trade activities, the Hadhrami people in Indonesia also played an important role in

supporting the Indonesian struggle for independence and post Indonesian independence, many Indonesian Hadhrami become important figures and play important role in the Indonesian government and communities.

This attaching emotional relations should become a strong asset foundation, for Indonesia and Yemen to strengthen their brotherhood diplomatic relations. In addition, it is estimated there are around 9 million Indonesian people which are Yemeni descendant in Indonesia. These certainly are valuable and indispensable strategic assets for Indonesia and Yemen to further strengthen the bilateral relations in all fields.

Mr. Al-Junaidi (2016) stated that in Yemen there is a metaphor “if you want to be blessed in this *dunia* (world), then, the Yemenis should adhere your elder brother, which is Indonesia”. In the context of the diplomatic relations, the Government of the Republic Yemen has always considered Indonesia as a brotherly country. During the Indonesian struggle for independence, Yemen was one of the first countries (on 3<sup>rd</sup> May 1948) which supported the recognition of Indonesia as an independent and sovereign state, and over the years (post Indonesian independence) Yemen has always supported the integrity of Indonesia as an independent state.

After the unification of the Republic of Yemen, Indonesia-Yemen diplomatic relations have started since 1992 (Ministry of Foreign Affairs of the Republic of Indonesia, 2016). In the diplomatic sphere, the close bilateral diplomatic relations could be seen by the frequency of the reciprocal high official visits by both countries. It is noted the Indonesian President, Mr. Abdurrahman Wahid made an official visit to Yemen in 2001, while the Yemeni President made working visits to Indonesia in 1998, 2009, and 2016. In addition, the Vice President, Mr. Hamzah Haz paid an official visit to Yemen in 2003. Meanwhile, Yemeni Vice President Abdu Rabbu Mansour Hadi visited Indonesia in 2002.

Within the economic realm, both countries have signed number of MoUs in economic cooperation, and bilateral economic relations have enhanced over the years. Both countries have expanded their trade and investment relationships. The socio-cultural cooperation has also expanded over the years, including education,

In 1990, the bilateral trade was only US\$10.46 million and in 2015, the bilateral trade volume reached US\$89.30 million. The bilateral trade reached its peak in 2013 amounted

US\$159.38 million, prior to the Yemeni armed conflict in 2014 (the Al-Houthi seized control of the Capital Sana'a in 2014) and culminated in 2015 when a Saudi-led coalition launched airstrikes in Yemen.

Based on the trade structure, in 1990, Indonesian export amounted US\$9.85 million consisting of intermediate goods (85.98%), consumer goods (11.77%), and capital goods (2.23%). Meanwhile, in 2015, Indonesian export reaches US\$88.2 million comprising of consumer goods (78.88%), intermediate goods (15.47%), capital goods (5.26%), and raw materials (0.37%). Thus, there is a significant change on the composition of the Indonesian export commodities to Yemen, from mainly intermediate goods to consumer goods.

Meanwhile, for the Indonesian imports from Yemen, in 1990 were raw materials (63.39%), intermediate goods (28.47%), consumer goods (7.49%), and capital goods (0.64%) with a total of US\$605929. And in 2015, the Yemeni exports were mainly raw materials (98.38%), consumer goods (1.21%), and capital goods (0.4%) valued US\$573182. This shows that over the years, Yemen still strong relies on raw materials export to Indonesia with a very little amount. In fact, in 2015 Indonesian imports from Yemen were mainly frozen fish accounted for 98.38% of the total Indonesian import.

Economic cooperation is one of the current emphasis in the Indonesia-Yemen bilateral relations. Over the years, the economic cooperation has enhanced but due to the internal conflicts in Yemen particularly in 2014/2015, then, the economic relations have deteriorated afterwards. The Yemeni revolution which is also known as the Yemen uprising (*Intifada*) took place back in 2011 after the series of Arab Spring protests in the Middle East and North African region (MENA).

Indonesia views Yemen as a potential non-traditional market. The population has almost tripled since 1980 from 8.4 million to 25 million people in 2015. Prior the war conflict 2014/2015, the economic relations were in general positive. Within the trade sphere, bilateral trade have been increasing and reached its peak in 2013 amounted US\$159.38 million. But post war conflict, bilateral trade has deteriorated and in 2015 only reached US\$89.3 million. Further, bilateral investment relations have also faced challenges. Indonesian companies such as Medco (oil and gas exploration firm) and Indofood (food producing company) have closed their operation in 2015. The current Yemen's foreign policy highest priority is to end the war conflict in Yemen.

Yemen is one of the least developed countries in the world. Then, the focus of the ICT cooperation could be to strengthen infrastructures and human resources capacity development. In 2015, Yemen ranks 4<sup>th</sup> lowest Human Development Index (HDI) in Middle East Northern African (MENA) region. The war conflict causes Yemen continues to suffer from the structural developmental problems that necessarily exacerbate the political crisis. Further, the weakness of the Yemeni state is also a huge concern. The government does not able to effectively provide adequate basic services to the Yemeni people including electric power and water supply shortages. In 2015, Kusuma (2016) mentioned that Yemen's economy contracted by 28 percent, making as the country with the worst economic performance in the world for the year 2015.

One of the emphasis of the Indonesian diplomatic relations with its are to enhance economic cooperation. Economic cooperation among others cover: trade, investment, finance, tourism technical cooperation, food security, and energy security. Economic diplomacy is one of the priority agenda in the current era of Jokowi Government for the period 2014-2019. In general, Indonesia's economic diplomacy efforts are aimed at increasing Indonesian exports, encouraging foreign investment to Indonesia, and attracting foreign tourists to Indonesia.

This study attempts to discuss ways boosting Indonesia-Yemen bilateral trade relations through formulating Indonesian product competitiveness mapping with one of the friendly countries, the Republic of Yemen which is considered as one of the countries in the non-traditional market classification for Indonesia's economic diplomacy mission (Sjahril, 2016).

#### ***DATA AND RESEARCH METHODOLOGY***

This paper uses the product mapping analysis as outlined by Tri Widodo (2008). To create product mapping analysis, two analytical tools are needed, namely Revealed Symmetric Comparative Advantage (RSCA) and Trade Balance Index (TBI). RSCA is an indicator of comparative advantage, whereas TBI is an indicator of export-import activity. The RSCA index is a simple transformation of the Revealed Comparative Advantage (RCA). RCA is also an indicator of comparative advantage (or product competitiveness). The RSCA index is formulated as follows:

$$RSCA_{ij} = (RCA_{ij} - 1) / (RCA_{ij} + 1)$$

Where the RSCA<sub>ij</sub> index value varies from -1 to 1 ( $-1 \leq RSCA_{ij} \leq +1$ ). If RSCA<sub>ij</sub> more than 0 means country i has a comparative advantage in product group j. Conversely, if RSCA<sub>ij</sub> is less than 0 then country i has no comparative advantage in product group j.

Meanwhile, TBI is used to analyze whether a country has specialized in export (as a net-exporter) or in import (as a net-importer) for a particular product group (SITC). TBI is simply formulated as follows:

$$TBI_{ij} = (X_{ij} - M_{ij}) / (X_{ij} + M_{ij})$$

TBI<sub>ij</sub> symbolizes the country's trade balance index i for product group (SITC) j; The index values vary from -1 to +1. Extreme, TBI equals -1 if a country imports only, and vice versa, TBI equals +1 if a country only exports it.

The value of the TBI index can not be determined if a country is not exporting or not importing at all. In this case, a value of 0 is given to potential product groups for export or import. The value between -1 and +1 indicates that the country exports and imports the commodities simultaneously. A country includes a net-importer on a particular product if the value of TBI is negative, and as a net-exporter if the value of TBI is positive.

Picture 1: Product Mapping Analysis

Revealed Symmetric Comparative Advantage Index (RSCA)	RSCA > 0	<b>Group B:</b> Have Comparative Advantage No Export-Specialization (net-importer) (RSCA > 0 and TBI < 0)	<b>Group A:</b> Have Comparative Advantage Have Export-Specialization (net-exporter) (RSCA > 0 and TBI > 0)
	RSCA < 0	<b>Group D:</b> No Comparative Advantage No Export-Specialization (net-importer) (RSCA < 0 and TBI < 0)	<b>Group C:</b> No Comparative Advantage Have Export-Specialization (net-exporter) (RSCA < 0 and TBI > 0)
		TBI < 0	TBI > 0
		Trade Balance Index (TBI)	

Source: Tri Widodo (2008)

Using the RSCA index and the TBI index, product mapping can be performed. The product (SITC) can be categorized into four groups, namely A, B, C and D as shown in the figure above. Group A contains products that have comparative advantages as well as export specialization. Group B consists of products that have comparative advantages but do not have export specialization. Group C contains export-oriented products but does not have a comparative advantage. Group D consists of products that do not have a comparative advantage nor do they have export specialization.

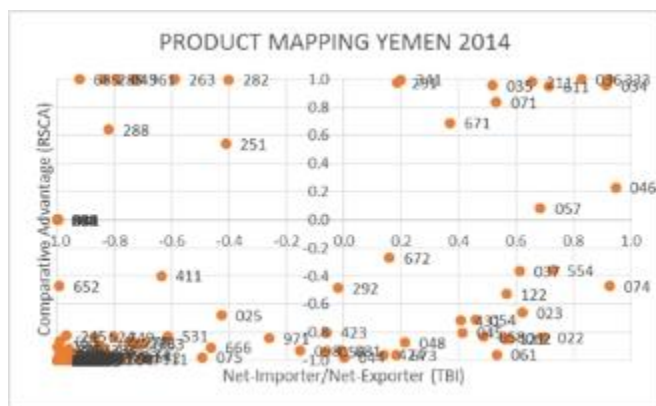
This study will examine the mapping of product competitiveness between Indonesia and Yemen by using trade data 2014, a year before the armed conflict in Yemen with consideration to illustrate the mapping and competition of export products of both countries at the second the state has no political and security problems. Furthermore, for product data will use SITC 3 Digit code. Given the wide range of export products, the analysis will be selective.

**PRODUCT COMPETITIVENESS MAPPING ANALYSIS**

***Product Competitiveness Mapping Analysis for the Republic of Yemen***

In mapping the competitiveness of Yemeni products, it is depicted that Yemeni export products included in Group A are very few as many as 12 products alone or 5 percent of all Yemeni export products. Most Yemeni export products (84.5 percent of Yemen's total export products) have low competitiveness and as net importers or belong to group D. Yemen relies heavily on imports of products from abroad due to the limited availability of domestic products as well as the result of Yemen's own product competitiveness which is indeed low. In addition, Yemen appears to have not diversified its export products and rely solely on exports of oil and gas products such as crude oil and natural gas.

Graph 1: Product Mapping for Yemen State of 2014



Source: World Integrated Trade Solutions (2017)

In detail, it is depicted that there are 12 (twelve) Yemeni export products that have very high competitiveness with the highest TBI, among others are: petroleum (SITC 333), fishery products (SITC 034, SITC 035 and SITC 036), leather products (SITC 046), crude animal materials (SITC 291), iron (SITC 671), and fruit (SITC 071) fruits & nuts (SITC 057). All of the export products are included in Yaman's product A group mapping.

Table 1: RSCA and TBI Results for the Republic of Yemen 2014 (Top 12)

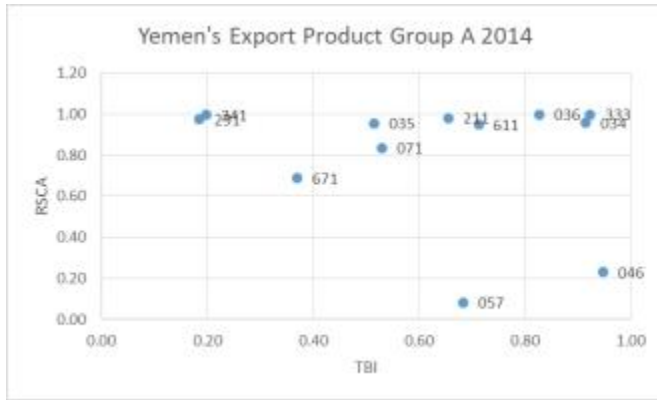
Rank	SITC	Description	RSCA	TBI	Rank Average
1	333	Petrol.oils,crude,&c.o.obtain.from	0.92	1.00	0.96
2	034	Fish,fresh (live or dead),chilled o	0.91	0.96	0.94
3	036	Crustaceans and molluscs,fresh,chil	0.83	1.00	0.91
4	611	Leather	0.71	0.95	0.83
5	211	Hides and skins (except furskins),	0.66	0.98	0.82
6	035	Fish,dried,salted or in brine ; smo	0.52	0.96	0.74
7	071	Coffee and coffee substitutes	0.53	0.84	0.68
8	341	Gas,natural and manufactured	0.20	1.00	0.60
9	046	Meal and flour of wheat and flour o	0.95	0.23	0.59
10	291	Crude animal materials,n.e.s.	0.18	0.98	0.58
11	671	Pig iron,spiegeleisen,sponge iron,i	0.37	0.69	0.53
12	057	Fruit & nuts(not includ. oil nuts),	0.68	0.08	0.38

Source: World Integrated Trade Solutions (2017)

The two main commodities exported by Yemen by 2014 are: petroleum (SITC 333) reached US\$1.27 billion followed by natural gas (SITC 341) of US\$68.77 million. Although Yemen is not the main crude producer compared to other countries in the Arabian Peninsula region, Yemen's government relies heavily on export earnings from the energy sector to finance Government programs primarily in financing infrastructure development, imports of capital goods and imports of food from abroad.

Graph 2: Yemen's Export Product Group A 2014 (Top 12)





Source: World Integrated Trade Solutions (2017)

In 2014, production and oil prices fell but Yemen is still able to export petroleum, even the export of crude oil reaches 83.3 percent of Yemen's total exports. By 2015, due to the war in Yemen especially since April 2015, many foreign oil and gas companies leave the country. Thus, most domestic crude oil and LNG production ceases operations, so practically no exports exist, meaning, the RSCA index practically decreases to none.

***Product Competitiveness Mapping Analysis for the Republic of Indonesia***

In mapping the competitiveness of Indonesian products, it is illustrated that Indonesia's export products that fall into Group A are relatively few as many as 56 products, and about 61.3 percent of the total Indonesian export products (or as many as 146 export products) still have low competitiveness and as net importers, entered in group D. It is illustrated that in 2014, the Government of Indonesia has not been able to diversify exports of products abroad. Indonesia still relies heavily on imports of products from abroad to meet domestic demand due to limited availability of domestic products or due to the competitiveness of Indonesia's own products which are still weak overall.

Graph 3: Product Mapping for Indonesia 2014



Source: World Integrated Trade Solutions (2017)

In detail, there are 56 (fifty six) Indonesian export products that have very high competitiveness with the highest TBI and the top ten are: vegetable oil (SITC 424), natural rubber (SITC 232 ), tin (SITC 687), wood and charcoal wood (SITC 245), coal (SITC 322), animal and vegetable oils and fats (SITC 431), ore & concentrates of precious metal (SITC 289), margarine and butter SITC 091), crustaceans and molluscs (SITC 036), and textile clothing (SITC 844).

Based on the value of export volume, some of the main commodities exported by Indonesia in 2014 are: coal (SITC 322) reached US\$20.82 billion followed by vegetable oil especially palm oil (SITC 424) of US\$19.95 billion, natural gas (SITC 341 ) of US\$17.18 billion, petroleum (SITC 333) of US \$9.27 billion, natural rubber (SITC 232) of US\$4.74 billion, footwear (SITC 851) of US\$3.97 billion, and paper products (SITC 641) of US\$3.32 billion. It is illustrated that Indonesia's export mainstay products still rely heavily on the oil and gas sector, although the Government of Indonesia has continued to diversify its export products from other sectors such as agriculture and manufacturing sectors.

Table 2: Results of RSCA and TBI for Indonesia 2014(Top 10)

SITC	Uraian	RSCA	TBI
<b>424</b>	Other fixed vegetable oils,fluid or	0.96	1.00
<b>232</b>	Natural rubber latex; nat.rubber &	0.93	0.98
<b>687</b>	Tin	0.94	0.98
<b>245</b>	Fuel wood (excluding wood waste) and wood charcoal	0.79	1.00
<b>322</b>	Coal,lignite and peat	0.92	0.97
<b>431</b>	Animal & vegetable oils and fats,pr	0.88	0.93
<b>289</b>	Ores & concentrates of precious metal	0.60	1.00
<b>091</b>	Margarine and shortening	0.79	0.92
<b>036</b>	Crustaceans and molluscs,fresh,chil	0.66	0.94
<b>844</b>	Under garments of textile fabrics	0.62	0.93

Source: World Integrated Trade Solutions (2017)

Graph 4: Indonesia's Export Product Group A Year 2014 (Top 12)



Source: World Integrated Trade Solutions (2017)

***Product Competitiveness Analysis: Indonesia vs Yemen***

Based on the analysis of product competitiveness mapping analysis from each country can be described that in general the number of Indonesian exports products that are superior to the superior competitiveness compared with Yemeni export products. There are 56 Indonesian export products that have superior competitiveness with net exporters (Group A), while Yemeni export products in the same group are only 12 products.

But at the same time, in overall the two countries can be said still not able to boost the competitiveness of their export products. About 61.3 percent of Indonesia's total export products are in the category of Group D, which is weak competitive and net importers. While Yemen, there are about 84.5 percent of the total export products are in group D.

Table 3: *Product Mapping Analysis, Indonesia vs Yemen*

2014					
<b>Group B</b>			<b>Group A</b>		
Indonesia	12	5.0%	Indonesia	56	23.5%
Yemen	17	7.1%	Yemen	12	5.0%
<hr/>			<hr/>		
Both Countries		6.1%	Both Countries		14.3%
 <b>Group D</b>			 <b>Group C</b>		
Indonesia	146	61.3%	Indonesia	24	10.1%
Yemen	201	84.5%	Yemen	8	3.4%
<hr/>			<hr/>		
Both Countries		72.9%	Both Countries		6.7%

Source: World Integrated Trade Solutions (2017)

## CONCLUSION

Economic diplomacy is one of the priority agenda in the current era of Jokowi Government. In general, Indonesia's economic diplomacy efforts are aimed at increasing Indonesian exports, encouraging foreign investment to Indonesia, and attracting foreign tourists to Indonesia. This study discusses efforts to boost Indonesia's exports by formulating Indonesian product competitiveness mapping with friendly countries, the Republic of Yemen which is one of the countries in the non-traditional market classification for Indonesia's economic diplomacy mission.

Based on the product competitiveness mapping analysis from each country could be concluded that in general the Indonesian exports products has higher competitiveness than the Yemeni export products. At the same time, however, the two countries can be said still have a low level of competitiveness of their respective export products.

It can be concluded that if Indonesia and Yemen cooperate in free trade, then by referring to the results of the product competitiveness mapping analysis of the two countries, it is predicted that Indonesia will be quite superior in so called 'open trade competition' with Yemen. Considering the result of the analysis, in the policy suggestions

of this study, the Government of Indonesia may be should explore opportunities for free trade cooperation with Yemen. This study is could become an anticipation study for the Indonesian policymakers to increase trade cooperation of both countries in the future.

Further, there are also several rationale and cooperation possibilities behind to expand bilateral trade cooperation including: 1) Countries' economic diversification effort. Currently the economic structures in Indonesia and Yemen are still highly concentrated on the primary sectors; 2) South-South Cooperation, in which there are opportunities to expand bilateral cooperation including technical cooperation.

For the economic diversification effort, all parties involved have strong interest to diversify their economic structures. Over the years, Indonesian economy and export structures have strongly relied on the primary sectors such as agricultural and mining sectors. Indonesia still mainly dependent on primary commodities exports such as coal, natural rubbers, mineral commodities (tin, copper, gold), and palm oil commodities.

Meanwhile Yemen is still largely dependent on oil and gas sectors. The current economic structure is also a significant matter. Oil revenues represent 70 percent of the government's total revenues and oil constitutes 90 percent of the total country's exports, which will be depleted within a decade if new oil reserves are not explored and discovered. Further, the agricultural sector faces huge challenges. The agricultural sector in Yemen takes up around 90 percent of water in Yemen and it only generates 6 percent of GDP - with majority of Yemenis are dependent on small-scale subsistence agriculture. Thus, depleting oil resources combined with wasted resources are huge challenges in Yemen.

For the South-South Cooperation, for the case of Indonesia-Yemen bilateral relations, to some extent Indonesia could actively contribute to help Yemen from being a 'fragile state' to become an 'effective state' in the Arabic region. In accordance to the Indonesia preamble constitution 1945, Indonesia has to actively contribute to build a sustainable world peace. Further, in accordance to the national agenda 2015-2019, Indonesia should play role to become a middle power country (Ministry of Foreign Affairs of the Republic of Indonesia, 2015).

Indonesia would be difficult to become a core player in aiding the Yemeni Crisis. But Indonesia could become the 'right and effective marginal player' in helping cope the

Yemeni Crisis. First, Indonesia as a moderate moeslim majority country could become a potential mediator in tackling the Yemeni political crisis. Second, Indonesia could become an alternative economic and technical aid providers to Yemen. Several potential technical capacity building includes: management of public finances, investment in human capital, and provision of infrastructure services.

Last but not least, Indonesia and Yemen should start to take seriously to attempt developing an emerging collaborative partnership based on brotherhood relations bond. Indonesia and Yemen have strong intangible assets to not only enhance, but elevate the bilateral diplomatic relations into so-called an emerging collaborative partnership. But to achieve this goal, both sides should be more creative and proactive in finding the cooperation opportunities by identifying their respective needs, wants, and their given capabilities.

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## DOES HALAL *RIBA* EXIST? EXAMINING THE CASE FOR *HIBAH AL-THAWAB*

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### ABSTRACT

*It is clearly stated that riba (usury) is strictly prohibited in Islam. It is based on the evidence of holy Quran, Hadith of Propohet Muhammad PBUH and consensus of Muslim ummah. It is a clear word of haram (prohibition) in holy Quran 2:275. Suppose there is no issue to raise on its legal status. However, it was found that holy Quran 30:39 leads to the interpretation about the kind of permissible riba. Why this occur when it already been a consensus? The most interesting is the statement does not been opposed by other Muslim scholars and been cited in many references. This paper aimed to explore the matter which related to the contract named as 'Hibah al-Thawab'.*

**Keywords:** *Islamic Finance, Riba, Hibah*

### INTRODUCTION

*Riba* (usury) is prohibited in Islam. The prohibition of it in the holy Quran is clearly mentioned by the phrase '*prohibition*'<sup>1</sup>. Furthermore, the sin of *riba* is ranked as the highest from the other kind of prohibition in *muamalat* (Islamic business transaction). To a certain extend, al-Fataani<sup>2</sup> rejected the status of Islamic State if the *riba* system is applied eventhough the *hudud* is perfectly implemented.

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<sup>1</sup> Holy Quran [2:275]

<sup>2</sup> al-Fatani IL, *Ikhtilaf Ad-Darain wa Atsaruhu fi Ahkam Al-Munakahat wa Al-Muamalat* [The Effect of Two Dars (Dar Al-Islam and Dar Al-Harb) on Islamic Personal and Transaction Law, Dar al-Salam, Cairo, 1990]



The holy Quran in the verses of *riba* prohibition not only put a stop to *riba*, but provides the punishment in the hereafter. Ibnu ‘Abbaas<sup>3</sup> discussed that a person who avoids repentance from *riba* will be asked to prepare for war opposing against Allah and Prophet PBUH in the hereafter. Apart from the prohibition verse, the scholars have discussed the punishment of *riba* here in this world, as to explain *riba* as the major type of prohibition in *muamalat*.

### MOTIVATION OF STUDY

While it became a consensus between scholars and ummah about the prohibition of *riba*, there is an interesting interpretation given by prominent scholars on the other verses related to *riba*. Allah SWT said in the Holy Quran

*And that which you give in gift (to others), in order that it may increase (your wealth by expecting to get a better one in return) from other people's property, has no increase with Allâh, but that which you give in Zakât seeking Allâh's countenance then those, they shall have manifold increase.*<sup>4</sup>

Al-Dhohaak<sup>5</sup> said while commenting the verse

*This is the halal riba that gives the gift (with) the need to get more from it. No reward for him and no burden. And only prohibited for the Prophet PBUH as Allah said<sup>6</sup> (And give not a thing in order to have more (or consider not your deeds of Allâh's obedience as a favour to Allâh).*

‘Ikrimah as narrated by al-Tobari<sup>7</sup> said

*There are two types of riba, riba halal and riba haram. The halal is the one who gives a gift and seek what is better than it.*

The point that they agreed is based on the statement of most *musfassin*<sup>8</sup> that there is a type of halal *riba*. This statement has initiated the author to explore on the matter, due to its contradiction of the prohibition of *Riba* in the Quran.

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<sup>3</sup> Al-Khin et all. *Al-Fiqh Manhaji*, v3 p76. Dar al-Qalam, Damascus, 7th Edition. 2006

<sup>4</sup> Holy Quran [30:39]

<sup>5</sup> Al-Zawiyati MS. *Tafsir al-Dhohak*, v2 p662-663. Dar al-Salam. Cairo. 1999

<sup>6</sup> Holy Quran [74:6]

<sup>7</sup> Al-Qurtubi AAA. *Tafsir al-Qurtubi*. v14 pg 36. Dar al-Syaab. Cairo.

<sup>8</sup> *Tafsir al-Son'aani* v3 p104, *Tafsir al-Wahidi* v2 p843, *Tafsir al-Baghoowi* v3 p484, *Tafsir al-Nasafi* v3 p275, *Tashil Ulum Tanzil* v3 p123, *Tafsir al-Kasyaf* v3 p487, *Tafsir Fath al-Qadir* v4 p227, *Tafsir Muharrar Al-Wajiz* v4 p339, *Tafsir al-Sam'ani* v4 p216, *Tafsir Zad Al-Muyassar* v6 p304, *Tafsir al-Qurtubi* v14 p36, *Tafsir al-Tobari* v21 p45-48, *Tafsir Ruh al-Ma'ani* v21 p46, *Tafsir al-Kabir* v25 p111

After reviewing the interpretation above, the scholars agree that the halal *riba* above is a contract of *hibah al-Thawab* (gift with compensation). The below questions have been raised.

1. What is the gift with compensation connected to the halal *riba*?
2. Is there any exceptional from the prohibition of *riba* for gift with compensation?
3. Is the phrase *riba* in the statement above based on the literal meaning?

### **REVIEW ON THE RULE OF RIBA TRANSACTION**

*Riba* is defined as any excess compensation without any corresponding counter-value recognized by the Shariah<sup>9</sup> Al-Bugha<sup>10</sup> gives a few characteristics of *riba* namely the subject matter and transaction process. This is a *riba* that occur on sale transaction. It is based on Abī Sa’īd al-Khudry who reported Allah’s Messenger as saying:

*Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt. (When a transaction is) like for like, payment being made on the spot, then if anyone gives more or asks for more, he has dealt in Ribā, the receiver and the giver being equally guilty. (Sahīh, Muslim)*

The subject matter concluded that *riba* only occurs on the transaction between *riba* item based on the reasoning (*illah*) either currency (including gold and silver) or commodity. The transaction process in other perspective concludes the transaction process which must be equal exchange and/or on the spot basis<sup>11</sup>

The other type of *riba* is based on loan. Any benefit of loan (monetary or non-monetary) will be considered as *riba* if it is part of the contract. Al-Bayhaqi said;<sup>12</sup>

*We narrated from Faddaalāh ibn ‘Ubayd that he said: Every loan that brings benefit is a kind of riba. And we narrated similar views from Ibn Mas‘ood, Ibn ‘Abbaas, ‘Abd-Allah ibn Salaam and others; it was also narrated from ‘Umar and Ubayy ibn Ka‘b.*

### **INTRODUCTION TO HIBAH AL-THAWAB (GIFT WITH COMPENSATION)**

The preferred definition of *hibah* is ‘to give ownership to those who are entitled for donation as approved by Shariah without counter value to those who are entitled to receive with the language or any that shows it’<sup>13</sup>. The phrase ‘without counter value’

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<sup>9</sup> ISRA Compendium, Kuala Lumpur, 2010

<sup>10</sup> Al-Khin et all. *Al-Fiqh Manhaji*, v3 p68. Dar al-Qalam, Damascus, 7<sup>th</sup> Edition. 2006

<sup>11</sup> Al-Khin et all. *Al-Fiqh Manhaji*, v3 p68. Dar al-Qalam, Damascus, 7<sup>th</sup> Edition. 2006

<sup>12</sup> Al-Sunan al-Sughra v4 p353

<sup>13</sup> Al-Dardir. *Aqrab al-Masalik* p126. Maktabah Ayub. 2000; Al-Sowi. *Bulghah al-Salik*. Dar Kutub al-Ilmiyyah v4 p38

refers to the exclusion of buying and selling but not for *Gift with compensation (Hibah-al-Thawab)*<sup>14</sup>

By referring to the definition above, the Maliki school considers the *Gift with compensation (Hibah-al-Thawab)* as part of the hibah contract. While other scholars do not recognize the *Gift with compensation (Hibah-al-Thawab)* as part of the Hibah contract since the definition lead to the counter value, which has been excluded. Some of Hanafi scholars include the *Gift with compensation (Hibah-al-Thawab)* in the hibah contract even though they initially agreed on the concept of Hibah as gift without counter value.

Nevertheless, the majority scholars do not reject the *Gift with compensation (Hibah-al-Thawab)* but they argued the allocation of the contract, with the opinion that it is a contract of sale; as majority agree.

With regards to the opinion of majority, al-Qurafi has quoted it and reported<sup>15</sup>

*The Sahib al-Muqaddimat said: Gift with compensation (Hibah-al-Thawab) is permissible, differ with the (opinion) of imams (of other scholars) which said (firstly) it is a sale on the item with the value paid, or with the unknown price if the price not be determined. So, it is not permissible from a perspective of sale unanimously. Thus, (Gift with compensation (Hibah-al-Thawab)) is same (as sale of unknown). (Secondly), because the topic of hibah is a (kind of) donation literally, and originally it is not movable. The donation does not lead to the counter value, hence hibah does not lead to the counter value (as well). This is because every aqad that leads to counter value cannot be named (as donation) without differentiation from the higher level to the lower level and as marriage of tafwidh. If hibah can lead (to be a counter value), suppose the (higer and lower level) is same. (Fourthly) And with the analogy of will with all kind of donation.*

But al-Qaraafi argued the opinion step by step with a clear justification. He said<sup>16</sup>

*First argument: the difference of hibah bi thawab evenif it has the counter value, is still the objective to give the mutual respect and love and thus, is not purely a Muawadah (exchange) and Mukayasah (donation), and the custom will prove it. Hence, it is permissible to have this kind of unknown and uncertainty as the Shariah permissible gold, silver and food are traded on the spot in the contract of al-Qiradh.(Mudharabah or profit sharing) This is because the objective is good and it differs from the argument (of majority).*

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<sup>14</sup> Al-Dardir. Syarh al-Soghri Maa Hasiyah al-Sowi. v5 p431 Isa al-Bab al-Halabi

<sup>15</sup> Al-Qurafi. Al-Zakhiroh. v5 p397 Dar al-Kutub al-Ilmiyyah. Beirut. 2<sup>nd</sup> Edition. 2008. v5 p397-398

<sup>16</sup> Al-Qurafi. Al-Zakhiroh. v5 p397 Dar al-Kutub al-Ilmiyyah. Beirut. 2<sup>nd</sup> Edition. 2008. v5 p397-398

*Secondly, if they said that every hibah focuses on the donation, so the basic need of hibah is to fulfill (this basic) which has to insert to it. They said some of the hibah (as previous) are accepted and do not harm us. It is because, for us, hibah from the lower level to the higher level (normally) subject to counter value, and from the higher level to lower level is a donation as been proven by the custom practice. Thus, it still considered as the literal (meaning of donation) and because the origin of it without moveable and alteration.*

Al-Qurafi also argued that the gift with compensation (*Hibah-al-Thawab*) can be analogized with the marriage of *tafwidh*, which allow disappearing the dowry and committed as the dowry *al-Mithly*. For *Gift with compensation (Hibah-al-Thawab)*, the unknown counter value is permissible, but the commitment must be based on the value of the hibah.

Al-Qurafi also stated that the permissibility of *Gift with compensation (Hibah-al-Thawab)* is based on the Quranic verse:

*When you are greeted with a greeting, greet in return with what is better than it, or (at least) return it equally.<sup>17</sup>*

He elaborated the verse commenting on the issue of greeting (*tahiyyat*), also includes the Hibah and *hadiyyah* based on the methodology of tafsir 'the lesson is taken from the general meaning, not with the specific reason'. Al-Samarqandi<sup>18</sup> narrated in his tafsir by Abu Hanifah and al-Baidowi<sup>19</sup> narrated by the *qaul qadim* of al-Shafie supporting the statement. Al-Qurafi also stated that the custom can create the evidence based on the *hadith* narrated by Abu Daud<sup>20</sup> where the Prophet will not receive the *hadiyyah* except from few due to the need of consent of *thawab* in the gift.

While commenting the Quranic verse, 4:86, Al-Qurafi has commented that it is true the people who take advantage as such do not receive the reward from Allah, but the responsibility of giving the *al-thawab* is not aborted. He said this is the evidence that this custom is applicable to permissible *Gift with compensation (Hibah-al-Thawab)*.

The verse is translated as :

*And that which you give in gift (to others), in order that it may increase (your wealth by expecting to get a better one in return) from other people's property,*

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<sup>17</sup> Holy Quran [4:86]

<sup>18</sup> Abu Laith. Tafsir Samarqandi v1 p349. Dar al-Kutub al-Ilmiyyah. Beirut 1993

<sup>19</sup> Al-Baidhowi. Tafsir al-Baidhowi 2 p229. Dar al-Fikr1996

<sup>20</sup> Hadith no 3537 – Sunan Abi Daud v3 pg 290. Dar al-Fikr

*has no increase with Allâh, but that which you give in Zakât seeking Allâh's Countenance then those, they shall have manifold increase.*<sup>21</sup>

Other evidence given by scholars' regarding the *Gift with compensation (Hibah-al-Thawab)* is:

*And give not a thing in order to have more (or consider not your deeds of Allâh's obedience as a favour to Allâh).*<sup>22</sup>

The author also has high tendency to agree with the opinion of al-Qurafi regarding this verse since the argument comes from the side of donor, while it has nothing to do with the responsibility of receiver. al-Mahally and al-Suyuti<sup>23</sup> were in the opinion that this is the specialty of the Prophet PBUH only.

The discussion of the hadith '*give the gift each other, you will get the love each other*' shows the permissibility and encouragement of *Gift with compensation (Hibah-al-Thawab)* in the daily transaction especially for the Ummah of Prophet Muhammad PBUH.

### **IS THERE ANY EXCEPTION ON THE PROHIBITION?**

It is possible to take the opinion of Ibnu Arabi<sup>24</sup> in his tafsir :

*We have elaborated Riba and its classification; addition to the wealth in terms of time and price, and the addition of other, as be reported before. And we have elaborated that Riba as specified for the contracting parties permissible with the knowledge of both and there is no different opinion on the matter; and also it is permissible of riba in Gift with compensation (Hibah-al-Thawab).*

*It has been mentioned by Umar bin al-Khattab R.A, that a person that gives gift and sees there is a thawab, he has the right to his gift till he agrees with the thawab. This means the exception from the general prohibition that enters into the contract'*

Even the end of comments by Ibnu Arabi mentioned the permissibility of *Riba* on *Gift with compensation (Hibah-al-Thawab)*, is known that the meaning of the permissibility in his writing is specified only for the things that are not considered as *riba* item. This statement is supported by al-Nafrawi<sup>25</sup> who stated that:

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<sup>21</sup> Holy Quran [30:39]

<sup>22</sup> Holy Quran [74: 6]

<sup>23</sup> Tafsir Jalalain v1 p577. Royal Aal al-Bayt Institute For Islamic Thought. Fon Vitae. 2008

<sup>24</sup> Ibnu Arabi. Tafsir al-Ahkam al-Quran. v1 pg 324 Dar al-Fikr lil al-Tibaah wa al-Nasyr

<sup>25</sup> Al-Nafrawani. Al-Fawakih al-Dawani v2 pg 158. Dar al-Fikr. Beirut

*It is not permissible to give al-thawab of silver (if the hibah is gold) and otherwise, that it causes the deferment on transaction...because the Gift with compensation (Hibah-al-Thawab) is a sale*

We can argue on this opinion by looking at the features taken at the end of the rules. This is because he sticks to the opinion that the *Gift with compensation (Hibah-al-Thawab)* is a sale. Nevertheless, the counter value of *Gift with compensation (Hibah-al-Thawab)* still applies the rule of hibah, can be unknown as the analogy with the marriage of *ta'widh*.<sup>26</sup>

### **INTERPRETATION OF RIBA BY MUFASSIRIN**

The interpretation of the verse above generally accepted that *riba* is permissible in the *Gift with compensation (Hibah-al-Thawab)*. There is one major issue and argument should be resolved. Is the *riba* in the tafsir of the verse considered as literal meaning or technical meaning in shariah?

If the *riba* definition is taken on its literal meaning, it can be the same rules as the opinion of Ibnu Arabi previously where the permissibility of *riba* in *Gift with compensation (Hibah-al-Thawab)* is excluded on the *ribawi* item.

If the *riba* definition is taken from the technical meaning of *riba* in shariah, it should solve the issue where the *ribawi* item is permissible in *Gift with compensation (Hibah-al-Thawab)*.

If we argued that the literal meaning of *riba* in the interpretation of the verse is the definition of *riba*, the contract of sale should also considered as *riba* since the mark-up price on the selling item. But the scholars do not include the sale as *riba*. So, it would be preferred and believed that the *riba* mentioned in the interpretation of the verse is the specified *riba*, which is based on technical meaning in shariah.

These opinions can be harmonized based on the opinion of al-Qurtubi where he classified the type of hibah based on the intention of the donor. Regarding this opinion, he concluded that there is a person who gives hibah on the basis of taking the reward from Allah, there is a person who gives hibah to hypocrisy, and there is a person who gives hibah to get the reward from the donee. Thus, it will be judged by the custom since the permission given by Malikis on *Gift with compensation (Hibah-al-Thawab)* is to appreciate based on the custom of people.

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<sup>26</sup> Marriage of Tafwidh means the marriage with the unknown dowry



According to Ibrahim al-Nakhaie in the tafsir of al-Andalusi<sup>27</sup> who commented the verse previously

*This verse is revealed to people who t give their relatives and friends to get benefit and expand the wealth and get the kindness and increase their wealth in the form of benefit*

Ibnu Asyur<sup>28</sup> mentioned that this verse is purposely for *Gift with compensation (Hibah-al-Thawab)* and *hibah lil-zulfa wa al-malaq*.

### **THE POTENTIAL OF GIFT WITH COMPENSATION (HIBAH-AL-THAWAB) IN ISLAMIC FINANCE**

There are a few authors who quoted the gift with compensation (*Hibah-al-Thawab*) as Takaful contract (Islamic insurance) such as al-Qura Daghi<sup>29</sup>, Nurdianawati Irwani Abdullah<sup>30</sup> and Mohammad N.H.N (2010) but yet to discuss further the *riba*. Their discussion ends at the view of majority that gift with compensation (*Hibah-al-Thawab*) is a sale, thus the characteristics of sale applied.

Except Mohd Parid<sup>31</sup>, who revised the *gift with compensation (Hibah-al-Thawab)* has the element of *riba*, where the exchange between the premium contribution with the benefit received could lead to both kinds of *riba* due to the deffered and excessive of exchange. Both exchange items are in the same currency.

She provided the alternative by exchanging the currency and that the sum covered should be different. But, the justification of his opinion is not strong enough to support it, since the sum covered can be considered as financial assets although it represents the currency.

Thus the opinion of Ibnu Arabi can justify that there is no need for us to find the alternative way of exchange in currency for *gift with compensation (Hibah-al-Thawab)* since this contract is permissible even if it has the characteristics of *riba*.

There probably a question where the participant can take the advantange to permissible *riba* in takaful by having this contract. In Malaysia, as far as the Takaful Act 1984 is concerned, takaful is defined as

*“takaful” means a scheme based on brotherhood, solidarity and mutual assistance which provides for mutual financial aid and assistance to the*

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<sup>27</sup> Al-Andalusi. Al-Muharrar al-Wajiz v4 339 Dar Ibnu Hazm. 2002

<sup>28</sup> Ibn Ashour. Tafsir al-Tahrir wa al-Tanwir v21 pg106. Dar al-Ihya al-Turath. 2000

<sup>29</sup> Al-Qura Daghi, 2009, al-Takmin al-Islami, Dar al-Basyair al-Islamiyyah, Beirut

<sup>30</sup> Nurdianawati Irwani Abdullah, N. A.. *Case Studies Of The Practice Of Nomination And Hibah By Malaysian Takāful Operators*. ISRA International Journal Of Islamic Finance , 2. 2010

<sup>31</sup> Mohd Parid, N. (2009). *Insurable Interest in Takāful Practices: An Analysis*. Kuala Lumpur: International Shariah Research Academy for Islamic Finance

*participants in case of need whereby the participants mutually agree to contribute for that purpose;*<sup>32</sup>

The opinions of Ibnu Asyur and Ibrahim al-Nakhaie on the verse of *gift with compensation (hibah-al-thawab)* support the principle of *Takaful* in a perspective, where there is a strong custom of having the hibah with each other among families and getting benefit from it. If a person participates in *takaful* to have *riba* or manipulates it as tool to permissible *riba*, Allah even said that they will not get any reward from the transaction.

The supportive legal framework of *takaful* needed to ensure the permissibility of *riba* in *gift with compensation (hibah-al-thawab)* cannot be manipulated in practice.

### CONCLUSION

As a conclusion, the halal *riba* is only a term used for *gift with compensation (hibah-al-thawab)* due to the characteristics of *riba* in the contract. According to Ibnu Arabi, it is an exception from the general rules for *riba*. This exception also does not violate the consensus of scholars towards the prohibition of *riba*.

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<sup>32</sup> Takaful Act 1984



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## **AN EXPLORATORY STUDY ON IJARAH SRI SUKUK FOR THE DEVELOPMENT OF WAQF PROPERTIES/ASSETS IN MALAYSIA**

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### **ABSTRACT**

*Sustainable and responsible investment (SRI) sukuk can be innovatively structured to support financing the development waqf assets into viable income-generating assets that can help with social programmes, and at the same time, maximise the potential of sukuk in achieving the objectives (maqasid) of Islamic Finance. The paper aims to explore a SRI sukuk model based on Ijarah that could be implemented to develop waqf properties and assets under the SRI sukuk framework in Malaysia. The paper adopts desk research and semi-structured interview as its methodology. The paper examines the first SRI sukuk issued in Malaysia and other waqf-related sukuk in the past and comes up with a preliminary waqf SRI sukuk model based on the principle of Ijarah. Four semi-structured interviews were undertaken to seek the opinion of subject-matter experts and industry practitioners. Based on the interviewees' response, the study proposes the most feasible Ijarah SRI sukuk model that could be implemented in the Malaysian context for the development of waqf properties/assets. The model is elaborated based on the purpose of development, functionality, choice of Shari'ah contract, obligor and return mechanism. This study is significant as it can serve great benefit to the government, waqf administrators, regulators, policy makers, foundations, corporations and interested investors to explore Ijarah SRI sukuk as one of the feasible financial instruments to develop waqf in Malaysia.*

**Keywords:** SRI sukuk, Waqf properties/assets, feasibility, Ijarah SRI sukuk

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### **INTRODUCTION**

Islamic Finance started as a promising sector in the 1970s mainly focusing on Shari'ah compliant banking and hajj funds. Today, Islamic finance has grown to become an

important segment in the international financial system, with estimated assets close to approximately USD2 trillion and compound annual growth rate of 15.4% (IFSB, 2016). By the end of 2018, the market size is expected to reach USD3.4 trillion (Mohammed, 2016). Concurrently, the Sustainable and Responsible Investment (SRI) has also been growing and gaining more prominence in recent years. At the start of 2016, global SRI reached USD22.89 trillion, an increase of 25% compared to USD18.28 trillion in 2014 (Global Sustainable Investment Alliance, 2016). In the United States alone, the estimated market size of SRI is estimated to be USD8.72 trillion as of 2016, a 33% increase since 2014, while SRI assets in Europe and Canada are estimated to be over USD12 trillion and USD1 trillion, respectively. This growing attention on SRI is due to the increasing awareness of policy makers and investors globally in investing in more sustainable and responsible investments that contribute to the advancements in social, environmental and governance practices (US SIF, 2016b).

In the pursuit of integrating Islamic Finance and SRI and making them relevant to the local context, the Sustainable and Responsible Investment (SRI) Sukuk Framework was launched by Securities Commission of Malaysia (SC) in 2014 as an extension of the existing sukuk framework to facilitate a conducive ecosystem for SRI investors and issuers. This framework is certainly beneficial for the natural progression of the sukuk market due to the growing awareness of investors and institutions towards ethically and socially responsible investment (MIFC, 2016). The framework lists down the projects that are eligible to be categorised under SRI projects, which include any activities related to the development of waqf properties/assets. This inclusion is meaningful because waqf asset development is a pressing issue in Malaysia. The 2012 statistics by Jabatan Wakaf, Zakat and Haji (JAWHAR) showed that there were 11,092 hectares of waqf land worth RM 1.18 billion in Malaysia. Unfortunately, only 7.2% of it was developed (Maznah, Mohamat Sabri & Radziah, 2014). It is an irony that thousands of hectares of waqf land remain undeveloped when land and property are highly in demand in the current economy (Muhammad Hisyam, 2014). Meanwhile, data on other waqf asset classes could not be provided by JAWHAR, but it is expected to have a huge value and are similarly underutilised.

This paper aims to explore an Ijarah SRI sukuk model that could be implemented to develop waqf properties and assets under the SRI sukuk framework in Malaysia. The paper adopts desk research and semi-structured interview as its methodology. The

structure of this paper is as follows: The following section reviews the literature on Islamic Finance, SRI, SRI sukuk and waqf. This includes the framework that was introduced by Malaysia's Securities Commission on the SRI sukuk and the study of past literatures on the development of waqf in Malaysia and the modes of financing for waqf development that have been done in the past. A section on methodology follows suit as well as a section that explains the proposed Ijarah SRI sukuk model that could be implemented in the Malaysian context for the development of waqf properties/assets. Finally, several suggestions and a conclusion will be provided.

## **LITERATURE REVIEW**

### ***Islamic Finance***

Today, Islamic finance has become an important segment in the international financial system, with estimated assets close to approximately USD2 trillion and compound annual growth rate (CAGR) of 15.4% (IFSB, 2016). Despite the encouraging growth, it is argued that the true objectives of Islamic finance practice are yet to be realised. For example, Islamic financial institutions are found mostly to be profit oriented over social oriented (Mohammad & Shahwan, 2013). Hence, there has been calls for these institutions to give more effort towards bridging the gap of Islamic finance theory and practice by putting more emphasis on social responsibility and impact (Ng et al., 2015). In September 2012, Kuala Lumpur Declaration was adopted by participants in the Second Strategic Roundtable Discussion which included Shari'ah scholars and Muslim economists. One of the declaration's critical recommendation is to broaden the organisational structures beyond traditional banking models to formats such as waqf to meet the social goals and risk sharing features of Islamic finance (ISRA, 2012). Waqf, which is part of the social sector, is rarely given the attention for further development even though it can actually bring remarkable benefits to the social welfare and justice, which is in line with the objective of Shari'ah (Ismal et al., 2015).

Therefore, it is high time for Islamic financial institutions to bridge the gap between Islamic finance theory and practice by developing and utilising tools that embody principles of Islamic finance such as SRI sukuk for the development of waqf properties and assets. To the best knowledge of the researcher, there has not been any research done in the area of SRI sukuk for the development of waqf properties and assets in Malaysia.

### ***Sustainable and Responsible Investment (SRI)***

SRI has been referred to as Socially Responsible Investment (Ministry of Finance Malaysia, 2013), Sustainable and Responsible Investment (Securities Commission, 2014), and Sustainable, Responsible, and Impactful investments (Centre for Islamic Wealth Management, 2015). According to the US Social Investment Forum (2016), SRI is integrating personal values and societal concerns into investment decisions, where investors consider both their financial needs and the impact of their investment on society. Generally, it can be referred to as any type of investment process which combines investors' financial objectives with concerns regarding environmental, societal and governance issues (Moghul & Safar-Aly, 2015).

There are many strategies within the SRI industry. SRI Connect has listed out 21 strategies which include ethical negative screening (which incorporates Shari'ah screening), positive screening, community investing, impact investing, sustainability theme investing and ESG investing (SRI Connect). In Europe, SRI strategies through negative screening or 'exclusions' are estimated to be EUR17.5 trillion, making up approximately half of the total professionally managed assets in Europe (Eurosif, 2016). Impact investing was seen to be the fastest growing investment sector under SRI with a compound annual growth rate (CAGR) of 120% since 2013 amounting to almost EUR1 trillion in total assets (Eurosif, 2016). Impact investing includes the issuances of financial tools such as the green bonds, vaccine bonds and vaccine sukuk. Meanwhile in the US, at the start of 2016, there has been a 33% growth since 2014 of the US-domiciled assets under management using SRI strategies to USD8.72 trillion (US SIF, 2016a).

### ***SRI Sukuk Framework***

Securities Commission Malaysia (SC) launched the Capital Market Masterplan 2 in 2011 to promote socially responsible financing and investment. The Masterplan sets the agenda to develop a conducive environment for investors and issuers interested in SRI, and facilitate the growing trend of new financial instruments such as green bonds and Social Impact Bonds (Securities Commission, 2011). In 2013, Malaysia's Prime Minister announced in Budget 2014 speech, that efforts will be intensified to promote Malaysia as a market for SRI (Ministry of Finance Malaysia, 2013). Subsequently in 2014, SC revised

the Guidelines on Sukuk to incorporate the new requirements for the issuance of SRI sukuk.

The guideline on sukuk states that SRI sukuk issuance proceeds will be utilised for the purpose of funding eligible projects that aim to preserve and protect the environment and natural resources; conserve the use of energy; promote the use of renewable energy; reduce greenhouse gas emission; or improve the quality of life for the society. Other projects that are eligible to be categorised under SRI project include those projects with physical assets/activities related to natural resources; renewable energy and energy efficiency; community and economic development, and waqf properties/assets, which includes any projects that undertake the development of waqf properties/ assets.

The inclusion of waqf properties/assets as one of the eligible categories for SRI projects is meaningful because it provides the avenue for investors to dedicate the wealth towards perpetual returns which can benefit the society. However, the issuance of SRI sukuk for development of waqf assets is still rather unexplored. Therefore, this study attempts to explore and further develop the connection of these two areas.

#### ***Case Study: First SRI sukuk in Malaysia***

The SRI Sukuk Ihsan by Khazanah is the first ever SRI sukuk to be approved under the SRI sukuk framework. This SRI sukuk has a total RM 1 billion in nominal value and the period of 25 years until its maturity. The sukuk is divided into several tranches. The first issuance on the 18<sup>th</sup> of June 2015 and second issuance on 8<sup>th</sup> of August 2017, managed to raise RM100 million respectively. The sukuk was given a rating of AAA by RAM Ratings Services Berhad (RAM Ratings, 2015), due to Khazanah Nasional being the obligor. Both issuances are intended to improve accessibility to quality education in Malaysia. According to Khazanah's executive director of investment, Dato' Mohd Izani Ghani, some of the next tranches may include healthcare and affordable housing.

The proceeds from the sukuk investments from each issuance are to be used to fund the roll-out of at least 20 schools under Yayasan Amir's Trust School Programme. Yayasan Amir is a Non-Profit Organisation (NPO) incorporated by Khazanah with the aim to help improve the quality of education in Malaysian public schools through Public-Private Partnerships with the Malaysian Ministry of Education (Khazanah Nasional, 2017). Before the first SRI sukuk was issued, there were already 30 schools under the

programme, encompassing rural and urban schools, and impacting more than 20,000 schools nationwide (Ghani, 2015). The strategic goals of the Trust School programme focuses on various stakeholders including: school leaders, teachers, students, parents, and the community (CIMB, 2015).

The SRI sukuk was structured based on Wakalah Bil Istithmar in which, the concept of appointment of other entities to manage sukukholders' fund on behalf of sukukholders is applied. The first step of the structure is the appointment of Ihsan as investment representative or wakeel. Then, Ihsan appoints Khazanah as its sub-representative or sub-wakeel to manage the sukuk fund. Khazanah will then use the sukuk proceed or the sukuk fund collected from sukukholders to invest in shariah-compliant tangible assets and shariah-compliant commodity murabahah. The proceeds or profit made from these investments shall be used to fund the roll-out the schools under the Trust School Programme and shall be distributed to sukukholders until the sukuk reaches its maturity date. The illustration is shown in Figure 1.

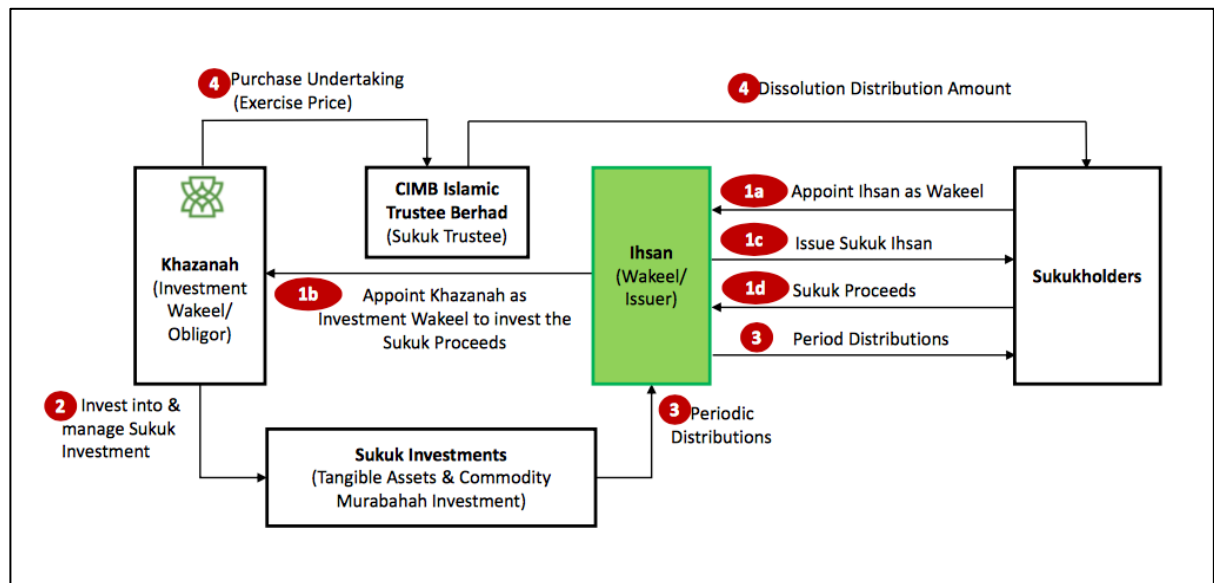


Figure 1: SRI Sukuk Ihsan  
(Source: CIMB)

The return mechanism for the SRI sukuk is based on the step-down returns structure that is dependent on the achievement of key performance indicators (KPIs). These KPIs set the required target levels for the number of Trust Schools to be implemented, performance of respective schools' teachers, senior leadership and students. For the SRI Sukuk Ihsan to be considered a success, all the four criteria need to be



fulfilled. The step-down returns structure introduced by SRI Sukuk Ihsan is the first of its kind, where the yield will be reduced when KPIs are met. This means sukukholders will actually earn less if the programme reaches its objectives as part of their social obligation in recognising the positive social impact that is generated by the Trust School Programme (Ghani, 2015). For the first issuance, the SRI sukuk was priced at a profit rate of 4.3% if the KPI are not met, or 3.5% when KPIs are been fulfilled. While the second tranche of SRI Sukuk Ihsan was recently priced at a profit rate of 4.6% if the KPIs are not met and 4.2% when KPIs are achieved.

Another feature that is unique to this sukuk is that it allows for the sukukholders to convert their investment in the sukuk into donations by exercising their “option to waive” the capital and proceeds of the sukuk (CIMB, 2015). By doing so, they are entitled to receive tax vouchers for an amount equal to the amount waived or the reduction in the nominal value of their respective sukukholdings (Ghani, 2015).

### ***Waqf***

Waqf, in the Arabic language, literally means to stop, contain or preserve. Conceptually, waqf refers to charitable endowments. It is a voluntary and irrevocable dedication of one's wealth, either in cash or kind, and its disbursement is dedicated for Shari'ah compliant projects that are beneficial (Elasrag, 2017). It transfers wealth and changes property rights from private to public. In Malaysia, waqf is administered by the respective State Islamic Religious Council (Siti Asishah & Rusnadewi, 2015).

Waqf has a great potential to be a tool for social welfare and economic development via various humanitarian projects such in the area of healthcare, education and training facilities for the society. This is why, according to Tahir, Abdul Hamid & Ismail (2005), for the interest of the beneficiaries of waqf properties and assets, the need for the existence of alternative financial mechanism is critical. The more the financial instruments there are, the more are the chances of development of the waqf.

Waqf can also be utilised as effective tools of wealth management. As most waqf are in the form of real estate, yet underutilised, there is a pressing need to develop these assets. Attempts should be made to upgrade waqf to a level where they become a sustainable source of funding and are able to generate income on their own, thereby



decreasing dependency on third-party donations (Lahsasna, 2013). As waqf is to continue till no more economic benefit can be taken from the asset, an investment product or mechanism should be structured for perpetuity. What is most important is to preserve the capital. Immediate disbursement is not necessary as there is already the charitable instrument of zakat for that (Mohd Marzuki et al., 2012).

According to Anwar & Mohamad I'sa (2016), most of the Muslim and Muslim minority countries presently are moving towards promoting cash as a form of waqf. According to his findings from interviewing waqf officers and researchers in Malaysia, they believe that cash waqf can be the capital for the development of idle waqf land. However, a large number of waqf trustees (Mutawalis) are not well trained in property and financial management (Tahir et al., 2005). This calls for help from the experts in the Islamic financial sector to help manage and offer innovative financial tools like SRI sukuk.

Magda et al. (2016) had studied cases of waqf development around the world including 25 cases from Malaysia. The modes of financing used in Malaysia are joint venture, ijarah (leasing), donations, internal funds, wakalah (agency), musharakah (partnership), waqf share, corporate waqf, state and federal funds. None has ever used SRI sukuk. One of the closest sukuk models that was issued for the development of waqf was in Singapore, also known as the Bencoolen Waqf project. It is the first fundraising project to renew a waqf property in Singapore via an issuance of Sukuk Musharakah by Majlis Ugama Islam Singapore (MUIS). On top of that, there is also a Sukuk Intifa' issued for the development of Zam Zam Tower on a waqf land in Saudi Arabia, which will be discussed further in section 2.3.1. Meanwhile in Indonesia, Ismal et al. (2015) explores the potential issuance of sovereign sukuk linked to waqf assets for the development of massive local waqf that are underdeveloped or as an underlying asset of financing in a sukuk originations. The waqf-linked sukuk issuance is intended for real economic sector development, just like a project-based sukuk. Depending on the investors' preference, the sukuk can be fine-tuned to serve both commercial and social purposes.

On another note, according to Centre for Islamic Wealth Management (2015), the accumulated funds for the establishment of waqf projects can be realised through a number of instruments including Cash and E-Waqf Fund, Per-square Feet Value

Certificate, and sukuk issuance. This paper's focus is on the sukuk issuance, particularly is proposing several SRI sukuk models for the purpose of development of waqf assets and properties because no such model is in place at the moment.

***Case Study: Sukuk Intifa' to develop Zam Zam Tower (Mekah)***

The King Abdulaziz Endowment (Waqf) has developed a waqf land, located near Masjidil Haram of the Holy City Mekah, into multiplex of high towers called Zam Zam Tower. The *waqf* land was leased to a prominent Saudi Arabian builder, Binladin Construction Group<sup>33</sup> through a Build-Operate-Transfer (BOT) agreement which agreed to build a shopping complex, four towers and a hotel under the project (Shabana, 2014). Subsequently, Binladin Group leased the project to a Kuwait-based International Lease Investment Company called Munshaat Real Estate Projects KSC to finance the project construction, operate it and then transfer it back to King Abdulaziz Endowment at the end of the 28-year lease tenure. Both the prominent Binladin Group and Munshaat signed a forward *ijarah* contract.

To finance the project, Munshaat issued a \$390 million *Sukuk Intifa'* for 24 years. *Sukuk Intifa'* is a certificate or a deed that allows its holders to utilise a specific real estate property for a specific period per year over a determined number of years (Ruzian, Engku Rabiah Adawiah, & Aznan, 2012). The proceeds from the *sukuk issuance* would be disbursed as progress payment by Munshaat to necessary parties involved in the development of the project. Once completed, the *sukukholders* are provided with four choices; 1) to show up at the allocated time, 2) exchange the time through a specialised affiliate of Munshaat, 3) contract to Munshaat to sub-lease the contracted time to a willing customer who wishes to visit Mekah at that point of time or 4) to sell the *sukuk right* to a willing buyer (Shabana, 2014). The sukuk structure is shown in Figure 4. Through the structure, a 24-year reversionary ground lease was awarded to the developer. This means, in terms of ownership, the land which belongs to the waqf will remain with the King Abdulaziz Endowment (Waqf), while the buildings belong to the developer and the usufruct was sold to sukukholders (lease).

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<sup>33</sup> <http://www.arabnews.com/node/244350>

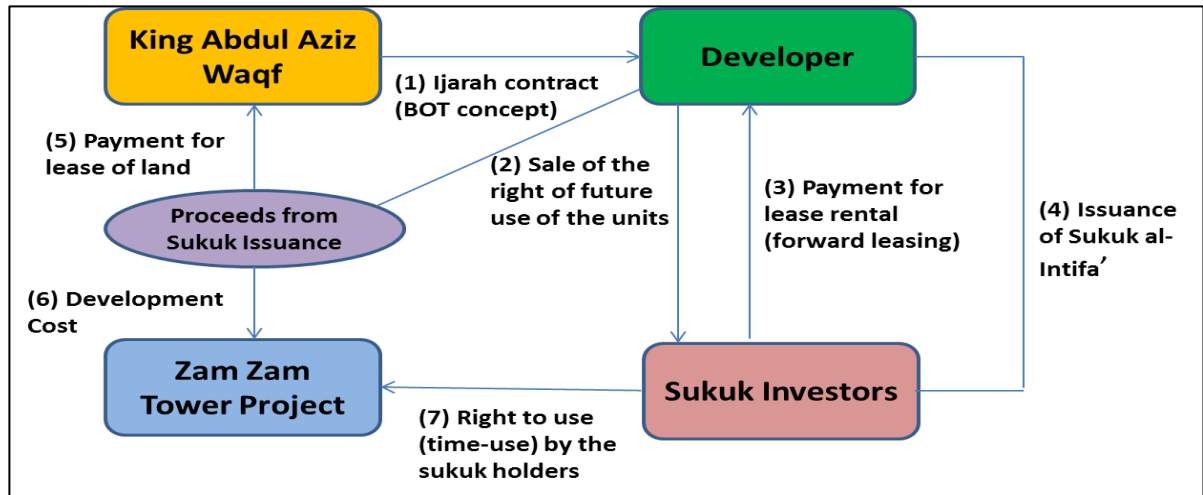


Figure 2: Sukuk Intifa' Structure

(Source: Dr. Aznan Hasan's presentation on *Sukuk: Concepts, Issues and Trends*)

## RESEARCH METHODOLOGY

As the area of research on the link between SRI sukuk and waqf is relatively unexplored, this study undertakes a combination of desk research and interview. To design the structure of an Ijarah SRI sukuk model for the development of waqf properties and assets, the best available data to achieve this is via a desk research, where a detailed critical review and analysis of past literature from reports, journals, framework, books and practices are undertaken. In the researcher's pursuit of seeking validation and feedback on the proposed model, face-to-face interviews were conducted with subject matter experts and industry practitioners.

Since SRI sukuk and waqf are specialised niche areas, there are not many individuals who are experts in these areas. Based on the researcher's search, the participants of the interview were then selected based on their vast relevant experience and understanding on the subject matters. The respondents<sup>34</sup> who agreed to participate consist of a chairman of a bank's Shariah Committee, two directors, a senior management, and a senior researcher at one of the top Islamic Banking and Finance institutes in Malaysia. They are all based in Kuala Lumpur and have had experience in dealing with sukuk, either as an issuer, investor, researcher or evaluator. A summary of the respondents is given in Table 1.

<sup>34</sup> For the purpose of anonymity, names of individuals and their respective organizations have not been revealed.

**Table 1: Summary of Respondents**

<b>Organisation</b>	<b>Individual</b>	<b>Respondent's Position</b>
A	A1	Chairman
B	B1	Senior Researcher
C	C1	Director
	C2	Vice President
D	D1	Director

***IJARAH SRI SUKUK MODEL***

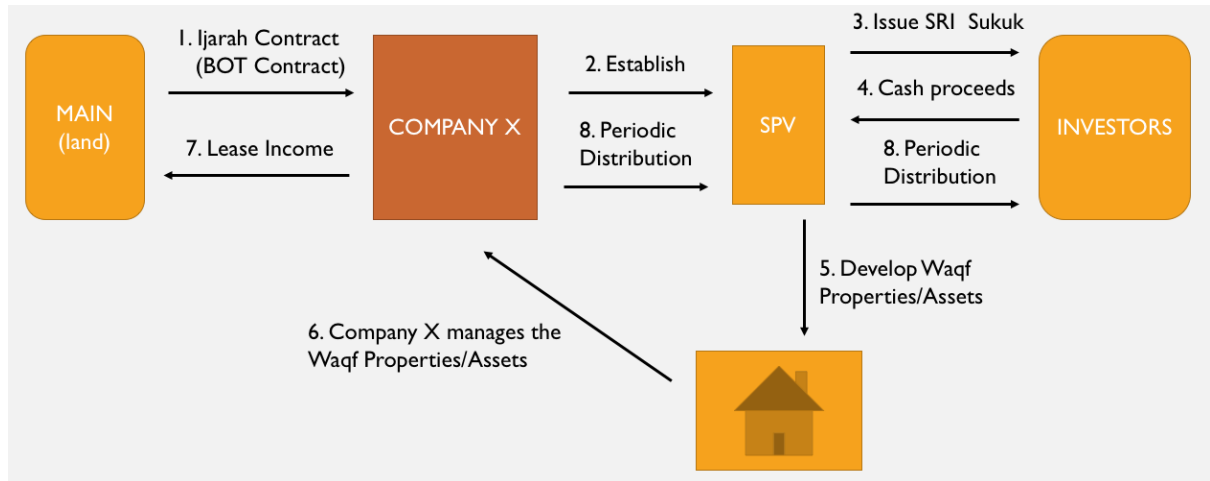
The model begins with the government or the Majlis Agama Islam Negeri (MAIN) or State Islamic Religious Council first identifying a specific social or economic issue that needs attention, like the issues of affordable housing and unemployment. The waqf development will then be aimed to be an income-generating asset while solving the intended social problem. This is similar to the Seetee Aishah waqf development, where the development of the waqf land helped to provide affordable housings in Pulau Pinang, Malaysia (Hydzulkifli, Asmak, Ahmad Rizal, Azizi, & Suhaila, 2013).

The model is based on Ijarah (leasing) contract with a Build, Operate and Transfer (BOT) specification. A BOT contract is a form of project financing, where a private company receives a grant of rights, land or property (concession) from the public sector to finance, design, construct, own and operate a facility for a specified period – normally during which the company is meant to make a return on its investment – before transferring the ownership back to the government. During this period, the company is responsible to raise the funds for the project. This BOT concept has been utilised in the development of Zam Zam Tower in Mekah as explained in the previous section. For the Zam Zam Tower project specifically, a developer was granted with a 24-year lease (ijarah) over the waqf land on a BOT concept from the King Abdulaziz Endowment. The developer then issued a Sukuk Intifa'a for the financing of the development. In return, the advance lease rental received from the sukukholders was used by the developer to pay for the 24-year lease rental to King Abdulaziz Endowment, as well as the construction costs of the Zam Zam Tower.

For this model, a similar arrangement is adopted. An Ijarah contract with a BOT concept is entered between Majlis Agama Islam Negeri (MAIN) or the State Islamic

Religious Council and Company X. MAIN, who owns the waqf land, leases the land to Company X for it to build properties on the land and operates them. In return, MAIN receives an annual lease income. After an agreed period, the properties will be transferred back to MAIN to be fully administered by them. When this happens, all the income that comes from the development on the waqf land will go to waqf beneficiaries.

Figure 3 and the explanations below provide the details of the proposed Ijarah SRI sukuk model.



**Figure 3: SRI Sukuk model based on Ijarah (BOT concept)**

1. Majlis Agama Islam Negeri (MAIN) enters into an Ijarah contract (BOT concept) with Company X.
2. Company X establishes SPV to raise funds.
3. SPV issues SRI sukuk for the development of waqf properties/assets.
4. Investors provides the cash.
5. SPV then makes the agreed development on the waqf properties/assets.
6. Company X manages the waqf properties/assets. The customers of the developed assets can either rent the properties, or buy the properties with conditions. In the case of Seetee Aishah waqf development, the developed properties on the waqf land were sold but on a leasehold arrangement, where the waqf land is still rightfully owned by MAIN and MAIN receives the lease as income.
7. MAIN receives lease income, which will be distributed to beneficiaries.
8. The remaining income from the development of waqf properties/assets is shared with the investors based on the agreed amount for an agreed period.

The proposed obligor for this model is the Government or MAIN based on two reasons. The first reason is having the government as the obligor has proven to increase the worthiness and rating of the sukuk and secondly, as the development of waqf would benefit the society, the responsibility of providing these social services should be taken

upon by the government as the caretaker of its people. The obligor is needed in the models to execute the obligations of the issuer (SPV) should it fails to observe.

The researcher is also keen on having the return mechanism to investors be based on KPIs. Unlike the SRI Sukuk Ihsan that has a step-down returns mechanism as described in the previous section, the researcher proposes for a step-up returns structure where investors would be getting higher returns if KPIs are achieved and lower returns if KPIs are not achieved. This is so that it becomes a motivation for all parties to ensure the success of the waqf development project. The KPIs can be anything set and agreed by all parties. Examples include setting the number of waqf properties and assets that should be developed by Company X within a certain period of time and that the development happening on the waqf should be income generating and benefitting the community. On top of that, replicating the SRI Sukuk Ihsan, the three models also provide the sukukholders the “option to waive” the capital and returns from the sukuk, hence converting their investment in the sukuk into donations. By doing so, they are entitled for tax vouchers of an amount equal to the amount waived or the reduction in the nominal value of their respective sukukholdings.

The researcher sought the interviewees’ feedback on the proposed Ijarah SRI sukuk model and its feasibility to be implemented in Malaysia.

### ***Feedback from Interview***

#### **a) Shari’ah Contract**

Generally, all the respondents are agreeable with the chosen underlying Shari’ah contract for the model in terms of its Shari’ah compliancy as Ijarah is an approved contract under the Securities Commission’s Sukuk Guidelines. According to respondent A1, Ijarah Sukuk is the most popular structure due to its return being directly linked to the rental income which investors are most comfortable with compared to equity-based structures like Musharakah and Mudarabah sukuk.

#### **b) Return Mechanism**

The responses for this section are divided into two parts. Part one discusses when should the returns be given to the investors given that the development project will take time, while part two discusses the respondents’ comments on the KPI return mechanism.

All respondents agreed that the disbursement of returns to investors do not have to wait until the completion of the development project, which might take a few years. It can be given since year one via a contract like *Ijarah Mawsufah Fi Dhimmah*, or also known as forward leasing, between Company X and the customers. Besides forward leasing, according to respondent B1, there could also be a “*technical arrangement*” that set out payment to be made once the development project starts. Payment is made based on the progress made, which is similar to an *Istisna’* arrangement, but not quite. According to him, a “*technical arrangement*” is easier to be arranged compared to having an additional standalone contract like *Istisna’* which could have Shari’ah implications. Multiple contracts in one transaction is a very delicate matter which needs to be assessed carefully to avoid unnecessary future implications (Lateh, 2016).

As for having the KPIs included in the return mechanism, a mixed response was received from the respondents. Respondent A1 does not see the need of having KPIs embedded in the return mechanism. For this model, investors are already entitled to the returns based on the cash flows of the project, not necessarily the KPIs. Similarly, according to C2, KPIs are not needed because the interests of all parties are already aligned. All parties are already together and motivated to ensure the success of the project so that returns are maximised. C1 then added that if anything, the existence of KPIs would be a turn-off to investors. Meanwhile, D1 is of the opinion that KPIs would work best for non-income generating projects like the Trust School project by Ihsan, which is not the same as the proposed model which are aimed to finance income generating projects.

### **c) Obligor**

The interviewees were asked to comment on the choice of obligor proposed by the researcher, which is the government or MAIN. All respondents are agreeable to the choice of government as the obligor and think it would be the most ideal arrangement. However, according to respondent C1, in practice, “*there is zero chance*” of getting the government to be the obligor. Echoing C1’s statement, C2 shared one of the reasons for that is because government receives proposals all the time but due to its limited budget, only promising or projects that have shown success in the past would be more likely to be considered. Expectedly, it is trying to reduce its contingent liability as most governments do.

On the other hand, according to respondents C1, C2 and D1, MAIN would not be a feasible choice of obligor as it does not have the credit standing. Since waqf asset cannot be pledged and MAIN cannot take liability, corporation is most likely expected to take up all the risks to the project. Therefore, in the Malaysian practice, there is a much higher chance for a corporation to be the obligor compared to the government, as seen in Khazanah being the obligor for the SRI Sukuk Ihsan structure.

**d) Interest by investors and feasibility to be implemented in Malaysia**

Respondents A1, B1 and D1 believe that investors would be interested in Ijarah Sukuk as the structure is most well-known in the market, most used in practice and straight forward as the returns are directly linked to the rental income. This also makes the Ijarah SRI sukuk model very feasible to be applied in Malaysia, even more so when Ijarah contract is recognised under the SC's sukuk guideline.

However, having provided the answers above, B1 also later added that at the end of the day, just like any other investments, the bottom line matters. Investors would want to know what will they get from the investment. He also mentioned that how the SRI sukuk is marketed is important. If the Ijarah SRI sukuk model is advertised from a religious perspective, investors might not be interested. D1 shares the same opinion. He thinks that the structure is not the main concern of investors. They will be keen if the investment generates return, it is well marketed and the benefits of investment can be seen in the long run, which becomes a 'feel good factor' knowing that they are contributing to the society. Additionally, respondent C2 thinks this model is feasible for a waqf property or asset that can be used for a known purpose; hence there is clarity in what to build, who the contractor is going to be, what/how to operate and when to transfer within a known fixed period.

***REVISED IJARAH SRI SUKUK MODEL***

Taking into considerations the feedback and suggestions by the respondents, below is the revised version of the Ijarah SRI sukuk model:

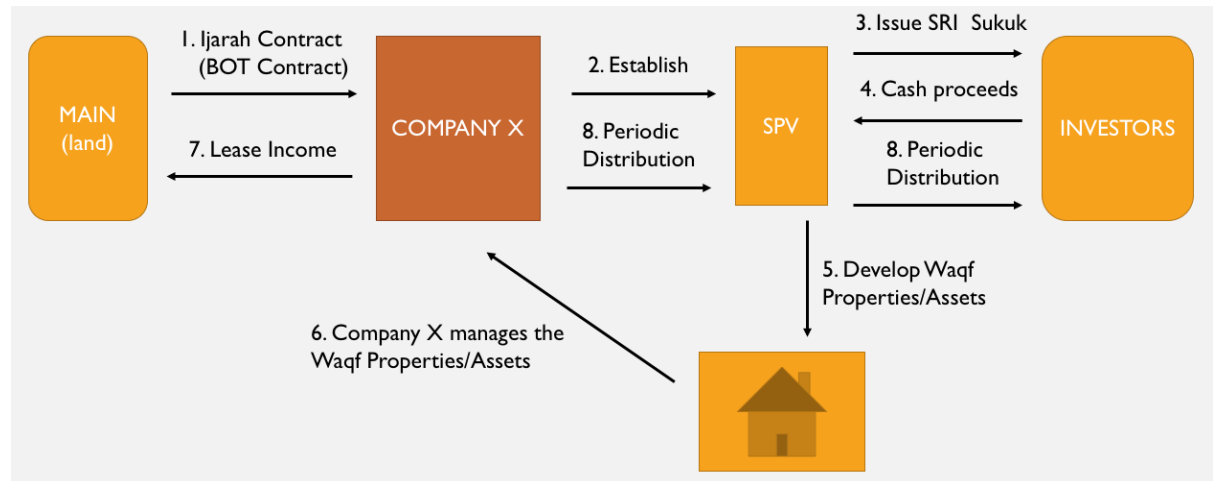
The model is based on Ijarah (leasing) contract with a Build, Operate and Transfer (BOT) specification. It begins with MAIN and Company X together identifying a specific



social or economic issue that they would like to address. The waqf development will then be aimed to be an income-generating asset while solving the intended social problem.

Thereafter, an Ijarah contract with a BOT concept is entered between Majelis Agama Islam Negeri (MAIN) and Company X. MAIN, who owns the waqf land, leases the land to Company X for it to finance, build properties on the land and operates them. In return, MAIN gets a lease return from the success of the income generating development. After an agreed period, the properties will be transferred back to MAIN to be fully administered by them. When this happens, all the income that comes from the development on the waqf land will go to waqf beneficiaries.

Figure 4 and the explanations below it provide the details of the revised and proposed SRI sukuk model for the development of waqf properties and assets.



**Figure 4: The revised SRI Sukuk model based on Ijarah (BOT concept)**

1. MAIN enters into an Ijarah contract (with BOT concept) with Company X. MAIN, who owns the waqf land, leases the land to Company X, where it builds properties on the land and operates them. After an agreed period, the properties will be transferred back to MAIN to be managed by them.
2. Company X establishes SPV to raise funds.
3. SPV issues SRI sukuk for the development of waqf properties/assets.
4. Investors provides the cash.
5. SPV then proceeds with the agreed development on the Waqf properties/assets.
6. Company X manages the waqf properties/assets, where a nominal management fee may be paid. The agreed lessor (customer) of the properties enters into a forward leasing with Company X. In the case where the properties are not leased but are sold, the developed properties on the waqf land can be sold on a leasehold arrangement, where the waqf land is still rightfully owned by MAIN and MAIN receives lease rental from the land as income.

7. MAIN receives the agreed lease income, which will be distributed to beneficiaries annually.
8. The remaining income from the development of waqf properties/assets is shared with the investors based on the agreed amount annually for an agreed period.

Based on the feedback from the interview, the following changes are made. Firstly, on the choice of obligor. The most realistic obligor for this model will be Company X or any other private corporation even though ideally, the government is most preferred. The obligor will guarantee the completion of the project as well as execute the obligations which the issuer (SPV) fails to observe.

Secondly, the model will not have the KPIs embedded in the return mechanism for three reasons. Firstly, the structure of the sukuk has had all parties motivated to ensure the success of the project so that returns are maximised. The SPV must develop income generating assets and Company X must manage efficiently to get the returns. Secondly, taking into consideration the respondents who have had experience with KPIs in SRI Sukuk Ihsan, setting up KPIs is expensive and therefore increases the cost of issuance. Finally, having KPIs might resist investors from investing because returns are dependent upon the performance of the KPIs.

Having said that, like SRI Sukuk Ihsan, investors will have the “options to waive” their rights, benefits and entitlements to the periodic distributions and the capital into the sukuk. By doing so, they are entitled to receive tax vouchers for an amount equal to the amount waived or the reduction in the nominal value of their respective sukukholdings.

## **CONCLUSION**

The Islamic finance industry has shown positive growth since its inception. However, despite this progress, the full potential of Islamic finance industry has not been realised and there have been calls to close the gap between theory and practice. This study has pioneered an exploratory research on SRI sukuk as an innovative financing tool to develop waqf properties and assets. With the proposal of Ijarah SRI sukuk model that could be implemented for the development of waqf properties and assets, the study serves great benefit to the government, waqf administrators, regulators, policy makers, foundations, corporations and interested investors to explore. Policy makers should take a bold step in improving the way waqf assets are managed currently and realise that not only SRI sukuk could be structured to support the financing of waqf assets development

into viable income-generating assets that can help with social programmes, it can also help to materialise the true potential roles of waqf as not only a religious tool, but also one of the instruments for human, economic and social developments in Malaysia as well as globally.

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## **PROPOSING THE MODELS OF UNIT TRUST WAQF AND THEIR PARAMETERS FOR APPLICATION**

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### **ABSTRACT**

*This paper aims to present the viability of unit trust waqf as an alternative asset class for waqf creation. The paper provides the conceptual framework of five models of unit trust waqf and their investment management parameters. This paper starts with the conceptual exploration of the literature in the area of waqf, which are sourced from authentic sources of Al-Quran and Al-Hadith, as well as secondary sources such as books, journal articles and online resources. The novelty of this paper lies in its attempt to highlight the importance of waqf investment strategy in ensuring sustainable return for waqf, by introducing the conceptual models for unit trust waqf as the viable mechanisms to pool more cash waqf from individual investors. The sustainability of the capital waqf assets in the form of unit trust is preserved through the parameters for its application as proposed toward the end of the paper.*

**Keywords:** *waqf, unit trust, models, parameters*

### **INTRODUCTION**

The institution of *waqf* is one of the socio-economic institutions in Islam that encourage Muslims to be creative and innovative in revising its modes and finance not only in terms of increasing its generated revenue but also in providing various goods and services needed in Muslim societies (Magda, 2013). Arguably, many *waqf* institutions are facing

the paradox of having huge number of *waqf* properties, yet many are still left idle and unproductive, despite the majority of the properties being located in prime areas. This issue has sparked the attention amongst *waqf* managers, policy makers, governments as well as Islamic financial institutions to transform unproductive *waqf* assets into high quality and income-producing properties. The recent call for its revival, as well as the renewed public attention and awareness on *waqf*, are indeed crucial factors for the rapid advancement of the Islamic finance industry.

There are a number of *waqf* stakeholder organizations in Malaysia, which include the federal agencies such as JAKIM (Jabatan Kemajuan Islam Malaysia or Department of Islamic Development Malaysia), JAWHAR (Jabatan Awqaf, Zakat dan Haji or the Department of Waqf, Zakah and Hajj) under the Prime Minister Department of Malaysia and Yayasan Waqaf Malaysia (Waqf Foundation of Malaysia) as well as the states' Islamic Religious Councils (Majlis Agama Islam Negeri or SIRC). These agencies have been instrumental in organizing and promoting various programs and research activities in order to further develop the institution of *waqf* and to harness *waqf*'s potential for the benefit of the ummah. Despite these commendable efforts, it has been reported that many *waqf* lands and buildings in Malaysia are not well managed or abandoned, rendering the institution of *waqf* in Malaysia to remain underdeveloped.

One contributing factor to this problem is the vast majority of *waqf* assets in Malaysia that are made of immovable properties with low liquidity (Aminah & Mohamad Tahir, 2011). For instance, in 2004 in Selangor alone, the real estate *waqf* accounted for 97% of *waqf* assets worth close to RM140 million, and only 3% in cash). This situation is a stark contrast to other countries, such as Singapore (a Muslim-minority country), Kuwait (a Muslim-majority country) where, respectively, 13% and 41% of their *waqf* assets are in cash deposits and other capital instruments. In fact, the pool of fixed *waqf* assets in Malaysia is much higher than some reputable endowments in Europe such as Harvard (27% of their endowment are in fixed asset and Yale at 25% fixed asset).

Other than that, the prospective of *waqf* institution as a source of wealth creation is also potentially hindered by a number of other issues. One of them is the lack of funds faced by *waqf* managers or *mutawalli* (Siti Mashitoh, 2006a; Siti Mashitoh, 2006b; Ahmad & Muhamed, 2011; Sohaimi & Syarqawi, 2008; Syahnaz, 2012). This is because, sufficient funds, particularly in the form of highly liquid *waqf* assets are desperately



needed by the *mutawallis* in order to enable them to manage the *waqf* assets toward realizing the *waqf*'s ultimate objective, that is, to serve the needs and affairs of ummah (Zarqa, 1994). This 'asset-rich, cash-poor' syndrome that has been suffered by many *waqf* in Malaysia (Abdul Karim, 2007) is indeed so serious that, according to a report published by JAWHAR, only 7.2% of the total 11,000 hectares of *waqf* lands (worth almost RM1 billion) throughout the country in 2014 could be developed, while the remaining sat idle.

Therefore, the prospect of investing *waqf* assets in highly liquid financial instruments must be explored by the stakeholders; in fact, it should be given utmost priority. This is especially so since to date, the number of *waqf* investment and Shariah-compliant products available in the capital market are still limited. Most of the times, *waqf* managers are left with no choice but to keep the *waqf* proceeds in Islamic fixed deposits, for want of better options. In fact, the time high for this option to be given full consideration, in view of the current interest and willingness shown by commercial Islamic financial institutions to be involved in the national *waqf* development agenda.

As such, this paper attempts to explore on the viability of integrating *waqf* with Islamic unit trust, a modern financial instrument that is not only Shari'ah-compliant, but also highly potential for competitive returns, while at the same time, preserving the initial capital. Through this instrument, the current *waqf* asset portfolios could be diversified instead of being concentrated or frozen in non-flexible instruments and assets. Nonetheless, notwithstanding this exciting prospects offered by Islamic unit trust funds, the practice of unit trust *waqf* (alternatively termed as *waqf* of unit trust or *waqf*-unit trust) is still at the inception stage, calling for more in-depth studies to explore its practicality from the legal and Shari'ah perspectives. The rest of this paper is structured as follows. Section two explores the extant literature pertaining to the concept of *waqf* and it related issues, among others, its role towards the sustainability and wellbeing of the ummah, *waqf* management and governance, Shari'ah rulings on *waqf*-unit trust, recent development of unit trust industry in Malaysia, permissibility of cash *waqf* and *waqf*-unit trust in light of Shariah, legality of *waqf* muaqqat, *waqf*-unit trust framework in Malaysia and sustainable *waqf* investment strategies. Section three proposes the models of *waqf*-unit trust. Section four explains on the parameters of *waqf*-unit trust's application particularly in addressing several important issues such as *istibdal* and risk management strategy. The paper ends with a conclusion section.



## LITERATURE REVIEW

### *Concept of waqf*

According to Ibn Qudamah (1998), *waqf* means “withholding the corpus of an asset (without disposing it) and distributing the return (outcome) of the asset”. Under the principle of *qurbah* (piety), *waqf* is the act of endowing one’s property for charitable purposes in order to get rewards from Allah s.w.t in the Hereafter (Kahf, 2003). Apart from the relationship between human being and their Creator (*habl minallah*), *waqf* also covers people’s affairs among themselves (*habl min al-nas*) in the spirit of *mahabbah* (love), *ukhuwwah* (brotherhood) and *ta’awun* (cooperation) (Syahnaz Sulaiman, 2008). According to Nadwi (2015), the institution of *waqf* primarily serves two objectives. First, in spiritual terms, *waqf* provides a vehicle for a perpetual reward for the donor and second, it confers numerous socio-economic benefits to the community in general, particularly to the underprivileged. Therefore, *waqf*, which is referred to as *sadaqah jariyah* in a hadith (Muslim, 1998) is more attractive to donors as it provides them perpetual rewards in the afterlife as compared to endowment where the benefits are only obtained in this world. The perpetual or continuous feature of *waqf* is further manifested through a progressive approach in developing *waqf* property, in which no *waqf* asset should be left idle and unattended in order to ensure sustainable return to beneficiaries (Syahnaz & Aznan, 2016) as well as for its survival. Likewise, Kahf (1999) asserted that the recurrence of benefits generated from *waqf* can be used as a mechanism to increase the standard of living of the ummah and reduce poverty and difficulties among the poor and needy.

### *Waqf for Sustainability and Well-being of the Ummah*

Waqf contributes towards promoting the well-being and social development of nations since its inception and has been particularly flourished during the golden age of Islam. It was once recognised as one of the world’s most influential third sector institutions (Sadeq, 2002; Mohd Nahar & Haneef, 2015). Claimed by the historian Hodgson (1974) as ‘a vehicle for financing Islam as a society’, *waqf* serves as an important and effective tool for raising adequate capital to be channelled to fund various economic and social activities in a sustainable manner. In fact, a similar concept to *waqf* had been adopted in the Europe with the establishment of the world’s famous educational endowment such as Merton College, University of Oxford (Arjomand, 1998). This success story of *waqf* has

not only inspired the formation of today's modern not-for-profit organizations and non-governmental organizations (NGOs), but has also left some influence in the determination of their organizational objectives.

Waqf is argued to be able to cover wider aspects of social and economic development and different from other philanthropic and redistributive instruments such as *zakah*, *sadaqah* and *hibah* which are focusing to help the needy and the poor. The use and purpose of *waqf* cover religious activities (Afifuddin, Ahmad Zaki & Mohd Afandi, 2014; Mohamad Khairul, Wan Kamal & Izziah Suryani, 2014; Rahman, 2009; Shapoe & Santoso, 2009), provision of public infrastructures such as hospitals, universities and libraries (Van Leeuwen, 1999; Hassan & Haniff 2007; Çizakça, 1998), education (Gaudiosi, 1988, Setia, 2011; Hadi, 2009; Hashim, 1990; Norsiah & Farahdina, 2009; Raja Nor Ashikin & Nor 'Adha, 2014), poverty alleviation (Khan, 2010; Saifuddin, Kayadibi, Polat, Fidan, & Kayadibi, 2014; Shahimi, Mohd Marzuki, & Embong, 2013; Shirazi, 2014) and employment (Mahmood & Shafiai, 2013; Ramli & Jalil, 2014; Ahmad & Muhamed, 2011), hence meeting the society's needs at large. On the other hand, the institution of *waqf* can be used to provide a wide range of welfare services to Muslims as well as non-Muslims. In fact, the beneficiaries of *waqf* could also be non-human such as animals and the environment.

One of the significant features of *waqf* is that it provides the flexibility in fund utilisation as compared to *zakah* (almsgiving). *Zakah* funds must be utilised for specific categories of recipients. On the contrary, *waqf* funds can be used to provide a wide range of welfare services including to Muslims as well as non-Muslims. *Waqf* beneficiaries could also be extended to other living beings in fulfilling specific drives such as for animal protection and environmental conservation. This in return reduces the cost of serving the public needs including the management expenditures for public infrastructures without any cost to the government (Cizakca, 1998; Magda, 2013).

Another focus of discussion on the contemporary application of *waqf* is concerning the sustainability of *waqf* institutions. Dafterdar (2011) argued that sustainability of *waqf* is an added bonus or a complement to the profitability generated by *waqf*. This is because, the surplus generated from profit-making activities can be used to sustain the provision of the social services. Similarly, in the case of *waqf*, sole reliance on cash donations; while not hedging against declination of purchasing power of money received as cash *waqf*,

could increase the exposure of *waqf* institutions to the risk of closure. Obaidullah (2016) opined that the preservation of benefits for the intended beneficiaries can be attained through prudent and efficient investment and development of *waqf* assets. Meanwhile, Sulaiman and Zakari (2013) emphasized the importance of diversifying the sources of income for *waqf* institutions alongside the important role played by investment managers in safeguarding the value of the *waqf* investment funds over time. In fact, diversification of *waqf* sources by venturing out into the contemporary forms of wealth like cash and shares could increase the flexibility of *waqf* and the public participation into *waqf*. For instance, this can be done through investing *waqf* proceeds in the less volatile and balanced unit trust portfolios, which underlying assets are mostly fixed income and stable asset classes such as sukuk and money market instruments.

In light of various economic indicators, this paper further presents how *waqf* as a social finance vehicle can contribute as a complementary alternative to governments and private-sector financial institutions which cannot undertake all socially desirable projects because of the lack of funds or commercial non-viability.

### ***Waqf Management and Governance***

Traditionally, *waqf* institution is considered similar to a non-profit trust (Acs, 2013). In regard to the administration and governance of *waqf* in contemporary times, many scholars emphasise the importance of professional management and transparent administration of *waqf* to ensure the effective outcomes of the *waqf*. Alpay and Haneef (2015) accentuate that the transparency and accountability of the funding as well as the implementing agencies are crucial in order for the *waqf* to achieve its ultimate goal of poverty reduction. In the same line of thought, Hassan and Shahid (2010) argue that professional business management would improve the institutional quality, service delivery and effective delegation of the responsibilities; thus would ensure and ease the accountability of the said management of *waqf*.

Hence, a sound corporate structure is important in ensuring that the *waqf* is managed professionally and able to operate in perpetuity. Sulaiman et al. (2009) argue that transparency is vital not only in the operation of the management of *waqf*, but also in its reporting, as it reduces the discrepancy between the donors and the *waqf* administration. Thus, under the management of professional manager such as the fund manager, the *waqf*

management would have better accountability and transparency toward adding value and promoting wealth (Ramli & Jalil, 2013).

### ***Definition of Unit Trust and Recent Development of Unit Trust Waqf Application***

Islamic unit trust fund (also known as Islamic mutual fund) is a type of collective investment scheme that offers the investors the opportunity to invest in a diversified portfolio of Shariah-compliant securities, sukuk, money market instruments, real estates or commodities. This type of the funds is determined by the assets or constituents that have largely created the portfolio. It determines the risk of a fund and the kind of investor the fund is targeting. Fundamentally, there are three varieties of unit trust funds namely Islamic equity funds (deals in shares), sukuk funds (fixed income funds which is relatively more stable) and money market funds (SC, 2009). Islamic unit trust fund provides the investors with the opportunity to diversify their investments into various financial assets. It is managed by professional fund managers who invest the money that is collected in a diversified portfolio of Shariah compliant financial instruments, depending upon the objective of the fund. Investors can earn income from the investment in Islamic unit trust fund through capital gains and/or distribution of income.

In Malaysia, the market capitalization of Islamic unit trusts has shown a significant improvement over the past several years, depicted by a tremendous growth of net asset value (NAV) of Islamic unit trust funds in the post financial crisis period from RM21 billion in 2009 to RM57.6 billion in 2016 (SC, 2016). This hence improves the net asset value (NAV) of Islamic unit trusts to Bursa Malaysia's market capitalization ratio from 18.7 per cent in 2011 to 21.7 per cent in 2016. The recent statistics provided by the Securities Commission Malaysia (SC) also show an increased number of Shari'ah-compliant funds from only 17 out of total 127 funds in 2000 (13%) to 199 out of total 641 funds (31%) in 2016 alongside a three times growth in the number of management companies from 13 companies in 1992 to 35 companies in 2016. The huge size of Islamic unit trust funds in Malaysia, which is estimated RM57.6 billion, obviously poses a significant impact of creating a superstructure source *waqf* fund for social financing, if the existing mechanics can provide an avenue for unit trust investors or unit holders to endow a portion of the units or the dividend.

The concept of *waqf* for mutual fund or unit trust is not new. In 2004, Dompet-Dhuafa Batasa Syariah *waqf* fund was first introduced in Indonesia on fixed income basis

where up to 80 per cent of the fund was allocated in sukuk and the rest in Islamic money market (Islamic deposits). The return rate of the fund was between 11 per cent to 13 per cent, and part of the dividend had been channelled to *waqf* (Dodik Siswantoro & Mirantika Kartika Dewi, 2011). Unfortunately, the fund was terminated and converted to hajj fund in 2006 due to lack of participation from the investors. In addition, the fund was deemed to be ambiguous, relatively small in size with very little promotion, as well as laden with some market risk issues (Rizki & Dodik Siswantoro, personal communications, 30 April 2017). Ten years later, BNI Asset Management in collaboration with Dompot Dhuafa, the latter is a well-known *waqf* institution in Indonesia, established a shariah compliant mutual fund with a special *waqf* feature. This new fund of Reksa Dana BNI-AM Dana Dompot Dhuafa, which was actually a rebranding of the previous Batasa Syariah fund, provided an avenue to the unit holders to endow some of the dividends for *waqf* purpose. As the fund manager, BNI-AS had not only attracted more investors, but had also managed to allocate one-third of the management fees to *waqf* fund (Harris S. Dalimunthe, personal communication, 1 Mei 2017). In terms of fund allocation, about 98 per cent was allocated in corporate sukuk while the rest of 2% was invested in Shariah compliant deposits.

To spur a similar initiative of unit trust *waqf* in Malaysia, this drive probably can be started by Permodalan Nasional Berhad (PNB), a government-linked fund manager. PNB is currently managing RM266 billions of funds through the Shariah compliant unit trusts, Amanah Saham Nasional (ASN) and Amanah Saham Bumiputera (ASB), demonstrating a large potential of having the unit holders to put aside a portion of the unit or dividend for *waqf*. ASB and ASN funds which are guaranteed by the Malaysian Government have been pronounced Shariah compliant by National Fatwa Committee along with other State Fatwa Committees namely Wilayah Persekutuan Kuala Lumpur, Selangor, Penang, Terengganu, Kelantan dan Negeri Sembilan. Waqf of unit trust could be a viable model as *waqf* can be created at low inlay that will open opportunity to everybody to create *waqf*. Therefore, in this context, *waqf* can be explored as a source of funding by *waqf* institutions and fund managers, due to its potential as a perpetual pool of funds for their social programs.

### ***The Legitimacy of Cash Waqf and Other Financial Assets Including Unit Trust***

There is a consensus among the majority of Muslim jurists regarding the legitimacy of cash *waqf*. From the Hanafi school, a disciple of Abu Hanifah, Imam Zufar approved all movable properties to be dedicated as *waqf* including the *waqf* of dirham and dinar (cash *waqf*) as the capital in business dealings based on *mudarabah*; the return of which can be directed to *waqf* (Ibn ‘Abidin, 2003; Ibn al-Humam, 2001; al-Tarabulsi, 1902) In addition, both Imam Muhammad al-Shaybani and Abu Yusuf (Ibn Abidin, 2003) approved all types of movable property as the subject matter for *waqf*. Imam Malik bin Anas had also agreed on both immovable and movable properties as a subject matter of *waqf* even if it is cash *waqf*. Cash *waqf*, which is based on loan without interest (*salaf*) is permissible among the Maliki jurists (al-Abi, Jawahir al-Iklil, 1970). With respect to the other two schools of *fiqh*, both Imam al-Shafi’i and Imam Ahmad Ibnu Hanbal had also agreed on the validity of both immovable and movable properties as a subject matter of *waqf* (Abu Zuhrah, 1959; Al-Zuhayli, 2002).

In modern application of *waqf*, movable assets in the form of cash and other financial assets have been widely accepted by Muslim jurists. Financial assets refer to intangible properties that represent a claim on ownership of an entity or contractual rights to future economic benefits that may flow to the owner. In other words, a financial asset represents the contractual right to receive cash or other financial assets (Said et al, 2013). Common types of financial assets include shares, sukuk and unit trusts. This provision enables people to contribute in establishing a *waqf* even if they do not personally own any real estate. The permissibility of making *waqf* using contemporary forms of wealth like cash, shares and unit trusts increases the flexibility of *waqf* and the public participation into *waqf*.

The permissibility of unit trust as the subject matter of *waqf* has never been specifically discussed by classical Muslim scholars. Hence, it is extremely necessary for the fatwa authorities as well as contemporary Muslim scholars to provide the interpretations on its permissibility according to the Shari’ah, in order to set the direction of its future implementation. To the best of our knowledge, there is only one Shari’ah resolution concerning on the permissibility of endowing the unit trusts. In 2009, the Majma’ Fiqhi in its 19th meeting held in United Arab Emirates resolved the

permissibility of *waqf* in the form of financial instruments including unit trust, shares, sukuk, intangible rights and benefits as follows (Akademi Fiqh Islam, 2009):

“It is permissible to endow shares (which are Shari’ah-compliant), sukuk, intangible rights, benefits and unit trust, as they are all assets recognized by Shari’ah” (Resolution No. 181).

For the purpose of this study, the fatwas and discussions on the permissibility of cash *waqf* and *waqf* of shares are relevant, as they are strongly related to unit trust, which in itself may constitute of shares, sukuk, or any of them. In conceptualizing the viable models of unit trust *waqf*, this study has also employed the concepts of cash *waqf* and *waqf* of shares.

### ***The Legality of Waqf Muaqqat***

*Waqf muaqqat* (temporary *waqf*) refers to the act of endowing assets for a specific period of time, which shall be returned to the original owner (*waqif*) at the specified date or maturity period. Islamic jurists seem to have differing opinions in this matter. Majority of the Islamic jurists prohibit the practice of temporary *waqf* as it does not satisfy the condition of perpetual *waqf*, hence nullifying the fundamental nature of *waqf*.

On dissent, temporary *waqf* is allowed by Maliki school, whom opined that permanent transfer of ownership is not a condition for a valid *waqf*. Thus, endowing an asset for a specific period of time and having it returned to the original owner after the *waqf* period ends is allowed according to this school of thought (Al-Dardir, 1991). For instance, a *waqif* may specify to endow his house for a month; therefore the ownership of the house shall be returned to him after the end of the period of time.

Temporary *waqf* is also allowed by some Shafii scholars (al-Bujayrimi, 1995) in the sense that any particular beneficiary may receive the benefit of the *waqf* temporarily; however, according to this view, the ownership of the *waqf* will never return to the *waqif*. For example, in the case of a house endowed as a *waqf*, any particular beneficiary may be replaced by another beneficiary after a period of time, and so on. Temporary *waqf*, however, is not allowed for the *waqf* of mosques and cemeteries.

Considering the potential of temporary *waqf* as permissible by the view of Malikis, many fatwa and Shari’ah rulings issued by the contemporary Shari’ah authorities allowing the practice of *waqf muaqqat*, among others:



- i. International Islamic Fiqh Academy, Resolution No. 181, in its 19th meeting in 2009 (United Arab Emirates)
- ii. AAOIFI Shari'ah Standard no. 33, 3/1/4
- iii. Selangor Fatwa Committee (Malaysia) 1/2014, 4 February 2014.
- iv.

### ***Waqf of Unit Trust and Waqf Muaqqat from the Malaysian States Legislation Framework***

The Federal Constitution of Malaysia confers the management and administration of *waqf* to be under the State jurisdiction. Hence, all affairs relating to *waqf* affairs in Malaysia is administered by 14 different Islamic Religious Councils (SIRCs) or Majlis Agama Islam Negeri. The SIRCs act as the sole trustee for all *waqf* properties in every state and Federation of in Malaysia as evident in all state Enactments/Act. The SIRC, as the mutawalli (sole trustee), is responsible to preserve *waqf* properties, maximize their revenues and distribute them. As such, remarkably, temporary *waqf* or *waqf muaqqat* is legally possible to be practised within the current Malaysian legal framework.

Generally, a number of the State enactments allow for financial assets such as shares and unit trust to be endowed. One clear cut example is in section 10, Enactment Waqf (Perak) 2015, which illustrates the permissibility of unit trust to be subject matter of *waqf*, based on the definition of *waqf* of shares that also include “saham amanah” or unit trusts. In addition, the provisions of *waqf muaqqat* is traceable in a number of state enactments such as section 17 of the Rules of Waqf Johor 1983, section 2 of the Administration of Islamic Law (Federal Territories) Act 1993, section 2 of Majlis Sarawak Ordinance 2001 and Enactment Waqf (Terengganu) 2016. Most explicitly, the recent Enactment Waqf of Terengganu 2016 recognizes the applicability of “wakaf muaqqat” which is defined by the enactment as “a *waqf* dedication for a specific period of time”.

These legal provisions demonstrate that modern application of *waqf* via contemporary financial assets and contemporary mechanisms have been recognised by a number of SIRCs in Malaysia. Nevertheless, its application is yet to be tested within the current Islamic finance legal framework.



### ***Sustainable Waqf Fund Investment Strategy***

Diversification is one of the key strategies in investments, as manifested by the popular sayings, “Don’t put all your eggs in one basket”. This strategy is meant to ensure that investors will still getting return from certain segments should any other segments are losing its momentum with little or no return at all. According to Jim Garland, in the context of preserving the capital such as in *waqf* fund, the most important strategy is to optimize the return for the beneficiaries rather than focussing on the capital appreciation (Dimson, 2007). Waqf fund which is left in typical saving account is exposed to inflation risk that can be detrimental to the value of the fund in the long run (Wildermuth, 2012). As such, the best investment strategy is not merely retaining the capital but also to consider the declining purchasing power of the cash *waqf* (Wildermuth, 2012). It is worth observing that in managing risks, only generated profits would be distributed to beneficiaries while preserving the original capital amount. Hence, portfolio rebalancing and active portfolio management are crucial to ensure the sustainability of *waqf* capital.

There are three important criteria that need to be addressed in managing *waqf* investment. First, *waqf* capital is not diminished, hence the protection against the capital should be the priority. Second, investments undertaken must be able to produce a stable and consistent income to be distributed to *waqf* beneficiaries, in order for the *waqf* to reap endless rewards from Allah (SWT). Third, all investments made for the *waqf* must be Shariah compliant.

Kuwait Awqaf Public Foundation or KAPF, an organization that is actively involved in managing *waqf* assets via contemporary approaches, highlights few important criteria in *waqf* investment strategy; namely, such investment must be based on Shariah, and taking into consideration the economic and diversification dimensions. To ensure this, investment activities of KAPF would focus on minimizing the risk in order to safeguard the *waqf* capital, preparing feasibility studies for any investment project, diversification of investment locations, portfolios and sectors including financial, real-estate and services and to define investment ceilings for each sector (Al-Busharah, 2012).

Meanwhile, the International Islamic Fiqh Academy in a 2004’s resolution (International Fiqh Academy, 2004) spelled out some important guidelines for *waqf* investment strategies that can be summarised as follows: 1) Complying to Shariah principles; 2) Generating stable incomes while preserving *waqf* capital; 3) Diversifying

investment portfolio to minimize the risk of loss; 4) Employing various hedging mechanisms to avoid declining or loss of *waqf* capital; 5) Implementing comprehensive research before investing in projects to ensure high success and great impact to economy; 6) Employing prudent investment tool and avoiding high risk investments; 7) The investment method should be consistent with the nature of *waqf* asset in sustaining the capital and ensuring the return to beneficiaries; 8) The ownership of movable *waqf* properties should be preserved from loss of ownership or illegal transfer; 9) If the movable is in cash form, it should be invested in contracts such as *mudharabah*, *musharakah*, *istisna'* and other contracts; and investment manager should be transparent in terms of reporting the operations, revenues and benefits distribution.

### CONCEPTUAL FRAMEWORK

This study is qualitative in nature that used document research as the method of analysis sourced from books, fatwa compilations, journal articles and other published sources. Based on the review of literature, we explored and a number of important underlying themes related to unit trust *waqf*, which we utilized in formulating the relevant conceptual models. The key themes are illustrated in the conceptual framework of this study, as shown in Figure 1.

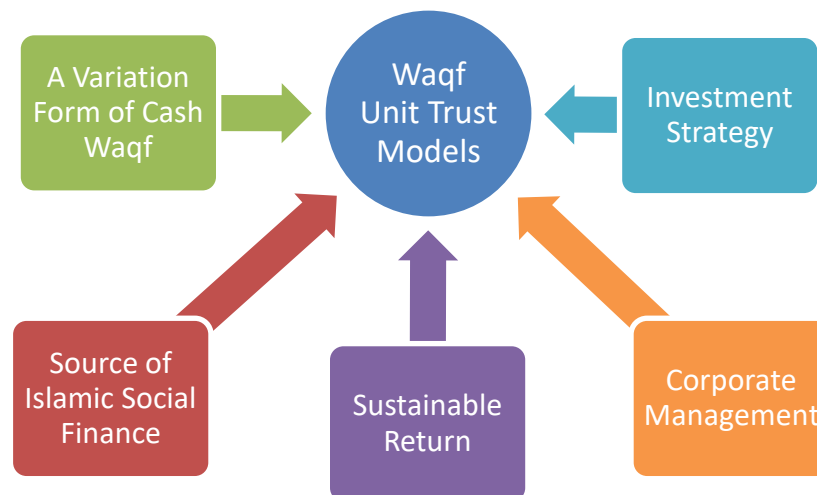


Figure 1: Conceptual Framework of Unit Trust Waqf Models

Figure 1 depicts the conceptual framework of this study toward formulating the working models of unit trust *waqf*. First, the models are formulated with the objective of providing

the possible mechanics for maximizing the benefits that can be potentially generated from cash *waqf*. Second, unit trust *waqf* models take into consideration some prudent and balanced investment strategies that are closely linked to the very objective of Islamic endowment, which is to safeguard the principal amount of *waqf* funds while generating sustainable returns to the beneficiaries. Apart from that, the establishment of unit trust *waqf* funds look into cultivating the corporate management of *waqf* funds, among others by promoting ethical and professional conducts by highly skilled managers of *waqf* institutions. Lastly, the unit trust *waqf* models are foreseen to become the alternative models of Islamic social finance in multiplying the generated revenues for the beneficiaries and creating more job opportunities for the benefits of the society through direct engagement with real economic activities.

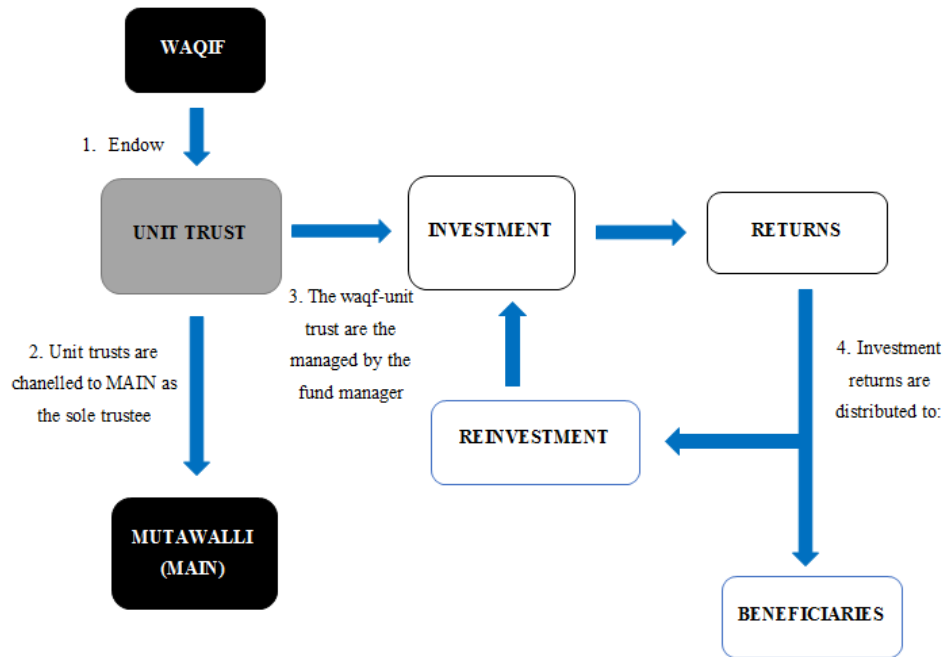
On the whole, the identification of the themes enables us to recognize some persistent concepts that are crucial towards the establishment of unit trust *waqf*. This realization will ensure that *waqf* properties are capable of generating continuous revenues for the beneficiaries as well as for the survival and revival of *waqf*.

### **PROPOSED UNIT TRUST WAQF MODELS**

In the bid to ensure that the *ummah*'s economy would continue to grow, on-going research pertaining to *waqf* development can be regarded as an evergreen facet of harnessing the creation of new *waqf* instruments. Fundamentally, the creation of robust and strategic *waqf* development models can be narrowed down to aim to achieve three goals: first, to exploit the scattered and abandoned *waqf* assets into productive properties, second, to enhance the performance of existing income producing assets for better return for *waqf* survival as well as for the beneficiaries' benefit, and last but not least, to have a wide base of *waqf* collection platform in optimizing cash *waqf* collection through feasible structures.

In this section, Figure 2 until Figure 6 presents the proposed five models of unit trust *waqf* implementation.

**Figure 2:** First Proposed Model: Unit Trust Model



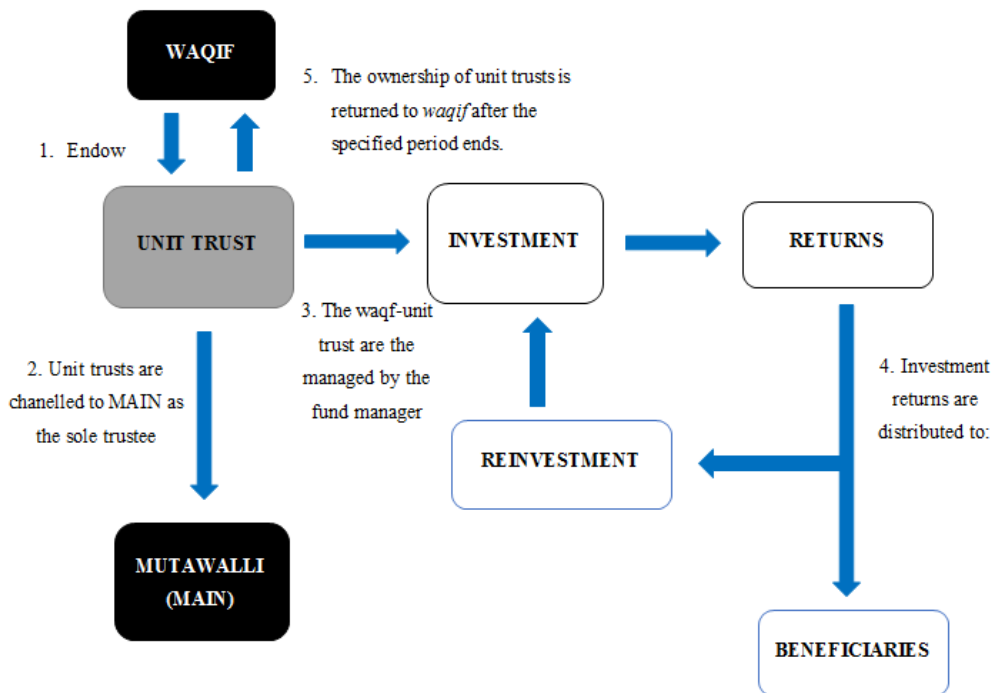
Step 1: The *waqif* endows the unit trusts owned by him or her.

Step 2: The endowed unit trusts are channelled to SIRC as the sole trustee.

Step 3: The fund manager is responsible to invest the *unit trust waqfs* and manage the investment portfolio.

Step 4: The investment returns will be distributed to beneficiaries. Where applicable, some portions of the returns are channelled for reinvestment purposes.

**Figure 3:** Second Proposed Model: *Waqf Muaqqat* Model



Step 1: The *waqif* endows the unit trusts owned by him or her for a pre-determined period of time.

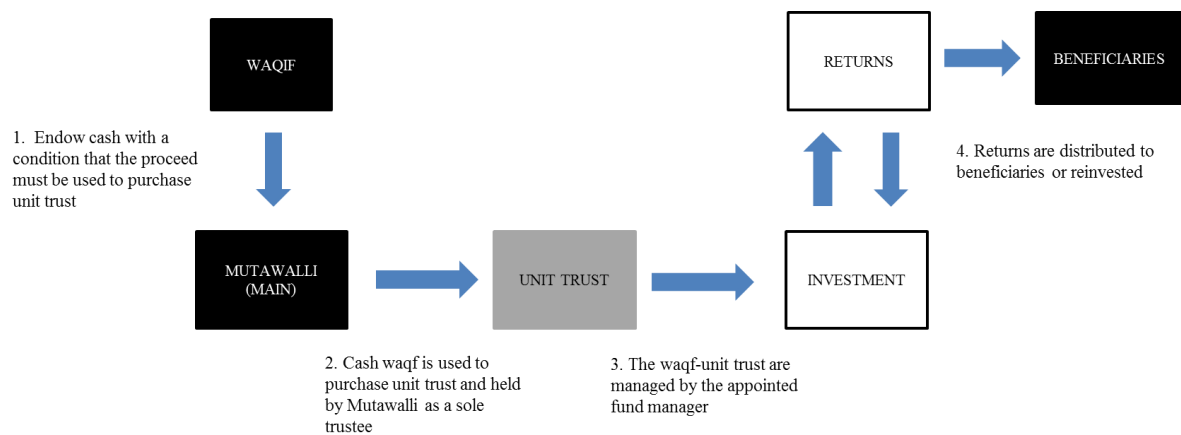
Step 2: The endowed unit trusts are channelled to SIRC as the sole trustee.

Step 3: The fund manager is responsible to invest the *waqf*-unit trusts and manage the investment portfolio.

Step 4: The investment returns will be distributed to beneficiaries. Where applicable, some portions of the returns are channelled for reinvestment purposes.

Step 5: After the *waqf* period ends, the ownership of the unit trusts is returned to the original owner (*waqif*).

**Figure 4:** Third proposed model: Cash Waqf for the Purpose of Purchasing Unit Trust



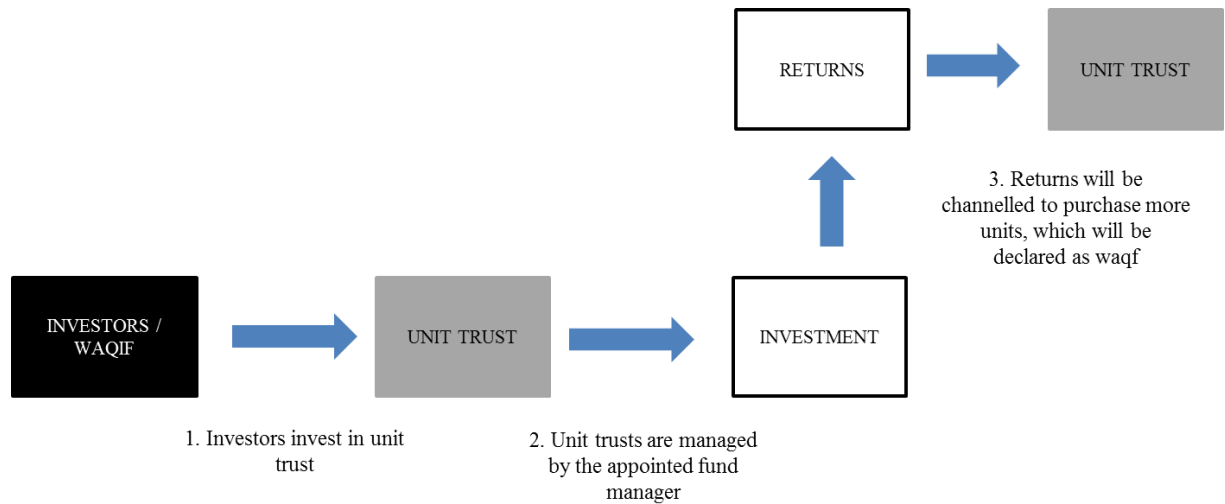
Step 1: The *waqif* endows cash and gives a condition that the proceeds must be used to purchase unit trust (hence, the purchased unit trust will be declared as *waqf* assets, not the cash).

Step 2: The proceeds will be used to purchase unit trusts and will held by *mutawalli* as a sole trustee.

Step 3: The fund manager is responsible to invest the *waqf*-unit trusts and manage the investment portfolio.

Step 4: The investment returns will be distributed to beneficiaries. Where applicable, some portions of the returns will be reserved for reinvestment purposes.

**Figure 5:** Fourth proposed model: Waqf Dividend

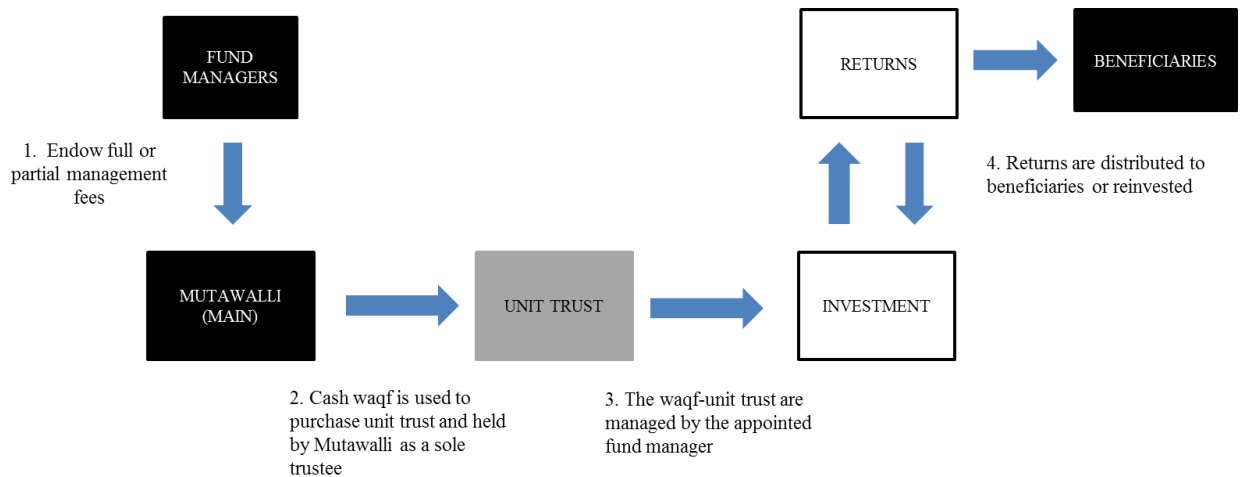


Step 1: Investors invest in unit trusts (but do not endow them).

Step 2: The fund manager is responsible to manage the investors' investment portfolio.

Step 3: Returns from unit trust investment will be used to purchase other units, which later will be declared as *waqf* and held by *mutawalli*.

**Figure 6:** Fifth proposed model: Waqf-management Fees



Step 1: The fund managers endow the full or partial amount of management fees that they have received and give a condition that the proceeds must be used to purchase unit trust (hence, the purchased unit trust will be declared as *waqf* assets, not the cash).

Step 2: The proceeds will be used to purchase unit trusts and will held by *mutawalli* as a sole trustee.

Step 3: The fund manager is responsible to invest the *waqf*-unit trusts and manage the investment portfolio.

Step 4: The investment returns will be distributed to beneficiaries. Where applicable, some portions of the returns will be reserved for reinvestment purposes.

### PROPOSED PARAMETERS FOR IMPLEMENTING UNIT TRUST WAQF

There are a number of issues that might arise related to the implementation of unit trust *waqf*. The issues include the compliance of the funds to the *Shariah* principles, supervision and governance of the fund, risk management of the portfolio to preserve the *waqf* capital from losses and sustainability of the fund. Hence, to address this concern, this study further proposes the parameters for implementing unit trust *waqf*, which could be a useful reference for the stakeholders of unit trust *waqf* including *waqif* (donor), *mutawalli* (administer of *waqf*), fund managers and *Shariah* advisors. These parameters are designed in view of ensuring the adherence of unit trust *waqf* activities with *Shariah* principles and the existing *waqf* laws and regulations in Malaysia.

The proposed parameters are divided into several sections, namely: (i) legality of unit trust *waqf* from the standpoint of *Shariah* and *waqf* laws and regulations in Malaysia; (ii) supervision of unit trust *waqf* investment; (iii) risk management; and (iv) sustainability of unit trust *waqf* investment. Table 1 depicts the parameters for implementing unit trust *waqf*.

Parameters	Description
Parameter 1: <i>Shari'ah</i> Compliance & Legality	<p>1/1 – Fund managers must ensure that all investment activities of <i>waqf</i> unit trust are <i>Shari'ah</i> compliant. This can be achieved by:</p> <p>1/1/1 - Meeting the requirements/criteria/qualities to be deemed as <i>Shari'ah</i>-compliant investment set by the jurisprudence's authoritative bodies, for instance, the <i>Shari'ah</i> Advisory Council (SAC) of Securities Commission (SC) and that of Bank Negara Malaysia (BNM).</p> <p>1/1/2 – Establishing a <i>Shari'ah</i> Committee who is responsible to review and advise on <i>Shari'ah</i> matters related to the <i>waqf</i> unit trust.</p> <p>1/2 – The entire process of <i>waqf</i> unit trust, for instance, collection of proceeds, marketing and promotion, investment, <i>istibdal</i> and distribution of profits must be conducted in accordance to the national and/or state's <i>waqf</i> legal framework.</p>
Parameter 2: Supervision and	2/1 – Supervisory and oversight responsibilities related to the governance and administration of <i>waqf</i> unit trust funds include the



Oversight	<p>following:</p> <p>2/1/1 – Majlis Agama Islam Negeri (MAIN) acts a sole trustee (<i>mutawalli</i>) for the <i>waqf</i> unit trust fund.</p> <p>2/1/2 – <i>Mutawalli</i> has duties and responsibilities for supervising and oversight the administration of <i>waqf</i> unit trust. MAINs may appoint any institution to perform the administrative duties on their behalf.</p> <p>2/1/3 – The amount of all fees due to the fund managers and its source of payment must be agreed between <i>mutawalli</i> and fund managers.</p> <p>2/1/4 – <i>Mutawalli</i> must establish its own supervisory and governance framework in order to ensure the <i>waqf</i> unit trust funds are properly managed by the appointed fund managers.</p> <p>2/2 – Supervisory and oversight responsibilities related to the collection and distribution activities of <i>waqf</i> unit trust funds include the following:</p> <p>2/2/1 – <i>Mutawalli</i> must decide which parties should be responsible for collection and distribution of <i>waqf</i> unit trust. <i>Mutawalli</i> is responsible to supervise the collection and distribution activities of <i>waqf</i> unit trust funds.</p> <p>2/2/2 – <i>Waqif</i> must ensure that their money or unit trusts which are intended to be endowed must be channeled to authorized institutions by MAIN.</p> <p>2/2/3 - In the event of money are collected from <i>waqif</i> for the purpose of <i>waqf</i> unit trust, <i>waqif</i> must be informed that the proceeds will be used to purchase unit trusts. Hence, the purchased unit trust will be declared as <i>waqf</i> asset instead of the cash chanelled by the <i>waqif</i>.</p> <p>2/2/4 – Unit trust funds endowed by the <i>waqif</i> must be <i>Shari'ah</i>-compliant.</p> <p>2/2/5 – The appointed fund managers are encouraged to endow some of the management fees received by them to purchases more units for <i>waqf</i> purpose.</p> <p>2/2/6 – All promotion and marketing activities associated with <i>waqf</i> unit trust must correspond with the ultimate objective of <i>waqf</i> and not solely profit-driven and bias towards the interest of certain individual or a group of people.</p> <p>2/2/7 – All relevant information on the <i>waqf</i> unit trust must be provided to <i>waqif</i> or investors in a transparent and timely manner.</p> <p>2/3 – Supervisory and oversight responsibilities related to the investment of unit trust funds include the following:</p> <p>2/3/1 - <i>Mutawalli</i> has duties and responsibilities for supervising and oversight the investment activities of <i>waqf</i> unit trust.</p> <p>2/3/2 – <i>Mutawalli</i> must equip itself with adequate knowledge and expertise of supervising <i>waqf</i> unit trust investment activities.</p> <p>2/3/3 - Fund managers appointed by <i>mutawalli</i> must have knowledge,</p>
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	<p>expertise and capabilities to manage the <i>waqf</i> funds in ways that consistent returns can be generated and the initial capital can be protected.</p> <p>2/3/4 – Fund managers must determine the risk tolerance level, investment strategies and governance framework for the <i>waqf</i> unit trust investment which must be agreed by <i>mutawalli</i>.</p> <p>2/3/5 – Supervision of <i>waqf</i> unit trust investment activities must be done on an ongoing basis.</p> <p>2/3/6 – Guidelines or clear-cut Standard Operating Procedures (SOPs) for supervision of <i>waqf</i> unit trust investment should be established by <i>mutawalli</i>.</p> <p>2/3/7 – Report on <i>waqf</i> unit trust investment must be made publicly available.</p> <p>2/3/8 – Effective communication and cooperation between <i>mutawalli</i> and fund managers in ensuring the sustainability of <i>waqf</i> unit trust investment are highly crucial.</p>
<p>Parameter 3: Risk Management</p>	<p>3/1 – Fund managers should establish an effective risk management system and due diligence process.</p> <p>3/2 – Capital protection must be placed as the ultimate objective of <i>waqf</i> unit trust investment.</p> <p>3/3 – <i>Waqf</i> unit trust investment must achieve the balance between profitability and capital protection.</p> <p>3/4 – Fund managers are responsible to ensure that <i>waqf</i> unit trust funds are not exposed to extremely high investment risks that can devalue its capital in a long run.</p> <p>3/5 – Fund managers must ensure that <i>waqf</i> proceeds are not invested in high volatile asset classes.</p> <p>3/6 – Fund managers must create highly diversified portfolios of <i>waqf</i> unit trust investment.</p> <p>3/7 – The process of <i>istibdal</i> (e.g. sell units and use the receipts to purchase other units) in <i>waqf</i> unit trust investment can be done in the following situations:</p> <ol style="list-style-type: none"> <li>i. <i>Waqif</i> has stipulated that <i>istibdal</i> must be done through assets trading.</li> <li>ii. The unit trust funds experience significant capital loss where high maintenance and management expenditures have to be borne by <i>mutawalli</i>.</li> <li>iii. The unit trust funds and its constituent assets become <i>Shari'ah</i> non-compliant.</li> </ol> <p>3/8 – <i>Istibdal</i> can only be done with the consent received from <i>mutawalli</i> and must not expose the <i>waqf</i> unit trust to high investment risks.</p>

<p>Parameter 4: Sustainability</p>	<p>4/1 – The primary objectives of sustainability of <i>waqf</i> unit trust investment and distribution of benefits to the <i>waqf</i> beneficiaries must be balanced by <i>mutawalli</i>.</p> <p>4/2 – In view of enhancing the sustainability of <i>waqf</i> unit trust funds, the fund managers must take measures ensuring consistent returns are channelled to the beneficiaries and promote capital growth in a sustainable manner.</p> <p>4/3 – In the event of capital deterioration occurs in the previous years, the returns generated in the next coming years must be used to purchase new units to restore the initial value of <i>waqf</i> unit trust funds (capital intact).</p> <p>4/4 – <i>Mutawalli</i> must ensure that management fees and other expenditures are paid before returns can be distributed to the beneficiaries.</p> <p>4/5 – Some investment profits may be retained as a reserve capital for the purpose of reinvestment.</p> <p>4/6 – All promotion and marketing activities related to <i>waqf</i> unit trust investment must be actively conducted.</p> <p>4/7 - Various forms of incentives may be provided to investors or <i>waqif</i> such as subsidizing management fees and provision of tax rebates.</p>
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**Table 1:** Parameters for Implementing Unit Trust *Waqf*

## CONCLUSION

*Waqf*-unit trust or unit trust *waqf* is an Islamic financial innovation, which could bring tremendous benefits to the *waqf* institution in Malaysia and other countries, other than the *waqf* beneficiaries. At any case, the current conversation on unit trust *waqf* is still theoretical, with little guidance available regarding its implementation. In particular, there is a lack of modern fatwa or ruling on the permissibility (or prohibition) of this type of *waqf* from the *Shariah* perspective. As such, this study was conducted with the objective to enrich the relevant literature, as well as to shed some light on its application and implementation, especially due its potential as an investment instrument that could help to sustain and further develop *waqf* assets in Malaysia. In addition, the *Shari'ah* rulings or fatwa on the permissibility of movable assets as the subject matters for *waqf*, which have direct relevance to *unit trust waqf*, namely, cash *waqf* (e.g. the permissibility to use the cash *waqf* proceeds to purchase units from Shari'ah perspectives) and *waqf* financial instruments such as sukuk and shares (as underlying constituents of unit trust funds) are also incorporated in this study.

Our study also found that there is no express provision in the Qur'an and Sunnah that clearly prohibiting, neither sanctioning unit trust *waqf*. The novelty of this study lies on the proposed conceptual models of *waqf* of unit trusts along with the parameters of their application that could be useful to *waqf* stakeholders in Malaysia, when its future implementation could be given a full consideration. This study is a part of many efforts from various quarters to promote the application of contemporary *waqf*, particularly unit trust, as a new category of *waqf* asset. At the same time and more importantly, promoting unit trust *waqf* can be a vehicle to encourage more philanthropic and charitable values among members of the society.

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## **ONLINE CROWDFUNDING: ADAPTATION FROM THEORY OF PLANNED BEHAVIOUR**

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## **ABSTRACT**

*This paper aims to explore donor's characteristics in online Islamic crowdfunding mechanism in Klang Valley, Malaysia. The sampling frame used in this study was undergraduate students in a public university. A self-administered online survey questionnaire was distributed to the selected respondents residing in Klang Valley in 2017. Descriptive analysis and regression analysis were conducted to investigate the perceived behavioral control, attitude and subjective norms towards online crowdfunding intention. Findings from this study will help fundraising companies to understand the donor's charity giving intentions, factors affecting the charity giving decisions and their preferences.*

**Keywords:** *giving behaviour, online crowdfunding, intention*

## **RESEARCH BACKGROUND**

Crowdfunding has recently gained attention worldwide as an alternative financing mechanism to the traditional fundraising methods for business ventures or social projects (Abdullah, 2016). Traditionally, if a person wants to raise capital to start a business or launch a new product, he/she would need to prepare a business plan or prototypes and then, shop his/her idea around to a limited pool or wealthy individuals or institutions (Dresner, 2014). Crowdfunding is the opposite of this traditional approach. It is a type of crowdsourcing, using the Internet to approach to thousands – if not millions – of potential funders. Or the other word, crowdfunding is a type of participative online activity in which an individual, institution, non-profit organization, or company proposes to a group of individuals of varying knowledge, heterogeneity, and number, through a flexible open call, the voluntary undertaking of a task which always entails mutual benefits (Alonso, 2015). The crowd participates in crowdfunding by bringing work, money, knowledge and/or experience (Enrique and Fernando, 2012). To date, crowdfunding has been increasingly used to gather entrepreneurial seed capital (Scwienbacher and Larralde, 2012) and new ventures (Mollicak and Kupposwamy, 2014). There are several types of crowdfunding models and platforms, such as 1) donation-based, where no rewards are given, 2) lending-bases, in which funds are offered as a loan carrying and expected interest, 3) equity-based, where funds are provided in exchange for shares in the new ventures, and 4) reward based, where financiers receive a tangible (but not financial) reward for backing the project (Barbi and Bigelli, 2015).

Crowdfunding is a relatively novel phenomenon, as earliest record use of the word crowdfunding dated back to 2006 and the field is in a young state of scientific research (Bouncken, 2015). Research on crowdfunding is growing at an impressive pace where past research has highlighted some important theoretical and empirical findings related to the crowdfunding phenomenon. Schwienbacher and Larralde (2010) is considered a pioneer in crowdfunding research. They conducted case studies on the music industry in France that offer crowdfunding. Later, there were several attempts to construct theories on crowdfunding forms (Belleflamme et al., 2012). Additionally, there were several articles focusing on the role of investors in crowdfunding. For instance, Kuppuswamy and Bayus (2013) describe efforts to assist in various projects depending on crowdfunding

platforms such as Kickstarter and evaluate its efficiency. Agrawal et al. (2010) used market musicians to get crowdfunding and how geography affects. Burtch et al. (2011) examined how time factor affecting acquisition in crowdfunding. All these researches were the study of value but rather focus on the sub-categories under the topic, without any review of the relevant projects.

### **CROWDFUNDING AND ISLAMIC FINANCE**

Crowdfunding possesses similar characteristics with Islamic finance. In a way that financing based on ethical and socially responsible standards, which ensures fair distribution of benefits and obligations between all the parties in any financial transaction. Islamic finance and crowdfunding both conceptualize customers as investors and can potentially provide investment opportunities with higher returns. Additionally, both put a strong emphasis on transparency, mutual involvement and trust. Therefore, crowdfunding provides the ground for new development in the field, as it can use Islamic finance as an ethical and socially responsible tool to promote financing and development. While crowdfunding model has achieved a very positive development, but research on Islamic crowdfunding is still lacking. Islamic crowdfunding mobilizing Islamic finance instrument including waqf, sadaqah, zakat and qard hasan is therefore not being considered.

### **PROBLEM IDENTIFICATION**

Donation and charity giving has been widely practiced worldwide through various channels. One of the new phenomenon in donation and charity giving is using crowdfunding mechanism. In the latest development of crowdfunding, online crowdfunding interface has upsurge where entrepreneurs utilize the online platform such as Kickstarter to start their project and pitch for donors. It has proven to be successful for the past few years for small business entrepreneurs to get funding for their business. This crowdfunding concept is nothing new in Islamic practices of donation and giving, as the concept is similar to sadaqah, zakat, waqf and qard hasan where the publics or crowds will fund the project voluntarily. However, the crowdfunding interface is not yet in place in Muslim majority countries as compared to the western countries.

Jalil et al. (2008) stressed the importance of donation and charity as a source of economic and social assistance fund, which is found to be very effective. They suggested that the

technology could be used to deal with the proceeds of donation and charity so that it can be utilized to the maximum level. Hussin et al. (2014) touched on the role of mosques as a charity fund manager as effective. They suggested that all mosques are cooperating to manage the fund for the benefit of Muslim mosques, especially in the economic field. Cooperative proposed as a facilitator in the management and managing funds. Based on the requirements of the management and allocation of funds over the crowdfunding system is expected to provide the best solutions to agencies and individuals concerned to manage the funds better. Therefore, it seems imperative to develop Islamic crowdfunding product utilizing information technology as the interface. Hence, this paper aims to examine the predictive factors affecting donation and charity giving.

### **SIGNIFICANCE OF THE RESEARCH**

This research will contribute to the present crowdfunding literatures. In order to facilitate the objective of the program to develop a crowdfunding model for Malaysian public fund institutions, this research specifically deals with the marketing aspects of Islamic crowdfunding model. This project is significance in two major ways. First is that it will undergo pre-product development to identify the construct and concepts for Islamic crowdfunding. This will be done via the engagements with prospective crowdfunders (donors, lenders, investors) and relevant Islamic-based social finance vehicles such as zakat, waqf, sadaqah and qard hasan. Via these engagements, a relevant Islamic crowdfunding product could be developed that is required by the public or rather marketable. This marketable product will be an indicator of what types of fund that public has the interest to donate as part of their investment for their celestial health. In addition, this research is significant in a way that it will identify marketing strategies to reach the target groups. This is important to ensure the promotion of the public fund is done accordingly and reach the target market. Well-developed product and good marketing strategies will increase the confidence of the public to contribute more fund in the future, which in turn will boost the public fund volume for the benefit of the ummah.

### **LITERATURE REVIEW**

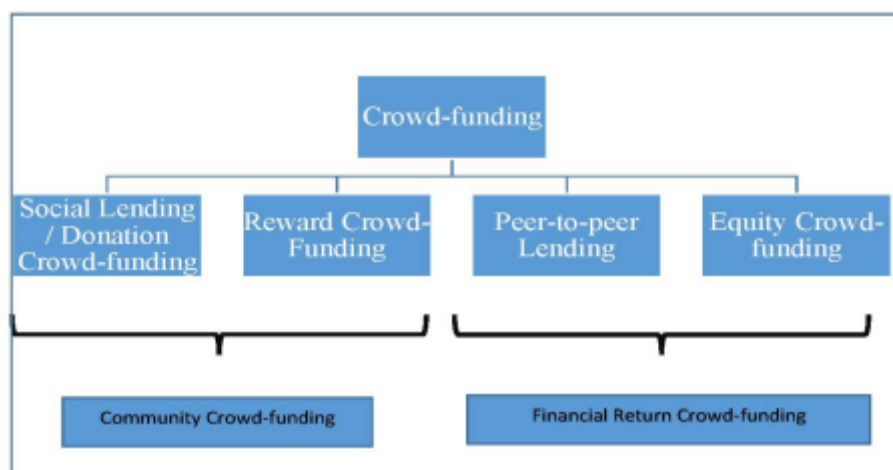
Much of the past studies conducted on the importance of proponent's external social capital found that the successful rate of crowdfunding is depending on factors of number of friends on their friends list (Mollick, 2014) and similarly individual social capital significantly increases the probability of the funding goal (Giudici et al.' 2013). Another

investigation using social influence theory tries to examine whether crowdfunder's behavioral is influenced by previous contributors where the evidence is mixed. Butch et. Al (2013) note a subsequent crowdfunders are less prone to finance if they realize that previous funding had decreased the marginal utility of their contribution to the project's success. Similarly, investor supports are negatively related to project that has received a lot of support (Kuppuswamy and Bayus,2013).

***Review of existing of crowdfunding models***

According to Borello, Crescenzo, and Pichler (2015) crowdfunding refers to circumstances whereby many people give typically small amount of money to projects and ideas via online platforms. The existing model as proposed by Kirkby and Worner (2014) suggest that crowdfunding models can be classified as community crowdfunding or financial return crowdfunding, which differ regarding the presence or a return of backers or not. Community crowdfunding includes social lending,/donation crowdfunding and reward crowdfunding, while financial return crowdfunding refers to peer-to-peer (p2p) lending and equity crowdfunding (Figure 1).

**Figure 1: Crowdfunding models**



Source: Kirby and Worner, 2014 p.8

***Community Crowd-funding***

**a. Rewards crowdfunding (all or nothing)**

Rewards-based crowdfunding is where contributions are exchanged for current or future of goods or services. Individuals or companies who launch campaigns may compensate

contributors with something like a t-shirt, a copy of whatever they're building or even just a thank you. Rewards-based crowdfunding is perhaps the most prolific form of crowdfunding currently taking place in the US. Two established sites that has launched crowdfunding activities are Kickstarter (Voelker & McGlashan, 2013) and Indiegogo who facilitate the idea. Now anyone can go and create a web page on these sites and pitch an idea.

#### **b. Social Lending (nothing)**

Donation crowdfunding takes place when an individual, company or organization accepts charitable donations. This has been taking place for a long time, where all participate in donation-based crowdfunding. It is appropriate for funding non-profitable activities.

#### ***Financial Return Crowdfunding***

**a. Peer to peer crowdfunding** is when a crowd lends money to an individual or company with the understanding that the loan will be repaid with interest. This is the methodology behind peer to peer lending sites. Appropriate for companies and individuals planning on multiple rounds of funding, companies who do not want to part with equity.

**b. Equity crowdfunding** is where the exchange is company equity, or ownership, and not goods or services. The idea is very similar to how common stock is bought and sold on the stock market.

#### ***Charity giving and donor's behavior***

Giving is a voluntary action favoring someone else or a public cause at a cost for oneself without requiring a counterpart (Kasri, 2013) where it occurs when the giver's desire for giving over-compensates the (potential) cost. Although giving behaviors have been discussed long time ago, by numerous economists such as A. Smith, J.S Mill and V. Pareto, the studies upsurge only in the last third of the twentieth century (Kasri, 2013). On the other hand, Islam is a religion that has a commitment to social conditions. It has a philanthropic tool in regard to the welfare of the ummah and poverty alleviation. One of the powerful tool is *waqf*. According to the history, the contribution of *waqf* in Muslim societies of the past has been significant. It is a tool for distributing public wealth.

Even though there is not a single verse in the *Quran* that deals specifically with *waqf*, Islamic scholars and jurists (the four prominent schools of thought, Shafie, Hanbali,

Maliki and Hanafi) agreed that a few of the following verses are to be referred to as the source of the subject matter (Hameed and Yacoob, 2005). In *Surah Al Imran*, verse 92, Allah (*s.w.t.*) says, “By no means shall ye attain righteousness unless ye give (freely) of that which ye love; and whatever ye give, of a truth God know it well”. The verse states that Muslims will not be rewarded with goodness unless they are willing to give their best to others. The gift must be of value and which is dear to the giver. Islam encourages the believers to help the unfortunate amongst them through sadaqah (general charity).

In general, literature suggests that variables affecting giving behaviors of individuals could be classified into extrinsic (demographic and socio-economic factors) and intrinsic (underlying / psychological motives) factors (Kasri, 2013). Persistence of education giving have positive relationship with family income, education level, number of children at school level and marital status Bennet (2013); (Wu & Brown, 2010) found that charity’s relationship marketing activities, service quality, reputation of the charity, relationship quality, donor engagement are among the determinants of donor behavior.

Interestingly, this research suggested that engagement-prone charity supporters are likely to have a higher lifetime donor values, it is desirable to target these donors in recruitment and retention campaigns. Charities also must decide how exactly they want donors to engage with the organization and then create mechanism and systems (e.g blogs, online communities) that make it easy for supporters to engage. Therefore, understanding donor characteristics and behavior are equally important to maintain sustainability in managing streams of donations for the proposed project. In relations to that, strategies on managing relations and reaching the crowd are also important and need to be considered into.

Source: (Byrnes, Ranganathan, Walker, & Faulkes, 2014)

Current marketing strategies utilized online platform where engagement of broad audiences is key to successful science crowdfunding (Byrnes et al., 2014). The above model is therefore can be applied onto another sector. As of Islamic charity giving, offline platform using Islamic institution such as zakat, waqf, microfinance, qard hasan has not been explored, therefore this research is going to mobilize on two things: first is the suitable marketing strategies on getting the fund and second is to facilitate the distribution channel.



### ***Theory of Planned Behaviour***

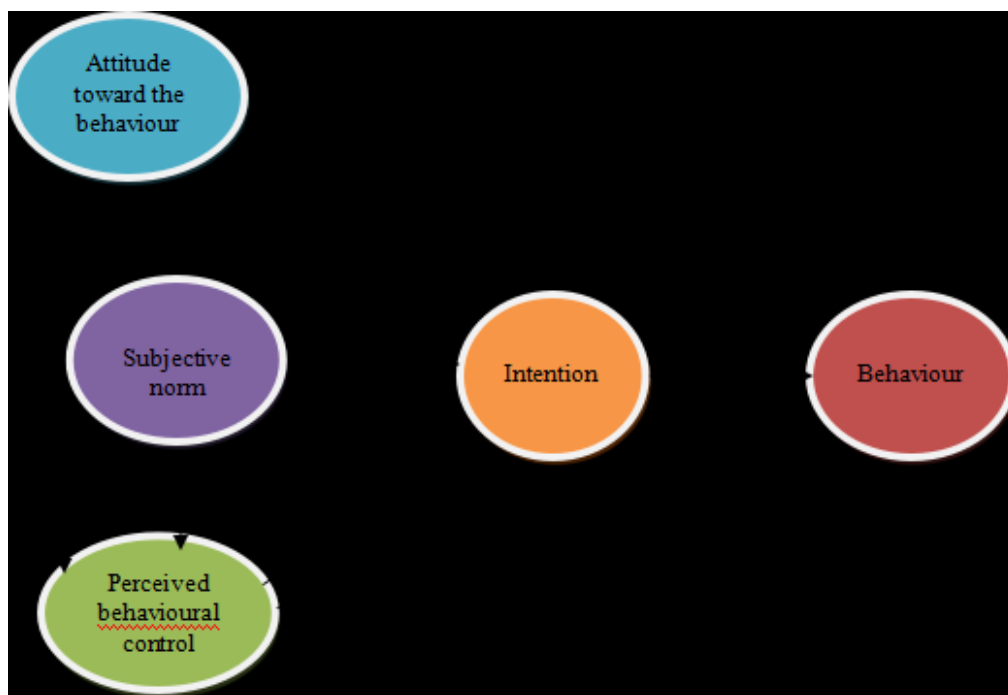
To further understand the underlying reasons of behavioral intention, the theory of planned behaviour (TPB) extends the understanding of the consumer decision making process by considering how the concepts of attitude, perceived behavioral control, subjective norms and intention influence specific behaviours (Ajzen, 1991; "Capitalism"). TPB provides a framework to examine the influence of attitudes on behaviours. A simple example, if an individual believes that the outcome of the behaviour is positive, he/she will possess a positive attitude toward performing it. In applying TPB in this field, if a customer believes that the result of the switching action is positive, he/she will have a positive attitude towards switching. The central factor in the TPB model is the individual's intention to perform a given behaviour (Ajzen, 1991). (See Figure 2).

The theory of planned behaviour is an extension of theory of reasoned action, suggested by Fishbein & Ajzen, cited in Ajzen, 1991). The theory of reasoned action state that the immediate antecedent of behaviour is the behavioural intention to perform this behaviour. The intention to perform the specific behaviour is affected by the belief that performing this specific behaviour will lead to certain outcome (Madden, 1992). The beliefs are affected by the attitude towards the behaviour and subjective norms. While attitude is considered as a function of the sum of the perceived values of expected outcomes of the behaviour; subjective norm (SN) is a function of the sum of perceived social pressures and perceived behavioural control (PBC) represents the collective effects of individuals' perception of both internal and external enabling factors (time, money, knowledge, etc.) That determines the ability to perform the behaviour.

According to Ajzen (1991), the attitude towards the behaviour concerns the degree to which an individual possess a generally favourable or unfavourable evaluation of the specific behaviour in question. Beliefs about a specific behaviour are formed by associating them with certain attributes; that are either positive or negative values. The consequence of this assessment will be the formation of an attitude towards the behaviour. Subjective norms relate to whether an individual is under strong social pressure. If the societal pressure is strong the individual may need approval from important social peers to perform the given behaviour, for example family and friends. Lastly, perceived behavioural control refers to whether an individual perceives it as easy

or difficult to execute the specific behaviour for example, whether the individual perceives they have sufficient control to perform the behaviour. Additionally, perceived behaviour relates to having confidence in performing the specific behaviour successfully; if the individual believes to be unable to perform the behaviour, the perceived behavioural control will be low. All three factors are positively related to behavioural intentions whereas the intention is positively related to performing the specific behaviour.

**Figure 2 Theory of planned Behaviour**



Source: (Ajzen, 1991)

While a model of behavioural intention can be valuable under some circumstances, the results of a study by Baumann, Burton, and Elliott (2005) indicated that intentions are poorly correlated with actual behaviour. Similarly, investigation from a customer satisfaction and loyalty study by (Keiningham, Cooil, Aksoy, Andreassen, & Weiner, 2007) found that recommended intention does provide insight into customer future recommend behaviour.

## METHODOLOGY

The paper adopts quantitative research method. The key independent variable (online crowdfunding intention) was measured using items adapted from Bansal et al. (2005) and Bansal & Taylor (1999). Guided by the literature and previous studies, the dependent variable constructs were namely attitude, perceived behavioral control and subjective norms. Attitudes consisted of positive perceptions perceived by the customers associated with the intention to donate through online crowdfunding, whereby perceived behavioral control are factors related to the perceptions on how much control do they have upon charity giving activities. Subjective norms are factor related to the perceptions of others, and were derived from Theory of Planned Behavior (TPB). A total of 13 measurement items was used.

A web-based survey containing all items, plus questions about demographic information and was administered to a sample of 130 young individuals ages (18-40) using online survey. The sample comprised 78 percent females and 22 percent males and covered a range of ages 18 years to 40 years old. Descriptive analysis was conducted and followed by regression analysis to predict attitude, perceived behavioral control and subjective norms and personal factors.

## RESULTS

In general, the finding of the study is divided into two parts consists of 1) descriptive analysis on the variables, and 2) results on regression analysis.

### *Descriptive Analysis*

This study revealed that 55.5 percent of respondents have participated in donation through online crowdfunding (see and Table 1).

Table 1 Partipation in Donation through Online Crowdfunding

<b>Answer Options</b>	<b>Response Percent</b>	<b>Response Count</b>
Yes	55.5%	117
No	44.1%	93

Table 2 list the sources of online crowdfunding. Most respondents know about the online crowding from online sources including social media, online forum and online search.

Table 2 Source of Online Crowdfunding

<b>Answer Options</b>	<b>Response Percent</b>	<b>Response Count</b>
News article	1.9%	4
Word of mouth / referral from friends	10%	21
Online search	4.7%	10
Online forum/discussion	1.7%	3
Social media	13.7%	29
Others	5.2%	11

In terms of types of crowdsourcing, 27 percent of the respondents have donated via traditional way of donation (i.e. offline) while 26 percent of the respondents have donated via online and offline.

Table 3 Types of Donation

<b>Answer Options</b>	<b>Response Percent</b>	<b>Response Count</b>
Online crowdfunding	9%	19
Traditional offline	27%	57
Both	26%	55
Others	4	

This questions aims to look at the respondents attitude towards online crowdfunding.

Table 4 shows that majority respondents responded positively pertaining to online crowdfunding. This is reflected through a response from respondents when asked to rate their agreements for the statements “To me donating through online crowdfunding is good idea, useful, wise,pleasant, desirable and something I like.

Table 4 Attitude Towards Online Crowdfunding

Answer Options	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Rating Average	Response Count
To me donating through online crowdfunding is a good idea	2	3	35	66	27	3.85	133
To me donating through online crowdfunding is useful	0	1	27	80	26	3.97	133
To me donating through online crowdfunding is wise	3	6	41	62	21	3.69	133
To me donating through online crowdfunding is pleasant	1	3	42	66	20	3.77	133
To me donating through crowdfunding is desirable	3	0	56	59	15	3.62	133
To me donating through online crowdfunding is something I like	3	8	48	55	19	3.59	133

Findings on subjective norms descriptive analysis suggested that majority of the respondents believed that people (friends, family, and colleagues) who are important to them strongly support the decision to donate through online crowdfunding and believed that people that they cared about would approve their decision donating through online crowdfunding .

Table 5 Subjective norms

Answer Options	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Rating Average	Response Count
Most people who are important to me would approve of me donating through online crowdfunding	1	9	55	58	10	2.99	133
People I care about would approve of my decision donating through online crowdfunding	1	6	50	65	11	3.02	133

Findings on perceived behavioural control descriptive analysis suggested that majority of the respondents claimed that if they wanted, they could easily donate money to online crowdfunding in the next 6 months and it is up to them whether they donate money to online crowdfunding the next 6 months .

Table 6 Perceived Behavioral Control

Answer Options	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Rating Average	Response Count
If I wanted to, I could easily donate money to online crowdfunding in the next 6 months	0	5	44	74	10	3.67	133
It is mostly up to me whether I donate money to online crowdfunding in the next 6 months	0	1	61	62	9	3.59	133

Donating money to online crowdfunding in the next 6 months is easy for me to do	1	8	67	49	8	3.41	133
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Majority of the respondents agreed to donate through online crowdfunding.

Table 7 Donation through online crowdfunding: Intention

Answer Options	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Rating Average	Response Count
I will definitely donate through online crowdfunding	0	5	55	61	11	3.59	132
I would plan to donate through online crowdfunding	0	5	54	60	13	3.61	132
I intend to donate money to online crowdfunding	0	4	55	63	10	3.60	132
I would likely to donate money to online crowdfunding	0	4	59	61	7	3.54	131

### ***Regression Analysis on Online Crowdfunding Donation Behavioural Intention***

A Multiple linear regression was calculated to predict online crowdfunding intention based on their attitude towards online crowdfunding, Subjective Norms (belief of others) and Perceived Behavioral control (ability to donate). A significant regression equation was found ( $F(2,208) = 4.777E3, P < 0.000$ ), with an  $R^2$  of .978.

The regression analysis was performed on sample and the  $R^2$  for this study was 0.979 (see Table 8). The study shows that all factors were found to have a significant contribution towards online crowdfunding donation intention (see Table 9). Subjective Norms towards online crowdfunding is statistically significant contribution to Online crowdfunding intention ( $\beta = 1.021$ ), followed by attitude ( $\beta = -.032$ ). Perceived Behavioral Control (ability to donate) variable was excluded from the regression (see Table 12).

Respondents' predicted online crowdfunding intention is equal to  $40.106 + 2.044$  (subjective norms) -  $0.21$  (attitude) where subjective norms and attitude are coded or measured using Likert scale of 1=strongly disagree, 2= disagree, 3= neutral, 4= agree, and 5= strongly agree.

Table 8 Model Summary<sup>b</sup>

Model	R	R Square	Adjusted R Square	Standard error of estimation
1	.989 <sup>a</sup>	.978	.979	.70.73891

a. Predictors : (Constant), ATTITUDE, SUBJECTIVE\_NORMS

b. Dependent Variable : ONLINE CROWDFUNDING INTENTION

Table 9 Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients		Sig.
	B	Std. Error	Beta	t	
1 (Constant)	40.106	24.843		1.614	.108
SUBJECTIVE NORMS**	2.044	.850	1.021	2.404	.017
ATTITUDE*	-.021	.248	-.032	-.075	.970

a. Dependent Variable: ONLINE CROWDFUDNING INTENTION

b.  $p^* < 0.1$ ,  $p^{**} < 0.05$



Table 10 Anova

**Table 11****ANOVA<sup>b</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	7.649E8	2	3.824E8	4.777E3	.000 <sup>a</sup>
	Residual	1.665E7	208	80063.9D4		
	Total	7.815E8	210			

a. Predictors: (Constant), ATTITUDE, SUBJECTIVE NORMS

b. Dependent Variable: (M) ONLINE CROWDFUNDING INTENTION

Table 12 Excluded Variable

**Excluded Variable**

Model		Beta In	t	Sig	Partial Correlation	Collinearity Statistics Tolerance
1	Perceived Behavioral Control	15.401	1.238	.217	0.86	6.604e-7

a. Predictors in the Model : (Constant), ATTITUDE, SUBJECTIVE NORMS

b. Dependent Variable: (M) ONLINE CROWDFUNDING INTENTION

## CONCLUSION

In conclusions, there are few behavioral issues need to be addressed in the field of Islamic crowdfunding. Online crowdfunding intention is measured using theory of planed behaviour model with the assumptions that online crowdfunding intention is represented

by belief of others, ability to donate and attitudes. In this study, belief of others is positively related to online crowdfunding intention which means the higher believe of others, the higher the online crowdfunding intention. However, attitude towards online crowdfunding is negatively related to intention and this requires further investigation. There are several possible explanations for this finding. It could be the due to the nature of online crowdfunding platform which is rather new in terms of its existence. On the other hand, there is no specific regulations that governs sadaqah based crowdfunding and this may have created some ambiguity. Therefore, suggestions for policy implications to online fundraiser or fund manager will include a proper governance is needed to govern the online crowdfunding activities as to promote positive attitude towards online crowdfunding. Another possible suggestion is to relook at the institutionalizing the crowdfunding body as to materialize its existence. Some suggestions such as improving and strengthening the current Islamic crowdfunding distribution channel through crowdfunding such be given a thorough look.

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## WHY I TRUST MY TAKAFUL AGENT?

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### ABSTRACT

*In Takaful industry, Takaful agents are seen as the ambassador of the Takaful operators and essential in ensuring long term relationship between the client and the Takaful operators. This study aims to explore factors contributing trust development towards Takaful agent. Using qualitative approach, four (4) focus groups with existing Takaful clients and 11 group discussions among students enrolled in Professional Selling subject were conducted to achieve the study aim. Findings from this study found that two (2) major factors namely as Takaful agent characteristics and positive image of Takaful operator contributed toward trust development. Takaful operators and Takaful agents may use the findings of this research to enhance the relationship between Takaful agent and client relationship.*

**Keywords:** *trust development, Takaful agent, selling*

### INTRODUCTION

Takaful is an insurance system that complies with Islamic regulations. The Malaysian Takaful industry has experienced encouraging growth since its inception in 1985. Annual growth rate of the industry has been estimated at 20 per cent (Redzuan et al., 2009). In the industry, sales representative or widely known as Takaful agents are responsible in marketing and selling of Takaful plans. The Takaful agents are the frontliners of the Takaful industry. They are responsible in developing a huge client base and service them (Anwar Batcha, 2010).

Trust between a sales representative and the client organisation is one of the keys to a long-term relationship (Dwyer, Schurr and Oh, 1987). Hawes, Mast, and Swan (1989) argue that a sales representative's career success is influenced greatly by his or her ability to earn trust. Oakes (1990) also suggests that the success of sales agents in the insurance industry depends on their ability to market trust. Prospects will buy a policy if they first buy the trustworthiness of the agent. Others propose that trust enhances the ability of a salesperson to influence a prospect (Dwyer and Oh 1987; Swan and Nolan

1985). Clearly, gaining customers' trust in a variety of contexts is vital to a salesperson's ability to achieve exchange.

Research on the importance of trust in Takaful studies are limited and still unexplored. Previous studies on Takaful have focused on the concept of Takaful and its operations (Hamid and Othman, 2009) as well as consumers perception towards Takaful product (Ab Rahman, Ali, Che Seman, and Wan Ahmad, 2008). Others have examined determinants of takaful demand, consumer attitude towards Islamic insurance participation, and awareness on Takaful (Yazid, Arifin, Hussin, and Wan Daud, 2012; Amin, 2012). Overall, there has been no research done previously discussing the role of trust in the context of Takaful agent-client relationship. In addition, consumer trust towards Takaful agent is important in the context of Takaful client-agent relationship given that insurance or Takaful plans are bought and renewed every year by the client. Furthermore, as the industry grows and becomes more competitive, Takaful clients will face a number of choices of Takaful plans and Takaful agents play a significant role in marketing the Takaful plans successfully given that they are the frontliners of the Takaful operators. Therefore, this research intends to explore factors contributing toward the trust development.

### ***Trust and selling and role of takaful agents and factors contributing towards development of trust***

Trust has been recognised as an important element in relationship marketing success (Morgan and Hunt 1994). Various studies in the literature have proven that trust has significant impact on marketing success such as brand loyalty (e.g. Morgan and Hunt 1994; Chaudhuri and Holbrook 2001), commitment (Delgado-Ballester and Munuera-Aleman, 2001), brand extension acceptance (Reast 2005), increase in market share and relative price (Chaudhuri and Holbrook 2001), positive effects on purchase intention and word of mouth behaviour (Schitman 2007).

Sales agents or Takaful agents are not only selling Takaful products, but to also offer Takaful services. The agent or *wakeel* (agent) in Arabic appears in the Qur'an as the representation of a person on behalf of another person in certain dispositions. According to Hairul Azlan et al. (2004), it could mean *hifz* (to preserve or defend) as stated in the Quranic verses 3:173 and 4:132. '*Wakala*' also means *tafwid* (to entrust as shown in Qur'anic verses 3:160 and 12:67) and to be responsible for arranging one's affair (stated in Qur'anic verses 6:66 and 6:107).

Agents are responsible to assist their customers in all circumstances related to their financial well-being and to disseminate knowledge of Takaful to Muslims and non-Muslims (IBFIM, 2011). Agents must undergo thorough preparation and be properly informed of the necessary information, skills and strategies in order to properly execute their responsibilities. Takaful agents are required to be vigilant and are responsible for losses arising from carelessness (Frenz and Soualhi, 2010). In addition, they also need to have good relationship including good rapport with his/her existing and prospective clients and helps the Takaful operator in promoting and selling of Takaful products and services to its client. In sum; they act on behalf of the Takaful operators in confronting the public.

Given that Takaful agents frequently deal directly with the client, trust element should exist in the relationship to ensure a long-term relationship. Previous studies have examined factors contributing towards development of trust. Generally, the factors can be divided mainly into two (2); i) determinants associated with the salesperson such as salesperson's benevolence, competence, selling technique, and likability/similarity (Ingram, LaForge, Avila, Schwepker, and Williams, 2008; Swan, Bowers, and Richardson, 1999; Sichtmann, 2007) and ii) factors associated with the salesperson company (Swan, Bowers, and Richardson, 1999; Doney and Cannon, 1997). Nevertheless, these previous studies have investigated the factors in the context of 'conventional' selling practices. It has been argued that the role of Takaful agents and insurance agents differ (Che Mohd Salleh, Abdullah, Razali, and Wok, 2013). In Islam, trust is important to acknowledge one person's personality that will be respected by others. Prophet Muhammad (pbuh) was given the title *Al-Ameen* which means a person that we can trust. He became a role model for Muslims as a businessman who was trustworthy in any circumstances (Che Mohd Salleh and Riwan Ramli, 2013). Hence, the factors contributing toward development of trust in the context of Takaful agent-client relationship might be distinct and requires a further investigation.

## **METHODOLOGY**

This study employed qualitative approaches to explore factors contributing toward development of trust in the context of Takaful agent-client relationship. The data collection involved two (2) categories of respondents; existing Takaful clients and students enrolled in Professional Selling subject. The first round of data collection involved focus group sessions with existing Takaful clients. The selected participants had

to be an existing Takaful client, aged 21 years old and above. In total, four (4) focus group sessions were held involving 22 participants. The second round of data collection involved focus group discussion with students enrolled in Professional Selling subject. 66 students were divided into 11 groups and were asked to discuss important factors that lead to trust development between Takaful agent-client relationships. All sessions were tape-recorded. Participants were briefed about the aims and objectives of the study. Participants were asked to give feedback based on their own views.

To analyse the focus group discussion, method suggested by Casey (1989) has been followed. All groups' discussion were audio taped and transcribed. After the group discussions have been carefully typed, the transcripts were reviewed so that the researcher could become familiar with the flow of the dialogue. All transcripts were merged and then all of the answers to question one from all the groups were moved to the same master document. This was done for each topic and question. From this master document (which contains all of the relevant responses), the patterns, trends or themes across all of the responses were examined.

## **RESULTS AND FINDINGS**

For the purpose of reporting the results, findings are organised by topics that arose during discussion that are relevant and pertinent to this study. Findings have been grouped according to the answers given on a specific question, yielding majority opinions and views.

### ***Factors contributing toward trust development***

Participants were asked to provide factors that influence their trust towards Takaful agents. The findings suggest that there are two (2) major factors that contribute toward trust development; agent character and Takaful provider. Besides that, background of the company is important because it represents reputation and reputable Takaful agent will link with many panel hospitals.

### ***Character of Takaful Agent***

In this study, participants placed importance on the competencies and knowledge of the Takaful agent in determining their trust. An agent's knowledge builds participants trust by increasing the confidence that the agent can deliver his or her promises. Participants consider knowledgeable not only limited to the agent's understanding on the

product but also their expertise in recommending suitable product that suit their needs. The following is a comment by a participant:

*With the old Takaful company, I'm less information, so when I'm inside at the new Takaful company which is I'm choose the agent and agent has give many information needed. (Male, 36 years old)*

Other than knowledgeable agent, participants also consider a responsible agent as important criteria in establishing trust towards their Takaful agent. The following comment depict the importance of having a responsible agent:

*Trust can be looked from agent responsibility in perform client business. (Female, aged 35 years old)*

### ***Takaful provider***

Another factor that influence levels of trust is the reputation of the Takaful operator that the agent is representing. It is a norm in the Takaful industry that an agent represents a particular Takaful operator. In this study, participants considered Takaful operator background as an important factor that determined their trust towards Takaful agent. Takaful operators that create positive image in the industry and a known as an established company is considered as reputable company.

## **CONCLUSION**

This paper has explored the factors contributing towards trust development. Findings from this study also show two important factors that contribute towards trust development are related to agent's background and reputation of Takaful operator representing the agent. Takaful operators and Takaful agents may use the findings of this research to justify their efforts in designing, developing and appropriate promotion and awareness interventions so that Takaful products and sales might witness extensive development in Malaysia. Future researches are encouraged to empirically test the propositions put forward by this study.



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## **BEST FIT MODEL FOR THE FUTURE PATRONAGE OF ISLAMIC RETAIL BANKING**

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### **ABSTRACT**

*Growth and stability are innate goals of any business. Companies like those which are in the banking industries invest on ideas and technologies in search for business models as unit of analysis, approach, concept, and means to create values particularly in terms of customer service satisfaction and expansion. Banking companies that hold the best fit models have the advantages of hitting future patronage targets than their counterparts. Aiming to determine the best fit model for the future patronage of Islamic Retail Banking (IRB), this study reaches out to at least 500 randomly selected samples, utilizes structural equation model as a statistical tool, and hypothesizes that there is no interconnection of the business-related variables namely, current banking practices, awareness of IRB, perception on customer awareness, relative advantage, compatibility, complexity, uncertainty, observability, promotional efforts, client characteristics, and future IRB patronage variables. Furthermore, this study uses the research paradigms appropriate to its objectives and the kind of data gathered namely quantitative in terms of technique and procedure in gathering the data, cross-sectional in terms of time horizon, mono in terms of method choice, survey in terms of strategy, inductive in terms of approach, and positivism in terms of philosophy, this study reveals that its modified research instruments obtained Cronbach alpha level of 92%. It also discusses the vast literatures that are dealing with the emerging innovative banking practices as opportunities, challenges, and risks reflected from financial market signal and management; that are dealing with awareness to paradigm-shift of Islamic Banking from conventional version, and about business success relying on client concept, measures, communication, and alignment of strategies, processes and capabilities as advantages for future patronage. Consequently, the reliability level of its instrument and the comprehensive narrations of published literatures on banking practices, paradigm-shift, banking success determinants, and future patronage are matters that merit for the pursuance of the final phase of the study.*

**Keywords:** *Islamic Retail Banking, banking practices, promotional effort, client perception and characteristics, future patronage, and structural equation model*

## INTRODUCTION

The birth of the Islamic finance system have caused a paradigm shift in the models of economy specifically in Islamic banking, as it captured significant range of share in the financial market across the globe. Thus the emergence of the Islamic finance have stirred up and created a new dimension range to the economic growth (Hassan and Lewis, 2007). Over the last four decades, the Islamic bank growth is drastic and greatly notable with an estimated range of 15 to 20 per cent growth rate annually and is expected to reach 1.5 trillion US dollar by the year 2015.

Oman is one of the last GCC countries to welcome Islamic Finance (Warde, 2000). Oman as a country is quite optimistic about both the successes and growth of Islamic finance taking into consideration the strong economic projection in the region. Some of the projections that promises a bright future of Islamic finance in Oman include huge government expenditure on infrastructure projects, a conducive and well regulated environment, and a Shariah-sensitive population that is relatively young (Hassan and Lewis, 2007). The country of Oman has necessary ingredients need to ensure successful Islamic finance sector (Sadiq and Shanmugham, 2002).

The first Islamic bank was opened in January 2013 and at the end of the year, the assets of the Islamic banking was established to reach 3.5% of the total banking assets of the country which was quite remarkable. In mid-2014, Shariah-compliant banking assets were estimated at 4.4% valued at \$2.78 billion (OMR 1.07 billion). According to ICD-Thomson Reuters Islamic Finance Development Indicator, Oman' Islamic finance industry is ranked third globally after Malaysia and Bahrain. The Islamic finance industry in Oman show growth momentum as indicated in the increase in both deposits and financing. Consistency in the growth of Islamic finance is supported by Islamic windows of strong conventional banks in Sultanate. In June 2014, the net revenue generated in the Islamic finance sector realised remarkable growth, which was OMR 16.6 billion: a growth of 147% from OMR 6.7 billion June the previous year.

One of the most important concepts in frame of competitor-oriented objectives of an entity is market share. Significance of such concept is created since past studies indicate the positive impacts it has on profitability and productivity of a business (Tukamuhabwa, Benjamin, Eyaa and Friday, 2011). Association between market share and profitability is most probably one of the most studies subject in management

research. Majority of past studies on the relationship between profitability and market share indicate that there is a significant and positive association between profitability and market share, which makes market share an important consideration in evaluating success of Islamic finance in Oman (Asyraf and Nurdianawati, 2007). Market share in an industry or an entity is measured by percentage of total revenues or sales for services and products in a given duration. Even though, market share is not the ultimate goal of sectors or entities in any given industry, it is a crucial indicator for enhancing profitability since higher market share leads to higher profitability and vice versa (Sadiq and Shanmugham, 2002). Banks, corporations and other business entities therefore aim to increase their respective market share to gain competitive advantage as well as to ensure productivity. In order to ensure effective competition in the Islamic finance industry, it is imperative that banks adopt suitable strategic mechanisms aimed at enhancing performance as well as concentration in the market. According to Tukamuhabwa (2011), analyzing competitive forces is the most appropriate and effective means of enhancing performance of an entity.

### **PROBLEM STATEMENT**

Islamic finance got recognised in the year 1996, by the Citi group branch in the form of Citi Islamic in Bahrain. But global financial crisis made academic and industrial participants start to question about the sustainability and viability of the conventional system of finance (Hasan and Dridi, 2010). It is true the financial crises have broken many conventional banks and Islamic banks are not exceptional. According to Rehman and Masood (2012) the obligation of the Islamic religion is the significant motivator as it got observed as the main practical determinant of conventional location playing an important role. Amin, et al (2011) stated that obligation of the religion and the support of the government can be an insignificant factor as it predicts the intention of using the finance of Islamic banking personal. While considering Oman consequence in particular the demands got increased in basis of national finance that could turn out comparatively higher. But in many countries that has the establishment of the Islamic financial system; the customers are enhancing their sophisticated knowledge of the Islamic products and services nature and are punishing the other banks being operated in their country. But Awan and Bukhari, (2011) found there is also need for additional quality of servicing the customers as it is key strategy. But while considering Oman circumstances, the situation may differ slightly as the Islamic finance introduction, customers found to seek or have a

little knowledge about the products of Islamic finance to make them buy their products. So this is where the Islamic finance system need development in staffing as they play main role in providing sufficient knowledge about their products and services so as to meet their demands. Even though there are various researchers' states about the Islamic finance and Islamic banking, there are very few of them explaining about the Islamic finance system adoption in Oman. This research explains about the Islamic retail banking adoption in Oman and also concentrating on the moderating factors client characteristics. The review of literature indicates that that in particular case of Oman customers seem to have limited knowledge about the Islamic Banking and Islamic Finance. Islamic banking system needs to further develop in Oman and awareness and knowledge about Islamic Banking has impacted the performance of Islamic Retail Banks which have been incurring losses (Arsalan, 2014). There is an identified research gap in the area and further researches are required to understand the adoption of Islamic Banking in Oman and explore the reasons for the challenges faced by it.

### **RESEARCH PROBLEM**

Islamic Finance Advisory and assurance Services (IFAA) published a report in 2011. According to that report 70% of consumers in Oman anticipated opening an Islamic saving account in next 12 month whereas 35% consumers were expecting to do so within 3 months after availability Islamic banking in Oman. The report showed that 86% of Omani consumers are somehow engaged with conventional banking products, out of that 60% declared themselves 'bothered' about using the products based on interest (Riba). Above mentioned information showed that there could be high demand of Islamic retail banking in Sultanate of Oman and people would adopt it within short period of time but it did not happened as it was expected.

Arsalan (2014) published a paper named ' Islamic Banking in Oman- Today and the way forward' showed that all the Islamic banks who started their operation in 2013; Bank Nizwa, Bank Al Izz, Meethaq , Bank Sohar, Al Muzn, Al Yusr, Al Hilal and Maisarah could get the expected outcome. Bank Nizwa showed loss of 2.505 million OMR, Bank Al Izz 3.232 Million OMR, Bank Sohar )0.65 million OMR , Muzn 0.30 million OMR, Al Yusr 0.50 million OMR, Bank Dhofar 13 million OMR, with total loss of 2.787 million OMR. Only one bank showed profits and that was Bank Muscat's Meethaq with 6.2 million profits.

As far as deposits savings/Time are concerned Bank Sohar received 6.9 million OMR, Bank Alizz 0.6, Maathaq 10.4, Muzn 15.1 and Al Ahli 4 million OMR on the other hand the conventional banks received net income as following : Bank Muscat 59%, Bank Dhofar 36%, Bank Sohar 45 %, National Bank of Oman 72% and Al Ahli Bank 45%.

### **AIM**

The main aim of the research is to identify the best fit model for the future patronage of Islamic Retail Banking

#### ***Research Objectives***

1. To determine the level of current banking practices in terms of:
  - 1.1 Bank user
  - 1.2 Duration as bank user
  - 1.3 Awareness of IRB
  - 1.4 User of IRB
2. To determine the level of awareness of IRB in terms of
  - 2.1 Product awareness
  - 2.2 Islamic banking attributes
3. To determine the level of perception on attributes in terms of
  - 3.1 Relative advantage
  - 3.2 Compatibility
  - 3.3 Complexity
  - 3.4 Observability
  - 3.5 Uncertainty
  - 3.6 Preference
4. To determine the level of perceived information quality in terms of
  - 4.1 Sources of information
  - 4.2 Influences of sources
  - 4.3 Quality of information
5. To determine the level of future patronage of RB in terms of
  - 5.1 User
  - 5.2 Non-user
6. To determine the client characteristics in terms of
  - 6.1 Gender

- 6.2 Age
- 6.3 Nationality
- 6.4 Religion
- 6.5 Marital status
- 6.6 Educational level
- 6.7 Monthly income
- 6.8 Occupation
- 6.9 location
- 7. To determine the significant relationship between determinant variables and the future patronage of IRB
- 8. To determine the degree of influence of the determinant variables on future patronage of IRB
- 9. To determine the best fit model for future patronage of IRB

### ***Research Questions***

The following are the questions of this research;

- 1. What is level of current banking practices in terms of:
  - 1.1. Bank user
  - 1.2. Duration as bank user
  - 1.3. Awareness of IRB
  - 1.4. User of IRB
- 2. What is the level of awareness of IRB in terms of :
  - 2.1. Product awareness
  - 2.2. Islamic banking attributes
- 3. What is the level of perception on attributes in terms of :
  - 3.1. Relative advantage
  - 3.2. Compatibility
  - 3.3. Complexity
  - 3.4. Observability
  - 3.5. Uncertainty
  - 3.6. Preference
- 4. What is the level of perceived information quality in terms of:
  - 4.1. Sources of information
  - 4.2. Influences of sources

- 4.3. Quality of information
5. What is the level of future patronage of RB in terms of
  - 5.1. User
  - 5.2. Non-user
6. What are the client characteristics in terms of:
  - 6.1. Gender
  - 6.2. Age
  - 6.3. Nationality
  - 6.4. Religion
  - 6.5. Marital status
  - 6.6. Educational level
  - 6.7. Monthly income
  - 6.8. Occupation
  - 6.9. location
7. What is the significant relationship between determinant variables and the future patronage of IRB?
8. What is the degree of influence of the determinant variables on future patronage of IRB
9. Which is the best fit model for future patronage of IRB

### ***Limitations***

The limitations of the study are as follows;

1. Only Islamic Banks in Oman are included
2. Only the bank clients present, during the data gathering are included
3. SEM is taken as a statistical tool, other statistical tools to determine best fit model are not tested.

### ***Significance***

The research is significant to Islamic Banking Companies to determine the correct model toward achieving and attaining future patronage.

## **LITERATURE REVIEW**



### *Adoption Theories*

Examination of an individual's choices for acceptance and rejection of any innovation or model is referred to as the adoption theory (Straub, 2009). There are different adoption models and theories. Some models of adoption theory examine the choices of individuals towards the acceptance of a particular innovation while some also take into consideration the extent to which the theories are accepted and integrated in context and practice. Therefore, adoption theory has a micro perspective which focuses on pieces that contribute to the whole. Diffusion theories in contrast to this examine how a particular innovation spread to a population or unit of adoption. The diffusion theory indicates the process of the adoption, adaptation and rejection of an innovation by considering the relative factors such as time, social pressure etc. to explain the phenomenon of adoption or rejection. Therefore the diffusion theory takes a macro perspective on the dispersion of innovation across a period of time (Straub, 2009). There are several models for the adoption of innovation by individuals and population. However, the adoption of innovation by individuals has been historically understood as behavioural change. Adoption and diffusion models have been used to explain the adoption and diffusion of new health behaviours, or innovation in fields of education, technology, sociology etc. The results of the adoption theories are measured in terms of the changes in behaviours of users and individuals whereas the factors affecting the behavioural changes are cognitive, contextual and affective factors which are dealt independently by different theories and models.

Other than the Innovation diffusion theory, two other adoption theories adopted in the education literature are the Concerns Based Adoption Model (CBAM) and the Universal Technology Adoption and Use Theory (UTAUT) and the Technology Adoption Model (TAM). As per Christou, Eliophotou-Menon, & Phillippou (2004) The CBAM is used to understand the changes and adoption of technology. The UTAUT and TAM are adoption models originally used to study the adoption of changes in computer technology and computer science, which were later also applied to educational settings to understand the adoption behaviours of teachers and students for example the adoption of online learning (studied by Ndubisi in 2006) or the adoption of implementation of laptop based testing model by (Baker-Eveleth, Eveleth, O'Neill, & Stone, in 2007). The CBAM theory projects the key components as individual characteristics at the SoC level (stages of

concern) and the innovation characteristics at the LoU level (level of Usage) and the innovation configuration (IC).

Diffusion theory has been used for this study instead of other adoption theories since diffusion is a macro perspective theory which includes adoption as a part of diffusion which includes the adoption, adaptation and rejection of innovation. Innovation Diffusion Theory is appropriate for this study as this research aims to understand the emergence of Islamic Banking in Oman including the factors that influenced its adoption. Adoption Diffusion theory is an inclusive models that includes adoption as a perspective along with the adaptation and rejection of an innovation by the population. Diffusion adoption theory will help in understanding the perceived attributes of innovation and awareness in order to comprehend the adoption of Islamic Retail Banking.

### ***Diffusion of Innovation Theory***

Thambiah, Ramanathan and Huda (n.d) analysed the determinants of Islamic retail banking adoption in Malaysia. Innovation diffusion theory by Roger has underpinned the theoretical framework and the dependent and independent variables of the research has derived from the theory of diffusion of innovation. Relative advantage, compatibility, complexity, observability and uncertainty are some of the perceived attributes of innovation which are closely associated with the adoption of Islamic retail banking. Personal characteristics of customer, attitude towards an innovation and barriers such as the financial constraints and accessibility are some of the key factors which are added more value to the study.

### ***Awareness on Attribute of Islamic Retail Banking***

Acceptance of a new brand cannot occur without consumer being exposed to the brand or information about a brand. Therefore, knowledge of a brand has to be gained by consumers before making informed decision (Black, Lockett, Winkhofer and Ennew, 2001). Persuasion can only occur after obtaining knowledge of a new brand. Therefore, before consumers adopt a brand they go through a process of knowledge, persuasion, decision and confirmation. Knowledge is the first stage of the process where a consumer is exposed to a brand and gets to understands how it works (Warde, 2000). Therefore, awareness of Islamic finance is key to the success of the industry with respect to gaining market share.

### ***Perceived Advantage***

The relative advantage most consumers are looking for in new products and services include economic benefits and the cost of adoption (Haque, Jamil and Ahmad, 2007). As a sub-dimension of relative advantage, individuals will look for economic profitability, immediacy of reward, savings in effort and time, social prestige, decrease in discomfort and low initial cost. Consumer adoption of Islamic products and services has to consider the benefits the banking system offers compared to existing or conventional banks (Asyraf and Nurdianawati, 2007).

### ***Uncertainty***

Uncertainty is the level in which various alternatives are viewed with regards to the occurrence of an event and relative probabilities of the alternatives (Hair, Black, Babin and Anderson, 2010). Uncertainty in an innovation or brand makes consumers search for information in order to gain knowledge about the innovation or new brand before making necessary decision, which can lead to either adoption or rejection of the innovation or brand (Ahmad, and Haron, 2002).

### ***Observability***

Observability is regarded as the degree to which an innovation is visible to others. In different brands across the globe, there are some ideas that can easily be observed and communicated while in others it becomes very difficult to observe and describe the innovation to other people. Inability to identify and describe innovation in brands is common mostly in services as opposed to products because intangibility of services hinder visibility of the innovation (Warde, 2000).

### ***Complexity***

Complexity as a determinant to adoption of Islamic finance is regarded as the level of difficulty in understanding and using innovation. Complex products and services are normally not easily adopted by consumers (Fazlan and Mohammad, 2007). Therefore, the higher the complexity of a product, the lower the rate of adoption. In regards to banking, Islamic banking complexity is viewed in regards to its banking principles (Aziz, 2010). Therefore, when consumers perceive Islamic banking services and products as simple and easy to use, then they are likely to adopt it.

### ***Perceived Compatibility***

Perceived compatibility is very important in adopting a brand or innovation (Asyraf and Nurdianawati, 2007). Perceived compatibility is regarded as the level to which an innovation is viewed as consistent with needs of potential adopters and their past experiences. Compatibility therefore entails the values and beliefs that consumers uphold (Black, Lockett, Winkhofer and Ennew, 2001). Therefore, in making decision on whether to adopt a new brand or innovation, the potential adopters will evaluate whether or not such brand or innovation will meet their needs and expectations. Therefore, ability of Islamic banking to meet the needs and enhance the experience of consumers can lead to the adoption of the banking system.

### ***Perceived Information Quality***

Perceived information quality is the value or standard of information provided about an innovation or a brand (Warde, 2000). Information about a brand or an innovation is key to enhancing adoption since such information play a very significant role in reducing level of uncertainty about the innovation or new brand (Rogers, 2003). Therefore, in Islamic retail banking marketing and publicising of the services and products offered by Islamic financial institutions to potential banking customers is key to enhancing adoption (Ahmad, and Haron, 2002). Therefore, brand development or innovation without precise information about the innovation or new brand to enhance knowledge of potential adopters can lead to failure of brand or innovation.

### ***Promotional Effort***

The manners in which companies connect with consumers in the contemporary world through marketing determine customer relationship as well as adoption of products and services. Development and spread of persuasive communication about a product or service plays a significant role in influencing decision making of consumers (Aziz, 2005). The main purpose of innovation or development of new brand is for consumers to use such products. Therefore, it is in order to develop and spread persuasive communication about new brands or innovation in order for potential consumers to be informed about the new product and service and decision whether or not to adopt such product and service (Fazlan and Mohammad, 2007).

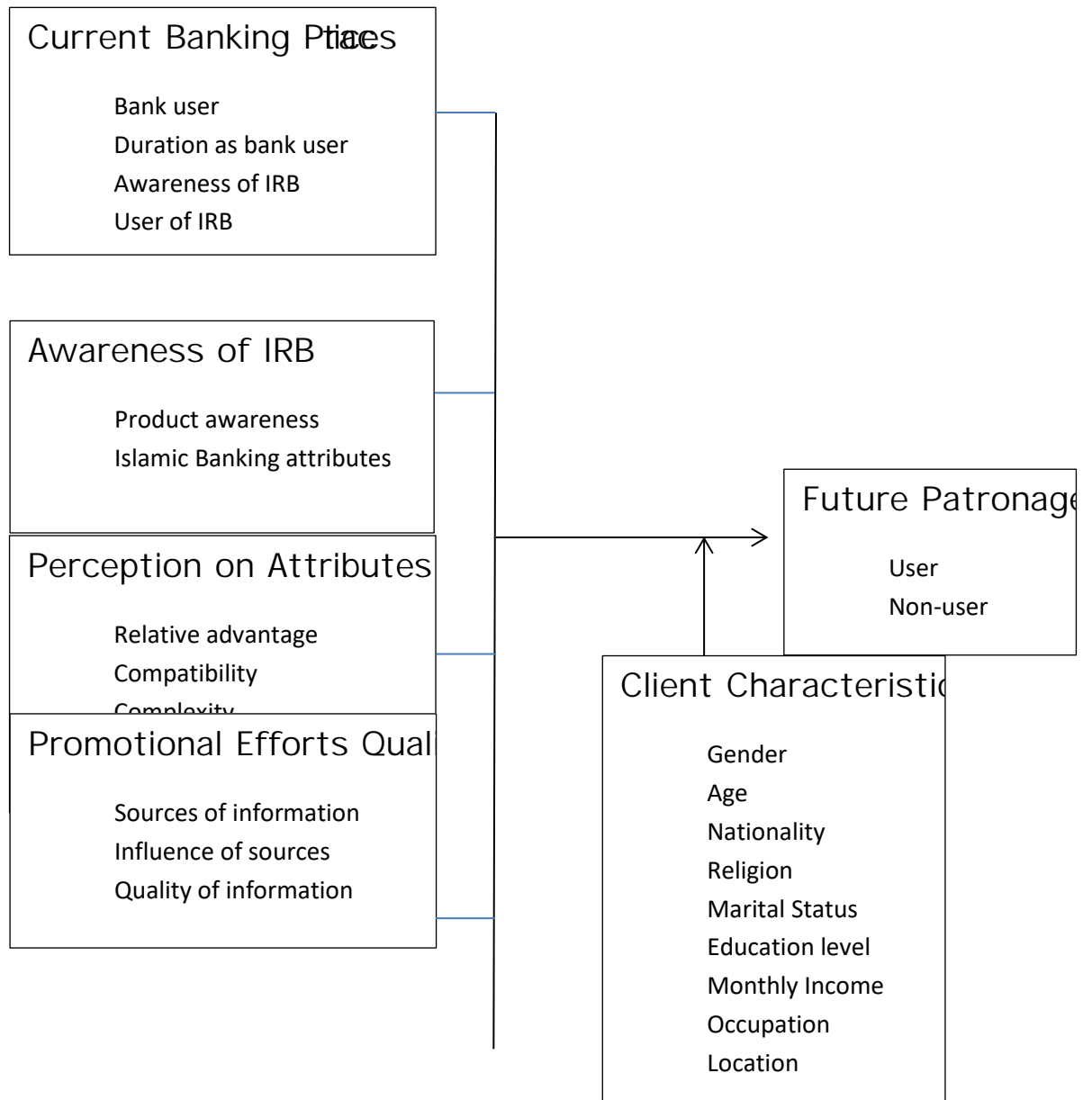
## **ISLAMIC BANKING CHALLENGES IN OMAN**

The Oman Islamic finance report (2015) identifies the challenges of Islamic banking is the small size as many banks much smaller than the conventional banking system with poor infrastructure. The competitions also continue as the conventional banks started to launch Islamic window, so this become complex as the main aspect of Islamic bank being Shariah complaint doesn't act as major regulation, standardisation and differentiation. Other key challenge in sultanate is the poor work ethic in the labour force of nation, inadequate educated workforce and restrictive regulations of labour. The Islamic finance investment banks are mostly project driven and it do not have constant source of finance revenue to tie them over the economic activity slumps, Sharia compliance and satisfactory framework for investors need to be regulated and Shariah multiplicity board and judgements and other accounting standards.

### ***Sultanate Business Environment and Islamic Banking Opportunities***

Apart from the challenges that Islamic finance development face in Oman, there are numerous opportunities in the country in the sector (Thorp, 2008). Oman's economic growth prospects are promising taking into account the pace of economic diversification, sustained domestic demand, increasing role of private sector and government's large planned expenditure as well as accommodative monetary policy. Omani banks are known to operate in one of the best regulated frameworks among GCC countries (Rogers, 2003). Appropriate regulations with which the Omani banks operate have contributed significantly to the quality of their asset and high capital adequacy compared to other GCC countries. Concerning the location of Oman, Sultanate is strategically located for trade and commerce being located at the western shore of the Gulf of Oman, linking Arabian Sea to Strait Hormuz (Aziz, 2010). Therefore, Oman is a crucial and important transit point of crude oil globally. The country has attracted foreign expatriates from across the globe with the population of foreign workers being 44% (Asyraf and Nurdianawati, 2007). The population of Oman is relatively young with people aged 20-34 years constituting 42%. The growth of Islamic finance is depended on the young populations of Oman. Exchange rate of Omani Rial is very strong, which is more than double that of USD: 1 OMR is about 2.6USD

## THEORETICAL FRAMEWORK



## RESEARCH METHODOLOGY

This study is to determine the best fit model for the future patronage of Islamic Retail, the other objectives are to find out the relationship between individual determinants variables and the future patronage IRB and determine the relationship between client characteristics and the future patronage of IRB. The present study consists on one dependent variable that is future patronage and six independent variables.

This study is a descriptive study, that includes positivism. Data gathers through primary and secondary sources, literature review is prepared through secondary data. A structured questionnaire is designed with all close ended questions to collect the quantitative data. Present study initially deploys quota sampling to divide the sample into Islamic and conventional banks' clients. In later part of the sampling procedure the convenience sampling was used to collect the data from the respondents. The present study uses SEM and SPSS for analysis of the data.

A pilot study is carried out to ensure the validity of the questionnaire designed, the pilot study was carried out on 40 respondents who were selected randomly. The purpose of conducting the pilot study is to test the validity and reliability on the research instrument. The result of Cronbach Alpha revealed that the reliability is 93. Five-point Likert scale was used in the study.

***Hypothesis:***

1. *Null Hypothesis:* There no significant relationship between individual determinant variables and the future patronage of IRB
2. *Null hypothesis:* The client characteristics does not significantly intervene the relationship between determinant variables and future patronage of IRB
3. *Null Hypothesis:* There is no best fit model for future patronage of IRB

***Expected Findings:***

1. There is a significant relationship between individual determinant variables and the future patronage of IRB
2. The client characteristics significantly intervene the relationship between determinant variables and future patronage of IRB
3. There is best fit model for future patronage of IRB

***Recommendations:***

1. Final phase of the study has to be undertaken.
2. Conduct similar studies but using other possible predictors and intervening variable.
3. Disseminate the information of the study to Islamic Banking organisations and Oman financial agencies

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## **WAQF DEVELOPMENTS IN THE STATE OF NEGERI SEMBILAN: POST WAKAF (NEGERI SEMBILAN) ENACTMENT 2005**

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### **ABSTRACT**

*The main objective of this paper is to highlight the role played by the State Islamic Religious Council Negeri Sembilan (MAINS) in enhancing the waqf institution in the State. Waqf management and administration in Negeri Sembilan is governed under the Waqf Enactment (Negeri Sembilan) 2005. MAINS has established the Negeri Sembilan Wakaf Corporation (PWNS) on 10 June 2005 to carry out the provisions under this Enactment. The specific objectives of the establishment of PWNS are to revive the waqf culture among Muslims in the state, to ensure a more systematic and productive waqf management, to enhance stock of awqaf assets and to apply the corporate approach in waqf management. Waqf is a form of worship/ibadah that is highly enjoined by Islam. Waqf is defined as the endowment of a portion of one's property/asset with the sole intention to be close to Allah SWT (taqarrub). Only the benefits/usufructs from the asset can be made available for beneficial use of the Ummah whereas the original asset is detained (cannot be alienated, transacted, bequeathed or given as hibah or wasiat). The waqf practice has been well established since the times of the Prophet (may peace be upon him). It is an important economic institution with great potential for the purpose of capacity building and generating economic activities. This arises from the unique characteristics of waqf viz. perpetuity (once a property has been dedicated as waqf, it remains as such forever) and permanence of conditions set by the waqif (waqf founder). As such the stocks of awqaf assets and hence the benefits/usufructs, will increase over time. However to realize its potential, awqaf institutions need to be supported by clear legislation, run and managed efficiently by professionals with integrity, and supported by adequate and sustained waqf funding. This paper will cover firstly, a discussion on waqf and its philosophy; secondly on the role of the State Islamic Religious Council Negeri Sembilan (MAINS), Malaysia in enhancing waqf institution. This paper will report on what PWNS has done and planned especially in the areas of capacity building and waqf*

*funding for higher education especially after the Wakaf (Negeri Sembilan) Enactment 2005.*

**Keywords:** *Waqf development, awqaf, productive waqf, waqf institution, perpetuity.*

## INTRODUCTION

Waqf is one of the voluntary charities highly enjoined by Islam. Its practice has been well established since the times of the Prophet (may peace be upon him). It is an important economic institution for the purpose of capacity building and generating economic activities. At the same time the benefits from the awqaf assets can accrue to specific sections of society in particular the poorer sections. This arises from the unique characteristics of waqf viz. perpetuity (once a property has been dedicated as waqf, it remains as such forever) and permanence of conditions set by the *waqif* (waqf founder). As such the stocks of awqaf assets and hence the benefits/usufructs, will increase over time. However to realize its potential, awqaf institutions need to be supported by clear legislation, run and managed efficiently by professionals, and supported by adequate and sustained waqf funding. The focus of this paper is on the role of the State Islamic Religious Council Negeri Sembilan (MAINS) in terms of the management and administration of waqf in the State. Under Section 5 of the Wakaf (Negeri Sembilan) Enactment 2005, MAINS is the sole-trustee of awqaf assets in the State.

This paper is structured as follows. A brief discussion on the fiqh of waqf is given after the Introduction section. This is followed by a discussion on the role of the State Islamic Religious Council Negeri Sembilan (MAINS), Malaysia in enhancing waqf institution; and the final section gives the summary and conclusion.

## FIQH OF WAQF

Waqf or awqaf (plural) is derived from the verb *wa-qa-fa* (وقف). In terms of language, waqf means to stop (السكن), to prevent (المنع) and to hold (الحبس) (Wahbah Zuhaili, 1985). In Islamic terms, waqf is an endowment of a portion of one's wealth either in kind or as cash that is permanent and irrevocable (the corpus is detained) for the sole purpose to be close to Allah SWT (*taqarrub*). Once the asset has been given out as a waqf, the right of the endower (*waqif*) over the property ceases. The asset can no longer be subject to sales transaction or bequeathed or given out as *hibah* or written as a *wassiyah*. The original asset (*mauquf*) may be invested and the usufructs or returns will be distributed to the beneficiaries either for general or specific welfare as specified by the *waqif*. An asset that

is endowed as waqf may be in the form of fixed/immovable asset such as mosque, musolla, madrasah and land or movable asset such as cash and shares.

Al-Quran and Sunnah have enjoined/encouraged Muslims to give out their property as charity in general or as waqf. The following are some verses (translations) from the Al-Quran that encourage Muslims to give out some portion of their property in charity:

“Example (of) those who spend their wealth in (the) way (of) Allah, (is) like a grain which grows seven ears, in each ear hundred grain(s). And Allah gives manifold to whom He wills. And Allah (is) All-Encompassing, All-Knowing” (Al-Baqarah 2:261).

In another verse:

“By no means shall you attain Al-Birr (piety, righteousness), unless you spend (in Allah’s cause) of that which you love. And whatever you spend is known to Allah” (‘Ali ‘Imran: 92).

From the Sunnah:

Ibn Umar reported: Umar acquired a land at Khaibar. He came to Allah's Apostle (may peace be upon him) and sought his advice in regard to it. He said: *“Allah's Messenger, I have acquired land in Khaibar. I have never acquired property more valuable for me than this, so what do you command me to do with it?”* Thereupon he (Allah's Apostle) said: *“If you like, you may keep the corpus intact (waqf) and give its produce as Sadaqa”*. So 'Umar gave it as Sadaqa declaring that property must not be sold or inherited or given away as gift. And Umar devoted it to the poor, to the nearest kin, and to the emancipation of slaves, aired in the way of Allah and guests. There is no sin for one, who administers it if he eats something from it in a reasonable manner, or if he feeds his friends and does not hoard up goods (for himself). *He (the narrator) said: I narrated this hadith to Muhammad, but as I reached the (words) "without hoarding (for himself) out of it." he (Muhammad) said: "without storing the property with a view to becoming rich." Ibn 'Aun said: He who read this book (pertaining to Waqf) informed me that in it (the words are) "without storing the property with a view to becoming rich." (Sahih Muslim, Book 013, Hadith no. 4006)*

Abu Huraira reported Allah’s Messenger (pbuh) as saying: *“When a man dies, all his acts come to an end, but three; recurring charity, sadaqa jariya (donation for the awqaf), or knowledge (by which people benefit), or a pious offspring, who prays for him”*

(Sahih Muslim). The rewards for the good actions including waqf are continuous even after the person passes away.

### **AN OVERVIEW OF WAQF DEVELOPMENTS IN THE STATE BEFORE WAKAF (NEGERI SEMBILAN) ENACTMENT 2005**

History and development of waqf in Malaysia (known as Malaya before achieving Independence on 31 July 1957) and Negeri Sembilan have begun for centuries. In the past, waqf activities were more focused on giving permanent properties such as land, houses, buildings and so on and were not officially documented under any State Islamic Religious Council. However, in line with the development and modernization of governance of the State Islamic Religious Assemblies including the Negeri Sembilan Islamic Religious Council (MAINS), wakaf activities have begun to expand rapidly through various initiatives including the more organized and documented waqf granting process.

Previously, the institution of waqf was an institution established through the contribution of the Muslim community or development on waqf land for the purpose of Islamic education. The ultimate aim is to get the blessings of Allah SWT, in addition to produce a righteous Muslim community (Ahmad Zaki Hj Abd Latif et. al., 2008).

The waqf-oriented educational institution in Malaysia is not so prominent except under the *pondok* system that maintains a traditional educational system. Mohamad Sahar Mat Din, Deputy President of the Malaysian Islamic Chamber of Commerce (DPIM), is of the view that zakat solves the problems of society while waqf is capable in building the civilization, but the role of waqf and zakat is still less effective in improving the quality of Islamic education in Malaysia (cited in Maffuza binti Salleh & Noor Syahida binti Abdul Rahman, 2014). Waqf has great potential in assisting universities' financing needs. What needs to be understood here is that the returns from the waqf, after being converted into productive assets or invested in financial instruments, could be used to supplement universities' incomes. The waqf fund is the recipient of philanthropy from alumnis, members of staff, members of the society and/or Government Linked Companies (GLCs), with the objective of assisting university finances (Aminah Md Yusof, 2016).

The institution of waqf is one of the most important institutions in the socio-economic development of Muslims. However, its practice is still relatively low and requires a more robust and comprehensive system and framework in order to achieve its

true potential. The total number of awqaf properties in Negeri Sembilan is much lower compared to other states in this country. Most of the land are State Government gazetted land and most of the land, mosques, suraus, religious schools, cemeteries are registered and categorized under State-owned land. This current situation does not meet the requirements of waqf where the reserve status land do not belong to Muslims and Negeri Sembilan Islamic Religious Council (MAINS) as it can be cancelled at any time without any compensation or replacement by the government.

Due to the lack of staff, resources and bureaucratic problems in Baitulmal, no effective effort has been made to register and develop all the waqf land and reserves as well as campaigns to encourage the Muslim community to practice waqf deeds. MAINS has approved the proposal of the Wakaf Enactment (Negeri Sembilan) at the 18th MAINS Meeting on 27 July 2004. The Proposed draft of the Wakaf Enactment (Negeri Sembilan) was drafted by the MAINS Technical Revision Committee and this enactment has come into operation in the year 2012 after being passed by the State Legislative Assembly and received Royal Assent on 24 January 2006. The enactment gives a fresh start to MAINS because this Enactment provides a wide range of provisions to Baitulmal to administer, manage and develop all waqf properties in a more structured manner so that it can be fully utilized by Muslims.

There are some provisions which have been enacted in the Wakaf (Negeri Sembilan) Enactment 2005 which must be utilized and implemented to further strengthen the management of the waqf institution in Negeri Sembilan. Among them is the appointment of the Registrar of Waqf, the establishment of the Waqf Management Committee, the creation of various types of waqf such as waqf ahli, waqf irsod, waqf muabbad, waqf musytarak including share waqf, cash waqf and the establishment of Waqf Fund. In order to realize this goal, an organizational management team has been established specifically to carry out waqf operations in a corporation. On 10 June 2005 Majlis Agama Islam Negeri Sembilan (MAINS) set up a subsidiary called Perbadanan Waqaf Negeri Sembilan (PWNS) Sdn Bhd as provided under the Wakaf (Negeri Sembilan) Enactment 2005. PWNS is wholly owned by MAINS Holdings Sdn Bhd. MAINS' venture into corporate waqf is to advance its mission in order to manage waqf initiatives professionally and systematically (see also Norma Md Saad et al., 2017).

PWNS has been established with the task of implementing the provisions under the Wakaf (Negeri Sembilan) Enactment 2005, to establish cash waqf and to update information and registration of real estate owned by MAINS including waqf and Baitulmal real estates (see Perbadanan Wakaf Negeri Sembilan web-site - <http://www.wakafnegerisembilan.com/> accessed on 23.10.2017). Among the objectives of the establishment of PWNS are:

- a. To revive the waqf culture among Muslims in Negeri Sembilan
- b. To encourage waqf management that is more systematic and productive.
- c. To enhance the acquisition of assets for the interest of religion and the development of the Ummah in Negeri Sembilan.
- d. To become one of the first states to implement corporate waqf management.

In Malaysia, affairs relating to religion of Islam lie entirely under the authority of the Sultan in each state and the Sultan delegates the authority to the State Islamic Religious Council (MAIN) to be responsible in handling such matters including matters relating to waqf. Under List II, State List, Ninth Schedule of the Federal Constitution, waqf is placed under the jurisdiction of states in Malaysia. Referring to this provision, MAIN is the sole trustee of all waqf properties in its respective state. This is clearly enshrined in the waqf enactments in the states of Selangor, Melaka Negeri Sembilan and Perak. For example in Selangor, Section 89, the Administration of the Religion of Islam (State of Selangor) Enactment 2003 states *'The Council becomes the sole trustee of waqf, nazar and trust'*. Waqf property is a trust that the holders should be responsible for, especially in ensuring that the purpose and aspirations of the waqifs are achieved. Trustees should also be able to rebuild their land to raise their value and return, manage and administer the lands in an organized manner and report their accounts every year to exhibit the transparency of all transactions.

#### **AWQAF DEVELOPMENTS POST WAKAF (NEGERI SEMBILAN) ENACTMENT 2015**

PWNS has grown in strength since 2013 with an increase of staff and the introduction of various waqf products and services. Currently, PWNS has an Acting Manager managing



several divisions: Administration and Finance Division, Marketing and Da'wah Division, Clinical Division and Hemodialysis Center as well as Special Duties Division.

BULAN	2013	2014	2015	2016	2017
<b>JANUARY</b>	-	RM3,225.2 5	RM12,350.0 0	RM114,040. 00	RM14,753. 00
<b>FEBRUAR Y</b>	-	RM2,950.0 0	RM12,800.0 0	RM1,965.00	RM6,966.0 0
<b>MARCH</b>	-	RM80,000. 00	RM4,150.00	RM2,020.00	RM11,283. 10
<b>APRIL</b>	-	RM4,830.7 0	RM3,360.00	RM4,435.00	RM4,843.5 0
<b>MAY</b>	RM620.00	RM12,455. 00	RM2,226.60	RM13,795.0 0	RM8,251.0 0
<b>JUNE</b>	-	RM10,890. 00	RM7,250.00	RM5,182.00	RM17,863. 00
<b>JULY</b>	RM10,000.0 0	RM8,185.0 0	RM45,525.0 0	RM20,782.0 0	RM916.00
<b>AUGUST</b>	RM2,450.00	RM2,230.0 0	RM2,309.00	RM9,563.00	RM151,545
<b>SEPTEMBE R</b>	RM12,850.0 0	RM4,895.0 0	RM8,520.00	RM6,145.00	
<b>OCTOBER</b>	RM2,750.00	RM6,080.0 0	RM2,000	RM46,534.0 0	
<b>NOVEMBE R</b>	RM3,350.00	RM5,641.0 0	RM7,080.00	RM403,199. 00	
<b>DECEMBE R</b>	RM1,429.00	RM 7,350.00	RM2,672.00	RM807.00	
<b>TOTAL</b>	<b>RM33,449. 00</b>	<b>RM 148,731.95</b>	<b>RM110,242. 60</b>	<b>RM628,467. 00</b>	<b>RM216,420</b>

**Table 1: Cash waqf collections NS (2013 – 2017 (August))**

**Source: PWNS**

***MAINS Waqf Fund (Cash Waqf Scheme)***

The 77<sup>th</sup> Muzakarah (Conference) of the Fatwa Committee of the National Council for Islamic Religious Affairs Malaysia (held on 10-12 April 2007) had concluded that cash waqf is allowable. The cash waqf received by MWF is categorized under general waqf. MWF will work together with MAIN (State Islamic Religious Council) which under the law is the sole-trustee. The cash waqf will be used to finance awqaf projects in the

respective states (Pamphlet Skim Wakaf Tunai, Perbadanan Wakaf Negeri Sembilan Sdn. Bhd.)

The Negeri Sembilan Islamic Religious Council (MAINS) has acquired property financed via cash waqf using the provision in Wakaf Enactment (Negeri Sembilan) 2005. Part III, Section 11 (1) The Majlis may establish any wakaf scheme:

(a). through cash contribution or any other form of financial contribution from any person, association or institution endowed as *wakaf* to the Majlis.

Under such provision, the Negeri Sembilan Cash Waqf Scheme offered in the form of share units to be sold to the public who will then charge the certificate of shares to MAINS. With a minimum participation rate of RM 1.00 and without any limitation, the cash waqf funds are used to purchase permanent properties as well as redeemed Islamic properties owned by Muslims in Negeri Sembilan. In 2013, the PWNS had conducted aggregate collection and managed to collect cash waqf amounting to RM33,449.00 from community donations (see Table 1 above).

The cash waqf scheme is an easy and effective approach for wealth acquisition. This method eliminates the traditional thinking which holds that waqf is only for the wealthy group who possess real estate such as home and land to be endowed as waqf. With as low as RM 1.00, PWNS provides an opportunity for anyone to join in this scheme. All contributions collected will be used as capital to buy and develop permanent assets such as mosques, orphanages, clinics and dialysis centers, commercial buildings and so on that can provide returns to the community. Table 1 below shows the amounts of cash waqf collected from 2013 (start of cash waqf collection) until August 2017. Total amount collected during the period: RM1,137,310.55.

### ***Waqf of Property***

Waqif with movable property such as car and al-Quran or immovable property such as land and house may endow such property either as general waqf or special waqf. General waqf is any property that is endowed as waqf for the purpose of general good without the waqif naming specific beneficiaries.

Special waqf means the waqif specifies in his waqf deed the recipients of the benefits from the asset/property he or she has endowed as waqf. The specification of use

of the waqf and its intended beneficiaries must be in accordance to Shariah 64 applications have been made to endow land as waqf and ownership transferred to MAINS (as the sole-trustee for waqf assets in NS) since the establishment of PWNS (Table 2). The properties involved have been land and living quarters. The majority of the land endowed as general waqf.

DISTRICT	QUANTITY OF WAQF LAND	TOTAL AREA OF WAQF LAND (HECTARES)
<b>SEREMBAN</b>	22	19.9612
<b>KUALA PILAH</b>	11	6.1792
<b>PORT DCKSON</b>	7	4.0136
<b>TAMPIN</b>	10	4.8583
<b>JELEBU</b>	6	4.0843
<b>JEMPOL</b>	5	2.1694
<b>REMBAU</b>	3	1.5698
<b>TOTAL</b>	<b>64</b>	<b>42.8354</b>

**Table 2:** Distribution of waqf land in the State of Negeri Sembilan

MAINS has also decided to convert all land for mosques in the State of Negeri Sembilan as waqf land. This proposal is still being deliberated by MAINS, PWNS and the Department of Islamic Religious Affairs Negeri Sembilan. The distribution of mosques by districts and the areas involved are given in Table 3 below.

DISTRICT	TOTAL NUMBER OF MOSQUES	TOTAL AREA OF LAND (ACRES)
<b>SEREMBAN</b>	53	90.119
<b>KUALA PILAH</b>	74	77.316
<b>PORT DCKSON</b>	23	35.883
<b>TAMPIN</b>	34	62.095
<b>JELEBU</b>	29	24.243
<b>JEMPOL</b>	39	68.634
<b>REMBAU</b>	39	56.502
<b>TOTAL</b>	<b>291</b>	<b>414.792</b>

**Table 3:** Distribution of Mosque land by districts in Negeri Sembilan to be converted as waqf land.

#### ***Joint Projects with Malaysian Waqf Foundation & JAWHAR***

On 27th March 2004, the Federal Government of Malaysia (hereinafter referred to as Government) formed Jabatan Wakaf, Zakat dan Haji<sup>7</sup>, or better known as JAWHAR, under the Prime Minister's Department with the aim of harnessing the potential of waqf, zakat and mal and assisting the MAINS to realize these potential in a systematic and

effective manner. JAWHAR is not an authority but rather is an active complimentary agency which aims to coordinate and facilitate the development of waqf, zakat and mal in Malaysia and also undertakes waqf development projects which are funded by the Government. The completed waqf development projects are handed over to the MAINs as the custodian in their capacity as the sole trustee for waqf in Malaysia.

Subsequently on 25th March 2006, in a meeting of the National Baitulmal Coordination Committee which was organised by JAWHAR and participated by the MAINs, the committee unanimously resolved on the need to establish a national waqf entity to assist the MAINs in managing waqf affairs. Following this resolution and after execution of its trust deed, JAWHAR established Yayasan Waqaf Malaysia (YWM) on 23rd July 2008 as the national body to unite and harness waqf resources while simultaneously complementing the MAIN's efforts in achieving sustainable waqf developments so as to ensure continuous benefit to the intended beneficiaries, the waqif or benefactor and the society in general.

Under the 9th Malaysia Plan, JAWHAR was granted a total allocation of RM256.5 million specifically to undertake 24 waqf projects. This marked the first time such a concerted and coordinated effort on waqf development undertaken by the Government. Out of the 24 projects, 19 involve physical development projects whereas 5 are non-physical projects, including the establishment of YWM.

The physical development projects represent a smart partnership between JAWHAR and the MAINs whereby JAWHAR is the developer and funder of certain agreed development and the MAIN involved provide the land. During the construction period, JAWHAR and the MAIN involved will execute a simple caveat charge on the land and JAWHAR will channel the required development funding. Upon completion of the development, this caveat will be cancelled and the enhanced land with the completed development will be returned to the respective MAIN. Under this arrangement, the Government via JAWHAR undertake a development project without the need to acquire land while the MAIN involved receive a newly productive waqf asset in the form of the original land which has been enhanced with new building premises. This partnership is shown in Illustration 1 above.

There are no specific development themes but the waqf development under JAWHAR's initiative broadly covers 5 areas which are education, economy, healthcare,

religious and shelter (accommodation). It is important to note that this JAWHAR initiative does not overlap with other types of waqf development undertaken by other agencies or authorities such as the building of mosques. JAWHAR/YWM have helped MAINS to develop a number of projects using Government allocations.

The development of Waqf and Bazaar Mart in the State is based on joint cooperation between MAINS and Malaysian Waqaf Foundation (an agency under JAWHAR). The projects have been developed in areas where many poor/low income people are located viz. at housing projects for the poor. Such projects would generate economic activities and hence contribute to employment opportunities and income generation in the local economy. At the same time the people are able to purchase household goods at much cheaper prices from suppliers who are cooperating with MWF. The development of the Waqf Mart marks a start in the era of waqf land development that gives a significant impact on the socioeconomic development of the Ummah in the country.

Wakaf Bazaar Rakyat (BWR) and Wakaf Mart projects offer low rental rates over market prices that aims to develop socio-economic communities. Therefore, YWM has placed the tenant's target for BWR to the local community. Tenant selection is submitted to MAINS and rental priority is given to viable asnaf, entrepreneurs and unemployed graduates among mosques' kariah members. This provides an opportunity for mosques' members to generate income through the business activities. They have fixed business premises which offer job opportunities as managers or shop assistants to the local community. The implementation of the BWR projects on waqf land has exhibited a positive impact to various parties.

Table 4 below lists the bazaar and waqf projects that have been undertaken with funds allocated by MWF. 40% of the profits from sales will be given to PWNS, 30% to be used for management and the remaining 30% to pay for the workers that have been appointed.

**Table 4: Joint projects between MAINS and JAWHAR/MWF**

No.	Bazaar & Waqf Mart YWM	40% of Rental on Bazaar/Waqf Mart (per month)	Overall Total MAINS Waqf Fund (Until Tahun 2014)
1.	1 Unit Waqf Mart at Panchor Jaya, Seremban	RM 500 x 40% = RM200	RM2,400.00
2.	1 Unit Waqf Mart Tampin	RM 400 x 40% = RM160	RM1,920.00
3.	1 Unit Waqf Mart Gemas	RM 400 x 40% = RM160	RM1,920.00
4.	6 Units Waqf Bazaar Wakaf at Rasah Jaya, Seremban	RM 150 x 40% = RM60 (RM 60 x 6 unit = RM 360)	RM4,320.00
5.	5 Units Waqf Bazaar at Felda Jelai 4	RM 75 x 40% = RM 30 (RM 30 x 5 unit = RM 150)	RM 1,800.00
6.	Yam Tuan Raden Bazaar, Kuala Pilah	Not in operation yet	

No.	Project Details	Cost of Construction
1.	<u>Bazaar &amp; Waqf Mart YWM</u> <ul style="list-style-type: none"> <li>- 1 Unit Waqf Mart at Panchor Jaya</li> <li>- 1 Unit Waqf Mart Tampin</li> <li>- 1 Unit Waqf Mart Gemas</li> <li>- 6 Units Waqf Bazaar Wakaf at Rasah Jaya</li> <li>- 5 Units Waqf Bazaar at Felda Jelai 4</li> <li>- Yam Tuan Raden Bazaar, Kuala Pilah</li> </ul>	RM 1,411,993.23

#### ***Clinic and Dialysis Center of Waqf An-Nur***

The clinic is a collaborative project between MAINS and Seremban Specialist Hospital (KPJ). This health waqf project is implemented to provide perfect health care services to low-income and poor people regardless of race and religion. The patient only has to pay RM 5.00 for each treatment and medication received at this clinic. Dialysis center services provide treatment for low-risk kidney patients and the cost of treatment is fully borne by MAINS. Patients seeking treatment at the dialysis center should complete the Medical Assistance Application Form which is available at Baitulmal office in each district. At the end of May 2016, the new branch of the Waqf An-Nur Clinic at Jamek An-Nur Mosque, Rembau was opened to the public (Table 7). The dialysis center is expected to commence operations in 2018 at the same location.

DETAILS	2013	2014	2015	2016	2017 (until July 2017)	TOTAL
<b>Number of Patients</b>	6,359	6,051	4,838	4,327	2,301	23,786 patients
<b>Collections from patients</b>	RM35,500.00	RM33,340.00	RM25,625.00	RM22,685.00	RM12,260.00	RM 129,410.00
<b>Clinic's Fund</b>	RM1,874.90	RM1,585.20	RM1,124.00	RM1,099.00	RM776.00	RM 6,459.10
<b>Total Waqf Collection</b>	RM37,374.90	RM34,925.20	RM26,749.00	RM23,784.00	RM13,036.00	RM 135,869.10

Table 5: Data from Clinic Waqf An-Nur-MAINS, Senawang

DETAILS	2013	2014	2015	2016	2017 (until July 2017)	JUMLAH KESELURUHAN
<b>Number Of Patients</b>	23	23	30	37	35	35
<b>Total Collections (RM)</b>						
<b>Patients Sponsored by MAINS</b>	492,482.00	544,445.50	615,055.68	859,197.88	397,747.44	2,908,928.50
<b>Patients Sponsored by PERKESO</b>	-	25,980.00	53,730.00	108,150.00	90,150.00	287,010.00
<b>Grand Total</b>	492,482.00	570,425.50	668,785.68	967,347.88	487,897.44	3,186,938.50

Table 6: Data provided by Pusat Hemodialisis Waqf An-Nur MAINS Senawang

DETAILS	2016	2017	OVERALL TOTAL
<b>NUMBER OF PATIENTS</b>	926	1,189	2,115
<b>COLLECTIONS (RM)</b>	5,810.00	7,070.00	12,880.00
<b>WAKAF FUND (RM)</b>	1,189.00	1,215.00	2,404.00
<b>TOTAL (RM)</b>	6,999.00	8,285.00	15,284.00

Table 7: Data provided by Klinik Waqf An-Nur MAINS, Rembau

Generally, the development of Negeri Sembilan waqf activities is seen to be more focused on health and economic development for the time being. The MAINS health projects are conducted through Waqf An-Nur Clinic. A patient pays a minimum of RM5.00 for medical treatment depending on the type of illness. Hemodialysis treatment is also provided to patients suffering from end-stage renal disease. The clinic has provided

medical treatment to 28,996 patients since 2005 (Source: Data Waqaf An-Nur Clinic, 26 Oct 2017) (Table 5 – data until July 2017).

Meanwhile, the dialysis center has been equipped with 12 dialysis machines since 2004 and dialysis treatment has been delivered to more than 93 dialysis patients. (Source: Data Waqaf An-Nur Dialysis Center, 26 Oct 2017) (Table 6). In 2017, 93 dialysis patients have registered under MAINS comprising of the lower income group. MAINS also intends to open more waqf clinics and dialysis centers for the benefit of the public.

### ***Muallaf Center***

A Muallaf Center known as the Darul Sa'adah Complex in Seremban costing of RM7.5 million has been built through waqf donations and RM4.5 million funding from JAWHAR. The main purpose of establishing this centre is to give support and provide opportunities to new converts to learn and appreciate Islamic religious knowledge. The centre is equipped with dormitories (10 female hostel rooms, 10 male hostel rooms, 4 rooms for couples and/or missionaries. The centre is also equipped with 3 lecture halls, a dining hall and a 300 capacity prayer hall. (Azri et al., 2012)

### ***Hospitality Industry***

MAINS and JAWHAR jointly developed the Hotel Klana Beach Resort project in Port Dickson, Negeri Sembilan costing RM33 million with 82 rooms, 3 apartments, swimming pools and a Baitulhilar complex. MAINS provided the land. Part of the cost was provided by JAWHAR using allocations from the Ninth Malaysia Plan meant to develop waqf land.

### ***Joint Cooperation between MAINS/PWNS and Universiti Sains Islam Malaysia***

Waqf contributions should be extended to other areas especially in the financing of higher education besides secondary and lower level education. Important components of funding would be the provision of infrastructure and financing of educational services. Waqf on education funding can reduce the cost of providing educational infrastructure such as school buildings, libraries, labs, surau, toilets and school canteens. Apart from the infrastructure, teaching materials, research and writing materials should also be provided.

In addition, this education waqf funding can also be utilized to provide a sound financial education institution. Collected waqf funds can be converted into valuable fixed assets to



generate regular income to the relevant educational institutions. For example, waqf funds are used to purchase business premises that are then rented out to other party. This will provide a steady return to ensure the sustainability of the educational institutions.

USIM and MAINS have ventured into waqf financing beginning with healthcare which augurs well for the future. Universiti Sains Islam Malaysia (USIM) is the 12<sup>th</sup> public university in Malaysia. USIM has established the Center for Awqaf Development Financing in March 2013. The Center manages the USIM Al-Abraf Waqf Fund. The Center has undergone restructuring and is now known as Center for Waqf and Zakat. The Fund is registered and approved by the Negeri Sembilan Islamic Religious Council (NSIRC/MAINS). The State Islamic Religious Council has approved the appointment of USIM as *Mutawalli* (manager) of waqf (letter dated 22 July 2013). USIM is collaborating with NSIRC in the development of waqf financing in higher education. The joint collaboration is in recognition of the legal provision in the Waqf Enactment (Negeri Sembilan) 2005 that NSIRC/MAINS is the sole trustee of waqf assets in the State of Negeri Sembilan, where USIM is located. MAINS and USIM signed a Memorandum of Understanding on 21 January 2014 with a view to jointly develop a number of projects to nurture the waqf culture especially through the establishment of the USIM Medical Specialist Clinic and the USIM Hemodialysis Clinic ([news.usim.edu.my/.../422-usim-meterai-mou-bersama](http://news.usim.edu.my/.../422-usim-meterai-mou-bersama)).

USIM Medical Specialist Clinic provides services by medical, eye and dental specialists and outpatient treatment. The specialists are from USIM's Faculty of Medicine and Health Sciences and the Faculty of Dentistry. MAINS has allocated RM2 million to USIM, RM 1 million as outright waqf grant and RM1 million as *qardhul hassan* to cover the costs of renovation and to purchase medical equipments. The clinic started operations from April 2015 after obtaining the operating licence from the Ministry of Health. USIM has entered into a 3 year (with a 2 year option for extension) tenancy agreement with Putra Nilai Development Sdn Bhd to rent 3 units of double storey shop-lots at Nilai Square, Bandar Baru Nilai as premises for the Medical Specialist Clinic and Hemodialysis Center. The renovation for the Medical Specialist Clinic has been completed. The application for the operating licence from the Ministry of Health Malaysia is under the name of USIM Tjjarah Holdings, a company wholly owned by USIM. The Medical Specialist Center is treated as a business arm of USIM Tjjarah. In

terms of marketing and branding, it will be acknowledged that the clinic has received waqf funding from MAINS.

MAINS has also allocated RM 1.5 million for the establishment of the USIM-MAINS Hemodialysis Center located next to the Medical Specialist Clinic. The renovation work and the purchase of medical equipments will be carried out by MAINS Holdings. The operation of the clinic will be under USIM medical staff. Renovation work and acquisition of dialysis machines will start in due course as the operating license has been obtained from the Ministry of Health Malaysia.

With the USIM Specialist Health Clinic (Medical and Dentistry) already in operation, the State Government of Negeri Sembilan via The State Secretary had allocated around RM650,000 to establish the USIM Mobile Specialist Clinic (Clip Mobile), officiated on 18 November 2015. USIM's eye specialists have carried out eye screening tests in rural areas, thus giving access specialist treatment to low income patients. Many have been found to suffer from eye-sight ailments (glacoma, cataract) and with further treatments have led to improvements in the quality of their lives (Mohammad Haji Alias & Fuadah Johari, 2017).

The joint cooperation between MAINS/PWNS and USIM augurs well for the development of the waqf culture in the State which will give benefits in the areas of health and education. Given that a substantial portion of the capital expenditure (renovation and equipment purchases) is covered by waqf grant, the clinic will be able to charge lower consultation fees compared to that charged by other private specialist clinics. The specialists are also willing to accept lower consultation fees by imputing part of their time as waqf of expertise. Well to do patients may also pay extra with the difference donated to a *tabarru'* fund. This fund may be used to support poor patients referred to the clinic. The use of waqf fund and the existence of the philanthropic spirit will help to make specialist medical service more accessible.

### **SUMMARY AND CONCLUSION**

The main objective of this paper has been to highlight the role played by the State Islamic Religious Council Negeri Sembilan (MAINS) in enhancing the waqf institution in the State. The State Islamic Religious Council (MAINS) is vested with the power as the sole-trustee of awqaf assets in the State of Negeri Sembilan. After restructuring, PWNS is now

the main Mutawalli of Waqf. As a comparison, in the State of Johore the main Mutawalli is called Nazir Am. Waqf management and administration in Negeri Sembilan is governed under the Waqf Enactment (Negeri Sembilan) 2005. PWNS is vested with the responsibilities to carry out the provisions under this Enactment. The specific objectives of the establishment of PWNS are to revive the waqf culture among Muslims in the state, to ensure a more systematic and productive waqf management, to enhance stock of awqaf assets and to apply the corporate approach in waqf management especially with respect to capacity building and waqf funding for higher education.

Even though PWNS was established in 2005 under the provisions of the Wakaf (Negeri Sembilan) Enactment 2005, it began to operate more actively from the year 2013 with the appointment more human resources. PWNS has offered a number of awqaf to the public including cash waqf. Given that the amount that has been collected is relatively small relative to the demands for it, more efforts need to be taken in particular to enhance the waqf culture among the Muslim public and to attract them to make waqf contributions on a sustained basis. Critical success factors for a waqf institution include clear legislation, efficient and professional management, and the availability of significant size of capital funds. A more aggressive approach has to be undertaken especially cash waqf scheme in order to finance productive waqf projects. Given the fact that waqf once established become inalienable and not amenable for transactions, the size and value of waqf and hence the benefits/profits/usufructs would increase over time. This would enhance waqf institution's ability to develop the economy of the Ummah. Another challenge for PWNS is to register waqf assets that are still under Government land ie to transfer the title under MAINS as the sole-trustee.

MAINS-USIM cooperation in the area of waqf funding for healthcare and education augurs well for the future of waqf. Success in these areas will enhance the confidence of the public in awqaf institutions thereby encouraging them to make Islamic endowments. The waqf for healthcare project is still in the early stage of development however. It still needs financial support from the University. But over time with the involvement of GLCs and philanthropists, the leased premises may be purchased using waqf funds. This would enhance the Medical Specialist Clinic to generate surpluses which can be used to support patients from the asnaf groups and also to channel resources to support education related projects.

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## **ASSESSING THE INFLUENCE OF SHARI'AH GOVERNANCE MECHANISMS ON ISLAMIC ECONOMIC PERFORMANCE OF ISLAMIC BANKS**

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### **ABSTRACT**

*This study examines the influence of Shari'ah governance mechanisms (SGM) on the Islamic economic performance (IEP) of Islamic banks in Malaysia. The data on SGM and IEP were obtained from annual reports of thirteen Islamic banks in Malaysia from year 2012 to 2014. The IEP measures have been developed from the established Islamic economic literature and then validated by selected scholars. The measures later were weighted based on the responses provided by Islamic banking practitioners and academicians. The data analysis has been done via Smart PLS SEM. The results indicate that SGM has a significant influence on IEP of Islamic banks in Malaysia. In the context of Shari'ah governance mechanisms that encompassed trust, ethics and moral values in addition to Shari'ah compliant should be able to enhance the Islamic banks' unique performance in achieving Islamic economic objectives. The IEP can be used and further tested as a new performance measurement from broader perspective for Islamic banks.*

### **INTRODUCTION**

Effective 1<sup>st</sup> January 2011, Bank Negara Malaysia (BNM), has prescribed the Shari'ah Governance Framework (SGF) for Islamic financial institutions in Malaysia with the ultimate objective to enhance the role of the board, the Shari'ah Committee and the management in relation to Shari'ah matters. Shari'ah governance can be defined as as "a set of institutional and organizational arrangements through which Islamic banks ensure that there is effective independent oversight of Shari'ah compliance over the issuance of

relevant Shari'ah pronouncements, dissemination of information and an internal Shari'ah compliance review" (BNM, 2011). Besides the corporate governance requirements as prescribed by other codes at the international level and locally, Islamic banks are also required to comply with the Shari'ah governance requirements to enhance Shari'ah compliance and accountability.

The agency problems in Islamic financial institutions are unique to other financial institution. As highlighted by Bukhari (2013); Darmadi (2013); Safieddine (2009); Grais and Pellegrini (2006); Archer and Karim (1998), and Sarker (1999) the need to comply with Shari'ah rules and regulations makes a huge difference between Islamic financial institutions as compared to others. This study examines how the monitoring and control mechanism of the Shari'ah governance can better contribute to Islamic economic performance. This study also analyses the adequacy of Shari'ah governance monitoring and control mechanisms that are expected to reduce or minimise agency and accountability problems in Islamic banks. This study provides empirical evidence on whether good governance leads to good performance by taking into consideration the implementation of the SGF. This, to a certain extent will contribute toward enhancing the governance unique and opaque nature of Islamic banks that requires proper understanding of the broader issues of responsibility and accountability from the Shari'ah perspective.

## **LITERATURE REVIEW**

Shari'ah governance sets out the expectations of the Bank concerning an IFI's Shari'ah governance structure, processes and arrangements to ensure that all its operations and business activities are in accordance with Shari'ah. Shariah governance also provides comprehensive guidance to the board, Shari'ah Committee and management of the IFI in discharging its duties in matters relating to Shari'ah. The Shari'ah governance mechanisms outlined four important supportive functions of Shari'ah review, Shari'ah audit, Shari'ah risk management and Shari'ah research (Bank Negara Malaysia, 2011). In theory, robust Shari'ah governance mechanisms would enhance the credibility of Islamic finance operations and boost general public trust and the confidence of the financial markets.

Shari'ah governance mechanisms were normally measured by the effectiveness of the Shari'ah Board/Shari'ah Committee using the proxy measures of the size or numbers of Shari'ah Committee members and the frequency of the Shari'ah Committee meetings in a



year. According to the SGF, the Shari'ah Committee is responsible and accountable for all the Islamic banks' decisions, views, and opinions related to Shari'ah issues. Meanwhile, the board bears the ultimate responsibility and accountability for the overall governance of the institution. The SGF prescribed that Islamic banks must not have less than five Shari'ah Committee members and they have to meet at least once every two months.

Islamic banks are accountable not only to the shareholders, depositors and other stakeholders, i.e., depositors and investment account holders, but also ultimately to Allah s.w.t. There have been numerous studies on Islamic banks and their performance, but, through the review of the literature, not many studies have been conducted that assess the impact of Shari'ah governance mechanism on Islamic banks' performance. Majority of the studies on Islamic banks have been on corporate governance, such as Adam and Mehran (2012), As-Saidi and Al-Shammari (2012), Zagarchev and Goa (2015), Pathan and Faff (2013), and Wasiuzzaman and Gunasegavan (2013).

There have been limited studies that use Shari'ah governance in Islamic banks as a variable for interpreting the performance of Islamic banks except for the study of Mollah and Zaman (2015). Other studies, such as Hassan (2011), Garas (2012), Choudhury (2013), Wan Abdullah, Percy and Stewart (2013), Mohammed and Muhammed (2017), Mohamad, Muhamad Sori and Shah (2015), and Shaharuddin (2011) focus on the implementation of Shari'ah governance.

Hasan (2011) aimed at understanding current Shari'ah governance practices in Malaysia, the GCC countries (Kuwait, Bahrain, United Arab Emirates, Qatar and Saudi Arabia) and the UK by identifying a regulatory framework (Shari'ah board structure, composition, role, function, independence, competence, disclosure and transparency) to create awareness of some of the crucial issues pertinent to Shari'ah governance of Islamic banks and to promote greater understanding of Shari'ah governance practices. However, no ranking or benchmarking has been done on the basis of the influence of corporate and Shari'ah governance concerning performance.

Several studies have examined the performance of Islamic banks such as Haniffa and Hudaib (2006), and Olson and Zoubi (2008). In addition, other studies measured governance against efficiency; for example, Ahmad and Abdul Rahman, (2012) and Lin, Ma and Su (2010); and growth, Mahmood and Abbas (2012), and Iqbal (2001).

Meanwhile, Mustafa (2011) measured Islamic bank performance using ‘*Maqasid Shari’ah*’ in formulating ratios to represent the performance measures. On the other hand, Ngalim and Ismail (2014) developed an index for measuring Islamic Values Based Development (IVBD) in Islamic banks.

Due to the lack of assessment of the performance of Islamic banking compared to conventional banking, this study attempted to measure Islamic economic performance from the Islamic economic objectives. Several studies measured governance against performance, and the Islamic banks’ performance has been assessed using conventional measurements, such as return on equity (ROE), return on assets (ROA), profit margin, and Tobin’s Q. Moreover, these measurements have been criticized for inaccurate and inappropriate indicators for Islamic banks if they have been used as the sole means to measure performance (Samad and Hassan, 1999; and Rosly and Bakar, 2001; Badeldin, 2008; Mohamed, 2010; Ajlouni and Omari, 2013; Nadia, Sonia and Jaleddine, 2014; Qasim, Mohamad and Ibrahim, 2017 and Siswanti, Salim and Sukoharsono, 2017). This study contended that Islamic banks should be measured using Islamic indicators to properly reflect their objectives, vision, and mission as Islamic institutions as well as in protecting other stakeholders.

Every social system has its unique economic system. In any Islamic economic system it must have its objectives. Islamic economic objectives have been described by several prominent Islamic economists such as Chapra (2000) and Naqvi (1994). Chapra (2000) claimed that Islamic economics must be able to achieve a proper balance in terms of the allocation, consumption, and distribution of scarce resources in a way that contributes to the needs being fulfilled, optimum growth and full employment, equitable distribution, and economic stability. According to Islamic principles, based on the nature of trust in respect of resources, these resources should be used to meet the necessities of humankind, while, at the same time, ensure that everyone experiences a humane and decent standard of living, and is able to live their life in harmony and peace. Scholars have reached agreement that it is the collective responsibility (*fardhul kifayah*) of Muslims to pay attention to the basic necessities of the poor. According to Chapra, (2000), a proper investment environment should be made available under the Islamic economic system. Profit and loss sharing based on a fair ratio between the financier and the entrepreneur may lead to a more efficient allocation of resources. Investment is one of the determinants of economic

growth. Importantly, the Islamic economic notion emphasizes equitable distribution. Extreme inequalities are totally against the Islamic teachings, which state that resources are not only gifts from God to all human beings but also part of the responsibility that should be managed fairly.

Meanwhile, Naqvi (1994) illustrated five policy objectives from the basic Islamic ethical postulates, which are individual freedom, distributive justice, economic growth, universal education, and maximum employment generation. Under individual freedom, three points need to be taken into consideration in applying Islamic economics. First, the concept of ‘absolute autonomy’ cannot be applied in Islamic economics as this only belongs to God, whilst man’s autonomy can only be relative. Second, the quantity and the quality of freedom are determined by the interaction between ‘free will’ and ‘responsibility’, which characterizes the broader quality of human choices in achieving the best social outcome. Hence, this will result in a welfare-oriented society environment. Third, the limits on human freedom on the choices in keeping a ‘balance’ between the claims of different individuals and classes on a nation’s total produce.

Distributive justice has been described as a superior distribution of income and wealth in accordance with the universally accepted norm of fairness. Knowledge can be used Islamic banks as a measurement that concerns the education issue, and by doing so, they would be able to produce productive workers (knowledge and skills) and knowledgeable customers (alert and conscious). This would improve the society as a whole by educating them to act for the worldly good, and, simultaneously, achieve spiritual salvation. Economic growth can be achieved via the creation of greater employment opportunities and the increase in real wages (of the unskilled labour). Islamic banks should have a proper and effective way of consumption, production, and distribution in order to promote economic growth. An Islamic economy would seek a balance between efficiency and employment when there is a trade-off between them. Efficient employment generation requires measurement for the ability to pay wages.

## **RESEARCH METHODOLOGY**

### ***Sample selection***

This study involves an examination of the monitoring and control mechanisms of Shari’ah governance amongst all Islamic financial institutions in Malaysia (excluding

Takaful and re-takaful). Altogether there are 16 Islamic banks in Malaysia (BNM's website assessed on 7<sup>th</sup> December 2013); however, only 13 have been taken as a sample for this study as three (3) of them were not able to provide the detailed information needed from their report.

### *Conceptual Definitions and Variables Measurement*

The conceptual definitions from previous studies have been adopted and aligned in accordance with the present study. Tables 1 and 2 provide the conceptual definition, code, and the operationalization of the research variables used in this study.

Table 1 Conceptual Definition and Operationalization of Exogenous Variables

### **Summary of Variables, Definition, and Operationalization**

#### **SHARI'AH GOVERNANCE MECHANISMS**

<b>Variable</b>	<b>Code</b>	<b>Definition</b>	<b>Operationalization</b>
Shari'ah Board Size	SBS	The total number of Shari'ah board members in the respective Islamic banks. (Mollah and Zaman, 2015; Rammal, 2010; Sheikh Hassan, 2012; Darmadi, 2013; Safieddine, 2009; Haniffa and Hudaib, 2007; Nienhaus, 2007; Magalhaes and Al-Saad, 2013)	Actual values - The number of Shari'ah board members
Shari'ah Board Meetings	SBM	As a proxy for the functioning of Shari'ah boards. (Andress and Vallelado, 2008; Adam and Mehran, 2003)	Actual values - The number of Shari'ah board meetings held during the year.

### *Operationalizing Islamic Economic Performance*

Table 2 explains the code, definition and formula ratio of endogenous variables for this study. Ratio analysis is an imperative method to examine the performance of any corporation. By combining with the trend analysis, it provides a health indicator for banks and for predicting their future performance.

Table 2: Code, Conceptual Definition and Operationalization of Endogenous Variables

ISLAMIC ECONOMIC PERFORMANCE				
No	Islamic Economics Objectives	Code	Conceptual Definition	Formula Ratio and Its Indicators
1.	<b>NEED FULFILMENT AND EQUITABLE DISTRIBUTION</b> (Chapra, 2000)	NFED	Islamic banks able to provide resources to the poor to raise their demand for the need-related goods and services. In simple words, Islamic banks may assist in improving one's living conditions and those of others.	<p>1. Total Consumer Financing/Total Financing</p> <p>Greater amount provided to the consumer/customer indicates that Islamic banks are able to fulfil the demand by the society in improving life conditions.</p> <p>2. Investment in Real Economic Sector/Total Investment</p> <p>Investment made in the real economic sector will be used as a yardstick in helping the society to gain equal benefits.</p> <p>3. Zakat Paid/Net Assets</p> <p>Greater amount spent on zakat from net assets represent a fair and equal distribution of income and wealth.</p> <p>4. Tax/Profits before Tax</p> <p>The tax payment also indicates the responsibility of Islamic banks in assisting the</p>

				economic growth of the country as a whole.
2.	<b>SOCIAL CONTRIBUTION</b> (Naqvi, 1994; Mohamed, 2011)	SC	Islamic banks are expected to provide a good platform for society, i.e., employees and public to contribute and gain knowledge or social contribution in a consistent and continuous manner.	<ol style="list-style-type: none"> <li>1. Education grant or scholarship/Total Expenses</li> <li>2. Research Expense/ Total Expenses</li> <li>3. Training Expense/ Total Expenses</li> <li>4. Publicity Expense/ Total Expenses</li> <li>5. Social Responsibility Expenses/Total Expenses</li> </ol> <p>The more Islamic banks provide assistance or spend money in terms of education grant, research, training, publicity and social responsibility indicates Islamic banks have fulfilled their social contribution.</p>
3.	<b>ECONOMIC GROWTH</b> (Naqvi, 1994)	EG	<p>Islamic banks are expected to grow steadily in the business operations via financing for a long period.</p> <p>Profit and loss sharing based on a fair ratio between the financier and the entrepreneur may lead to a more efficient allocation of resources.</p> <p>Finally, Islamic banks can contribute back to the operational efficiency and stakeholders as a whole.</p>	<ol style="list-style-type: none"> <li>1. Mudharabah and Musyarakah/ Total Financing</li> </ol> <p>Higher amount of Mudharabah and Musyarakah financing indicates that Islamic banks are in a good position to help entrepreneurs to engage more in the economic growth.</p> <ol style="list-style-type: none"> <li>2. Total Financing/Total Assets</li> </ol> <p>The higher the amount that goes to financing from the total assets also</p>

				<p>indicates the assistance of Islamic banks in promoting economic growth.</p> <p>3. Net Income/Total Assets</p> <p>Income generation from the total assets indicates growth in the Islamic banks.</p>
5.	<b>ECONOMIC STABILITY (Chapra, 2000)</b>	ES	<p>Islamic banks are expected to assist in reducing the misery and injustices conditions to promote economic stability. Efficient employment via higher employee remuneration can indicate the ability of Islamic banks to survive.</p>	<p>1. Net Income/Total Equity</p> <p>Income generation from total equity measures the stability of the long-term performance for Islamic banks as they can provide a guarantee of return to the owners of the business.</p> <p>2. Remuneration/Total Number of Employees</p> <p>The ability of the Islamic banks to pay a greater amount of remuneration to the employees indicates the stability of the banks.</p>

Note:

Real economic sector **refers to the sector in which there is the production of goods and services through combined utilization of raw materials and other production factors, such as labour force, land, and capital or by means of the production process. It covers agriculture, hunting, forestry, mining, quarrying, fishing, manufacturing, real estate and construction.**

Total investment **means total assets an owner puts into the business.**

Zakat **is a religious obligation of alms-giving for Islamic banks to pay a certain amount of their wealth annually to the needy Muslims (*asnaf*).**

Net Assets **is equal to total assets minus total liabilities.**

Tax **is the money taken by the government or by an official body to pay for**

**government services.**

**Profit before tax is the amount of profit a bank makes before taxes are deducted.**

**Education grant or scholarship is an award of financial aid for students to further studies.**

**Total expenses are the cost of assets consumed or services used in the process of earning revenue.**

**Research is an organized inquiry carried out by Islamic bank to provide information for solving any problems.**

**Training is the acquisition of knowledge, skills, and competencies as a result of the learning process.**

**Publicity expenses refer to the expenses spent by Islamic bank to promote Islamic products or services.**

**Social responsibility expenses refer to the amount spent by the bank in doing charity for public.**

**Mudharabah is a form of Islamic equity-based partnership contract, also known as a profit-sharing contract.**

**Musarakah is a financing technique adopted by Islamic banks, which involves an agreement under which the Islamic bank provides funds which are mingled with the funds of the business enterprise or others.**

**Total financing is the amount of money channelled to the customers in the form of financing for business firms, financial for real estates and financing for customers.**

**Net Income refers to Islamic bank's income, which is left after taking away tax and other deductions.**

**Total Assets are equal to fixed assets plus current assets.**

**Total Equity is the value of the shares in the Islamic bank.**

**Remuneration is the total amount paid to the employees of the Islamic bank.**

**Total Number of Employees refers to the number of staff employed in the Islamic bank.**

**Source:**

**Naqvi (1994); Chapra (2000); Mustafa (2011); Mustafa and Fauziah (2010); Ross et al., (2016); Weygandt, Kieso and Kimmel (2008)**

### *The Computation of Islamic Economic Performance (IEP)*

The *M Score* has only three dimensions of the Islamic economic performance, which are measured together with seven ratios. The development has been done in detail by Memiyanty et al. (2016) in which the process of scrutinizing *M Score* derived from the rigorous literature review from Islamic economic *gurus* such as Chapra (2000) and Naqvi (1994) in addition, some relevant ratios from Mustafa (2010). The data collection for the ratio computation required a detail work. The researcher had to gather an average of 273 entries (7 ratios x 3 years x 13 Islamic banks) from the annual report (financial statements and notes to the accounts) of the respective Islamic banks.



*M Score* comprises three elements of the Islamic economic objectives, namely, *Need Fulfilment and Equitable Distribution* (NFED), *Economic Growth* (EG) and *Economic Stability* (ES). The NFED has been rated by the expert respondents from 35 practitioners and 35 academics as the highest weighted importance score in the form of a percentage, which was (36%) followed by Economic Growth (EG) (33%) and Economic Stability (ES) (31%). Three ratios represented NFED, two ratios for EG and two ratios for ES. The *M Score* was the total sum of the Islamic economic performance (IEP).

All the ratios had a total score of 5 (refers to the maximum value of the Likert scale) each of which was given a specific value by the respondents in this study. These were *Need Fulfilment and Equitable Distribution* (NFED): *investment in real economic sector* (IRES) (4.3), *zakat paid* (ZPA) (4.39), and *tax paid* (TPA) (3.57). The second element, *Economic Growth* (EG): *total financing over assets* (TFA) (3.96) and *income generation over assets* (IGA) (3.89). The third element, *Economic Stability* (ES): *income generation over equity* (IGE) (3.99) and *employee remuneration over assets* (ERA) (3.75). The *M Score* can be simplified in this study by the equation format, as shown in Table 3. The detail of the financial ratios can be referred in Table 4.

**Table 3 *M Score* Equation**

$$M\ Score = \sum WNFED [(WRIRES \times RIRES) + (WRZPA \times RZPA) + (WRTPA \times RTPA)] + WEG [(WRTFA \times RTFA) + (WRIGA \times RIGA)] + WES [(WRIGE \times RIGE) + (WRERA \times RERA)]$$

Hence,

$$M\ Score = \sum 0.36 [(4.3 \times RIRES) + (4.39 \times RZPA) + (3.57 \times RTPA)] + 0.33 [(3.96 \times RTFA) + (3.89 \times RIGA)] + 0.31 [(3.99 \times RIGE) + (3.74 \times RERA)]$$

Note: **Islamic Economic Performance Measures (IEP / *M Score*):**

$\sum$  = Total Sum

$x$  = Multiplied with

**WNFED = Weighted Need Fulfilment and Equitable Distribution:**

WRIRES = Weighted Ratio of Investment in Real Economic Sector over Assets;

RIRES = Ratio of Investment in Real Economic Sector over Assets;  
 WRZPA = Weighted Ratio of Zakat Paid over Assets;  
 RZPA = Ratio of Zakat Paid over Assets;  
 WRTPA = Weighted Ratio of Tax Paid over Assets;  
 RTPA = Ratio of Tax Paid over Assets;

**WEG = Weighted of Economic Growth:**

WRTFA = Weighted Ratio of Total Financing over Assets;  
 RTFA = Ratio of Total Financing over Assets;  
 WRIGA = Weighted Ratio of Income Generation over Assets;  
 RIGA = Ratio of Income Generation over Assets;

**WES = Weighted of Economic Stability:**

WRIGE = Weighted Ratio of Income Generation over Equity;  
 RIGE = Ratio of Income Generation over Equity;  
 WRERA = Weighted Ratio of Employee Remuneration over Assets;  
 RERA = Ratio of Employee Remuneration over Assets.

Table 4 Islamic Economic Performance Ratios

<b>Islamic Performance</b>	<b>Economic</b>	<b>Code</b>	<b>Ratio</b>
Need Fulfilment and Equitable Distribution		IRESA	Investment in Real Economic Sector/Total Assets
		ZPA	Zakat Paid/Total Assets
		TPA	Tax Paid/Total Assets
Economic Growth		TFA	Total Financing/Total Assets
		IGA	Net Income/Total Assets
Economic Stability		IGE	Net Income/Total Equity
		ERA	Employee Remuneration/Total Assets

Source: Memiyanty et al. (2016)

Note: For this particular study in Malaysia, element such as 'Social Contribution (SC)' has been omitted as Islamic banks in Malaysia had reported differently in the annual report for each item that leads to difficulty in doing accurate and fair computation. For instance: education grants/scholarship expenses, training expenses, publicity expenses and social responsibility expenses.

***Hypotheses Development***

As per the general requirements, as stated in the Shari'ah governance framework (SGF), the Shari'ah Boards or Shari'ah Committee have important roles in implementing the strategic objectives of the Islamic banks to achieve better performance. Shari'ah governance has an imperative role in administering, monitoring and controlling the

business operations of Islamic banks to ensure that Shari'ah compliance is in place. By having a proper and good structure of Shari'ah governance it is presumed that it would enhance Islamic banks' performance. As per the general requirements stated in the Shari'ah Governance Framework (2011), the number of Shari'ah Committee members must not be less than five with the majority possessing strong knowledge of Shari'ah and backed by the appropriate qualifications, which are first, must be Muslim; second, at least hold a Bachelors degree in Shari'ah (which includes the study of Usul Fiqh or Fiqh Muamalat) from a recognized university; third, be able to demonstrate strong proficiency and knowledge in written and verbal Arabic, and have good understanding in Bahasa Malaysia and the English language.

Another requirement is that the Shari'ah Committee may also comprise experts with a finance and law background, and that a diversity of qualifications, experience, and knowledge is preferable. Paragraph 2.7 of the Shari'ah Governance Framework clearly mentions the ultimate responsibility and accountability of the Shari'ah Committee for all decisions, views, and opinions related to Shari'ah matters. The Shari'ah Board/Committee must also ensure that meetings are held at least once in every two months (Appendix 5, SGF), the argument being that the more people handling the key Shari'ah compliance functions in the Islamic banks, the better the banks would perform. The key Shari'ah compliance functions cover Shari'ah Review, Shari'ah Audit, Shari'ah Risk Management and Shari'ah Research.

According to Darmadi (2013) and Safieddine (2009), a Shari'ah Supervisory Board is essential to ensure that the activities of Islamic banks are in line with Shari'ah law and serve as an internal control mechanism (Mollah and Zaman, 2015, Haniffa and Hudaib, 2007; Nienhaus, 2007; Magalhães and Al-Saad, 2013). They describe this mechanism for reviewing and supervising the activities of an Islamic bank. In addition, they are an independent body within an Islamic bank and are not obliged to follow any instructions or be influenced by the management of banks or shareholders.

Islamic banks need to invest more in monitoring mechanisms, particularly in providing ample training to the Shari'ah Board members to increase the confidence of the Islamic investors and society, as urged by Farook, Hassan and Lanis (2011), Al-Tamimi (2012), and Abu-Tapanjeh (2009). By having a proper structure of Shari'ah governance practices, shareholders and other stakeholders will be more confident that the Islamic financial institutions are efficient, stable, and trustworthy providers of financial services to the

public (Bhatti and Bhatti, 2010). Based on the above explanation, the following hypotheses has been proposed.

**Hypothesis: Shari'ah governance mechanisms (SGM) have a significant influence on the Islamic economic performance (IEP) of Islamic banks.**

$$IEP = \beta_0 + \beta_1 SGM_{it} + \mu_{it}$$

Note:

*B* = The vector of parameters to be estimated

*i* = Respective Islamic bank

*t* = Year

*IEP* = Islamic Economic Performance Measures

*SGM* = Shari'ah Governance Mechanisms

(*SGM* = *SBS* + *SBM*)

Where,

*SBS* = Shari'ah Board Size; and

*SBM* = Shari'ah Board Meetings

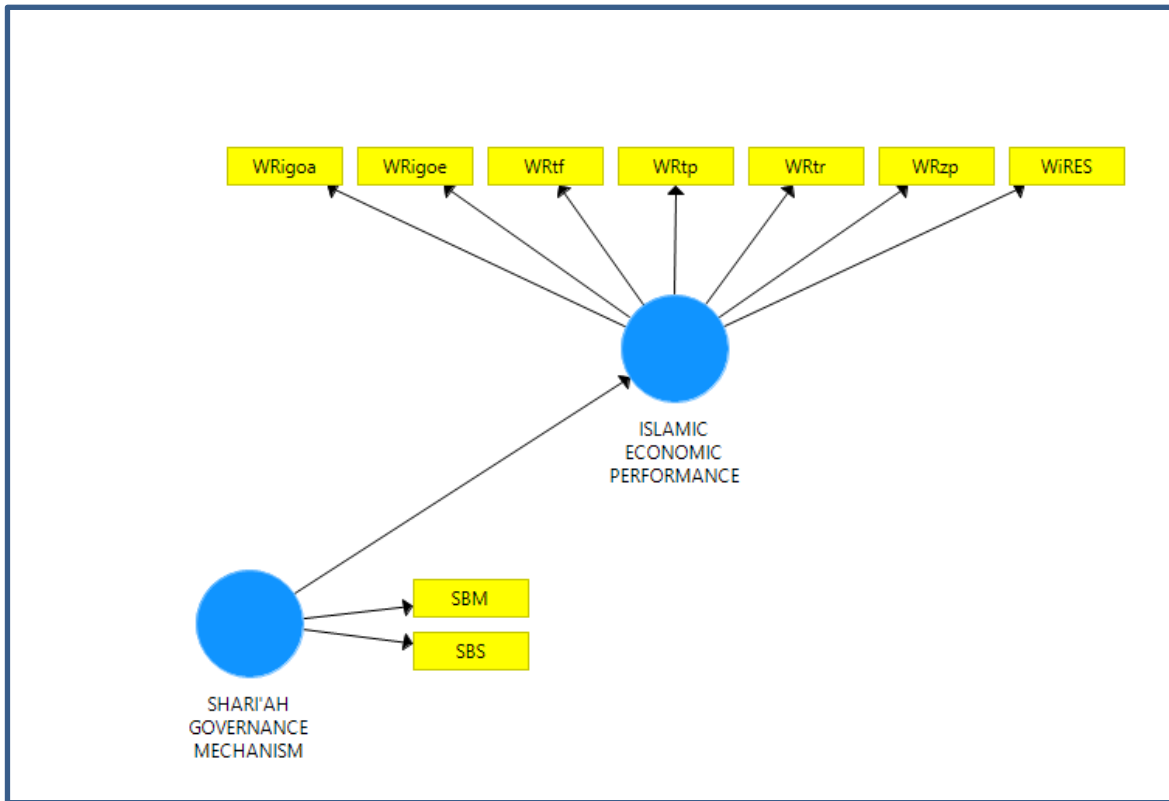
#### **Model development for Hypotheses Testing**

Model in equation shows the regression equation model to test the hypotheses and make decision either to accept or to reject the hypotheses. The data as in the regression equation model will be analyzed using SmartPLS SEM version 3.2.6.

### **RESEARCH MODEL**

The research model for this study is illustrated in Figure 1. There are Shari'ah Governance Mechanism (SGM) as an exogenous variable and Islamic Economic Performance Measures (IEPM) as an endogenous/dependent variable.

Figure 1 Research Model



Generally, PLS-SEM data analysis was run via two stages (Anderson and Gerbing, 1988 and Hair et al., 2017): firstly, on the evaluation of the measurement model (MM), which was the relationship between the indicators and the constructs. Secondly, the evaluation of the structural model (SM), which was the relationship among the constructs that showed the influence of the exogenous variables (SGM) on the endogenous variables (IEP).

The assessment of the formative constructs is conducted via testing the significance of the item (weights) and the multicollinearity (VIF) between indicators, as proposed by Gholami, Ainin, Ramayah and Molla (2013), Gotz, Liehr-Gobbers and Krafft (2010), and Petter et al., (2007). This has been done via the bootstrapping procedure.

The general rule for FMM, according to Hair et al. (2017, p.163 &165), is first, the indicator's weight must be more than 0.5, if not we can always check the outer loading, which must be more than 0.5; then the item can be retained in the research model. However, if neither criterion has been met, then the prior construct content validity must be done to validate the item in measuring the construct.

Looking at the significance levels (outer weights) in Table 5, we found that the WRIGA (0.396), WRIGE (0.384), WRIRES (-0.121), WRTFA (-0.049), WRTPA (-0.063), WRERA (-0.214) and WRZPA (0.190) values are all below 0.5. A negative correlation had not been taken into consideration, such as the value for WRIRES -0.121(-0.388); WRTFA -0.049 (0.055); WRTPA -0.063 (-0.238) and WRERA -0.214 (-0.609) as Hulland (1999) mentioned that indicators for formative index can have positive (+), negative (-) or zero (0) correlation (outer weights and outer loadings).

Table 5 Significance and Relevance of the Formative Indicators

Formative Constructs	Formative Indicators	Outer Weights (Outer Loadings)	t-values	Significance Level	p-values
SGM	SBM	0.528 (0.705)	2.774	***	0.006
	SBS	0.731 (0.859)	1.557	NS	0.121
IEP	WRIGA	<b>0.396</b> (0.889)	2.160	**	0.032
	WRIGE	<b>0.384</b> (0.955)	2.000	**	0.047
	WRIRES	<b>-0.121 (-0.388)</b>	1.096	NS	0.274
	WRTFA	<b>-0.049 (0.055)</b>	0.369	NS	0.713
	WRTPA	<b>-0.063 (-0.238)</b>	0.402	NS	0.688
	WRERA	<b>-0.214 (-0.609)</b>	1.32	NS	0.188
	WRZPA	<b>0.190 (0.486)</b>	1.343	NS	0.181

Note: NS = Not Significant.

- a. Bootstrapping confidence intervals for 10% probability of error ( $\alpha = 0.10$ ).  
 The t-value was greater than 1.645 (\* $p < .10$ )  
 The t-value was greater than 1.946 (\*\* $p < .05$ )  
 The t-value was greater than 2.57 (\*\* $p < .01$ )
- b. Indicators for formative index can have positive (+), negative (-) or zero (0) correlation (outer weights and outer loadings) (Hulland, 1999).

For formative constructs, the nonsignificant indicator weights (relative importance) should not be automatically interpreted as an indicator of poor measurement quality (Hair et al., 2017, p.129), rather, consideration shall be given especially for its construct via the value of the outer loading (absolute importance). Hence, when an indicator's outer weight is not significant (for formative constructs) but its outer loading is high (i.e., above 0.50) then the indicator should be interpreted in the statistical terminology as '*absolutely important but not as relatively important*'. After looking at the outer loadings for WRIGA (0.889) and WRIGE (0.955) their outer loadings are more than 0.5; thus WRIGA and WRIGE are '*absolutely important but not as relatively important*'. Hence, these three items can be retained in the measurements.

Meanwhile, the outer loadings of the remaining items – WRIRES, WRTFA, WRTPA and WRZPA – were below 0.50. Nevertheless, these elements in the *M Score* have been validated and agreed earlier by the experts during the pre-test of the instrument (expert content validity) in the initial stage of the research via the first survey. All items, as mentioned above have been agreed by the experts as important in representing the measurement for the *M-Score/IEP*. Therefore, this study retained the indicators in the formative constructs for the research model for the *M Score – Islamic Economic Performance (IEP)*.

The second assessment was the collinearity issue for the measurement model via Variance Inflation Factor (VIF). The VIF is described as the degree to which the standard error is increased due to the presence of collinearity, and the value must be at 10 or below to ensure that collinearity does not exist (Chin, 1988). Table 6 shows all the formative items with the VIF all below 10; hence, there were no collinearity issues for the formative measurement model (FMM) for this particular study.

Table 6 Collinearity Issues

<b>Item</b>	<b>VIF (&lt;10.00)</b> <b>(Chin, 1988)</b>	<b>Collinearity Exist</b>
<b>SBM</b>	1.062	Not exist
<b>SBS</b>	1.062	Not exist
<b>WRIGA</b>	5.093	Not exist
<b>WRIGE</b>	7.268	Not exist
<b>WRIRES</b>	1.407	Not exist
<b>WRTFA</b>	2.407	Not exist
<b>WRTPA</b>	2.487	Not exist
<b>WRERA</b>	3.161	Not exist
<b>WRZPA</b>	1.322	Not exist

In conclusion, the formative measurement model in this study was considered to fulfil the major requirements of the PLS-SEM analysis in that it had met all the requirements for free/less collinearity and all the indicators were significant and relevant to be retained for further testing in the structural model. All the indicators can be used for predicting the concept/theory for this particular study. Therefore, further analysis can be conducted to ensure the structural measurement results.

## FINDINGS AND DISCUSSION

The R<sup>2</sup> for endogenous variable of IEP is 0.509 or 50.9%. The value suggests that 50.9% of the variance in the Islamic economic performance measures for Islamic banks in Malaysia can be explained by the SGM as predictor in this study. Table 7 shows the significance of the relationship as a t-value statistic of 1.645 or more is considered to have a significant influence with a one-tailed test. The results indicate that: Shari'ah governance mechanisms (SGM) have a significant influence on Islamic economic performance measures (IEP) (1.677) in a one-tailed test (T Statistic > 1.645).

Table 7 Path Coefficients and Hypothesis Testing

Hypo - Thesis	Relationship	Path Coefficient t	t-value	p-value	Significance Levels	Significant t
H	SGM → IEP	0.469	1.677	0.095*	S	Yes

Note:

NS = Not Significant;

S = Significant

The t-value was greater than 1.645 (\*p <.10)

The t-value was greater than 1.946 (\*\*p <.05)

The t-value was greater than 2.57 (\*\*p <.01)

The SGM was found to have a significant influence on the IEP for Islamic banks in Malaysia (t-value = 1.677); therefore, this finding supports hypotheses. This shows that SGM is a significant predictor in terms of influencing the IEP of Islamic banks in Malaysia. SGM has been described as the key factors for the monitoring and control of Islamic banks. Hence, this finding should be interpreted as board of directors and Shari'ah boards that administer, monitor, direct and control the Islamic banks should always behave according to the Shari'ah compliance and Islamic values to ensure better performance.

In the context of SGF (2011), the finding of this study indicates that the right step taken by the regulators to enhance the SGM quality of Islamic banks may be seen as a step in the right direction. The evidence that SGM have a significant influence on IEP indicates the need for Islamic banks to provide an ideal attribute of Shari'ah boards in discharging duties and accountability for Shari'ah matters. These results confirm that the greater the extent of the control and monitoring mechanisms from the Shari'ah compliance



perspective, the greater it will enhance IEP. This implies the essential role of the Shari'ah Committee supports Islamic banks' performance (Hashim et al., 2015; Garas, 2012; Mollah and Zaman, 2015; Muhamad Sari, 2015; Choudhury, 2015; Magalhaes and Al-Saad, 2013; Rashid et al., 2013; Hamza, 2013; Andres and Vallelado, 2008; Adam and Mehran, 2003; Haniffa and Hudaib, 2007; Nienhaus, 2007; Farook et al., 2011; Al-Tamimi, 2012; Abu-Tapanjeh, 2009; Safieddine, 2009; and Darmadi, 2013).

Ideally, the members of Shari'ah committees should be knowledgeable in economic, legal and accounting issues in relation to Shari'ah matters. They should be a pious person and should be able to give good advice. Clearly, an efficient board is a strong base for governance and is valuable not only for its shareholders and stakeholders, but also for the development of an Islamic economic system. Moreover, the sound governance of banks is a necessary condition to safeguard both the health of financial intermediaries and the economic development of a country.

The findings of this research also support the theoretical proposition of the Islamic governance and accountability model for this study. The works of Abdul Rahman (1998) and Ilyas (2004) have been highly influential in describing the governance and accountability from an Islamic perspective in this study. The ultimate purpose is to portray the responsibility and accountability of the key players to ensure the successful performance of Islamic banks. Governance and accountability from an Islamic perspective have been derived due to the nature of the Islamic banks themselves; they should be Shari'ah compliant and have broader stakeholders in a heavily regulated industry. Having ideal SGM in the Islamic banks would assist the institutions to enhance the Islamic economics performance. Shari'ah governance in Islamic banks presents distinct characteristics and features that refer to a special case of a broader decision-making theory that also enhances accountability, honesty, and integrity (Farook et al., 2011).

## CONCLUSION

In sum, SGM provides an illustration of the Shari'ah compliance, which is religious requirements includes trust, ethics and moral values to portray the accountability concept in Islam. Thus, it is crystal clear that these mechanisms should be able to enhance the Islamic banks' performance in achieving Islamic economic objectives. Finally, the

contribution is in terms of the theoretical perspective as this study uses the concept of governance and accountability from Islamic perspective in interpreting the responsibility of people having the right to monitor and control Islamic banks to discharge their duties for shareholders and stakeholders. This study only covers Islamic banks in Malaysia; hence, the results cannot be generalized to other industries or to other countries. Other countries have not been selected due to differences in the regulations and capital structures, as they are not using the SGF established by the Malaysian government in June 2011. The future studies may consider other external variables in governance, such as external auditors and proportion of ownership by foreign countries in measuring the performance of the Islamic banks.

### ACKNOWLEDGMENTS

Islamic Economic Performance (IEP) also known as *M Score* has been developed via several stages and it had received constructive feedbacks from experts during data collection for the construct content validity. IEP/M Score also had received positive response in the International Conference of Islamic Perspective of Accounting, Finance, Economic and Management (IPAFEM 2015, 12 – 13 April 2015) in the University of Glasgow, Scotland, and at the International Conference of Management, Leadership and Governance (ICMLG 2015, 10 – 11 February 2015) in the Auckland University of Technology, New Zealand.

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## DETERMINANT OF ISLAMIC BANKING PROFITABILITY IN INDONESIA

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### ABSTRACT

*Finding a determinant of profitability has become one of the most popular topics in banking research. Previous research has identified many factors that significantly influence bank profitability. There are also many studies that measure the effectiveness of sharia banking globally, but few analyze the profitability issues of sharia banks. This study aims to analyze the impact of factors affecting profitability in Islamic Banks listed on the Indonesia Stock Exchange. The method used is multiple linear regression analysis. The variables are return on assets as dependent variable and murabahah, musyarakah, mudharabah, branch office, cash office, and Automatic Teller Machine as independent variable. This study found that funding factors such as murabaha, musharaka and conventional and electronic networking factors such as Branch Office, Cash Office, and ATM had positive and significant impact on profitability of Sharia Bank, while mudharabah had a negative and significant influence on profitabilitas Sharia Bank. Sub-Branch Offices also had a negative but insignificant effect on the profitability of Sharia Banks. This result indicated that income on management became the most dominant income in generating profit of sharia banking. However, the management of funds could not work if not supported by Islamic banking channeling tools. Networking was the only way for sharia banks to distribute funds to the third parties. The networks owned by sharia banks in channeling their funds management was still focus on conventional networks, so banks should increase the use of technology innovation to increase their profits.*

**Keywords:** *Sharia Bank, Profitability, Fund Distribution, Networking.*

### INTRODUCTION

The banking sector as an agent of economic development in Indonesia is required to provide banking services for the people of Indonesia. The main functions of banking is as

a mediator between the state and the community; to organize the distribution of money in a country. Therefore, banks open network more rapidly and widely utilizing electronic services such as Automatic Teller Machine (ATM), Electronic Data Capture (EDC), Conceptual Data Model (CDM), Internet Banking and Mobile Banking as well as to support of financial services, the government has the regulatory agencies for financial services, Bank Indonesia and the Financial Services Authority (OJK).

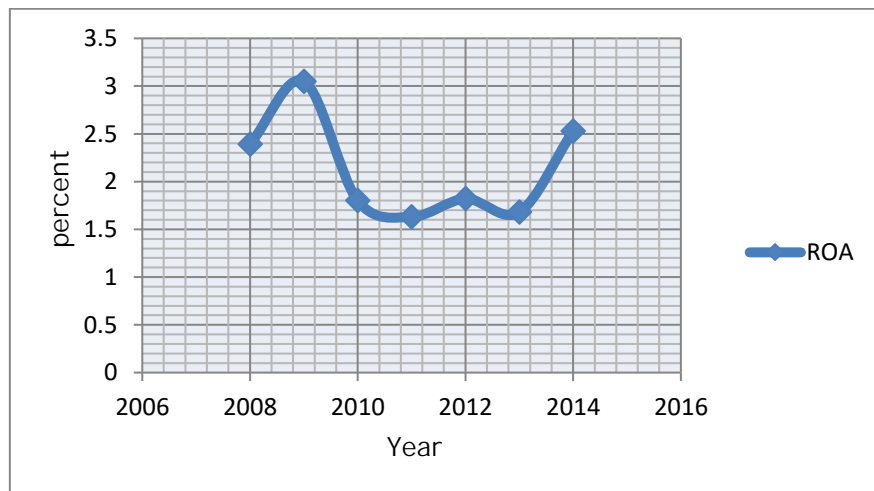
Islamic commercial bank is a financial institution that serves to facilitate the economic mechanisms in the real sector through the activities of business activities (investment, buying and selling, or otherwise) based on Islamic principles. Sharia principles is based on Islamic law agreement between the bank and other parties to deposit funds and or financing of business activities in accordance with the values of sharia macro and micro. The values of the macro in question is fairness, *maslahah*, the system of zakat, free of interest (*riba*), free of speculative activities and non the productive like gambling (*maysir*), free of things that are unclear and dubious (*gharar*), free of things that are broken or invalid (false) and the use of money as a medium of exchange.

The services offered by Islamic banks is packaged in the products of Islamic banks, one of which is a *murabaha* financing. *Murabaha* is a buy and sell transaction in which the bank acts as the seller and the customer as a buyer, determination of the selling price is the purchase price of the supplier is added to the profit (margin), in accordance with the agreement between the bank and its customers. Besides *Murabaha*, there are also *mudharabah* and *musyarakah* financing. *Mudharabah* is a partnership contract between a bank as the owner of the funds (*shahibul maal*) with customers as (*mudharib*) who have the expertise or skills to manage a productive and lawful business, the results benefited from the use of these funds are shared by the agreement of customers. *Mudharabah* used by banks to facilitate compliance with the capital requirement for customers to conduct business or project by way of capital investment for the related business or project. *Musharaka* is an agreement between two parties or more to finance a business and the profits are shared according to the agreement but losses divided by capital respectively.

The low distribution of profit sharing financing or the domination non profit-sharing financing in the financing portfolio of Islamic banks proved to be a global

phenomenon not only happen in the Islamic banking in Indonesia. This phenomenon occurs not only in the new Islamic banks, but also in the well-established Islamic banks.

Chapra (2007) in previous research, stages toward improvements have been visible. For example, data from the International Association of Islamic Banks or IAIB 1996, the proportion of *murabaha* previously reached 90% of the total funding has dropped to 40.3%. Meanwhile financing profit and *musharaka* has risen to 7.2% and 12.7%. However, the use of financing in Islamic banking revenue share is still very marginal, that figure is still below 20%. The problem of financing for the use of the results are still very low, this is a not simple problem and it has multi-dimensional facet. In addition to funding, the existing problems in Islamic banks now is profitability. Due to the very strict rules in selecting the appropriate lawful Sharia investment and low capital owned compared to conventional banks, which make Islamic banking profit to be less optimal. Here are the conditions of ROA in Islamic Banks in the year 2006-2012.



Source: Bank Indonesia, 2016

Figure 1. Average Rating ROA Islamic Banks 2008-2014

Seen in the above Figure 1 that the ROA in Islamic Banks in 2009 has increased, and in 2010-2011 has decreased, the year 2012 has increased, and in 2013 fell back, and finally in 2014 experiences significant progress. ROA at Islamic banks has increased and decreased each year. It is because the FSA rules that require banks to increase their capital reserves and sharia banks are difficult to generate a good profit. It is incompatible with the concept of profitability which states that the factors affecting the profitability of a bank is financing provided by a bank. If high levels of financing, the profitability will

increase, but in reality when the profitability is relatively stable, the financing of *murabaha* and *mudaraba* tend to decline, while the financing *musharaka* tend to increase and decrease.

Table 1. The development of Islamic banking in Indonesia

Indication	Year							
	1998	2003	2004	2005	2006	2007	2013	2014
IB	1	2	3	3	3	3	6	11
SBU	-	8	15	19	20	25	25	35
RBS	76	84	88	92	105	114	139	148

Source: Bank Indonesia, 2016

Table 1 shows the development of Islamic banking based on the annual report of BI. In terms of quantity, the achievement of Islamic banking progressed significantly and the number of banks continued to increase. If in 1998 there was only one Islamic Bank (IB) and 76 Rural Bank Sharia (RBS), then in December 2014 the number of IB had reached 11 units and Sharia Business Unit (SBU) 35 units. In addition, the number of RBS reached 148 units in the same period.

Innovation in technology brings great impacts for the banking sector and creates a new way for customer interaction with the banks. The development of electronic tools changes the habits of financial services made by customers to use tools such as ATM, CDM, EDC, Internet Banking and Mobile Banking (Azeem, 2014). These electronic tools can provide an alternative to accelerate the bank's financial services customers extensively (Yu, 2003). Since the massive population growth every year, Indonesia becomes the 4<sup>th</sup> most populous country in the world. According to the World Bank survey, less than 50% of the population of Indonesia had an account at formal institutions (Bank) as much as 36% of the total population in Indonesia in 2014. This reality makes the banking sector to spread its financial services across the remote area and the aim is to digging the enormous potential that is equal to 64% of the total population of Indonesia to immediately use banking services.

Based on the previous explanation where Islamic finance which consists of *murabaha*, *mudaraba* and *musyarakah* as well as a conventional network consisting of branch offices, sub-branches and cash offices and the number of ATMs is expected to affect the ROA. This study tried to see the impact of the profitability of Islamic banks in Indonesia. This study focuses on the internal conditions of Islamic bank in Indonesia. The

advantages of this study are the use of cost, conventional network and the number of ATM as a factor that can directly affect the ROA of banks.

### ***The Influence of Murabahah on ROA***

Financing with the principles of buy or sell in the Islamic bank is done through contract *murabaha*, *salam* and *istishna*. One of the contract in the financing of buying and sell namely *murabaha* contract is the most popular products in the Islamic banking industry. This is due to several reasons, among others, the *murabaha* is a short-term mechanism investments and quite easy compared to the system profit and loss sharing (PLS), a mark-up in the *murabaha* can be defined such that it ensures that the bank can earn profits comparable with the profits of conventional banks based on interest. *Murabaha* distances uncertainties in income from businesses with PLS system, and *murabaha* do not allow Islamic banks to interfere in business management since the bank is not a partner of customers, because their relationship in *murabaha* is between creditors and debtors.

Management of buy or sell financing which becomes the largest constituent assets in the Islamic banking will generate revenue in the form of margin or mark-ups. By obtaining mark-up income will affect the amount of Islamic banks income and, finally able to influence the increase in profitability reflected by ROA. This finding is corresponding to research conducted by Fahrul (2012), Oktriani (2011), Rahman and Rochmanika (2012) which states financing *murabaha* influence on ROA. The hypothesis of this study is:

*H<sub>1</sub> : murabahah has positive effect on ROA.*

### ***The influence of musharaka on ROA***

*Musharaka* transactions is based on the desire of the related working parties to increase the value of their assets together and all business forms that involves two or more parties in which they jointly integrate all forms of resources both tangible and intangible. In *musharaka* financing, all capital are put together to be a capital project of *musharaka* and managed together. Each of the capital owners are entitled to participate in making business policies, run by the project implementers. Costs incurred in implementing the project and duration of the project must be shared. Profits are shared according to the portion agreement while losses are divided in proportion to the capital

contribution and the bank gets its revenue from those profit. Earned income will affect the amount of the profits from the banks. The amount of the profits from Islamic banks will be able to affect the profitability achieved. This statement is consistent to previous research conducted by Fahrul (2012), Oktriani (2011), Rahman and Ridha Rochmanika (2012) which states *musyarakah* influence return on assets. Then the hypothesis in this study is:

*H<sub>2</sub> : Musyarakah financing has positive effect on ROA.*

### ***The influence of financing mudharabah on ROA***

Mudharabah financing is one of the constituent components of assets in Islamic banking. Karim (2011) states that mudharabah is a form of cooperation between two or more parties in which the owners of capital (*sahibal-maal*) entrusts the amount of capital to the manager (*mudharib*) with a profit-sharing agreement. This cooperation combines the 100% cash capital contribution of the *sahib al-maal* and expertise of *mudharib*. Results of the management of capital financing can be taken into account by the calculation of project revenue (revenue sharing) and the calculation of the benefits of the project (profit loss). Project revenue and profit will affect the profits obtained by the bank.

The amount of the profits from Islamic banks will be able to affect profitability. The higher mudharabah financing will result higher profitability of Islamic banks. This statement is matched to the research conducted by Fahrul (2012), Oktriani (2011), Rahman and Ridha Rochmanika (2012), stated that mudharabah financing influences return on assets. Then the hypothesis of this study is:

*H<sub>3</sub> : Mudharabah has positive effect on ROA.*

### ***The influence of Conventional Network on ROA***

Aryanto (2010), states that a variable number of bank branches has a positive effect and positive impact on revenue. The number of branch offices is a measure of the success of Islamic commercial banking, meaning that if Islamic banks have a lot of branches, more number of people will deposit their funds to Islamic banks. The existence of relationship directions among the number of branches is positive, meaning that the more number of branches Islamic banks the more opportunity of the people to save more, and vice versa, if the number of branches of Islamic banks is little or minimal then the



public will be reluctant to deposit their funds to the Islamic banks because it is shortcoming of mileage, transportation far and the time required to visit an Islamic commercial bank. This is suitable to the previous research conducted by Meihami, *et al* (2013), then the hypothesis in this study are:

*H<sub>4</sub> : The branch office has a positive impact on ROA*

*H<sub>5</sub> : Office branches have positive impact on ROA*

*H<sub>6</sub> : Office cash has positive impact on ROA*

### ***The Influences of ATM on ROA***

ATM is one of the Bank's product and services, used by most people in Indonesia and even in all parts of the world. With the rapid advancement of technology, competition between banks will increase. ATM as one of the services of the Bank provide substantial income in addition to credit, savings or other savings; process of ATM transactions can affect to the increase in income or basic income to the linked bank. Banks earn income from inter-bank ATM transaction, called operational expenses.

Operating expenses are fees charged by Bank as a commission for each linked ATM transaction. Banks earn income not only from customers credit but also obtained from electronic services that rely on information technology such as credit cards, debit cards and ATM. Function of ATM is not only as a cash withdrawal and account transfer but also to pay various bills for example credit card payment, internet access subscriptions, mobile telephone or beeper (pager), until the electricity bill by using the instrument cards through its ATM network. All transactions are subject to deductions automatically to Bank operations as an income basis for the issuing bank or bank issuer (Idrus, 2004). The reduction of interest is a revenue to the Bank. This is stated in the research conducted by Meihami, *et al* (2013), while this hypothesis is:

*H<sub>7</sub> : ATM has positive effect on ROA*

### **METHODOLOGY**

In this study, the writers use quantitative data form of data Annual Report in 2010 to 2014 where Islamic finance can be seen in the Balance Sheet of Company at the end of the Annual Report. Meanwhile, the number of Conventional Network is contained in the Annual Report in the part of a network, while the total ATMs can be found in the company's Annual Report on the E-Banking. In this study, data collection techniques are conducted by recording the object of study, namely Islamic Banks listed on the



Indonesian Stock Exchange from 2010 through 2014 using Corporate Publishing Report. The writers use SPSS to process the data.

Regression analysis is used to assess the value of the variable Y based on the value of the variables X and estimated change of variables Y for each unit change in the variable X. The shape of multiple regression equations with free seven variables are as follows:

$$Y = a + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + e$$

where:

Y = Return on Assets

X<sub>1</sub> = *murabaha*

X<sub>2</sub> = *musyarakah*

X<sub>3</sub> = *mudharabah*

X<sub>4</sub> = branches

X<sub>5</sub> = branch offices

X<sub>6</sub> = cash office

X<sub>7</sub> = Automatic Teller Machine (ATM)

e = Error term

The samples of this research are six public Islamic banks listed on the Indonesian Stock Exchange (BEI) by using the Annual Report of the company during the period of 2010 through 2014. As for the sample criteria is a company belonging to the Public Islamic Banks company for consecutive periods, 2010 to 2014, listed on the Indonesia Stock Exchange and publishes Annual Report for the period ended December 31, 2014 and has been audited and in rupiah currency. Data obtained from Bank Indonesia is in a form of financial statements of Public Islamic Bank in Indonesia in 2010 through 2014 as many as 6 reports within five years. The financial statements are required in form of balance sheet and income statement, then it will be taken in accordance with research data.

## RESULTS AND DISCUSSION

The results of calculations using multiple linear regression stated that coefficient of determination seen at numbers on Adjusted R Square was 0.518. This showed that the percentage contribution of independent variables namely *murabaha* financing, *musharaka*, *mudaraba*, branches, sub-branches, cash office sand ATMs could contribute effect 51.8% on the variable which depend on the return on assets, and the remaining 48.2 % was influenced by other variables and was not included in this research model.

Table 2. Results of Output Multiple Regression Analysis

	Unstandardized Coefficients	
	B	Std. Error
constants	1,748	3,871
<i>murabahah</i> X <sub>1</sub>	,006	,411
<i>musyarakah</i> X <sub>2</sub>	,029	,522
<i>mudharabah</i> X <sub>3</sub>	-,264	,173
branches X <sub>4</sub>	,006	,012
branch offices X <sub>5</sub>	-,002	,002
cash office X <sub>6</sub>	,015	,006
ATM_X <sub>7</sub>	,001	,001

From the multiple regression equation above, it could be explained as follows:

1. The variable regression coefficient of financing *murabaha* was 0.006, meaning that if a variable *murabaha* increased to one million, the return on assets would increase 0.6%, assuming that other independent variables remain constant.
2. The variable regression coefficient of *Musharaka* was 0.029, meaning that if a variable *Musharaka* increased to one million, the return on assets would increase 2.9%, assuming that other independent variables remain constant.
3. The variable regression coefficient of *Mudharabah* was -0.264, meaning that if a variable *Mudharabah* rose to one million, the return on assets would decrease 2.64%, assuming that other independent variables remain constant.
4. The variable regression coefficient of branch offices was 0.006, meaning that if a variable branches increased one unit, then the return on assets would increase 0.6%, assuming that other independent variables remain constant.
5. The variable regression coefficient of branch offices was -0.002, meaning that if the variable sub-branches increased one unit, then the return on assets would decrease by 0.2%, assuming that other independent variables remain constant.
6. The variable regression coefficient of cash office was 0.015, meaning that if variable of cash office increased one unit, then the return on assets would increase 1.5%, assuming that other independent variables remain constant.
7. The variable regression coefficient of ATM was 0.001, meaning that if a variable of ATMs increased one unit, then the return on assets would increase 0.1%, assuming that other independent variables remain constant.

**The Analysis Hypothesis Test F**

Table 3 contained values that was used for Test F. According to the table above, it was known that the value of F-Sig. was 0.001, meaning that the p-value  $<\alpha$  or 0.001  $<0.05$  so that decisions was made in Ho was rejected and Ha was accepted. This showed that simultaneously (together) there is positive between effect on *murabaha* financing, *Musharaka*, *mudaraba*, branches, sub-branches, cash offices and ATMs on ROA.

Table 3. The Result of Regression Analysis Output Test F

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	20.474	7	2.925		5.449,001 <sup>b</sup>
Residual	11.809	22	537		
Total	32.283	29			

a. Dependent Variable: ROA\_Y

b. Predictors: (Constant), ATM\_X7, *Mudharabah\_X3*, *Murabahah\_X1*, branch offices\_X5, cash office\_X6, *Musyarakah\_X2*, branches\_X4

Meanwhile if the determination decisions was by comparing F count with Ftable. On the table was obtained Fcount equal to 5.449, using a confidence level 95%,  $\alpha = 5\%$ , df 1 or 7-1 = 6 and df 7 or 30 - 7 - 1 = 22, then the results obtained for the Ftable was 2,464. Since F count  $>$  Ftable (5.449 $>$  2.464), therefore Ho was rejected and Ha was accepted, meaning that *murabaha* financing, *Musharaka*, *mudaraba*, branches, sub-branches, cash offices and ATMs had significant effect on ROA simultaneously.

Based on the results of the F test showed that the effect concurrently or simultaneously from all independent variables (*murabaha*, *musharaka*, *mudaraba*, branches, sub-branches, cash offices and ATMs) to the return on assets showed positive results. This was shown from the value of Fcount  $>$  Ftable equl to 5.449  $>$  2.464 with 0.000 significance level (less than 0.05).

Meanwhile, from the calculation of the coefficient of determination ( $R^2$ ), it could be concluded that the independent variables in this study, the value of Adjusted R Square was 0.518 or 51.8%. This showed that the percentage of variable contribution *Murabaha*, *Musharaka*, *Mudaraba*, branches, sub-branches, cash offices and ATMs could give the effect of a 51.8% of the return on assets while the rest of 42.2% were influenced by other factors which were not included in this study.

Table 4. Results of Output t-test Regression Analysis Coefficient

	t	Sig.
constants	,452	,656
<i>murabahah</i> X <sub>1</sub>	3,015	,008
<i>musyarakah</i> X <sub>2</sub>	3,056	,006
<i>mudharabah</i> X <sub>3</sub>	-2,526	,001
branches X <sub>4</sub>	4,515	,002
branch offices X <sub>5</sub>	-,774	,447
cash office X <sub>6</sub>	2,430	,024
ATM_X <sub>7</sub>	3,535	,009

Results of testing at the hypothesis 1 showed that variable *murabaha* had a partial positive effect on ROA. This financing had a definite ratio level for profit since it had been calculated at the time of the transaction that led to the risk of profit loss was reduced so that it would affect the upcoming customer's payment. These conditions affected the profitability achieved by Islamic banks. *Murabaha* financing is financing that uses the principle of buying and selling goods whereby the bank buys goods from suppliers and then resell it to customers. The selling price of goods is the acquisition cost plus a mark-up or profit which has been agreed between the bank and its customers as buyers. From the management of financing *murabaha*, Islamic banks earn income in accordance with the ratio agreed with the customer (Mohammed, 2005).

Income will affect the amount of the bank's profits. The amount of the profits from Islamic banks will be able to affect the profitability achieved; therefore, *Murabaha* is the most widely used in Islamic banking. Empirical evidence from Wicaksana (2011), Fahrul (2012), Oktriani (2011), Rahman and Ridha Rochmanika (2012) showed that the higher of the *murabaha* financing which is one type of financing transactions, the higher the profitability of Islamic banks are targeted by ROA.

Results of testing the hypothesis 2 showed that variable *musyarakah* had a positive effect on ROA. Karim (2006) states that *musyarakah* are all forms of business that involves two or more parties in which they together combine all forms of resources both tangible and intangible. Profits and losses are shared in proportion to the preset. Through financing, the results of delivered profit sharing, Islamic banks will earn revenue.

The practices of *musharaka* actually is not much different from the practice financing of *mudharabah* in Islamic Banking the difference is to whom such financing is

directed. *Mudharabah* financing is distributed to the cooperative, BMT (*Baitul Maal wa Tamwil*), as well as finance companies; meanwhile *Musharaka* financing is distributed for working capital such as trade or service. In practice in Islamic Bank, distribution of funds for working capital such as trade and services are very much used compared to the distribution of funding to cooperatives or BMT. *Musharaka* is more commonly used than the *mudharabah*, so *musyarakah* has significant effect on ROA. Rahman and Rochmanika (2011) states that the financing of profit sharing has positive significant effect on profitability proxied through ROA on sharia banks in Indonesia.

Results of testing the hypothesis showed that the *mudaraba* had negative and significant influence on ROA. *Mudaraba* is a partnership contract between two parties where the first party (*Shahibul Maal*) in this case Islamic Bank provides 100% capital, while the other party as a manager and the profit is divided by the agreements set forth in the contract. If there are losses, the owners of capital will take in charge, as long as the loss was not due to negligence of the manager. However, if the manager has contributed to the loss, manager shall bear it. (Antonio 2001). Revenue or profit sharing ratio of financing *Mudharabah* is uncertain, due to the profit sharing ratio determined by Islamic banks is in accordance with the turnover of the business acquired. Therefore, the calculation of income is constantly changing in accordance with the achievement of the business turnover, thus it makes *Mudharabah* financing has significant negative effect on ROA. It is the same as described by Rahman and Rochmanika (2011), they stated that the *Mudharabah* has negative effect on ROA.

Results of testing the hypothesis 4 showed variable partial of branches, it had a positive effect on ROA. Hypothesis 5 testing results found that the variables branch offices partially showed a negative effect but not significant to the ROA. While the results of hypothesis testing 6 showed, that variable partial cash office had a positive effect on return on assets. The regression results showed the number of branches affect the ROA. It showed that more and more number of branches would increase the profitability of Islamic Banks. When the Islamic Banks expand branch network, the customer will be easier to investing or financing so as to increase the number of branch offices provide an important role for Islamic banks to improve profitability. This study is in line with research of Rachman, *et al* (2013) which states that the conventional network affects the return on assets.

The results of testing the hypothesis 7 showed that variable partial ATM had a positive effect on ROA. In order to maintain the ability to make a profit, banks continued to increase non-interest operating income called fee-based income. This way banks increase revenue by optimizing the function of ATM transactions to increase fee-based .This shows that the number of ATMs is very influential on the increase in non-interest income of banks with very little risk. This shows that despite the bank's main source of revenue comes from bank ratios derived from the finance portfolio, the quality of financing provided must be well considered, or risk of such financing should be minimized. The better the quality, the better the level of bank interest income and vice versa and funding depends on the quality of those financing.

### CONCLUSION

Overall test results stated that only *mudaraba* had negative and significant impact on the ROA. Profit sharing ratio of financing *mudharabah* is uncertain due to the profit sharing ratio determined by Islamic banks in accordance with the turnover of the business acquired. Therefore, the calculation of income is constantly changing in accordance with the achievement of the business turnover, and it makes significant negative influence on ROA. While the existence of branches was dominant and very important variable to influence ROA. The more the number of branches owned will increase the profitability of Islamic Banks. By seeing this result, the government is expected to pay more regulation to the course of the Islamic banking system by completely separating between conventional and Islamic, so Islamic banking applies pure sharia. Islamic banks also have started to invest electronic networks by utilizing information technology.

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## ASSESSING THE ENTREPRENEURIAL ECOSYSTEM OF OMAN AND DISCOVERING THE INNATE SUITABILITY OF ISLAMIC FINANCE

*Preliminary Draft*

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### ABSTRACT

*With the aim of economic diversification and vision 2020, on the 9<sup>th</sup> five year economic plan, the Sultanate of Oman is intending to reduce its dependence on hydrocarbon to stabilize the economy and achieve sustainable economic development. To signify diversification, Oman therein is showing keenness to increase the role of private sector investments through different modes in order to increase the contribution of the same in GDP. In this context, the focus on Entrepreneurship has gained a fresh momentum. Simulating an entrepreneurship focused economic diversification requires a well-developed entrepreneurial ecosystem. The same captures various determinants of relevant activities on the micro and macroeconomic levels. Among the main factors is the, all important, suitable financial architecture; one that while meeting the financing needs, innately adjusts to the risk-return dynamics of businesses. The purpose of this paper is to first analyses pillars of Omani entrepreneurship ecosystem and identify the areas of strengths and weaknesses. This is done by applying time series analysis to each pillar. Moreover, cross sectional analysis is carried out between each pillar and with MENA region, World, Saudi Arabia, and Malaysia. A range of strengths and weakness are found. Among the prime weaknesses; well suit financing schemes is found pivotal. The study purposes Islamic Finance, with its essence of Risk Sharing (Al-Bay) in finance as an ideal financing scheme to address the weakness.*

**Keywords:** *Entrepreneurship, Oman economy, Entrepreneurial ecosystem, Islamic Finance, Risk Sharing*

### INTRODUCTION

Sultanate of Oman, as one of GCC, is endowed by oil and gas. This towards its economy to be highly dependent on oil and gas extraction activities, which made its economy vulnerable to economic fluctuation as a result of uncertainty of oil and gas prices. This



towards Oman governments to implement policies to support economic diversification to strengthen the business environment and increase the share of non-hydrocarbon sector in Omani GDP. Furthermore, Oman government paid more attention to increase the role of private sector investments as a tool to increase the private sector contribution in GDP. In this context, stimulating private sector drew the attention towards the importance of Entrepreneurship for developing Omani private sector.

Entrepreneurship stimulation requires a well-developed entrepreneurship ecosystem. This ecosystem captures various determinants of entrepreneurship activities on both macroeconomics and microeconomics levels. In this regard, the first step is assessing the existing entrepreneurial ecosystem to diagnosis of potential challenges and opportunities that can be addressed through specific interventions.

The research in ecosystem for entrepreneurship has received considerable attention from researchers (even individual researchers or belonged to institutions), which developed many approaches for assessment. Some approaches are comprehensive and use large number of individual indicators, others are more conceptual and focus mainly on some key domains and specific actors.

The first purpose of this paper is to analyze pillars of Omani entrepreneurial ecosystem to identify the areas of strengths and weaknesses. The second purpose of this paper is to analyze how expansion in implementing the Islamic finance affect the entrepreneurship ecosystem in Oman.

To fulfill research purposes, researchers implemented “Global Entrepreneurship and Development Institute” (GEDI) index which is named “Global Entrepreneurship Index” (GEI) on Oman to assess the different pillars of Oman entrepreneurship ecosystem and determine the strong pillars and the weak ones. This analysis is followed by a discussion about the impact of expansion of Islamic Finance implementation on the different pillars of entrepreneurship ecosystem in Oman.

The paper proceeds by reviewing the literature review about entrepreneurship ecosystem followed by the research methodology. Then, the analyses and assessment for the Omani entrepreneurship ecosystem is carried out. Then Islamic Finance and the innate suitability for entrepreneurship has been discussed. Finally, the paper draws conclusions

and proposes recommendations to improve the entrepreneurship ecosystem in Sultanate of Oman.

### **LITERATURE REVIEW**

The research in ecosystem for entrepreneurship has received considerable attention from many researchers and institutions, which created many approaches for assessment. There is a wide variety between these approaches. (Aspen Network of Development Entrepreneurs, 2013).

One of the common approaches in assessing entrepreneurship ecosystem is “Global Entrepreneurship and Development Institute” (GEDI), which defined entrepreneurship ecosystem as “A system is an organized set of interacting and interdependent subsystems that function together as a whole to achieve a purpose”. (Mathews and Brueggemann, 2015) argued that the “ecosystem is a purposeful collaborating network of dynamic interacting systems and subsystems that have an ever-changing set of dependencies within a given context”

As per GEDI, Entrepreneurial ecosystems are composed of sub-systems (pillars) that are aggregated into systems (sub-indices) that can be optimized for system performance at the ecosystem level. GEDI issued index named “Global Entrepreneurship Index” (GEI). The index consists of fourteen pillars of entrepreneurship ecosystem. (Zoltán J., et al., 2017).

Table (1): The structure of Global Entrepreneurship Index

Global Entrepreneurship Index													
Attitudes Sub-Index					Abilities Sub-Index				Aspiration Sub-Index				
O	S	R	N	C	O	T	H	C	P	P	H	I	R
p	t	is	e	u	p	e	u	o	r	r	i	n	is
p	a	k	t	lt	p	c	m	m	o	o	g	t	k
o	rt	A	w	u	o	h	a	p	d	c	h	e	C
rt	-	c	o	r	rt	n	n	e	u	e	G	r	a
u	u	c	r	a	u	o	C	t	c	s	r	n	p
n	p	e	k	l	n	l	a	t	t	s	o	a	i
it	S	p	i	S	it	o	p	i	I	I	w	t	i
y	k	t	n	u	y	g	it	o	n	n	t	h	o
p	il	a	g	p	S	y	a	n	o	o	h	n	a
e	ls	n		p	t	A	l	v	v	a	a	l	l
r		c		o	a	b		a	a	t	t	l	l
c		e		r	rt	s		t	t	o	o	n	l
e				p	-	o		i	i	n	n	n	l
p				o	u	r		o	o	n	n	n	l
t				r	p	p		n	n	n	n	n	l
i				t		t		n	n	n	n	n	l
o						o		n	n	n	n	n	l
n						n		n	n	n	n	n	l

Source: Zoltán J., et al., (2017), “The Global Entrepreneurship Index”, USA: *Global Entrepreneurship and Development Institute*, P:1.

One of the most important approaches in assessing the ecosystem for entrepreneurship is OECD approach. The OECD uses a unique definition of entrepreneurship, it considers three components: Entrepreneurs, Entrepreneurial Activity and Entrepreneurship. (Ahmad N., and Hoffmann A.).

The OECD conceptualizes the ecosystem of entrepreneurship as the combination of three factors: opportunities, skilled people and resources. These three factors are influenced by two important themes: culture and regulatory framework. These factors and themes can be simplified into six key determinants: regulatory framework, market conditions, access to finance, R&D and technology, entrepreneurial capabilities and culture.

Another approach in assessing the ecosystem for entrepreneurship is the World Bank's approach. The World Bank's Enterprise Surveys are the most comprehensive, and wide-ranging datasets available. Key data points include firm characteristics, sales, finances, R&D, entrepreneur/top manager, government relations, quality of infrastructure, competition and workforce, employee characteristics, impact on communities, and entrepreneurial motivation/culture. The World Bank project for collecting data on entrepreneurship was completed in June, 2015. The project created understanding for the different aspect of entrepreneurship. (World Bank, 2016)

The World Economic Forum (WEF) developed comprehensive diagnostic tools for assessing and tracking the development of the ecosystem. The WEF believes that entrepreneurs rely on four enablers of support: Personal Enablers (such as mentors and education); financial enablers (such as banks investors and microfinance); businesses enablers (such as incubators and networking associations); and environmental enablers (such as regulatory framework, infrastructure and culture). By examining an entrepreneurial ecosystem through this framework the WEF is able to identify strengths and weaknesses in the ecosystem and recommend policy to fill gaps. (World economic forum)

Babson College - The Babson Entrepreneurship Ecosystem Project (BEEP) stems from the observation that in all societies in which entrepreneurship occurs with any regularity or is self-sustaining, there is a unique and complex environment or ecosystem. The BEEP categorizes their framework into six domains: i) Policy (government regulations and support of entrepreneurship); ii) Finance ( the financial services which are provided to entrepreneurs); iii) Culture (societal norms and the presence of success stories in entrepreneurship); iv) Support (physical infrastructure, non-governmental institutions, and the presence of supporting professions); v) Human Capital (the quality of higher education system and the skill level of the work force); Finally, vi) Markets (entrepreneurial networks and the presence of early customers). (Daniel Isenberg and Vincent Onyemah, 2016)

## METHODOLOGY

*Research Design:* This study uses a combination of two well-known approaches, namely; qualitative based on multiple case studies approach and quantitative approach. The former approach relied mainly on analyzing different case studies related to entrepreneurial eco-system at multinational level. A quantitative analysis was utilized, specifically non-hypothetical relationship, in other words, a descriptive study with statistics indicators was performed, in order to understand the progress of eco-system in Oman.

*Unit of analysis:* This study considers the country as the unit of analysis. Different countries were under analysis for the eco-system.

*Data types and sources:* The data was collected from secondary sources. The data was collected from the databases, reports, and websites of World Bank, GEDI, OECD, World Economic Forum, Al Raffad fund (Sultanate of Oman) and other former relevant studies. These reports and previous studies related to the different pillars of entrepreneurship ecosystem in Oman, world, MENA region, Saudi Arabia, and Malaysia. To gain more in depth of analysis, the secondary data was collected for every sub-indices of each pillar of Omani entrepreneurship ecosystem.

*Data presentation:* The collected data has organized in tables and then presented in charts. This allowed the researcher to analyze the data, come to a conclusion, and provide recommendations.

*Data analysis:* With reference to research design approaches. A comparative narrative analysis was undertaken on the aforementioned countries with particular emphasis on entrepreneurship eco-system. This method is suitable for case study analysis at multiple levels. The comparison analysis, allow the researcher to compare the progress and provide justification per case, with strong tie to economic and financial performances, as part of eco-system entrepreneurship adoption at different countries under consideration. Furthermore, a descriptive analysis for each pillar of Omani entrepreneurship ecosystem and the components of these pillars was implemented. This analysis provides indicator about the progress and the level of each pillar in Omani entrepreneurship ecosystem to assess its level in comparison with its value in these levels. Similarly, such analysis was carried out and compared with each pillar of Omani entrepreneurship ecosystem against Saudi Arabia and Malaysia. For instance, a comparison with the average level of each

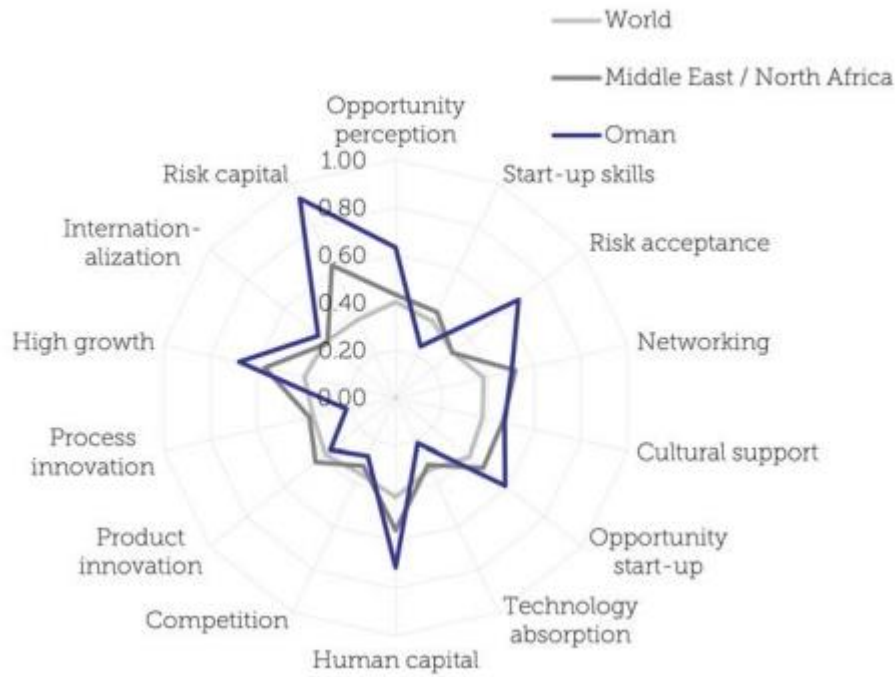
pillar on the world and MENA region provides good indicators about the level of the strengths of the pillar in Oman. Furthermore, a comparison with other economies, as benchmarking, enabled to have accurate assessment for Omani entrepreneurship ecosystem, that's why a comparison with both Saudi Arabian and Malaysian entrepreneurship ecosystems is carried out.

***Entrepreneurship Ecosystem of Sultanate of Oman:***

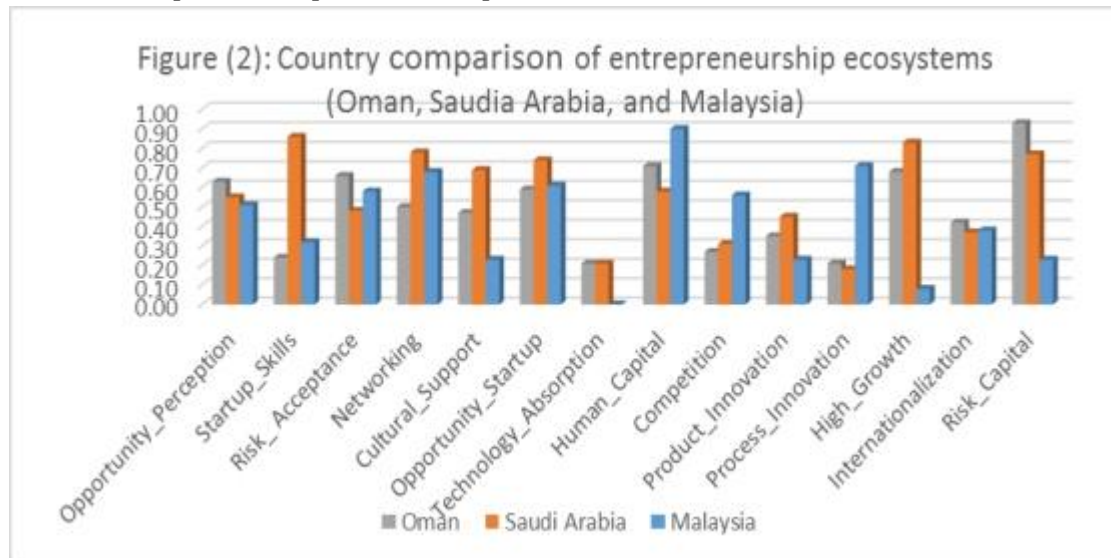
This section includes implementing GEDI approach on Oman economy to assess each pillar of entrepreneurship ecosystem of Sultanate of Oman. As per GEDI approach, the entrepreneurship ecosystem is assessed via Global entrepreneurship Index (GEI). GEI consists of three sub-indices. *First* is Attitudes sub-index, its pillars are: Opportunity perception; Start-up Skills; Risk Acceptance; Networking; and Cultural Support. *Second* component is Abilities Sub-Index, which consists of the following four pillars, they are: Opportunity Start-up; Technology Absorption; Human Capital; and Competition. *Third* sub-index is Aspiration Sub-Index, it has five pillars: Product Innovation; Process Innovation; High Growth; Internationalization; and Risk Capital.

A comparison between GEI Omani indices 2017 with world and MENA indices are shown in figure (1), while figure (2) represents a comparison between GEI 2017 for Oman, Saudi Arabia, and Malaysia.

Figure (1): Omani entrepreneurship ecosystem: A comparison with world and MENA indices (2017)



Source: Zoltán J., et al., (2017), “The Global Entrepreneurship Index”, USA: *Global Entrepreneurship and Development Institute*.



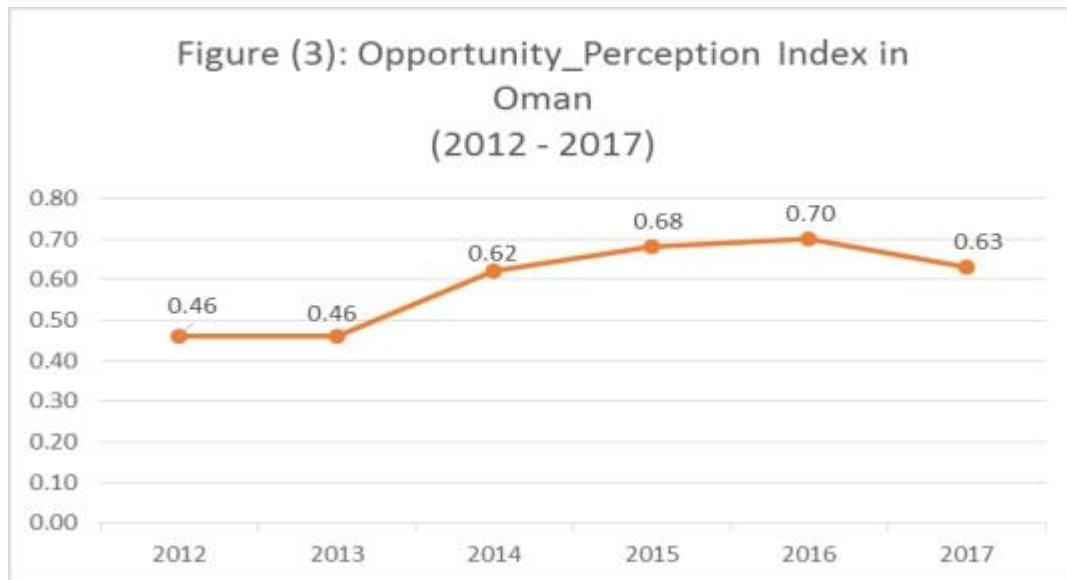
Source: Zoltán J., et al., (2017), “The Global Entrepreneurship Index”, USA: *Global Entrepreneurship and Development Institute*.

**Entrepreneurial Attitudes Pillars in Oman:**

**Pillar 1: Opportunity Perception:**

This pillar captures the potential “opportunity perception” of a population by considering the state of property rights and the regulatory burden that could limit the real exploitation of the recognized entrepreneurial opportunity. (Zoltán J., et al., 2017).

The opportunity perception index for Oman increased from 0.46 in 2012 to reach its peak (0.70) in 2015, then it dropped to be 0.63 in 2016 (Figure 4). The level of opportunity perception in Oman is higher than the world average level and the MENA level as well (Figure 1). Moreover, it's higher than its level in both Saudi Arabia and Malaysia (Figure 2).



Source: Zoltán J., et al., (various issues), The Global Entrepreneurship Index, USA: *Global Entrepreneurship and Development Institute*.

This increase in opportunity perception index is resulted from increase in the components of this index (opportunity recognition, economic freedom and property rights).

Opportunity recognition is measured by the percentage of the population that can identify good opportunities to start a business in the area where they live, the value of these opportunities also depends on the size of the market. Market size is the sum of gross domestic product plus value of imports of goods and services, minus value of exports of goods and services. (Zoltán J., et al., 2017)

Table no (2) Domestic market size index for Oman (2011 – 2015)

year	Rank	Index value (out of 7)
2015	68	3.8
2014	73	3.6
2013	78	3.3



2012	78	3.2
2011	75	3.2

Source: World Economic Forum, *The Global Competitiveness Report*, various issues.

The market size index for Oman increased from 3.2 in 2011 to 3.8 (out of 7) in 2015. The rank of Oman market size improved from 75 in 2011 to 68 in 2015. This reflects expansion in Oman market size which improves the opportunity perception for Oman.

Freedom is vital for individuals to become entrepreneurs. Economic freedom captures the overall burden of regulation and the government's regulatory efficiency in influencing businesses startups and operations. Business freedom is a quantitative measure of the ability to start, operate, and close a business. That represents the overall burden of regulation and the efficiency of government in the regulatory process. (Bjørnskov, C., & Foss, N., 2010). The value of Omani business freedom index is around 70, which reflects high level of economic freedom (Table 3).

Table (3) Business freedom index in Oman (2011-2016)

index year	business freedom index
2016	70.1
2015	68.4
2014	68.3
2013	68.1
2012	68.2
2011	69.4

Source: World Bank. (n.d.). Retrieved from:

<http://www.heritage.org/index/explore?view=by-region-country-year#top>

Property rights: “*enforced property rights guarantee that individuals have the right to harvest the fruits of successful opportunity exploitation and no one is confiscating or stealing their property or business*”. (Bhola, R. et. al., 2006).

The property rights component is an assessment of the ability of individuals to accumulate private property, secured by clear laws that are fully enforced by the state. It measures the degree to which a country's laws protect private property rights and the degree to which its government enforces those laws.

Oman implements its obligations under those treaties through a number of Royal Decrees made in 2000 on patents, copyrights and neighbouring rights, trade marks and

unfair competition, industrial designs, geographical indications and semiconductor topographies. The Sultanate's copyright law has been supplemented by Royal Decree No. 65/2008 Promulgating the Law on Copyright and Related Rights and its law on industrial property rights by Royal Decree No 67/2008. (NIPC Gulf) Moreover, Oman signed many Treaties related to intellectual property rights (TRIPs, Intellectual Property Law in Kuwait, the GCC Patent Regulation and Implementing Bylaws, Oman is also party to the Paris and Berne Conventions, the WIPO Copyright and Performances and Phonograms Treaties, the Patent and Trademark Law Treaties, the UPOV Convention and the Patent Co-operation Treaty, Madrid Protocol and Hague]. *Hence, the level of property rights in Oman is high.*

Table (4) property rights index for Oman (2011-2016)

index year	property rights
2016	55
2015	55
2014	50
2013	50
2012	50
2011	50

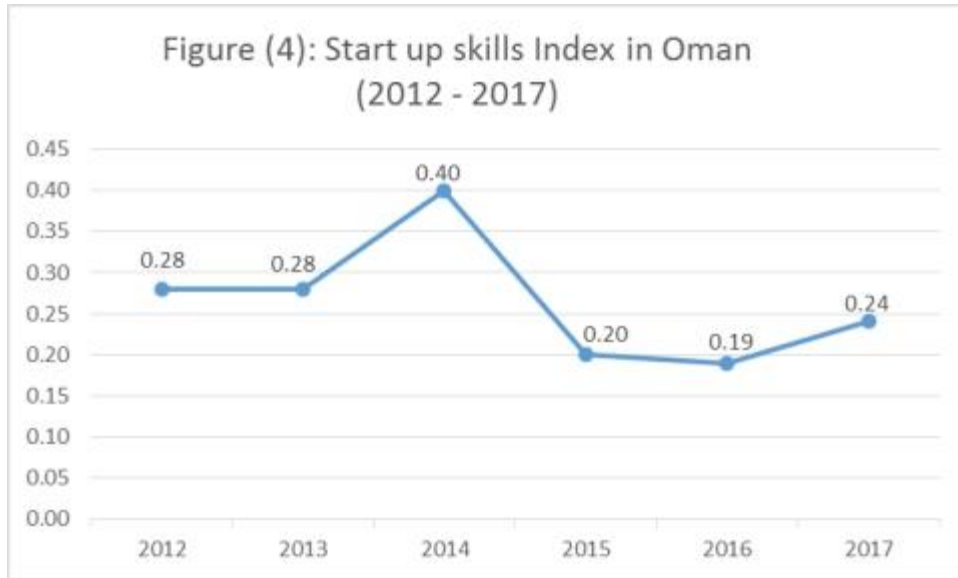
Source: World Bank. (n.d.). Retrieved from:

<http://www.heritage.org/index/explore?view=by-region-country-year#top>

Omani property rights index increased to be 55 since 2015 instead of 50 in the prior years.

## **Pillar 2: Startup Skills**

Business formation, operation, and management, require skills which are acquired through education and training. Hence education, especially postsecondary education, plays a vital role in teaching and developing entrepreneurial skills. (Zoltán J., et al., 2017)



Source: Zoltán J., et al., (various issues), The Global Entrepreneurship Index, USA: *Global Entrepreneurship and Development Institute*.

Although that start-up skills index in Oman increased from 0.28 in 2012 to 0.40 in 2014, it dropped to be 0.20 in 2015 and increased slightly to be 0.24 in 2017.

Start-up skills index for Oman is lower than the average of MENA and lower than the average of the world as well (Figure 1). Moreover, Start-up skills index for Oman 2017 is lower than the same index for Saudi Arabia, and lower than the same index for Malaysia (Figure 2).

Table no (5) Quality of education Indicators of Oman (2011 – 2015)

Indicator	Tertiary education enrollment rate (gross)		Quality of the education system		Quality of math and science education	
	Indicator value	Rank	Indicator value (out of 7)	Rank	Indicator value (out of 7)	Rank
Year						
2015	28.6%	87	3.6	80	3.7	89
2014	28.1%	82	3.1	106	3.3	102
2013	28.1%	83	3.5	81	3.6	95
2012	28.7%	80	4.0	53	3.9	87
2011	24.5%	83	3.9	60	3.7	86

Source: World Economic Forum, *The Global Competitiveness Report*, various issues.

Table no (5) represents the Tertiary education enrollment rate gross, Quality of the education system, and Quality of math and science education. The Tertiary education

enrollment rate gross increased from 24.5% in 2011 to 28.7% in 2012 and still at the same level till 2015. Quality of the education system index fluctuated between 3.1 and 4.0 (out of 7.0) through 2011 – 2015. Quality of math and science education fluctuated between 3.3 and 3.9 (out of 7.0) through the same period.

Furthermore, the higher education doesn't include –up till now- awareness for students about entrepreneurship. In this regard, The Ministry of Higher Education decided to offer entrepreneurship course as one of university/college requirements, which will start in implementation by the beginning of (2017-2018) academic year. This may increase students' awareness about entrepreneurship, which, in turn will increase the level of start-up skills from Omani population.

On the other hand, although that many higher education programmes in Oman are business programmes, only one of them is a bachelor degree in entrepreneurship and it's a new offered programme.

The start-up skills are influenced by the efforts of institutions which stimulate entrepreneurs and support them while managing their businesses. The effort of these institutions is still limited, for example, Al Raffd Fund which was founded in 2013 as a financial organization aimed to support, encourage and promote the entrepreneurial growth and advancement among the citizens of Sultanate of Oman has only 65 beneficiaries. Table no. (6) shows the number of beneficiaries from Al Raffad classified by sector.

Table no (6) Beneficiaries of Al Raffad Fund per sectors

S/N	Sector	Number of beneficiaries	Percentage (%)
1	Agriculture and Fisheries Sector	1	1.5
2	Commercial	14	21.5
3	Health	2	3.0
4	Industrial	12	18.5
5	Logistic service	1	1.5
6	Selling and distribution	1	1.5
7	Services sector	21	32.3
8	Telecommunications	1	1.5
9	Tourism Sector	1	1.5
10	Trade Sector	11	16.9
Total		65	100.0

Source: By the researcher, using the data of Al Raffad fund.

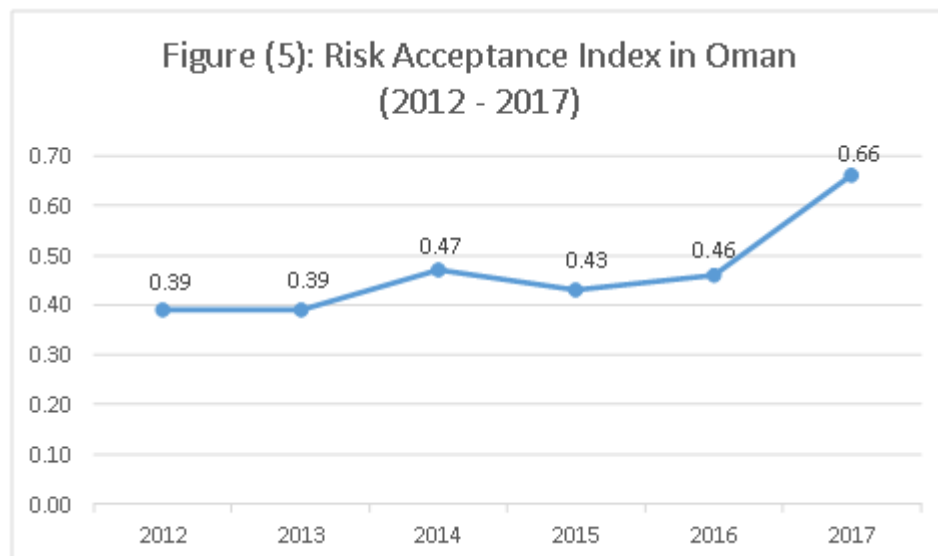
Al Raffad. (n.d.). Retrieved from

<https://www.alraffd.gov.om/Beneficiary.aspx?ID=5&PID=0>

Another authority is “The Public Authority for Small & Medium Enterprises Development” (Riyada) was established as the Public Authority for Small & Medium Enterprises Development as per Royal Decree No. 36/2013 has 100 beneficiaries.

### Pillar 3: Risk Acceptance

Fear of failure is one of the most important obstacles to a startup. Risk acceptance is defined as the percentage of the population who do not believe that fear of failure would prevent them from starting a business. (Vieider et al., 2015)



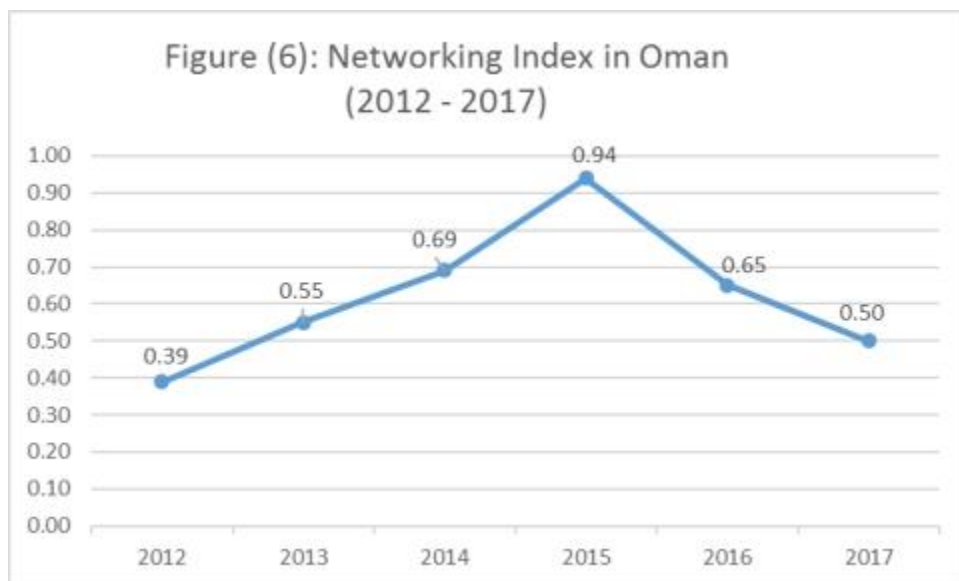
Source: Zoltán J., et al., (various issues), The Global Entrepreneurship Index, USA: *Global Entrepreneurship and Development Institute*.

Risk acceptance index for Oman increased from 0.39 in 2012 to reach 0.66 (in average 14% annual growth rate). The risk acceptance index 2017 in Oman is higher than the average of MENA and higher than the average of the world as well (Figure1). Moreover, the value of the same index for Oman is higher than its value in Saudi Arabia and Malaysia in 2017 (Figure 2).

Risk acceptance is related to country risk. Country risk index is composed of transfer and convertibility risk (i.e. the risk a government imposes capital or exchange controls that prevent an entity from converting local currency into foreign currency and/or transferring funds to creditors located outside the country) and cases of force majeure (e.g. war, expropriation, revolution, civil disturbance, floods, earthquakes). As per OECD risk classification for countries, Oman is classified Oman Prevailing was (3) in 2017, which reflects a lower country risk. (OECD)

**Pillar 4: Networking**

Networking combines an entrepreneur’s personal knowledge with their ability to connect to others in a country and the whole world. Entrepreneurs who have better networks are more successful, can identify more viable opportunities, and can access more and better resources.



Source: Zoltán J., et al., (various issues), The Global Entrepreneurship Index, USA: *Global Entrepreneurship and Development Institute*.

Networking index for Oman increased from 0.39 in 2012 to reach its maximum (0.94) in 2015, then it decreased to reach 0.50 in 2017.

The networking index 2017 for Oman is close to the average of MENA and higher than its value for the world (Figure 1). The value of the same index for Oman is lower than its value in Saudi Arabia and Malaysia in 2017 (Figure 2).

The basic networking potential is defined by a possible entrepreneur by the percentage of the population who personally know an entrepreneur who started a business within two years. The connectivity variable has two components: **Urbanization** which measures the urbanization of the nation and the **Infrastructure** which measure the quality of the transport infrastructure. (Audretsch et al., 2015)

Table no. (7) Shows that the level of urbanization index in Oman is high, its value is 75.7 in 2011 and increased slightly to be 77.7 in 2015.

Table (7) Urbanization index of Oman (2011 – 2015)

Indicator	Urbanization index
Year	
2015	77.7
2014	77.2
2013	77.0
2012	76.2
2011	75.7

Source: World Bank. Retrieved from <http://databank.worldbank.org/data/reports.aspx?source=2&series=SP.URB.TOTL.IN.ZS&country=#>

Data about the quality of transport infrastructure in Oman is not available. However, there is an improvement in air transportation in Oman result from establishing new airports and new Omani economy airlines (Al Salam airlines) as well.

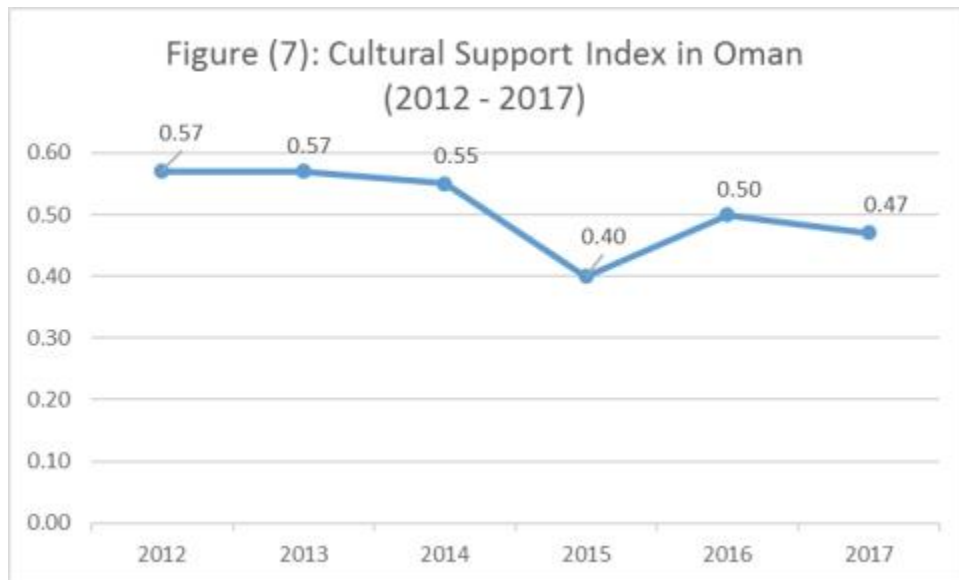
Muscat International and Salalah International Airport including three regional airports are under development. The new Muscat International Airport will have capacity to handle 12 million passengers per annum and the new Salalah International will be able to handle one million passengers per annum. Both of them will be completed in the coming few years. (OAMC)

Salam Air is a proposed low-cost carrier. Oman's Public Authority for Civil Aviation granted ASAAS a new air services operator license in Jan-2016 to establish the country's first LCC. The carrier would support Oman's air traffic demand, which is expected to increase by 40% by 2019. (CAPA)

It's expected that these two factors will improve the level of networking for Oman.

### **Pillar 5: Cultural Support**

Cultural support is an essential element in motivating people to be entrepreneurs. Without it, the best and brightest do not want to be responsible entrepreneurs, and they decide to enter a traditional profession. This pillar is a combined measure of how a country's inhabitants view entrepreneurs in terms of status and career choice, and how the level of corruption in that country affects this view.



Source: Zoltán J., et al., (various issues), The Global Entrepreneurship Index, USA: *Global Entrepreneurship and Development Institute*.

Culture Support index for Oman fluctuated between 0.40 and 0.57 through 2012 – 2017. The 2017 index is close to the average of MENA and higher than the world index



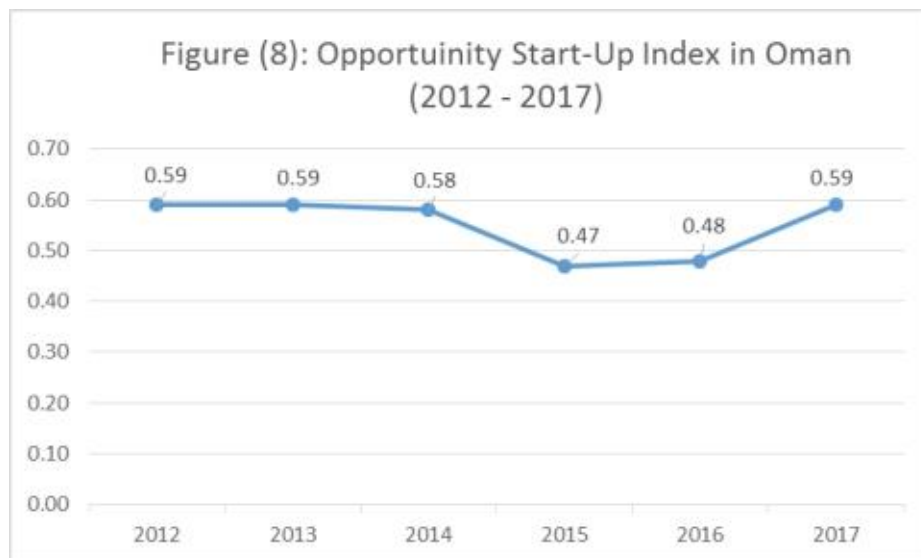
(Figure 1). The value of the same index for Oman is lower than its value in Saudi Arabia and higher than Malaysia in 2017 (Figure 2).

***Entrepreneurial Abilities Pillars***

**Pillar 6: Opportunity Startup**

This is a measure of startups by people who are motivated by opportunity but face red tape and tax payment. An entrepreneur’s motivation for starting a business is an important signal of quality. Opportunity entrepreneurs are believed to be better prepared, to have superior skills, and to earn more than what we call necessity entrepreneurs.

Opportunity Motivation is defined as the percentage of the Total Entrepreneurial Activity (TEA) businesses started to exploit a good opportunity. The overall effectiveness of the government services is measured by the Good Governance variable and the cost of the governance is by the level of overall. The variable is a combination of these two components, government service quality and costs. (Asoni, A., & Sanandaji, T. 2014)



Source: Zoltán J., et al., (various issues), The Global Entrepreneurship Index, USA: *Global Entrepreneurship and Development Institute.*

Opportunity Start-up index of Oman is almost fixed through 2012–2017. The 2017 index is higher than the average of MENA and higher than the world index as well (Figure 1). The value of the same index for Oman is lower than the index’s value in Malaysia (0.61) and also lower than its value in Saudi Arabia (0.74) (Figure 1).

The Governance index consists of sub-indices: Political Stability and Absence of Violence/Terrorism; Government Effectiveness; Regulatory Quality; Rule of Law; and Control of Corruption.

Table (8) Governance sub-indices for Oman (2011 – 2015)\*

Year	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
2015	0.69	0.09	0.58	0.46	0.20
2014	0.71	0.29	0.69	0.58	0.25
2013	0.45	0.22	0.48	0.57	0.08
2012	0.45	0.27	0.48	0.59	0.08
2011	0.42	0.27	0.34	0.54	0.00

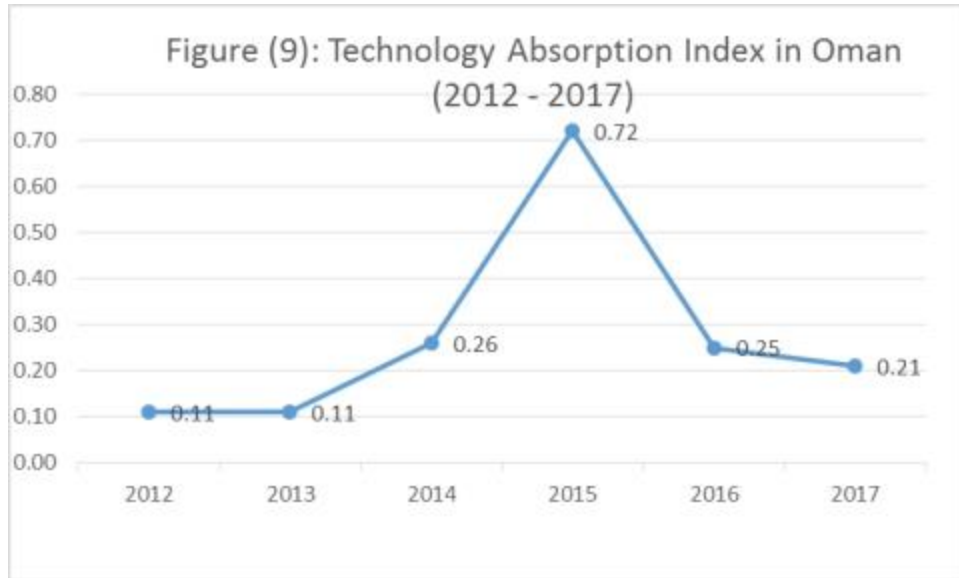
Source: World Bank. (n.d.). Retrieved from <http://info.worldbank.org/governance/wgi/#home>

\* Estimate of governance (ranges from approximately -2.5 (weak) to 2.5 (strong) governance performance)

Table (8) shows that all the sub-indices of governance for Oman are strong for 2015 (All of them are higher than zero), the strongest sub-index Political Stability, the second strongest one is Regulatory Quality, the third sub-index is Rule of Law, the fourth sub-index is Control of Corruption, the fifth sub-index is Government Effectiveness.

### **Pillar 7: Technology Absorption**

In the modern knowledge economy, information and communication technologies play a major role in economic development. The Technology Level variable is a measure of the businesses that are in technology sectors. The institutional variable, Tech Absorption, is a measure of a country's capacity for firm-level technology absorption. The diffusion of new technology, and the capability to absorb it, is vital for innovative firms with high growth potential. (Garcia-Morales, et. al., 2014)



Source: Zoltán J., et al., (various issues), The Global Entrepreneurship Index, USA: *Global Entrepreneurship and Development Institute*.

Technology absorption index for Oman was 0.11 in 2012 and 2013. It increased till reach 0.72 in 2015 and dropped to be 0.21 in 2017.

Technology absorption index 2017 for Oman index is lower than the average of MENA and also lower than the world index (Figure 1). The value of the same index for Oman in 2017 equals the value of the index for Saudi Arabia (Figure 2). (The data for the same index for Malaysia is not available).

Technology absorption is a part of technology readiness. Table no (9) represents some indicators of technology readiness in Oman (2011 – 2015)

Table no (9): Some indices of technology readiness in Oman (2011 – 2015)

	Availability of latest technologies		Firm-level technology absorption		FDI and technology transfer	
	Rank	Index value (out of 7)	Rank	Index value (out of 7)	Rank	Index value (out of 7)
2015	66	4.9	57	4.7	85	4.1
2014	65	4.8	56	4.8	84	4.2

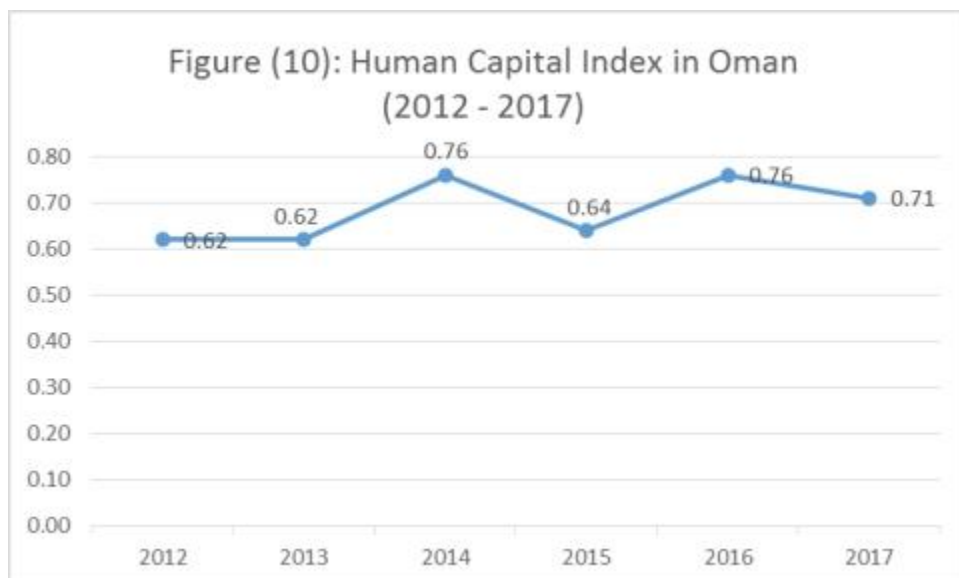
2013	56	5.1	58	4.8	52	4.8
2012	56	5.2	53	5.0	48	4.9
2011	46	5.4	52	5.0	45	4.9

Source: World Economic Forum, *The Global Competitiveness Report*, various issues. Table (9) shows that the Availability of latest technologies index for Oman dropped from 5.4 in 2011 to be 4.9 in 2015 (The rank also dropped from 46 to 66 for the same years). Firm-level technology absorption index also dropped from 5.0 in 2011 to 4.7 in 2011 (The rank of Oman dropped from 52 to 57 for the same years). FDI and technology transfer index for Oman dropped from 4.9 in 2011 to 4.1 in 2015 (the rank of Oman dropped from 45 to 85 for the same years).

### Pillar 8: Human Capital

The prevalence of high-quality human capital is important for ventures that are highly innovative and require an educated, experienced, and healthy workforce to continue to grow.

An important feature of a venture with high growth potential is the entrepreneur’s level of education (discussed in star-up skills pillar) and the labour market possibilities which can be illustrate by the institutional variable Labour (Labour freedom and staff training). Labour Freedom measures the freedom of the labour from the regulatory perspective. Staff training is a country’s level of investment in business training and employee development. It can be expected that heavy investment in employees pays off and that training increases employee quality. (Qian, 2016)



Source: Zoltán J., et al., (various issues), The Global Entrepreneurship Index, USA: *Global Entrepreneurship and Development Institute*.

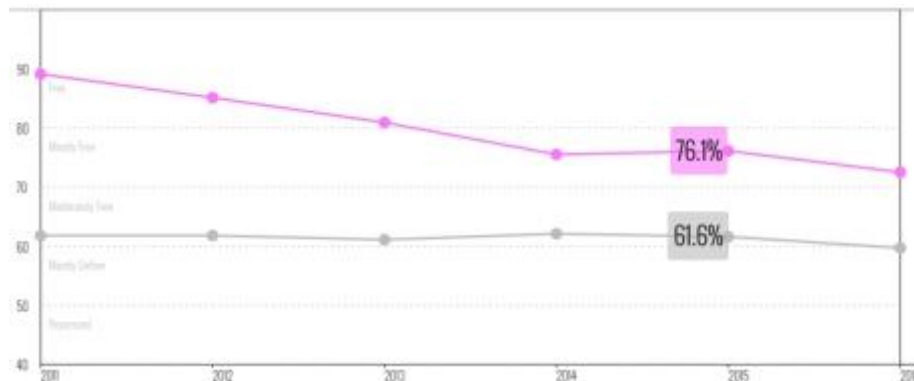
Human Capital index for Oman fluctuated between 0.62 and 0.71 through 2012- 2017. The 2017 index for Oman is higher than the average of MENA and higher than the average of the world as well (Figure 1). The value of the same index for Oman is higher than its value in Saudi Arabia while it's lower than the value of the index for Malaysia (Figure 2).

Table (10) Labour freedom index for Oman (2011-2016)

index year	labor freedom index
2016	72.5
2015	76.1
2014	75.5
2013	80.9
2012	85.1
2011	89.1

Source: World Bank. Retrieved from <http://www.heritage.org/index/explore?view=by-region-country-year>

Figure (11) Labour freedom for Oman v.s. the world (2011-2016)



Source: World Bank. Retrieved from <http://www.heritage.org/index/visualize?cnts=oman&src=country>

Although that labour freedom index for Oman dropped from 89.1 in 2011 to 76.1 in 2016, it still classified as a “Mostly free” market as shown in figure (11), which means high level of labour freedom from the regulatory perspective the legal and regulatory framework of a the labor market, including regulations concerning minimum wages, laws

inhibiting layoffs, severance requirements, and measurable regulatory restraints on hiring and hours worked.

Table no (11) Staff Training index for Oman (2011 – 2015)

year	Rank	Index value (out of 7)
2015	49	4.2
2014	68	4.0
2013	49	4.3
2012	33	4.5
2011	34	4.4

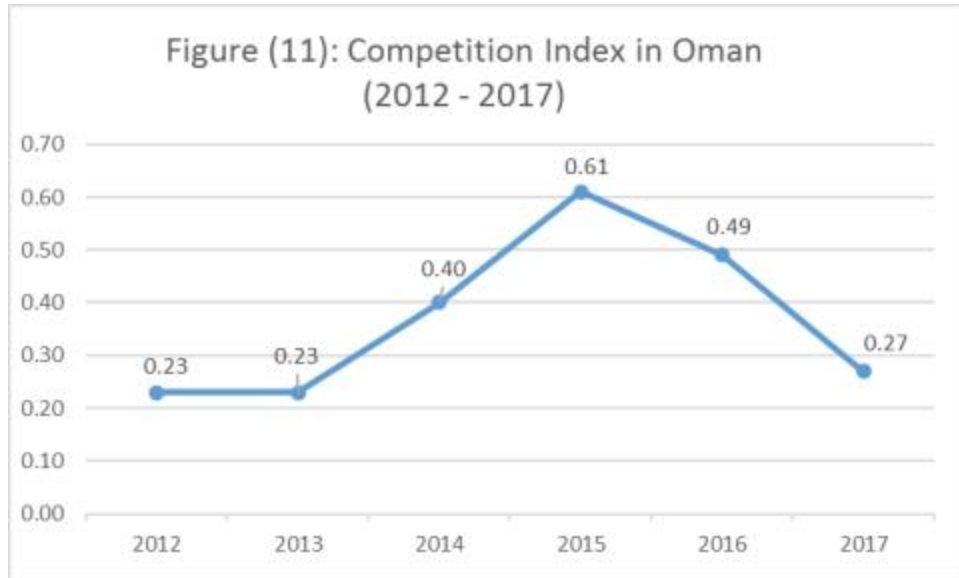
Source: World Economic Forum, *The Global Competitiveness Report*, various issues.

Staff Training index for Oman fluctuates between 4.0 and 4.5 through 2011-2015. This reflects a stability in the level of Omani investment in training and employee development.

### **Pillar 9: Competition**

Competition is a measure of a business's product or market uniqueness, combined with the market power of existing businesses and business groups and the effectiveness of anti-monopoly regulation.

The Competition institutional variable is the combination of Regulation and Market Dominance. The extent of market dominance by a few business groups is measured by the variable Market Dominance while the effectiveness of the regulatory bodies (Regulation) could also influence the level of competition in a country. (Calcagno & Sobel, 2014)



Source: Zoltán J., et al., (various issues), The Global Entrepreneurship Index, USA: *Global Entrepreneurship and Development Institute*.

Competition index for Oman increased from 0.23 in 2012 to reach its maximum (0.61) in 2015, then it decreased to reach 0.27 in 2017.

Competition index for Oman is lower than the average of MENA and lower than the average of the world as well (Figure 1). Moreover, competition index for Oman 2017 is lower than the same index for Saudi Arabia, and lower than the same index for Malaysia (Figure 2).

Market regulation is measured by the effectiveness of anti-monopoly policy index. Table (12) shows the value of this index for Oman dropped from 4.7 in 2011 to 3.7 in 2015.

Table no. (12) Effectiveness of anti-monopoly policy index for Oman (2011 – 2015)

year	Rank	Index value (out of 7)
2015	61	3.7
2014	90	3.6
2013	49	4.3
2012	19	4.9
2011	28	4.7

Source: World Economic Forum, *The Global Competitiveness Report*, various issues.

Table no. (13) Market Dominance index for Oman (2011 – 2015)

year	Rank	Index value (out of 7)
2015	110	3.2
2014	123	3.0
2013	80	3.6
2012	45	4.1
2011	61	3.8

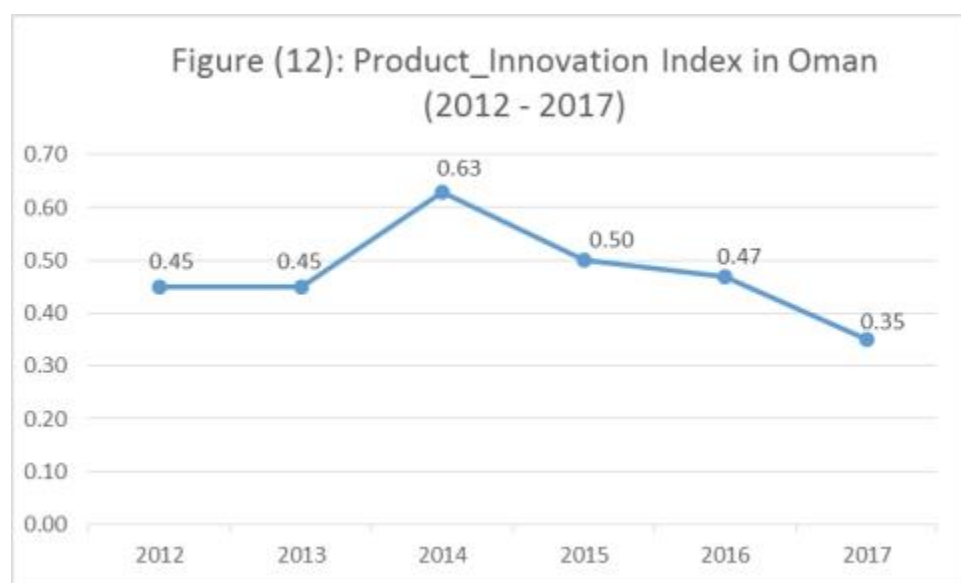
Source: World Economic Forum, *The Global Competitiveness Report*, various issues.

Table no. (13) shows that the market dominance index for Oman dropped from 4.1 in 2012 till 3.2 in 2015. The rank of Oman for this index is 110 (Out of 138 countries).

### *Entrepreneurial Aspirations Pillars*

#### **Pillar 10: Product Innovation**

Product Innovation is a measure of a country’s potential to generate new products and to adopt or imitate existing products. In order to quantify the potential for new product innovation, an institutional variable related to technology and innovation transfer seems to be relevant. Technology Transfer is a complex measure of whether a business environment allows the application of innovations for developing new products. (Autio, 2015)





Source: Zoltán J., et al., (various issues), The Global Entrepreneurship Index, USA: *Global Entrepreneurship and Development Institute*.

Product Innovation index for Oman increased from 0.45 in 2012 to reach its maximum (0.63) in 2014, then it decreased to reach 0.35 in 2017.

Product Innovation index for Oman is lower than the average of MENA and lower than the average of the world as well (Figure 1). The index for Oman 2017 is lower than the same index for Saudi Arabia, and higher than the same index for Malaysia (Figure 2).

Table (9) shows that the FDI and technology transfer index for Oman dropped from 4.9 in 2011 to 4.1 in 2015. Moreover, the rank of Oman for this index dropped from 45 to 85 for the same years.

**Pillar 11: Process Innovation**

Applying and/or creating new technology is an important feature of businesses with high-growth potential. Many businesses in developing countries may apply the latest technology through buying or copying it. The process innovation index is a combination of research and development (R&D), the quality of scientific institutions in a country (Scientific Institutions) and the availability of scientists and engineers (Availability of Scientist). (Audretsch. et al., 2014)



Source: Zoltán J., et al., (various issues), The Global Entrepreneurship Index, USA: *Global Entrepreneurship and Development Institute*.

Process Innovation index increased from 0.01 in 2013 to 0.31 in 2014. Then it fluctuated between 0.20 and 0.24 through 2015 – 2017. Process Innovation index 2017 for Oman is lower than the average of MENA and lower than the average of the world as well (Figure 1). Process Innovation index 2017 for Oman is higher than the index for Saudi Arabia. The value of the index for Malaysia is 340% higher than its value for Oman (Figure 2).

Table (14) Gross Domestic Expenditure on Research and Development in Oman (2011 – 2013)

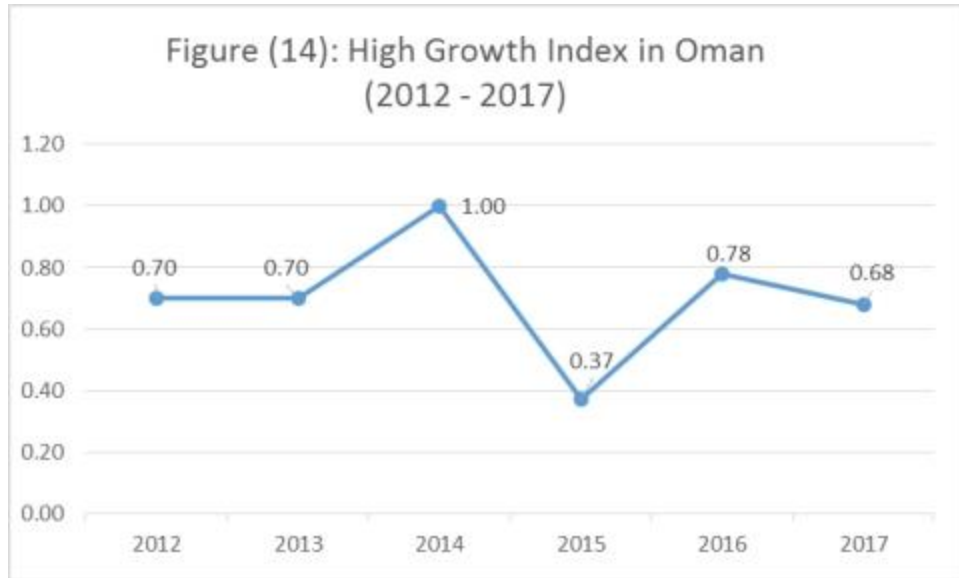
	Oman	Arab States	World
year	% of GDP	% of GDP	% of GDP
2013	0.171	0.3	1.7
2012	0.209	0.27	1.68
2011	0.136	0.27	1.65

Source: UNESCO. (n.d.). Retrieved from <http://data.uis.unesco.org/?ReportId=2656>

Table (14) shows that the percentage of Gross Domestic Expenditure on Research and Development in Oman is about 10% of the average percentage for the world and lower the average percentage for the Arab states.

### **Pillar 12: High Growth**

High Growth is a combined measure of the percentage of high-growth businesses that intend to employ at least 10 people and plan to grow more than 50 percent in five years (Gazelle variable) with business strategy sophistication (Business Strategy variable) and venture capital financing possibility (Venture Capital). It might be argued that a shortcoming of the Gazelle variable is that growth is not an actual but an expected rate. Business Strategy refers to “the ability of companies to pursue distinctive strategies, which involves differentiated positioning and innovative means of production and service delivery.” High Growth combines high growth potential with a sophisticated strategy and growth specific venture capital finance. (Wright & Stigliani, 2013)



Source: Zoltán J., et al., (various issues), The Global Entrepreneurship Index, USA: *Global Entrepreneurship and Development Institute*.

High Growth index for Oman increased from 0.70 in 2012 to reach its maximum in 2014, then it fluctuated till reach 0.68 in 2017.

High Growth index 2017 for Oman is higher than the average of MENA and higher than the average of the world as well (Figure 1). High Growth index for Oman 2017 is lower than the same index for Saudi Arabia, and higher than the same index for Malaysia (Figure 2).

### **Pillar 13: Internationalization**

The internationalization pillar is designed to capture the degree to which a country's entrepreneurs are internationalized, as measured by the exporting potential of businesses, controlling for the extent to which the country is able to produce complex products.



Source: Zoltán J., et al., (various issues), The Global Entrepreneurship Index, USA: *Global Entrepreneurship and Development Institute*.

Internationalization index for Oman increased from 0.44 in 2012 to reach its maximum (0.58) in 2015, then it decreased to reach 0.42 in 2017.

Internationalization index for Oman 2017 is higher than the average of MENA and higher than the average of the world as well (Figure 1). The Internationalization index for Oman 2017 is higher than the same index for Saudi Arabia, and higher than the same index for Malaysia as well (Figure 2).

Oman is the 57<sup>th</sup> largest export economy in the world and the 68<sup>th</sup> most complex economy according to the Economic Complexity Index (ECI). In 2014, Oman exported \$49.9B and imported \$31.1B, resulting in a positive trade balance of \$18.8B. In 2014 the GDP of Oman was \$81.8B and its GDP per capita was \$38.6k.

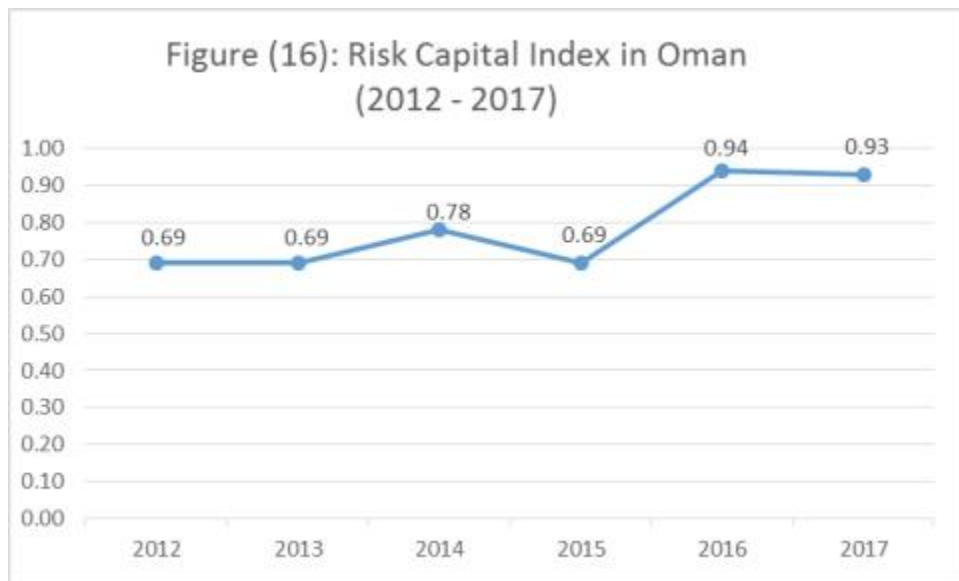
The top exports of Oman are Crude Petroleum (\$31.3B), Petroleum Gas (\$5.77B), Refined Petroleum (\$2.72B), Cyclic Hydrocarbons (\$1.21B) and Nitrogenous Fertilizers (\$745M). Oman top imports are Cars (\$4.34B), Refined Petroleum (\$1.63B), Delivery Trucks (\$950M), Iron Ore (\$932M) and Vehicle Parts (\$555M).

The top export destinations of Oman are China (\$23.2B), South Korea (\$4.51B), Other Asia (\$3.81B), Japan (\$3.71B) and the United Arab Emirates (\$2.02B). The top

import origins are the United Arab Emirates (\$9.4B), Japan (\$3.59B), China (\$1.62B), the United States (\$1.49B) and India (\$1.36B). (Observatory of Economic Complexity)

#### **Pillar 14: Risk Capital**

The availability of risk finance, particularly equity rather than debt, is an essential precondition for fulfilling entrepreneurial aspirations that are beyond an individual entrepreneur's personal financial resources. This index is a combine of two sub-indices: informal investment and the institutional depth of capital market (DCM).



Source: Zoltán J., et al., (various issues), The Global Entrepreneurship Index, USA: *Global Entrepreneurship and Development Institute*.

Risk capital index for Oman increased from 0.69 in 2012 to reach 0.93 in 2017. Internationalization index for Oman 2017 is higher than the average of MENA and higher than the average of the world as well (Figure 1). Moreover, The Risk Capital index for Oman 2017 is higher than the same index for Saudi Arabia, and higher than the same index for Malaysia (Figure 2).

#### ***Islamic Finance and the innate suitability for Entrepreneurship***

##### ***The risk sharing in Islamic Finance:***

The objective of Islamic finance is to promote sustained growth and full employment while contributing positively to poverty alleviation and, ultimately, to economic and social justice. This is achieved by institutionalizing the economic order on risk sharing based financing. Driven by the Quran and the Sunnah, the epistemological root of risk sharing, as the organizing principle of the Islamic financial system, is discernible from chapter 2 verse 275 of the Quran. This verse, in part, decrees that all economic and

financial transactions are conducted via contracts of exchange (*al-bay'*) and not through interest-based debt contracts (*al-riba*). It can be argued that risk sharing – the crux of Islamic finance – serves as one of the most important desiderata of Islam i.e. the unity of mankind.

Classical Arabic Lexicons of the Qur'an define contracts of exchange (*al-bay'*) as contracts involving exchange of property rights claims in which there are expectations of gains and probability of losses, see, for example, Al-Tahqiq Fi Kalamat Al-Quran Al-Karim; Lisan Al-Arab; Mufradat Alfaz Al Quran, Arabic Lexicon, among others. These sources define *al-bay'* as “*mubadalati al-maali bi al-maal.*” In English this can be rendered as “*the exchange of one set of property rights claim for another*”. By entering into contracts of exchange, parties improve their welfare by exchanging the risks of economic undertakings, thus allowing division of labour and specialization (see Mirakhor, 2011a). Since in the Verse the contract of exchange (*al-bay*) appears first and the prohibition of *riba* thereafter, it can be argued that requiring contracts to be based on exchange constitutes a necessary condition and “no-*riba*” the sufficient condition of existence of an Islamic financial system. Together, these conditions constitute the organizing principle of that system. The necessary condition (*al-bay'*) and sufficient condition (no *riba*) must be met for a contract to be considered Islamic. “A careful consideration of all the permissible contract modes that have reached us reveals them to be basically risk sharing contracts. The instruments designed to financially empower them must also be risk sharing instruments”.

Considering the aspects of an Islamic financial system based on risk sharing, where there is no room for any return that is determined ex-ante to the contractual outcomes, independent of any profit or loss, the system becomes one that is based on no risk free assets, where all the financial assets are contingent claims. It can be stated that shares or equity issues of corporations appear to best fit the criteria. In a typical risk sharing arrangement such as equity finance, parties share the risk as well as the rewards of a contract. Assets are invested in remunerative trade and production activities. The return to assets are not known at the instant assets are invested, and is therefore a random variable making equities risky. In equity investment, the income is random and depends on the performance of the equity investment i.e. the payoffs are contingent upon a certain state of occurrence; Akin to Arrow-Debreu securities.

***The Islamic Financial System:***

Based on the above discussions—with risk sharing and no-riba based financing as its chief tenants, an Islamic financial system can be envisioned as a two-tier financial system:

- ❖ A 100 percent reserve depository and safekeeping banking system for domestic and international payments.
- ❖ Equity based risk-sharing investment banking that places real saving directly in private or public projects or indirectly via the stock market. Investors are shareholders.

The first sub-system keeps money deposits in trust and settles payments via clearing, withdrawals and other forms of payments. The second part of the system receives savings, which it invests in productive projects or in more liquid investment such as mutual funds or stocks. Depositors receive transferable or marketable shares that enable them to liquidate their investment if they chose to do so. Returns from the funds invested are ex-post and are distributed to the depositors as to the shareholders of equity capital. As a result, they share in profits and losses as well as in capital gains and losses. Islamic capital markets intermediate between saving units and investing units through risk sharing. They would include investment banking, venture capital, stock markets, mutual funds, exchange-traded funds, crowd financing and other forms of intermediary risk-sharing institutions.

***How the risk sharing financial system (Islamic financial system) is healthy for the economy:***

Risk sharing via equity financing is not novel to economic endeavors. Historical accounts suggest that equity financing has been a centuries old phenomenon in the Muslim world as well as in Europe of the Middle Ages. Enterprises were established with share ownership and were recorded as share owned or anonymous enterprise. Among the most used instruments were the '*Mudaraba*' and '*Musharaka*' partnership contracts. Borrowed from the Muslims and later came to be known as '*Commenda*' and '*Maona*', such financing modes were commonly used for financing long-term trade and investment in Western Europe. Further historical research submit that Commenda's contribution to industrial development of Ruhr Valley in Germany and in building railroads in Europe were particularly pronounced The Goitein examination of Geniza records suggest that (i) trade in Middle Ages was both extensive and intensive, financed by risk sharing

partnerships; (ii) partnerships were used in industrial, commercial and public administrative projects; (iii) trade were largely not based on cash benefits or legal guarantees, but on the human qualities, mutual trust and friendship.

A number of influential scholars, in the past, proposed reforms that would abolish the credit system and replace it by an equity-based investment system. For instance, among the most celebrated proposals along these lines was the plan formulated in the University of Chicago, ‘Chicago Memorandum’ in 1933 which called for 100% reserve money and for an equity-based investment system. This would ensue in (i) Much better control of a major source of business cycle fluctuations, sudden increases and contractions of bank credit and of the supply of bank-created money (ii) Complete elimination of bank runs. (iii) Dramatic reduction of the (net) public debt (iv) Dramatic reduction of private debt, as money creation no longer requires simultaneous debt creation. A recent IMF study titled “the Chicago Plan Revisited”, found robust support for all of claims made in support of the proposed plan.

Comparing the features of debt and equity financing such as venture capital, Nobel Laureate Joseph Stiglitz argues that from the perspective of the entrepreneur, equity has two related distinct advantages. Risk is shared with the provider of capital, and there is no fixed obligation for repaying the funds. Thus, if times are bad, payments to the providers of capital are suspended. The firm will not face bankruptcy, and will not be forced to take the extreme measures intended to stave off bankruptcy. From a social point of view, equity has a distinct advantage: because risks are shared between the entrepreneur and the capital provider, the firm will not normally cut back production as much as it would with debt finance, if there is a downturn in the economy.

In addition, debt contracts need to be continually rolled over: as a result new credit supply is vitally important to the economy. Equity instruments are typically permanent; they do not need to be continually replenished each year; an economy could function for a period with new equity issue markets completely closed. Debt contracts in contrast have finite terms. Without continual refinancing, many otherwise solvent firms would go bankrupt. Oscillations in new debt supply are therefore potentially far more harmful than oscillations in new equity supply. It can hence be asserted that equity based finance, like venture capital, is stable as assets and liabilities adjust to shocks, given the automatic matching in risks, maturity and value, making the system immune to debt crisis



and more progressive. The economy will necessarily be driven by the rate of return to the real sector and will contribute to the same; ideally suiting the Omani/GCC ambitions of human development, increase employability and diversification.

***The risk sharing (Islamic finance) and Omani entrepreneurs:***

Given the recent times, the surging phenomenon of venture capital financing is a classic utilization and demonstration of risk sharing based financing. *It can be stated that there is an inseparable relationship between Islamic finance and venture capital, since the latter is based on risk sharing and no “Riba” based financing; the essence of Islamic finance.* Purely founded on the notions of Islamic *Mudaraba financing*, Venture capital (VC) is a type of risk sharing/equity financing that addresses, via pooled investments, the funding needs of entrepreneurial companies that for reasons of size, assets, and stage of development cannot seek capital from more traditional sources, such as public markets and banks. Obtaining venture capital is substantially different from raising debt or a loan. Lenders have a legal right to interest on a loan and repayment of the capital irrespective of the success or failure of a business. Venture capital is invested in exchange for an equity stake in the business. The return of the venture capitalist as a shareholder depends on the growth and profitability of the business. This return is generally earned when the venture capitalist "exits" by selling its shareholdings when the business is sold to another owner. Most venture capital investments are done in a pool format, where several investors combine their investments into one large fund that invests in many different startup companies, even SMEs. By investing in the pool format, the investors are spreading out their risk to many different investments instead of taking the chance of putting all of their money in one start up firm. By definition, VCs also take a role in managing entrepreneurial companies at an early stage, thus adding skills as well as capital, thereby differentiating VC from buy-out private equity, which typically invest in companies with proven revenue, and thereby potentially realizing much higher rates of returns.

The best demonstration of venture capital could be found in some European and U.S centers, mainly the Silicon Valley of the U.S, reaping enormous benefits from risk sharing/equity based financing. According to Cybercities (2008), in 2008, Silicon Valley was the third largest high-tech center (cyber-city) in the United States, behind the New York metropolitan area and Washington metropolitan area, with 225,300 high-tech jobs.

The Bay Area as a whole however, of which Silicon Valley is a part, ranked first with 387,000 high-tech jobs. Silicon Valley has the highest concentration of high-tech workers of any metropolitan area, with 285.9 out of every 1,000 private-sector workers. Silicon Valley has the highest average high-tech salary at \$144,800.

It is often argued from those who favour debt financing that the unprecedented development particularly in the last fifty years is essentially an outcome of the capitalistic system, based on interest bearing debt financing. To them the reduction, let alone elimination, of debt financing and bank money creation would reduce economic growth. The latter is an empirical issue that needs careful estimation alongside considering the social cost and benefits under such a regime. However, while not denying the development and overlooking the aspect of sustainable development, question arises as to how much of the ensuing development has only been through debt financing. It can be safely argued that most of the advances that seemed to have changed the dynamics of the world—particularly in the technological arena—have been through risk sharing modes than debt financing. To Askari et al., (2012), “much of the assumed contributions of finance over the last 30 or so years, and thus debt financing and leverage, have only been a mirage”, given also the pro tax and legal support. In Quran, Allah has ordained the believers, not to get discouraged by the apparent well-being of the non-believers (see chapter 43 verse 33-35).

In view of, for example, Oman/GCC’s economic diversification, increased employability and human development goals, recently a ground breaking development on the above lines took place. This relates to the formal announcement of the advent of venture capital in Oman. Kick-started by Oman’s first ever venture capital firm ‘*Ethmar*’, with an initial fund of RO10 million (USD 2.6 million). The VC firm is mandated to support innovative ideas of those who are not able to avail loans due to the high risk that their projects involve. In addition, the current laws and regulations can sustain such initiatives encouraging companies even from outside Oman to set up venture capital companies in the Sultanate, either as standalone or in partnership with companies in Oman. This development could be viewed as a major step towards achieving the above goals while securing a progressive and stable economy.

## DISCUSSION

The Omani entrepreneurship ecosystem pillars is analysed Using Global Entrepreneurship index (GEI) to explore the strengths and weaknesses pillars in the system. GEI for Oman from 0.37 in 2012 to be 0.44 in 2017 which reflect improvement in Omani entrepreneurship ecosystem as a whole. This improvement is generated from the improvement in many pillars (Sub-systems) in Omani entrepreneurship ecosystem, although that some pillars worsened.

### *Opportunity Perception:*

Opportunity Perception is one of strengths pillars in Omani entrepreneurship ecosystem. This strengthen is resulted from the high level of: Opportunity recognition and market size, freedom, and implementing more regulations and laws which increase the property rights in Oman.

### *Start-up:*

Start-up pillar in Oman is one of weaknesses pillars. This is resulted from the low position of Oman in the international rank for Tertiary education enrollment rate, Quality of the education system, and Quality of math and science education.

The main reason of the low level of start-up pillar is that the efforts which are taken to push this pillar up are recently taken. The entrepreneurship course in the universities and colleges will be applied by (2017-2018) academic year and the Bachelor degree in entrepreneurship is only one degree for the whole Sultanate and newly offered. Furthermore, the institutions which are responsible for stimulating entrepreneurs to start their own businesses have started few years ago (since 2013), so their influence in the entrepreneurship ecosystem will be seen by time.

### *Risk Acceptance*

Risk acceptance is one of strengths pillars in Omani entrepreneurship ecosystem. Moreover, the value of GEI Risk acceptance index growth rate was 14% in average through 2012 to 2017. This reflects a lower level of business constraints in Oman, as there are no capital or exchange controls which prevent an entity from converting local currency into foreign currency and/or transferring funds to creditors located outside, and there are no cases of force majeure. Moreover, the risk classification for Oman is at a lower level.

### ***Networking***

Although that networking indicator in Oman dropped from 2015 to 2017. This reduction is resulted from data unavailability about the quality of transport infrastructure.

By analyzing the individual data of urbanization in Oman, the networking level is high and stable which reflects that Omani governances and willayate become larger as more people begin living and working in central area.

Although that the data about the quality of transport infrastructure is not available. The Omani networking will significantly improve as a result of establishing new airports and new Omani economy airlines (Al Salam airlines) as well.

### ***Cultural Support***

Cultural Support is related mainly to the society view to entrepreneurs. The level of this pillar is in the middle level, it can be improved via dissemination of entrepreneurship for the population through the educational institutions and the media.

### ***Opportunity Start-up***

Opportunity Start-up in Oman is one of the strengths pillars. This is resulted from high level of governance in Oman. All the sub-indices of governance for Oman are strong for 2015. The strongest sub-index Political Stability, the second strongest one is Regulatory Quality, the third sub-index is Rule of Law, the fourth sub-index is Control of Corruption, and the fifth sub-index is Government Effectiveness.

The high level of these sub-indicators reflects a higher level of opportunity which stimulates for population to start-up their own business.

### ***Technology Absorption***

Technology absorption pillar is one of weaknesses pillars in Omani entrepreneurship ecosystem. This low level of technology absorption is generated from the low level of technology readiness (Availability of latest technologies, Firm-level technology absorption, and FDI and technology transfer).

### ***Human Capital***

Human Capital pillar is one of strengths pillars for Oman. This reflects High level education, mostly freedom of the labour market from the regulatory perspective the legal and regulatory framework of a the labor market, including regulations concerning

minimum wages, laws inhibiting layoffs, severance requirements, and measurable regulatory restraints on hiring and hours worked, and a stability in the level of Omani investment in training and employee development

### ***Competition***

Competition pillar is one of weaknesses of Oman entrepreneurship ecosystem. The main reason of this is mainly that the market is controlled by a low number of business groups and in turn, low level of market dominance index for Oman.

### ***Product Innovation***

Product Innovation pillar is one of weaknesses pillars of Oman entrepreneurship ecosystem. This reflects a lower potential of Oman to generate new products and to adopt or imitate existing products. The main reason of this is the lower level of technology transfer to Oman.

### ***Process Innovation***

Process Innovation pillar is one of weaknesses pillars of Oman entrepreneurship ecosystem. This is resulted from lower expenditure on R&D and lower availability of scientists and engineers.

### ***High Growth***

High Growth is one of strengths pillars in Oman. This reflects the high ability of Omani companies to pursue distinctive strategies, which involves differentiated positioning and innovative means of production and service delivery.

### ***Internationalization***

Internationalization is one of strengths pillars in Oman. This reflects that exporting potential for Omani businesses is high.

### ***Risk Capital***

Risk capital is one of strengths pillars in Oman. The capital risk index for Oman increased strongly between 2012 and 2017. This reflects an increase in: i) percentage of informal investors in the population age 18-64, ii) the size and liquidity of the stock market, and iii) the level of debt and credit market activity.

### ***The Impact of Islamic Finance***

Lastly and most importantly, the expansion of **Islamic finance** can positively influence the entrepreneurship ecosystem in Oman through improving many pillars of the same. (i) The first pillar can be improved via implementation of risk sharing finance in the “Opportunity Perception”, the same can increase the opportunity recognition (the first component in opportunity perception index). Risk sharing means no fixed obligation for repaying the funds which lead to more stimulation for entrepreneurs to identify good opportunities to start a business. (ii) The second pillar that can also be affected by the expansion of Islamic finance in Oman is “Opportunity Startup”. Implementing risk sharing based finance will minimize the cost of finance in the venture start-up, which, in turn, will motivate more entrepreneurs to start-up and get proper tools of finance for their new ventures. This also may improve “The Competition” pillar in Omani ecosystem, as the entry of new entrepreneurs in the market, which will be facilitated from risk sharing. This will not only reduce any market dominance but will also amplify overall market performance. (iii) Islamic finance will also add needed impetus to the pillar of “High Growth” pillar. The risk sharing phenomenon will increase venture capital financing possibility which is an important component of high growth pillar. (iv) Finally, the “Risk Capital” pillar will be significantly affected by the expansion of risk sharing finance. It will lead to entrepreneurial aspirations beyond an individual entrepreneur’s personal financial resources.

## CONCLUSION




The purpose of this paper was to analyze pillars of Omani entrepreneurship ecosystem to identify the areas of strengths and weaknesses which address the following research question “What are the strengths and weaknesses pillars in Omani entrepreneurship ecosystems?”

Omani entrepreneurship ecosystem has strengths in eight pillars: Opportunity Perception, Risk Acceptance, Networking, Opportunity Start-up, Human Capital, High Growth, Internationalization, and Risk Capital. Culture Support is a medium level pillar in Omani entrepreneurship ecosystem. There are 5 pillars represent weaknesses in Omani entrepreneurship ecosystem, which are: Startup Skills, Technology Absorption, Competition, Product Innovation, and Process Innovation. Table no. (15) shows the level of strengths for each pillar in Omani entrepreneurship ecosystem.

Omani entrepreneurship has weaknesses in three areas: The first area is related to the entrepreneurs’ start-up, the second area is related to the technological aspects even related to technology absorption or the innovation, the third area is the competition which Omani entrepreneurs may face in the markets.

Table (15) the level of strengths level for each pillar in Omani entrepreneurship ecosystem.

Global Entrepreneurship Index													
Attitudes Sub-Index					Abilities Sub-Index				Aspiration Sub-Index				
O	S	R	N	C	O	T	H	C	P	P	H	I	R
p	t	is	e	u	p	e	u	o	r	r	i	n	is
p	a	k	t	l	p	c	m	m	o	o	g	t	k
o	r	A	w	u	o	h	a	p	d	c	h	e	C
r	t	c	o	r	r	o	n	e	u	s	r	r	a
u	u	c	r	a	u	l	C	t	c	s	o	n	p
n	p	e	k	l	n	o	a	i	t	s	r	a	i
i	S	p	i	S	S	o	p	o	I	I	w	t	i
t	k	t	n	u	y	g	i	n	n	n	t	h	a
y	il	a	g	p	S	A	a		n	o	v	a	n
p	ls	n		p	t	b	l		o	v	a	l	l
e		e		o	rt	s			v	a	t	i	z
r				r	-	o			a	t	i	o	a
c				t	u	r			t	i	o	n	t
e					p	p			n	n			n
p						t							
t						i							
i						o							
n						n							

-  Strong Pillar
-  Medium Pillar
-  Weak Pillar

The expansion in Islamic finance can influence the entrepreneurship ecosystem in Oman through improving the following pillars: Opportunity Perception; Opportunity Startup; The Competition; High Growth; and Risk Capital.

More research can be carried out in the same field through implementing survey techniques to collect data from Omani entrepreneurs and assess the Omani entrepreneurship ecosystem pillars from the entrepreneurs' perspective. On the other hand, more research can be conducted to assess the level of impact of implementing Islamic finance of each pillar of Omani entrepreneurship ecosystem.

### RECOMMENDATIONS

- Functioning the implementation of entrepreneurship course as one of university/college requirements to increase students' awareness about entrepreneurship.
- Offer more higher education programmes in entrepreneurship specialization.
- Disseminate the awareness for entrepreneurship for the Oman population through the media institutions.
- Improve the level of technology readiness for Oman ventures.
- Decrease the high market dominance in Oman.
- Improve the technology transfer process to Omani firms.
- Increase the expenditure on R&D in Oman and increase the availability of scientists and engineers.
- Develop the proper Islamic finance tools for Omani entrepreneurs.
- Implement the risk sharing basis of finance for all institutions provide finance to entrepreneurs in Oman, as the Islamic Finance is suitability with the innate for entrepreneurship.

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## **INTRA-INDUSTRY TRADE DETERMINANTS BETWEEN MALAYSIA AND SELECTED OIC TRADING PARTNERS**

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### **ABSTRACT**

*This paper investigates the determinants of intra-industry trade focusing on manufactured goods at SITC 3-digit level by using panel data analysis for the year 1995 to 2015. Country-specific determinants such as economic differences between countries, scale of economics, foreign direct investment inflows, geographical distance and trade imbalance are tested in the model. The analysis focuses mainly on intra-industry trade between Malaysia and its OIC trading partners countries such as United Arab Emirates, Saudi Arabia, Oman, Turkey, Bahrain, Qatar, Kuwait, Iran, Egypt and Indonesia. The results indicate that intra-industry trade share for manufactured goods between Malaysia's and the selected OIC trading partners is positively influence by economic differences between countries and foreign direct investment inflows. However, determinants such as scale of economics, geographical distance and trade imbalance shows insignificant influence on the intra-industry trade share. This paper concludes that more appropriate and effective policies need to be formulated and implemented to accelerate more intra-industry trade between Malaysia and the OIC countries.*

**Keywords:** *Intra-industry trade, manufactured goods, panel data, OIC countries*

### **INTRODUCTION**

Intra-industry trade is a simultaneous export and import of similar types of goods or services belonging to the same industry. The phenomenon of intra-industry trade received world's attention as early as in the 1960s. However, solid theoretical foundation explaining intra-industry trade came later in the 1980s and 1990s with the literature were broadly based on monopolistic competition framework.

Intra-industry trade economic literature can be classified into two main groups. The first group focused on the intra-industry trade index measurement (see Grubel and Lloyd 1975) and the development of theoretical explanation of intra-industry trade which emphasize the role of product differentiation and increasing return to scale (see Krugman 1979, 1981 and Lancaster 1980). On the other hand, the second group (see Helpman and

Krugman 1985, Stone and Lee 1985, Chemsripong et. al 2005 among others) focuses on the determinants of intra-industry trade in an econometric framework.

Greenway et. al. (1994) has group the studies of intra-industry trade determinants into two group namely country-specific studies and industry-specific studies. Country-specific studies explain intra-industry trade through macroeconomic variables such as per capita income, economic dimension, geographical distance, relative factor endowments and foreign direct investment. Meanwhile, industry-specific studies explain intra-industry trade through variables such as scale economies, product differentiation and firm's concentration ratio. Most empirical findings support the country-specific determinants compared to industry-specific determinants.

This paper has identified several good reasons supporting the investigation on Malaysia's intra-industry trade particularly on manufacturing sector. Firstly, Malaysia is well known as one of the major trading country for manufactured products especially for chemical and chemical products, machinery, appliances and parts and electrical products. As pointed out by Marrewijk (2002) that the main characteristics of intra-industry trade is that intra-industry trade is particularly high for sophisticated manufactured products such as chemicals, machinery, and electrical equipment (which based on products differentiation and fragmentation). The second important empirical characteristics of intra-industry trade according to the author is intra-industry trade is particularly high for very open countries where both imports and exports account for more than half of GDP; thirdly intra-industry trade is connected to foreign direct investment inflows; and finally, intra-industry trade is related to preferential trade agreements. Malaysia has these characteristics; hence we perceive that it is relevant and significance to identify the determinants of intra-industry trade between Malaysia and its trading partners.

Following Shahbaz and Leitao (2010) in the static panel data models, pooled OLS, fixed-effects (FE) and random-effect (RE) estimators are used and the model is estimated in log-linear form. The rest of the paper is divided according to the following; literature review, research methodology, results and conclusion.

## **LITERATURE REVIEW**

One of the most important characteristics which influence the volume of trade is the size of the economy. Helpman and Krugman (1985) pointed out that the larger an economy,

the larger its' domestic market size and hence create greater possibilities to reap the economies of scale and increase the variety of products. A larger economy size also reflects a greater demand for foreign differentiated goods. They further pointed out that the share of intra-industry trade in manufactured goods tends to increase as the average market size of the two countries increase which is also due to the presence of economics of scale. Hence, this means that intra-industry trade tends to increase as the average economic size of two trading countries increase.

The similarity or difference in the size of economics of trading partners defines the ability of that country to produce differentiated products. Linder (1961) as noted in Shahbaz and Leitao (2010) among other interpret the difference level of income per capita as differences in demand structure i.e. consumers taste and preferences. It has been argued that as per capita income of two countries become equal, their tastes and preferences also become similar. Another view was pointed out by Helpman (1981) that a similar level of gross domestic products indicates the similar ability to manufacture differentiated products, hence if the size of economics of trading partners is similar they are likely to trade with each other.

Grubel and Lloyd (1975) and Greenaway and Milner (1986) among others had pointed out that in the presence of demand for different varieties of the same products with production subject to economies of scale, there may be a tendency for foreign direct investment and intra-industry trade to go hand in hand. On this ground then the association between the intensity of foreign investment and intra-industry trade is expected to be positive.

According to Grubel and Lloyd (1975) distance between trading partners serves as a proxy for costs of information necessary for trading non-standardized products. Therefore, it is argued that distance will increase the transaction costs including insurance and transportation costs. Geographical closeness might also be a measurement of psychological and cultural similarities which have the possibilities of creating similar consumption patterns and increasing trade in differentiated products. Stone and Lee (1995) further noted that physical distance also acts as a natural trade barrier that deters trade proportionately more for closely substitutable products that for standardized products.

Measurement of intra-industry trade will be affected by the trade imbalance of a country (Grubel and Lloyd 1975). The greater the share of net trade, the smaller the share of intra-industry trade, therefore the Grubel-Lloyd index becomes smaller as the size of the trade imbalance increases. According to Clark and Stanley (1999) the estimated coefficient in the intra-industry trade regression equation will be biased if the trade imbalance is correlated with the explanatory variables. Hence the size of the trade imbalance is included in the analysis to control for any possible bias in the estimation.

Empirical investigation for the above-mentioned country-specific determinants are massive and very rich. These studies include countries such as Australia (Matthews 1998 and Sharma 1999), Korea (Lee and Lee 1993), United States (Clark and Stanley 1999), Spain (Martin and Blanes 1999), Mexico (Ekanayake 2001), Thailand (Chemsripong et.al 2005), Turkey (Turkcan 2005), Portuguese (Faustino and Leitao 2007), Zimbabwe (Sunde et.al 2009) and Pakistan (Shahbaz and Leitao 2010) among others. The empirical findings from these studies show that the relationship between the trade index and the determinants are according to the theories described by the scholars.

### ***Malaysia's Intra-Industry Trade***

Malaysian economy has always been trade dependent, influenced by both its major trading partners and the commodities prices. The rising share of manufactures in the total exports of Malaysia for more than three decades was proven to be a result of the growing volume of intra-industry trade flows. Table 1 shows the total trade volume between Malaysia and the selected OIC trading partners (please refer to the appendix). The data indicate that trade volume from 1995 until 2015 shows an increasing trend with the largest trading partner in 2015 is Indonesia (USD 15,450,756), followed by United Arab Emirates (USD 6,160,744), Saudi Arabia (USD 2,812,079) and Turkey (USD 1,449,589).

Ariff (1991) as in Ariff and Chye (2003) estimated the intra-industry trade index at 3-digit SITC level for each of Malaysia's major trading partners with respect to manufactures over period from 1970 to 1987. The result indicates the rising indices at that period which shows significant increase in Malaysia's intra-industry trade with its major partners as early as the 1970s. The study identified a significant increased in Malaysia trade vis-a-vis the United States, the Northern Asian (NIEs) and the ASEAN partners. The growing importance of intra-industry trade during that period was attributed largely to the

activities of MNCs. The MNCs operated in Malaysia had generated both exports and imports through their international investment and trading networks.

Min (1992), Thorpe (1993), and Duc (1994) as noted in Chemsripong et. al. (2005) had done similar analysis on Malaysia. Min (1992) examined the determinants of bilateral trade in manufactures between Asian developing countries namely China, Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand and developed countries namely the United Kingdom and the United States. Thorpe (1993) also examined the determinants of intra-industry trade of three ASEAN nations namely Singapore, Malaysia and Philippines and their trading partners over the period 1970-1989. The result shows that the levels of bilateral trade between the countries appear to have risen not only with one another, but also with countries outside the region. Duc (1994) investigated the determinants of IIT between 10 Asia-Pacific region countries namely China, Hong Kong, Indonesia, Japan, Malaysia, Philippines, Taiwan, Singapore, Korea, Thailand with the United States from 1980 to 1990. All these studies concluded that country characteristic factors such as income per capita and openness of the economy, capital endowment and economic size are important determinants of bilateral intra-industry trade between these countries.

Since 1996, some studies (see Menon 1996 and Khalifah 1996, 2000) had focused on the extent of intra-industry trade among ASEAN free trade area (AFTA) countries. Menon (1996) result shows that more than 75 per cent of the growth in Thailand's intra-ASEAN trade between 1986 and 1991 was due to intra-industry trade growth, while in Malaysia and Singapore the percentage was above 60 percent. For Indonesia and the Philippines, intra-industry trade growth accounted for almost half and one third of the growth in intra-ASEAN trade. This study concludes that not only intra-industry trade recorded rapid increased amongst ASEAN countries, but it also has become increasingly significant within these countries compared to with developed countries.

Khalifah (1996, 2000) investigates the extent of intra-industry trade in manufacturing sector and the changing structure of merchandise trade balance. The pattern of intra-industry trade show that Singapore's contribution is the highest followed by Malaysia, Thailand and Indonesia. The result also shows that on top of other sectors, G-L index in the electronic sector increased from 28 per cent in 1990 to 45 per cent in 1997, and the electronic machinery sector sustained surpluses of between 4 to 6 per cent of total trade

from 1992 until 1997. While the trade share of the primary sector decreased from 30 per cent of total trade to 16 per cent from 1990 to 1997.

Brulhart and Thorpe (1999) investigate the structure of East Asian trade flows over the high-growth period of 1970-1996. The result found that despite the different development levels of the four countries namely Korea, Malaysia, Indonesia and Philippines, the static intra-industry trade (Grubel-Lloyd index) and the marginal intra-industry trade has grown steadily over the period of study. In 2000, Brulhart and Thorpe again investigate the association between intra-industry trade and marginal intra-industry trade with employment changes in Malaysia between 1970 and 1994. The empirical result showed that both trade indices exhibit continually increasing trends during the period studied. The steep and continuous increase in Malaysia's trade orientation represent by the total trade as a percentage of Malaysian GDP rose from 73.4 % in 1970 to 160.7 % in 1994. Hence shows that Malaysian trade expansions have gone together with an increase in the share of intra-industry trade.

As such, this paper has provided the calculation of intra-industry trade share for manufactured goods (SITC 5 to 8) and total all products (SITC 0 to 9), between Malaysia and selected OIC trading partners. The trade share calculated for both classification of products is shown in Table 2 (please refer to the appendix).

## **RESEARCH METHODOLOGY**

### ***Intra-industry trade index measurement***

The unadjusted Grubel-Lloyd (G-L) index is the most popular measurement and had been used by many empirical researchers. This method was introduced by Herbert G. Grubel and P.J. Lloyd in 1975. The index determines the extent of intra-industry trade using Standard International Trade Classification (SITC) at 3-digit level which measures the proportion of intra-industry trade in total trade rather than of the absolute amount of intra-industry trade itself. The IIT index is calculated as follows:

$$IIT_{ij} = [ 1 - |X_{ij} - M_{ij}| / (X_{ij} + M_{ij}) ] \quad (1)$$

where the subscript *i* denotes industry and the subscript *j* denotes country; *X* denotes exports and *M* denotes imports of the related industry and country respectively. The



computed value of IIT<sub>ij</sub> lies between 0 and 1. The closer the value of the index to 1 the greater is the degree of intra-industry trade.

### ***Variables Description and sources***

In the analysis, this paper uses intra-industry trade (IIT) index as the dependent variable and country-specific characteristics as explanatory variables. The intra-industry trade index between Malaysia and trading partner countries are calculated using trade data published by United Nation Comtrade Database (UNCTAD). The data set is annual and runs from 1995-2015. It consists of export from Malaysia and import to Malaysia from ten selected OIC countries, at the 3-digit level Standard International Trade Classification (SITC).

The data for the explanatory variables is sourced from the World Bank and International Monetary Fund report, except the data for geographical distance's calculation which is sourced from CEPII (Geodesic Distance) website. As such, the explanatory variables and expected sign are as follows:

1. Difference in economic size between trading countries – which is define as difference in gross domestic products (PPP) in current international US dollars. The expected sign is positive.
2. Average economic between trading countries – which is define as average in gross domestic products (PPP) in current international US dollars. The expected sign is positive.
3. Foreign direct Investment - which is define as the foreign direct investment inflows in current international US dollars. The expected sign is positive.
4. A proxy for the geographical distance between trading countries - which is define according to Stone and Lee (1995) and Balassa (1986) as the average of the distances (in kilometres) between the two capital cities of both trading countries weighted by the size of the economy of the respective country. The expected sign is negative.
5. Trade Imbalance - which is define according to Stone and Lee (1995) as:

$$TIMB_j = [X_j - M_j] / (X_j + M_j)$$



where  $X_j$  is exports to country  $j$  and  $M_j$  is import from country  $j$ . So TIMB is approximately zero if trade with a country is balanced and one if the country either exports or imports exclusively. The expected sign is negative.

### ***Model Specification***

Following Shahbaz and Leitao (2010) and Faustino and Leitao (2007), the model is specified as follows:

$$\text{LogIIThjt} = \beta_0 + \beta_1 \text{LogDGDPPhjt} + \beta_2 \text{LogAGDPPhjt} + \beta_3 \text{LogFDIhjt} + \beta_4 \text{LogDISThjt} + \beta_5 \text{TIMBhjt} + \varepsilon_{it} \quad (1)$$

where subscript  $h$  denotes ‘home country’ Malaysia, subscript  $j$  denotes each trading partner country individually and subscript  $t$  denotes year ( $t = 1, \dots, 15$ ); IIT denotes the unadjusted Grubel-Lloyd index of manufactured goods at 3-digit level (SITC 5 to 8 excludes 667 and 68); DGDP denotes the differences in per capita gross domestic products; AGDP denotes the average per capita gross domestic products; FDI denotes the Foreign Direct Investment inflows; DIST denotes the geographical distance between the two capital cities of the trading countries; TIMB denotes the proxies of trade imbalance; and  $\varepsilon_{it}$  denotes a random disturbance assumed to be normal and identically distributed (IID)  $\sim (0, \sigma^2)$ .

## **RESULTS**

From the OLS regression estimation, explanatory variables such as difference in economic size, foreign direct investment, distance and trade imbalance are statistically significant with the directions as hypothesized in the previous section. The goodness-of-fit measures for OLS estimation;  $R^2$  is 0.169 which indicate a low variability of the observed data in the models. Although the coefficient computed represents statistically significant value, a potential problem that may arise in cross-sectional and time-series model is inefficient result attribute to heteroskedasticity and autocorrelation. As such, the test to identify these problems is conducted using the White’s general test and Wooldridge test. The result failed to reject the null hypothesis of both test which produced  $\chi^2$  of 73.35 ( $p=0.000$ ) and  $F(1,7) = 5.373$  ( $p=0.000$ ), respectively. Hence, the standard errors computed in the OLS estimation are biased and this will lead to bias in test statistics and confidence intervals.

The OLS coefficient estimate is also biased as the regression does not consider the unobserved factors for country and time characteristics that are correlated with the variables in the model. Substantively, fixed effect and the random effect models are performed to study these changes. The statistic for Hausman test is  $p = 0.056 > 0.05$ , hence leads to strong rejection of the null hypothesis that fixed effect provides consistent estimates and favours the random effect result. The random effect regression result shows that only difference in economic size and foreign direct investment are statistically significant while, average gross domestic products, geographical distance and trade imbalance are insignificant.

Difference in economic size shows that the difference between per capita incomes which is used to evaluate the similarities in demand, taste and preference between trade partners; presents a statistically significant positive sign. This result is according to empirical studies by Chemsripong et al. (2005) and Faustino and Leitao (2009). The findings also show a positive relationship between the trade share and the proxies for foreign direct investment which is consistent with Greenaway et al. (1994) findings. Table 3 (please refer to the appendix) shows the regression results for Fixed and Random Effect estimation.

## CONCLUSION

The objective of the study was to analyse the determinants of intra-industry trade for trade of all products and manufactured goods between Malaysia and its OIC trading partners countries. The econometrics estimations and the coefficient generated support the hypothesis as formulated. Difference in per capita income presents a positive impact on intra-industry trade which is consistency with the theory of differences in factor endowment while average per capita income as a proxy to describe economic dimension (in term of product differentiated and economies of scale) is proven to have positive influence on intra-industry trade share and is also according to the literature. This study also found the expected negative sign of geographical distance which has confirms the theory related to cost of transportation and distance in the gravity model.

The analysis of intra-industry trade pattern between Malaysia and OIC countries show that the trade share between Malaysia particularly in the manufactured goods is still low. Some of the justification to this finding could be relate to short time period studied and the products group aggregation. As such, further study should focus on the analysis of

distinct groups of products to have a detail picture of the trade structure between Malaysia and the OIC countries. The finding also suggests that more of appropriate and effective policies need to be formulated and implemented to generate more trade between Malaysia and the OIC countries. For example, the policy related to priority and challenges of transport corridors (TC) among the OIC countries which is very significance in economic development and trade facilitation and the role of IDB group in facilitating trade among the OIC countries particularly on the issue of cross-border cooperation and roles of customs administrations need to be further address.

Another important aspect of future research analysis is to focus on disentangle vertical intra-industry trade (VIIT) and horizontal intra-industry trade (HIIT). This distinction is important as pointed out by Kinnerup (2005); because the theories of both types of trade lead to contradictory hypotheses regarding the determinants however this approach was empirically under-researched previously due to lack of methods to delimit VIIT and HIIT from each other. Many empirical analyses had used total IIT as the dependent variable, hence as consequent different econometric analyses had resulted in different conclusions. As such the findings of this paper can be improved if the econometric analysis or the measurement aspect is differentiated between vertical and horizontal intra-industry trade types.

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## Appendix

**Table 1: Total Trade Volume between Malaysia and Selected OIC Countries**  
(in thousands of dollars)

Year	1995	2000	2005	2010	2015
<b>Country</b>					
United Arab Emirates	721,357.2	1,159,956	2,610,043	6,148,666	6,160,744
Saudi Arabia	450,656.2	838,085.1	2,075,639	2,901,743	2,812,079
Oman	50,922.08	400,646.9	451,436.3	265,806.5	582,195.6
Turkey	371,954.6	304,901.6	842,812.4	795,379.8	1,449,589
Bahrain	63,089.09	82,964.04	149,672.6	184,460.2	111,976.7
Qatar	35,634.99	71,943.77	164,333.1	404,252.4	817,146.2
Kuwait	172,163.9	167,789.5	449,238.8	556,793.1	895,337.9
Iran	145,896.3	225,821.2	707,076.1	743,855.1	178,855.6
Egypt	282,605.5	240,520.7	496,519.2	1,516,996	818,510.3
Indonesia	1,753,469	3,100,615	5,579,826	14,780,10	15,450,75

Source: Author's calculation based on UNCTAD database (2016)

**Table 2: Intra-Industry Trade Share between Malaysia and Selected OIC Trading Partners  
for All Products and Manufactured Goods**

Year	SITC 0 to 9					SITC 5 to 8				
	1995	2000	2005	2010	2015	1995	2000	2005	2010	2015
<b>Country</b>										
United Arab Emirates	0.099	0.519	0.584	0.766	0.987	0.045	0.040	0.060	0.074	0.172
Saudi Arabia	0.804	0.676	0.470	0.616	0.625	0.534	0.553	0.532	0.560	0.636
Oman	0.344	0.213	0.275	0.643	0.809	0.236	0.031	0.070	0.655	0.823
Turkey	0.709	0.348	0.224	0.348	0.655	0.485	0.221	0.124	0.352	0.510
Bahrain	0.824	0.717	0.557	0.744	0.964	0.174	0.074	0.069	0.210	0.210
Qatar	0.949	0.612	0.720	0.823	0.524	0.970	0.412	0.536	0.619	0.799
Kuwait	0.999	0.952	0.619	0.352	0.251	0.009	0.678	0.746	0.866	0.793

Iran	0.574	0.881	0.984	0.929	0.936	0.642	0.207	0.227	0.096	0.055
Egypt	0.079	0.129	0.148	0.153	0.602	0.135	0.101	0.120	0.212	0.277
Indonesia	0.876	0.728	0.770	0.762	0.968	0.866	0.601	0.755	0.876	0.817

Source: Author's calculation based on UNCTAD database (2016)

Note: SITC 0 to 9 (Total all products)

SITC 5 to 8 (All manufactured goods less SITC 667 and 68)



**Table 3: Fixed and Random Effects Results for Intra-Industry Trade Determinants**

Variable	FE	RE
LogDGDP	0.248	0.283*
	(0.90)	(2.17)
LogAGDP	3.770	0.249
	(1.95)	(1.15)
LogFDI	0.007	0.095*
	(0.09)	(2.35)
LogDIST	-2.457*	-0.191
	(-2.01)	(-1.84)
TIMB	-0.603	-0.856
	(-0.74)	(-1.31)
_cons	7.908	7.278*
	(0.98)	(2.41)
Observations	210	210

Notes: <sup>1</sup>t-values and <sup>2</sup>z-values are given in parentheses.

legend; \* p<0.05; \*\* p<0.01; \*\*\* p<0.001

## ON THE MIND AND SPIRIT OF ISLAMIC FRAMEWORK FOR ECONOMIC JUSTICE

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### ABSTRACT

*The aftermath of recent financial crisis has added fresh impetus to the belief where non-adherence to business ethics is viewed a powerful contributor to the fallouts. Scholarship has asserted on deducting and decoding the nexus economic behavior for economic justice; sufficing it as pivotal for the development of the societies. It has been shown that absence or lack of understanding and hence attaining the same has resulted in mal-distribution of income and wealth and economic resources. This has intensified class culture and breed of economically deprived. Different strand of theories were put forward in explaining the notions and the relationship of the same. Consequently, a number of models and frameworks has been circulated, over the decades, to provide philosophical underpinnings. The current study will not only dwell on the known theories of ethics and justice but will put forward a relevant framework from an Islamic perspective. It will be argued that a system based on the proposed framework not only offers a unique and all-encompassing institutional configuration to ensure economic justice but simultaneously provides a complimentary scaffolding of base rules that essentially maintains the same.*

**Keywords:** *Business Ethics, Theories of Justice, Economic justice, Islamic framework*

### INTRODUCTION

With the adoption of market capitalism, it was not before long, the proponents started realizing the side effects in terms of creating huge amount of poverty and economic injustice. Consequential were the writing of the scholarship, including that of Karl Marx's anti-capitalism analysis and the views of known social scientists (see later). In essence, to secure economic justice, the scholars prescribed the need for clearly defined common behavioral rules which will establish operational limits for the market system and government behavior. As a result, the most important job of the state viz-a-viz the society was viewed to define just rules for market behavior; rules that not only support the market but also to provide the desired behavioral framework, without which the market cannot function. Nevertheless, what

remained dominant amidst the philosophical and pragmatic disclosures was the Keynesian view. Advocating an interventionist approach, the societies began to look towards governments to try to adopt ways and means through which the negative impacts of market capitalism could be reduced. Governments thus became an intervener in the market or in the economy. As a result, masses related governments as ‘night watchmen’ in market capitalism, while making sure that people do not infringe on other’s rights. Apart from this, governments had no other business in getting involved in the economy.

While dissecting Keynesian prescription, it commanded a crucial contingency. Keynes(1936) argued that market capitalism, if left to it-self, would create two major problems. These are (i) poor income and wealth distribution and (ii) the fact that this system is incapable of creating full employment (see Mirakhor and Krichene, 2008;\_Mirakhor and Shaukat, 2012, 2013; and Shaukat and Alhabshi, 2015). Keynes’s claims of poor income and wealth distribution could be further validated by a recent study which showed how high leverage and crises can arise as a result of changes in the income distribution (Kumhof and Ranciere, 2010). The authors empirically showed that the periods 1920-1929 and 1983-2008 both exhibited a large increase in the income share of the rich, a large increase in leverage for the remainder, and an eventual financial and real crisis. Keynes solution was the “*euthanasia of rentier*” by socializing financial resources through which financial capital would be provided for investment without the intermediation of the rent seeking class of the money lenders (Mirakhor and Shaukat, 2012, 2013 and Shaukat et al., 2015).\_Concluding to the necessity of political/government intervention for the survival of such a system, Keynes eventually advocated that governments could control the means to equilibrate economic results.

Question arises, how one would judge that a given policy, an action or a given behavior is beneficial for the economy. To answer the same, philosophers, ethicists and social scientists got involved into a debate arguing that the best way to do is to look at some criteria of ‘*Justice*’. It was basically to see whether or not certain policy, action or behavior is ethical. Consequently, sufficing ethics became a criteria for judging a just approach/outcomes. Ensued were an array of ethical and justice theories. ‘*Ethics*’ are a particular view of actions and there consequences based on some criteria that determine, whether or not a given action matches the expectations of those criteria or not. In this respect, there were controversies even among the ethicists, the philosophers and the social scientists, trying to judge the ethical or moral aspect of economic policies. It is noteworthy however that all these endeavors were

an afterthought or ex-post of the system's adoption of the policies and the resulting damage. However, what made the judgement difficult was the dependence of selected criteria on the views of the ethicists, philosophers or/and social scientists.

Before the study provides brief on these criteria, in order to craft the nexus between ethics and (economic) justice, it is pivotal to first briefly discuss the notion of a state versus government, the origins and the implications of the embryonic relationship for crafting the overall fabric of a societal behavior. This is served by section two. In section three the study provides discourse in the prescribed roles of the state towards serving the desired social behavior. To attune the same towards economic justice, section four philosophically indulges into important behavioral notions and add, to the discourse, known theories of justice; that are either implied by or enshrined on the given pattern of social behavior. Section five brings , in detail, the Islamic position in to discussion and provides crucial insights to establish superiority of the same for better economic justice. Section six concludes the study.

### **UNDERSTANDING STATE FROM GOVERNMENT**

Efforts to differentiate between a 'State' and 'Government' generally end up by terming both as same. However, it is not common knowledge as to why the governments came into being and the logic behind. Could it be not possible that the societies be run without a government or would the absence of government create anarchy. It is possible to have anarchy where there is no government, but people could still cooperate and practice cohesive behavior for individual and societal benefits. For that to happen, there has to be a common reference point, individuals must be willing to help each other; they should be close to one and other so that they know the common needs. So the question is where do governments come from and why we have them?

The answer can be traced from observing situations where common beliefs and value system necessitate 'Individuals' to form 'Groups', the exact rationalizes groups to form 'Communities', communities to create 'Societies. Communities though may have some different values or beliefs, but will form societies because of the collective benefits via cooperation in a shared worldview. This agreement of a society, leads to set behavioral rules that need to be monitored in order to serve the interests of the society, the society feels necessary to create rules (institutions) which may be authoritative where the society or a state has invested reinforcement and sanctions on violation of these rules. A society can create many such authoritative institutions or rules, for example, a court system which in most

countries is independent of government. Eventually societies form a 'State'. It is the states that originate/create 'Governments', with the view that the later will go on to make just policies to serve common interests.

While the state vests the power to government, it is expected that the later will serve the desired interests by constantly yielding welfare and stopping self-interested individuals from violating those interests. The government is hence mandated by the state to create policies to achieve the aims the later has conceived from it. However, if the policies fail to meet the ends, the state has the power to institute and force changes. Given that the world views and beliefs of communities are being shared by the ensuing societies, this in turn creates values and preferences. These preferences are then translated into the decision making and behavior or action of a society, giving birth to the notion of '*Rational performers*': arguing that people perform rationally i.e. their actions are '*reasoned based*'. The notion of rationality has been looked into in some detail and has yielded many forms. Among the forms is the kind of rationality based on common belief system where as another form include '*Scientific Rationality*' where if a certain process, performance or action can be explained and justified by scientific reasons, only then it is considered rational.

Rationality also has forms called '*Ends Rationality*', '*Means Rationality*' and '*Ends, Means Rationality*', '*Revealed Preference*' and the '*Consistency of Inconsistency*'. The first directly relates to the concept of '*deontological*' which will be dealt later. It argues that if the ends of a certain action or decision are consistence to a certain common belief system, it is considered rational. If the means to achieve something are in line with the beliefs, it falls into the category of means rationality. However if both the means and the ends are in consonance to the beliefs, then it is '*ends, means rationality*'. The '*Revealed Preference*' which does not care for ends and means and is only interested for the preference of, for example, a certain individual to be revealed by even pure observation. The '*Rationality of Irrationality*' is quite reminiscent to the '*Consistency of Inconsistency*'.

Keeping in view the above back ground, it is known that today most societies, if not all, are 'Pluralistic' societies. It means that they are made of groups, communities, societies where each of them, have their own world views. How these societies came into being and how did they create the required solidarity to keep society together, for example, Malaysia which is made up of different world views. They did this by reaching an agreement to disagree while observing fully the notion of '*Tolerance*'. This creates and further nurtures the feel for

respecting each other's worldviews, consequently to achieve common goals and benefits for the whole society. Subsequently this forms an '*All inclusive society*' rather than an '*All exclusive society*' which, could challenge the existence of the society it-self, creating anarchy even in presence of state and government. Such outcomes are based on '*Intolerance*' where a group or few groups, insist that their world view have to dominate the rest.

It is important to understand that the sustainability or continuity of a society depends on the degree of 'Tolerance'. Therefore there are then set of rules of mutually accepted behavior created to achieve the common goods or benefits for the society by observing tolerance. Complete compliance to these rules, creates 'Utopia' as opposed to anarchy. The society thus can be defined as *a collective human community, held together by set of rules which are born out of the necessity of these communities to live together and share the gains of collective action*. There are two basic rules which will keep a pluralistic society together: (i) Mutual respect and (ii) Tolerance. Trust and reciprocity also play an important role to keep such a together and preserve the solidarity of it. Going back again as to why states and governments are formed? As discerned earlier that the communities and societies need to make rules and those rules needs enforcement. The challenge to the state is to create an incentive structure in order to address a major problem that every society faces and that is the problem of '*Coordination*'. *As perquisite to (economic) justice, a society would always want to narrow the divergence between the interests of public and private sectors through mutual cooperation, trust and coordination and to have these interests to converge.*

There are lots of ways of showing why it is such a necessary thing and also a huge challenge. This could be further understood, by using an example of a society made up on only two individuals engaged in a productive activity, creating pay-offs. The activity can be creation of goods and services or even money creation. Because they later form a society and in that society, they interact with one and other; they form strategies (a way of proceeding to decide an act when there are others involved whose decision will affect your outcome or vice-voce) which governed by the self-interested behavior of these individuals, revolve only around an individual's own maximum interest. The two strategies are then either to cooperate or do not cooperate and compete. If both individual cooperate, they, for example, get 10units each. If one cooperates and the other does not, the ratio gets say 12:2 as one party is taking advantage of the other's cooperation vice voce. However, if they both compete, they will end up with 5 units each which is quite less. The 5:5 appears to be the only solution for societies which are

governed by self-interest and does not help public interest (though through learning experience they may end up later choosing options which have public interest).

Public interest is in the totality of gains/payoff which is highest for the two in cooperative arrangement with no lack of interest. Thus individualism cannot nurture the societies therefore it is important to create a societal agreement and come up with rules/institutions and policies that govern such outcomes. Hence a state has all the power to govern, coerce or take corrective actions in order to sustain the solidarity of the society; meaning to ensure a coordinated behavior. As explained, it will achieve this via mandating the government to assure suitable policy action and incentive structures for people to cooperate and serve the required purpose. Of course the most important purpose is that of wellbeing and welfare of the society. Enshrining a just society. The government can impose a penalty in case of violation of the societal contract by parties. All in all, to achieve (economic) justice, a state via the government performs dual function: policing to ensure that private structure do not diverge too much from public interest and incentive creation to encourage the convergence of interests.

In today's market system, a given state is basically such that it displays three major characteristics: **(i)** by virtue of being born in that state, a person becomes a member of the state **(ii)** Modern states are permanent. In other words you may have different governments but the state are a permanent existence. **(iii)** The states are the only monopoly the only possessors of means of violence, it has the force or coercive power to compel people to do things according to the rules or not to follow them. In other words, it is the compulsive ability of the rules laid down by the state that make people to comply with the rules. However, in an Islamic state you comply with the rules because you are answerable to Allah swt: *No one can compel you.* The states in Muslim countries/societies have coercive power, but that is only to stop people from hurting each other. This power is used also to converge the individual interest with the interest of the society as a whole. The characteristic of the Muslim society is basically the interest of the community according to the specifications of the Quran and Sunnah; *so the above three characteristics are of the states that have market system in them.* It is thus necessary to have procedures to select the governments that will implement the objectives laid down by the state. This brings into discussion that once selected, what then are the functions of a government from an economic point of view? The discussion is pivotal to understand the whole scheme of ensuing economic justice.

## **ROLES OF GOVERNMENT FROM ECONOMIC VIEW POINT**

First of all is the 'allocative function'. It means that the government operates in this system as a seller and buyer that effects how the resources of the society are going to be allocated. Recall that one of the characteristics of the market system is that individual through exchange decides the allocation of resources. Government, alongside the individual producers and consumers, is an additional actor in allocation of resources. By virtue of its power to tax and spend, it effects the function of allocation in the economy. It also has a 'Regulative role'. One disadvantage of market system is that it sometimes fails to look after the interest of the society. As market mechanism has no conscious; it does not recognize any bad or good and has no ethics. As a result, it operates on the Quid-pro-Quo rule: The more the Quid processed the more the Quo in return. It means that part of the population, lacking quid, will not be served by the market. What transpires is thus a market failure: markets failing to provide the sort of commodities the society may need or the market was abused by the more able. The government regulative power is invoked in order to correct for market failures. For instance, what does the government do in order to reduce the impact of free-riders? What is done to reduce externalities, for example, environmental pollution which market itself cannot handle. Governments' regulative role is to try and combat the impacts of such market behavior. This role of government protects citizens; for example the licensing procedures for doctors or pharmacist or physicists. One part of this regulative role is 'Authorization': for example, only the authorized doctors are allowed to practice and treat people.

Now comes the 'Distributive' role of government. This function of the government essentially relates back to the allocative role given the government itself is a market player. The role brings into discussion the basic questions of (i) *what to produce?* (ii) *How to produce?* (iii) *Who gets what has been produced?* The latter is essentially a question of distribution making the presence of governments crucial. Again as a buyer and seller of things, performing allocative role, it acts as player in the markets, affecting the distributive function of the market system. The fourth role is 'redistributive' role. On the question of 'who gets who', as mentioned earlier, a lot of people could be left out because they may not have the Quid to get the Quo. The governments then take from those who had the quids and distribute to those who need the quo. This redistribution is normally performed through taxation, regulation or any mean they can find to affect redistribution.



The fifth function is ‘Stabilization’. One of the problems of market systems is that it can fluctuate, prices, production, output, investment, income, employment can go up and down and going up and down damages people. There are winners and losers. Sometimes losers lose more than the winners win. Nevertheless this fluctuation is very difficult for people and have impacts on their lives. Government tries to reduce these fluctuations (elsewhere the authors have discussed what policy prescriptions are adopted or required to assure stabilization. See for example, Shaukat. M., Bushra. S., 2017 and Shaukat. M., 2017). The sixth one is ‘Growth’. Since population grows the economy has to grow too. The size of the pie has to get bigger to accommodate the growth in population. Economic growth becomes an important function of a society that has a market system. The government tries to ensure to take decisions and actions that encourage growth so that with the growth of population the economy grows and people who do not have as much as they need, benefit with the growth of economy.

Finally the seventh role is that the government is the ‘risk manager of the society’. The society faces enormous amounts of risk; the simplest for is the internal and external security even natural disasters or competitions coming from outside. Governments come in where the private sector fails to provide the kind of insurance that can protect the people from various kinds of risks to their lives. For instance government can use its tax power or spending; in fact all of the above roles or powers can be used to manage risks to in a society. In the best of market societies, the government becomes risk managers of the last resort. In other words it will only get involved to manage the risk the private sector does not or fails to handle. For example, livelihood of people can be subjected to risks, the same could get unemployed and cannot find or get insurance. Government hence provides employment insurance. All in all, for government to perform all its roles, policy prescription is the approach. As a result, it is then extremely crucial for policies to be in consonance to the common interests and desires of the societies/states. The policy makers hence need to be in complete cognition with their understanding of the psyche and philosophy of individual and common behavior.

### **THE NEXUS OF (ECONOMIC) BEHAVIOR AND (ECONOMIC) JUSTICE**

When it comes to indulging into behavioral studies, there are the two important notions of (i) ‘*Teleological*’ or consequentialist versus (ii) ‘*Deontological*’. The former basically directs one’s focus on the end-state i.e. the consequence. Every action has to be decided by its consequence as satisfied by the phrase ‘*ends justify the means*’. ‘Deontological’ on the other

hand is rule based and says that actions are appropriate on their own and that no end can justify the obligations attached to following the rules, no matter what that end state maybe. In other words not all actions are justified by their end-state. These are duties and obligations that has to be attached with, regardless of the end state that you consider.

A clear line of demarcation may appears between the two concepts, but it may not be as clear, for example, when the latter states that it does not matter from where the rules and obligations come from, but one must stick to them and there is no justification to deviate from them even if the end state turns out to be not very good. Supposing that one source is the Quran and the Sunnah of the Prophet (Peace Be Upon Him); the question is that are these 'deontological' or 'teleological'. Looking at the Quran it is absolutely clear that there are rules with which one has to comply, but some people think otherwise too saying that if one follows these rules, there is an end-state i.e. 'Jannah/heaven'. Thus there is already a mix of two notions as it depends on the person which way he/she is looking at it.

### ***Equality, Equity and Western world view of Economic justice***

Prior to explaining the concepts of justice, there are two more concepts that needs to be dealt with. (i) 'Equality' and(ii) 'Equity'. 'Equality' for example, means equality of income and equality of wealth and so forth. 'Equity' means justice in that. For instance, there might be an unjust society but have equal income distribution or the other way round. The other concepts are those of 'Endowment' and 'Contribution'. These are necessary to understand before talking about the theories of justice reply on them. 'Contribution' is basically an obligation to contribute to the society and that obligation decides the Quid for the pro Quo. 'Endowments' is the right to property before you actually enter the market i.e. how much wealth or income one has. These endowments are the starting points for everybody. In other words what does one have to begin the life and this effect everything? Endowment decides the opportunity in the economy as one participates in the market and if you have no endowment at all then it offers no opportunity for effective participation. Endowment also is very crucial in terms of how much the society has produced you will get; your share depends on your endowment in terms of wealth, income, status, the resources or property even the physical and mental ability (these are actually the endowments that come from Allah swt) one has prior to entering the market.

This brings to attention the concept of 'efficiency' versus 'equity': most economists believe that market capitalism is efficient which simply means one is getting most output with least

possible resources. Of all the characteristics available, the study will just talk about two of them as they relate directly to the discussion of an ideal Islamic system in section five. One of them is '*Utilitarianism*' which comes from utility meaning satisfaction/pleasure. The idea came from a philosopher/economist by the name of 'Jeremy Bentham'.

Jeremy Bentham used his idea as basis for a rational behaviour of human being. According to him Utility is the main motivation for humans towards any action, however, this may vary in duration, certainty, propinquity, purity, fecundity and extent. Bentham not only believed in measurability of utility but also its comparability among individuals. That's where he started talking about maximization of pleasure and minimization of pain and mixed ethics and moral philosophy with economics. The utilitarian idea is and hence, end-state ideas, making it fall in the category of 'Teleological'. On the basis of Bentham theory, there are three main components of Utilitarianism

(i) '*Sum-ranking*'- According to him, an individual knows his interests better than anyone else, while utility is comparable among individuals. Therefore total utility/satisfaction of any society/community is combination of utilities of all individuals in the society/community. Suppose we have 'N' individual with U utilities by each individual in a society/community. Summing up all these utilities ( $U_1+U_2+\dots+U_n$ ) constitutes the aggregated or total utility/satisfaction in the society.

ii) '*Welfarism*' -This implies to those moral principles which can maximise the good of a society. The only criterion for anything under this category is the index of utility; the whole idea is that the individual is the locus of utility and nothing else. In other words all we want to know is: what is the total satisfaction of an individual, from a particular commodity, behaviour or policy etc. beyond that individual does not matter. In a situation where there two policy actions available or a comparison of two end-states, the notion of aggregate utility say that you take the policy action which provides maximum pleasure to maximum number of people. This then becomes an 'Aggregate Utilitarian Position'.

Though this may not be very hard to accomplish sometimes, it may actually create injustice especially Bentham did not believe in involvement of government as opposed to Adam Smith. For example society is made up of two people, one (rich) person is getting 1200 utilities of say a given commodity from a given policy while the other one gets 200 utilities, making aggregate or sum of utilities to 1400. If a policy decides to increase the rich's utility to 2000 and the other's to 400, the total now is 2400. The 'Aggregate Utilitarian Position'

will suggest to implement the policy as the total utility of the society has increased; over all society appears better off. There is also the idea of '*Average Utility*' which says that take a policy which augments the utility for the average individual in a society. Even the application of average utility concept will result in injustice among individuals.

The major weakness of this ideology lies in its major fundamental assumption that all are equal and pleasure/happiness which is derived from any commodity/policy is same for all. This assumption, however, does not have any support from reality. John Rawl (see later) rejected the fundamental postulate of utilitarian theory that allows losses to individuals if aggregate gains of society overbalances the loss as morally it is not suffice to be acceptable. Moreover, to link satisfaction of an individual to economic conditions only does not have enough grounds from reality. Bentham though believed in lassies-faire economy, however, he has emphasised on certain legal reforms for improving the overall utility of the society via improvement in individual's utility-August Comte later presented complementary relationship of Individualism and Altruism; one's satisfaction is positively linked with community satisfaction and vice a versa. This has influenced the emergence of Socialism and later Communism during 19th and 20th centuries. Coming back to the idea of '*Average utility*', the next component is that of '*Paretianism*' after Wilfredo Pareto, an Italian economist in the 1890s.

Though Pareto is a utilitarian but refuses to measure utilities in cardinal numbers, arguing on the grounds of justice (it cannot be distributed based on the fact that money means less to the rich than to the poor by lowering from 1200 to 700 and increasing from 200 to 700 while total utility remaining the same). He thus came up with the idea of '*Ordinal ranking*'. Let the person tell how he/she would rank among e.g. policy actions and then take that ranking, sum it over an ordinal utility space and get the total utility of the society, but Pareto put on a criteria known as '*Pareto Optimal*'.

It says that a state 'S' is a Pareto optimal state of a given system if it is impossible to find alternate state of that system in which "*we can make one person better off without making others worse off*". So a policy is Pareto optimal, if there is no other way to change that as by doing so would make one person better off without making other worse off. In other words, making somebody better off but not at expense of other is a Pareto optimal policy. This indicates that Pareto's primary focus was on interdependence..However, it is important knowing that a Pareto efficient economy refers to maximisation of aggregate economic

welfare for given distribution of income with specific set of consumer preferences (Levin, Jonathan 2006, 11). Therefore alteration in income distribution will result in a new equilibrium point by changing consumer preferences. This implies that there is an infinite number of Pareto optimal equilibrium points given there is infinite number of ways in which income is distributed.

There is another criterion called '*Pareto Superior*'. Say we again have a state  $S'$ . It says that if there is another state called  $S^1$ , in comparison to  $S'$ , at least one person is better off in  $S'$  than  $S^1$  and no one is worse off in  $S^1$  than in  $S'$ . For example, In Islamic system, at least one person is better off than in a capitalistic system and there no one better off in a capitalistic system than in an Islamic system. The importance of these criteria is their use as measure of 'efficiency'. If the situation or policy is 'Pareto Optimal', select it. If 'Pareto Superior': definitely select it. According to Pareto, overall economic welfare (economic-efficiency and wellbeing) requires essentially dualistic approach to study economics and social phenomenon Pareto himself offered distinction between Economic Welfare and Social Welfare (well-being) through distinction in their origins; Optimality and Utility. Utility according to him refers to 'useful' or 'opposite to harmful' to wellbeing while Optimality implies to sensation derived from satisfaction of wants and desires and is linked with economic welfare. Pareto highlighted the focus on sociology with respect to maximisation of utility and discussed two stage process towards this end; (i) first stage is about establishing individual's social utility function (ii) a political attempt to transform the social utility of all individuals into single unit (utility) of community by holding individual's utility constant. Hence government policies can help in redistribution of economic goods(McLure, Michael 2013, 21:22).

The determination of Pareto superiority does not require interpersonal comparison. It is important noting that Pareto-efficiency of material resources can coincide with well-being only in a case where one is dependent only on one's own resources. However, this is not realistic assumption, there prevails interdependency of resources among individuals. Under these circumstances, Pareto efficiency with respect to material resources does not necessarily coincide with Pareto efficiency with respect to well-being. However, these are correlated through the initial distribution of resources; by reducing inequality on level of material resources may helping in improving Pareto-efficiency in terms of well-being (Hansson,S. 2004). Pareto himself offers justification of government involvement under his Social Welfare approach for maximisation of utility.

However, we should be aware that by offering distinction between economic welfare and wellbeing Pareto delinked the idea of maximisation of utility from economics. Moreover, his approach to maximisation of utility under sociological framework makes the assumption of holding individual utility function constant for transforming utility as homogenous commodity over the time when government is implementing policy towards the objective (McLure, M. 2010). Consequently, assumption makes end-result volatile and unsustainable. This brings in to discussion 'Liberalism'. Recall that 'Utilitarianism' works just on the end state and it does not care about individual other than saying that it is a locus of utility and that how it will be measured. Also remember that we want to talk about the difficulties of these systems for justice, how do you measure justice because if you have efficiency, you may miss on equity (an efficient system can be 'Pareto Optimal' and Pareto superior' but not be equitable and has not justice in it). (Levin, J. 2006, 4)

'Liberalism' focuses only on individual one way or the other. The underlying concept is 'Freedom' or 'liberty' (of individual). Three most important ideas are related to this concept of 'Liberalism'. The first are the ideas of *John Rawls*. Taking influence from Classical & Social Contract theory of eighteenth century and being Kantian in nature, John Rawls presented his Theory of Justice, where justice is defined as fairness (Bronfenbrenner, M. 1973, 21:22). He himself called his theory a construction of a workable and systemic moral conception to oppose utilitarian. Being a proponent of justice over efficiency, he presented his Two Principled based Theory of Justice with the assumption of "Veil of Ignorance". As Rawls believed in Procedural Justice, the idea of Original Position was imperative to set up a fair procedure because in this manner any principles agreed to that condition will be just. However, to identify original position Rawls makes a big condition of Veil of Ignorance defined as:

*"Parties do not know certain kinds of particular facts. First of all, no one knows his place in society, his class position or social status; nor does he know his fortune in the distribution of natural assets and liabilities, his intelligence and strength and the like. Nor, again, does anyone know his conception of the good, the particulars plans of life, or even the special features of his psychology such as his aversion to risk or liability to optimism or pessimism. More than this, I assume that the parties do not know the particular circumstances of their own society."*

According to Rawls, the condition of Veil of Ignorance makes possible a unanimous choice of a particular conception of justice-individuals' consent to justice which is crucial for justice of institution. With the assumption of consent of self-interested rational individuals behind the Veil of Ignorance, Rawls presented his vision of a just society through two principles (Garette, J. 2011, Arneason, D. 2008) as follows;

1. **Equal Liberty Principle:** This first principle is the liberty principle and is egalitarian; according to this principle, each person has got equal right to the most extensive basic liberties like political liberty, freedom of thought, freedom of speech, freedom of conscience and rest. This implies that each individual has got the right to have as much liberty as he can, however, that should not infringe liberty of other individuals. It is important noticing that Rawls is classical liberal who believes in individual liberty without any involvement of government.
2. **Social Inequality Principle:** This second principle suggests that social and economic inequalities can create a just society only if they are (a) to the greatest benefit of the least advantaged persons, and (b) attached to offices and positions open to all under conditions of equality of opportunity.

Second component of second principle is egalitarian as it recommends equal opportunities for all, however, first components recommends compensation for the disadvantaged group. This is also known as the *Difference Principle*. This principle of Rawls though allows merit principle- use of special skills/talent/abilities should be rewarded benefits in proportion to skills/talents/abilities, however, this will be conditional to improvement in overall wellbeing of the disadvantaged group. In other words any economic inequality is justified only if it is in maximum advantage of least well-off. While discussing Rawls theory, we should not forget that the lexical order between two principles and within principle is as important as principles themselves. According to him the first principle has got priority over second one while for second fair equality of opportunity has lexical preference to Difference Principle. With the help of lexical preference, Rawls tries to overcome initial inequalities which he calls "deep" as one does not have much control on those.

The two principles are of Rawls intended to be applicable to the basic structure of society i.e. institutions, these are not for actions by governmental officials or individuals. And this has attracted criticism especially from Welfare Economist like Sen. Rawls despite being concerned about basic structure of society focused on just institutions rather than the just



society. Rawls is making an assumption that by laying just institutions, appropriate behaviour of individuals will be ensured which is not necessarily the case. This theory of Justice is also being criticized by advocates of both Desert-Based Principles and Resource-Based Principles because according to both groups this is neither sensitive to incentives or ambitions (Doody, R. 2015, Sullivan, S.O and A. Pecorino, P. 2002) . While agreeing to their criticism, we think that this is not realistic; one would like to have benefits in light and proportion to their own actions/resources and no such situation prevails, there is a greater possibility of decline in productivity/efficiency. However, the main criticism of the theory is on its underlying assumption of Veil of Ignorance. The impracticality of the assumption undermines the utility of Rawlian theory for creating justice in the society.

While the school of Rawls is found wanting, Robert Nozick submitted his position on economic efficiency and justice. To Nozick it is imperative to also discuss the Entitlement Theory-a theory of distributive justice by Robert Nozick through which he criticises Rawls for mandating government for its involvement (Lucibella, C. 2009) to extend fair distribution. He is against the conscious effort to ensure fair distribution as he believes in invisible hand of market that leads to fair distribution through free exchange of goods. Nozick theory is procedural; it is historical and not patterned; not linked with any other filter like moral merit, social justice or usefulness of society. He offers three following principles as basic requirements for a distribution to be just distribution

(i) Principle of Justice in Acquisition. Acquisition is allowed only in a just way. This implies that an individual can own an object/property only if that object/property is not owned by any other individual earlier (Conway, D 1990, 2).

(ii) Principle of Justice in Transfer. If a person acquires any holding in a just manner, he has got the right to transfer its holding for other holding acquired justly. However, the principle that Nozick applies on such transaction is that by acquisition/ownership of the object by an individual, no one else is made worse off. In this second principle, Nozick takes help of John Locke's proviso that an individual can own anything but he does leave 'enough and as good' for others. In other words since acquisition of holding by one, other though cannot appropriate but just the acquirer, however, that can be used by others especially if it falls in category of necessity. However, owner may charge any price and on basis of this even monopoly appears acceptable as long as others have got enough purchasing power. Another element of concern with this principle is that Nozick has not provided any basis to indicate



whether people have become worse-off or not. He did reject baseline offered by Rawls's theory to explain being worse off - a person must be no worse off than he would be under any other possible arrangement -but remained unable to offer his own (Kilcullen, R.J 1996)

(iii) Principle of Justice in Rectification- Violation of principle 1 and 2 leads to the status where rectification is desired. Nozick himself realised that it is not necessary that masses will abide by rules mentioned above and when these rules are violated, injustice is inevitable. Nozick allows government intervention in these scenarios. In other words government involvement is allowed only in case when direct injustice occurs. Just acquisition being central to his attacks on distribution schemes of egalitarian liberalism, he emphasizes on historical perspective to check injustice (Lucibella,C. 2009).

This is the distinct feature of Nozick like libertarians who believe that individuals should pursue their self-interests without any interference of the government; government or state's role should be minimal , restricted to only protection against force, theft, fraud, enforcement of contracts, and so on (Rentmeester, C. 2014). This argument has serious implications for society in terms of creating inequalities. However, it appears that Nozick does approve such inequalities rather doesn't consider these unjust. According to him, one has the right to keep what one earns only and only if that is earned in a just manner (in accordance to his above mentioned principle). Therefore, any kind of taxes or policies of government that can alter the distribution of resources by shifting some resources/benefits from haves to have-nots is not approved.

The most probable reason for Nozick to disapprove redistribution mechanism as recommended by justice theories is that these theories do ignore the interaction of production and distribution. However, according to him laissez faire works effectively in leading market to equilibrium. This is agreeable that market leads to efficient allocation where each agent is paid his marginal product, but it all depends upon initial endowment which Nozick completely ignores. Market-demand and supply forces can act as self-correcting mechanism only when initial endowments are suitable redistributed (Varian, Hal R. 1975, 235).

As we will see in section five, the point of 'endowment' is very crucial for these views of justice as well as for Islamic view. Both the views of Rawls and Nozick are hypothetical states. Where one is playing a mind game and the other is imagining. The third view is that of economist James Buchanan. A Nobel Laureate and the architect of "public-choice theory",

Buchanan is in his book “*Reasons for Rules*”, also starts from a ‘natural state’; sooner or later there will a social contract which will then be enshrined in the constitution, specifying the rules according to which the society has to operate. Buchanan (1791-1868) has introduced ethics and social thinking into Economics. There were three distinct postulates of his economic thinking;

- (i) Social order in its standard sense is not scientific
- (ii) Government is not a benevolent despot
- (iii) Rejection of postulate that allocative efficiency is an independent standard of evaluation

His postulates were based on the premise that human conduct is purposive and forward looking in all disciplines including politics and economics. He has used the same rationale in his Public Choice Theory for successful explanation of government failures. He was not in agreement with collective problem solving theory of neo-classical. He rejected the idea that government can correct markets because he believed in wealth trading and rent seeking behavior of individuals forming government or involved in legislation process. Buchanan rejected the assumption of neo-classicals that governments will do anything and everything in favour of masses or for balancing macro-economic condition. He explained his rejection by identifying politicians/governments like any other individual, who are influenced by their personal interests. In order to favour their political agenda, governments in general are inclined towards discriminatory distribution, favouring one particular group, to enhance overall utility of the community. He used Philips Curve (trade-off between unemployment and inflation) to explain the discrimination that unemployment is addressed through increasing income of a particular group instead of changing the general aggregate demand/price level (Wagner,R.E. 2009). This kind of actions/policies results in creating political business cycles

According to Buchanan, policy making is a process instead of a single action and this postulate has helped him in providing explanation of his second rejection to neo-classical regarding cost/pricing of any action. According to neo-classical, failure of government in terms of macro-economic imbalance is owing to the cost not observable to internal but external agents only. Buchanan defined price or cost as the market value of the alternate product that might be produced by rational reallocation of resource inputs to uses other than

that observed (Thomas J. Dilorenzo 1990). Hence, the cost or consequences of actions of governments are known to them but to anybody else.

Therefore on basis of his above mentioned postulates it can be inferred that political business cycle of economic instability is the conscious policy of politicians as it supports/favours their political agenda. They are able to manipulate voters/ community in general because the only agent that can have access to complete information of any policy/action is one who is implementing it. This has also provided basis to Buchana for not approving John Maynard Keynes's support of big government deficit for boosting a sagging economy. For him the monopoly of government over resources especially on money and credit leads to political generation of economic disorder which causes a cost to overall community in the long run. The fiat currency where government does not have to pay much as exchange of printing money and bad consequences which can negatively affect their political agenda appear with lag, it gives more manipulating power to government. That is what made Buchana believed in institutions than government as correcting entities.

Buchana believed in exchange rather than maximization postulate as according to him market is never competitive by assumption or by construction; exchange makes it competitive (J. Boetick et al 2005). Moreover, it is always internal not external rules that leads to general equilibrium. However, there is a paradoxical situation here; if Buchana's basic principle of being driven by self-interest is applied then nothing can work as correcting entity if there are no checks in fundamentals of economic system .This implies that if economic system allows elements like interest, speculation, excessive uncertainty, risk transfer then even self-correcting market mechanism will create injustice affecting the sustainability of overall welfare and wellbeing of the society. Here Islamic economic system provides solution by having inbuilt checks and balances on increasing one's welfare without compromising on interests of others (see section five).

Another Nobel Laureate Amartya Sen (2009), has also addressed this issue in some detail by building further on the above contribution. Sen (2009) recommended alteration in Rawls institutional framework to make it more inclusive of such disabilities. He suggests shifting from “resource perspective” toward “capability perspective”. Sen argues that “capability metric is ‘superior to a resource metric because it focuses on ends rather than on means, can better handle discrimination against the disabled, is properly sensitive to individual variations

in functioning that have democratic import, and is well suited to guide the just delivery of public services, especially in health and education” (Sen, 2009, p. 263).

This implies that the state would tax the upper strata of the society to address the capability needs of the lower strata of the society. Public services on the other hand are assumed to be inefficient in comparison to private enterprise, from a neo-liberal perspective (Starr, 1990; World Bank, 1995). The private education or health care system therefore is assumed to provide good quality services to only those who can afford, as compare to the rest who are entertained by the public education and health care system. This eventually makes those belonging to the upper strata of the society more competitive as compare to the poor eventually keeping them worse off as compare to the advantaged ones, who eventually becomes capable to take away the lion’s share of the resources. The problem therefore remains unsolved.

Sen, despite being on the same epistemological plane as of Rawls, differs with him on justice in three ways. Firstly he suggests that justice is comparative, rather than ideal or transcendental (Sen, 2009, p. ix). Secondly it is pluralist in valuation, as in his view “we can have a strong sense of injustice on many different grounds, and yet not agree on one particular ground as being the dominant reason for the diagnosis of injustice” (Sen, 2009, p. 2). And finally it focuses on lives of human beings and their behaviors, rather than institutions (Sen, 2009, p. x).

Difference between Sen and Rawls position exemplifies a dilemma in liberal discourse on the concept of justice, i.e. since the beginning of the discourse; a universal and sustainable idea, theory or criterion to impart justice hasn’t been worked out. Rather scholars and academics have worked out their respective ideas on justice and economic-justice customized and compartmentalized for the needs of a particular time and space. For example, Rawls and Sen have worked together, and does agree on lots of different aspects of their theory, however since both of them have been raised in different parts of the world therefore (Rawls was from America, and Sen was raised in India) their perception about the nature and dynamics of injustice prevalent across the globe differs substantially as well. Even Kolse has addressed this problem by referring to the introduction of capital intensive technologies which replaced labor creating the problem of employment and correct determination of wage value. This problem in his view was not witnessed in pre-industrial economies (Kelso & Adler, 1958, p. 73).

This eventually makes ones think about the possibility of someone coming forward in near future, who would highlight the inconsistencies and limitation of Sen's idea of justice in some new emerging scenario at some place in the globe and present a new customized alternative. This implies that liberal conception of justice is therefore unsustainable and cannot be universally applied all across the liberal world due to difference of economic conditions, culture etc. Societal and technological changes also make an idea irrelevant for the new age, keeping the need to constantly work on the improvement and its empirical testing of new the idea so that its ability to ensure justice is confirmed, however keeping in view the pace of technological and societal change across generation of the contemporary world, it seems quite unlikely for an idea to concretely establish and ensure justice in the modern liberal world; before a new idea of justice would establish on theoretical and empirical groups, it may already be obsolete, in authors view.

All in all, from Buchanan to Rawls to Nozick and to Sen, all appear to concur that if people are left without being under the influence of any coercive power but ensure that no one will step into others rights, they will come up with a social contract of there-own, ending up having a '*Minimal state*' who would be like night watchmen, making sure the rights of people are not violated. In such a situation, if the 'initial endowments' are achieved through justice i.e. through absolute freedom and liberty of individuals, then that is justice and individuals having full liberty, negotiates with one and other and some body gives up something willingly while being absolutely free, is fine. *It means that the inequalities in the society that have come up because somebody willingly gave up his share, is fine and there is no reason for government to get involved.* Note that under this system, one can also sell oneself to slavery based on the notion of willingness. In other words the society has no right to legislate morality. *The ethics of the situation have served by respecting the rights and liberty of individuals.* Such a system will not work in reality as has been the case with capitalism, creating huge inequality. So a 'Just' state is one that obeys the rules or which is 'rule-compliant'. The problem with this (which is very important) is that people who get involved in the social contract today will have to answer the next generation who may not want to follow the constitution. Therefore the rules to be followed should be generational, dynamic and universal in any time and age while being immutable is essence and results.

## **THE ISLAMIC POSITION ON (ECONOMIC) JUSTICE: A RULE COMPLAINT REGIME**

Whereas the western philosophies and the humanly plausible scientific deduction has dug deep to explore insightful, yet imperfect, behavioral notion and theories for economic justice, Islamic has simply one rule: “*Giving everyone their right due*”. The colliery of this rule is “*putting everything in its rightful place*”. The question is how do we do it? How do we know that everyone is given their right due and everything is put at its rightful place? This can only be achieved by being rule compliant; the rules/institutions that are given by Quran and sunnah. Over the past three decades an important field of enquiry has developed in economics, called the ‘New Institutional Economics’ (NIE), that has made significant contribution to understanding how economic system function. Most importantly, the NIE has focused on reasons why some economies perform strongly while others lag behind with substantial margins. The reasons, the NIE explains is the “institutional scaffolding” of the economy. NIE defines institutions as rules and norms governing economic behavior in the society. Accordingly how well the economy performs depends crucially on the rules governing economic behavior. Principles among these are: rule of law, well defined property rights, and a high degree of trust, efficient contract enforcement, and good governance.

An economic expertise-dominated view of the relevant verses of the Quran reveals a comprehensive set of rules governing the structure and operations of an economy; including rules that extend well beyond what the NIE would consider needed for a well-functioning economy. The Quran makes clear that the compliance with the prescribed rules is the guarantor of: better socio economic justice and cohesion, unity and order in any human collectivity and economic growth and stability (see for example chapter 5 verse 2; chapter 3 verse 103; chapter 8 verse 46). The promise made in the verse 96 of chapter 7 of the Quran (see also chapter 65 verse 2; chapter 65 verse 3; chapter 5 verse 65-66; chapter 12 verse 90’ chapter 5 verse 66; chapter 8 verse 53; chapter 10 verse 9; chapter 2 verse 25; chapter 16 verse 97; chapter 24 verse 55; chapter 40 verse 40). Conversely all prohibited behavior are those that ultimately lead to social injustice and disintegration. Central among the rules that constitute the institutional frame work of an Islamic economic system are rules governing:

- ❖ Property Rights
- ❖ Contracts
- ❖ Market conduct

- ❖ Production and Exchange
- ❖ Distribution and redistribution

### ***Property rights in Islam***

In this rule, there are sub-rules (i) The Quran makes it clear that all property (including natural resources as well as human physical and mental capabilities) belongs to Allah swt whose ownership never diminishes and remains always constant—*thobat melkiyyah* of Allah swt: that is the immutability and constancy of ownership of Allah. This is regardless of the transformation which may take place to change the form of property (see chapter 2 verse 29, 107; chapter 3 verse 26; chapter 5 verse 120; chapter 40 verse 16 as well as chapter 3 verse 180). By medium of agency (Khilafah), Allah swt has transferred his property rights to the entire humanity (chapter 2 verse 29; chapter 15 verse 21; chapter 35 verse 3). Therefore everyone is entitled to the resources (natural or human), which Allah swt has created. Humans are allowed to combine their labour with the created resources to produce means of sustenance for themselves and others (Hasan, 1988) [see also, for example, Al-Quran chapter 2 verse 60, 126; chapter 11 verse 61] provided they follow the rules that have been laid down for the use of His given properties to their benefits. This generates the second sub-rule within the property rights rule (ii) *all the humanity has rights in His property*. However, It maybe that not everyone in the society can actually have access or use these resources because some people for instance may have physical infirmity, they may have mental problems or may not have the opportunity. Nevertheless, that does not deny them the rights and the rights remain intact.

As a result, the more able access greater resources. However, this they do so knowing that other's shares are held in trust with them as 'Amanah' (Hasan, 1988). The less able are in effect silent partners to the more able who have greater access to resources because of greater capabilities ( see chapter 2 verse 110; chapter 9 verse 60; chapter 73 verse 20; chapter 17 verse 26 and chapter 51 verse 19). *This originates the third sub rule (iii) no one can be denied the rights to property*. These rights must be redeemed, in kind or in monetary equivalence (see for example chapter 51 verse 19; chapter 24 verse 33; chapter 16 verse 71). This is the foundation of the rule of sharing ordained by the creator.

Once the basic rules of property rights have been laid, the next step is how these rights are gained. In Islam, there are only two ways in which individuals can gain legitimate property



rights. (i) Individuals can gain property rights through a combination of their own creative labour and other resources or (ii) through transfer—via exchange, contracts, grants or inheritance—from others who have gained property rights title to an asset through their own labour (see chapter 53 verse 40; chapter 17 verse 26; chapter 24 verse 22; chapter 30 verse 38; chapter 4 verses 11-12). Fundamentally, therefore, work is the basis of acquiring rights to the property. The next rule governing property rights forbid instantaneous property rights claim without commensurate work.

The exception is transfer via gifts from other who have gained legitimate property rights claim on the asset transferred. The prohibition covers theft, bribery, gambling, interest from money lent, or, generally, income and wealth obtained from sources and activities not permitted by Shariah (see for example chapter 5 verse 38; chapter 2 verse 188 and 275; chapter 5 verse 90). On the subject of how interest income from lent money violates the Islamic laws of property rights, it can be argued that in a riba transaction, a sum of money is loaned today for a larger sum in future. This is without the transfer of the property rights over the principal from the lender to the borrower. Not only does the lender retain property rights over the sum lent, but property rights over the additional sum to be paid as interest is transferred from the borrower to the lender the moment the contract of riba is entered into. To Khan and Mirakhor (1994: 7):

Interest on money represents an unjustified creation of instantaneous property rights: unjustified because interest is a property right claimed outside the legitimate framework of individual property rights recognized by Islam; and instantaneous because as soon as the contract for lending upon interest is concluded, a right to the borrower's property is created for the lender. It is clear that money lent is used either productively in the sense that it creates additional wealth, or unproductively, in the sense that it does not lead to the creation of incremental wealth by the borrower. In the latter case, since no additional wealth, property, or asset is created by the borrower, the money lent cannot claim additional property rights since none are created. In the former case, that is, when it is used in combination with the creative labour of the entrepreneur to create additional wealth. It can also not claim any right to the incrementally-created wealth because the lender, when loaning his money, does not



bargain for a portion of this incremental wealth but for a fixed return, irrespective of the outcome of the enterprise.

The others rules relate to the impositions and limitations on disposing a property over which legitimate rights are claimed. Property owners have a severely mandated obligation not to (i) waste (Israf), (ii) squander or destroy (Itraf), or use property opulently (Itlaf) or as means of attaining unlawful purposes. Once the rules governing property rights claims are observed and related obligations, including sharing and re-discharging property rights on the remaining part of income, wealth, and assets are held sacred, then no one has the right to force appropriations or expropriations (Askari et al., 2012).

### ***Contracts***

The next in line are the rules regarding the sanctity and enforcement of contracts in an Islamic financial system. The rule relates to the “*Faithfulness to the contracts*”. Islam forcefully anchors all social-political-economic relations on contracts. More generally the whole fabric of the divine law is contractual in its conceptualization, content and application. Its very foundation is the primordial covenant between the Creator and the humans (see also Al-Quran chapter 7 verses 172-173). The covenant imposes the obligation on humans to remain faithful to its affirmations that they recognize the supreme Creator as its Cherisher Lord.

In verse 152 of chapter 6 the Quran urges the believers to fulfil the covenant of Allah. This is extended to the terms and conditions of all contracts through another clear verse 1 of chapter 5 in which believers are ordered to be faithful to their contracts. They are ordered to protect faithfulness to their covenants and what has been placed in trust with them as a shepherd protects sheep (see chapter 23 verse 8; also chapter 17 verse 34; chapter 2 verse 2; chapter 16 verse 91-92; chapter 3 verse 61). So much so that the Quran has dedicated the longest verse on the importance of contracts and their fulfilment (see chapter 2 verse 282), thus believers do not treat obligations of contracts lightly. They will take on contractual obligations only if they intend fully to fulfil them. Hence, their commitments are credible. Mirakhor (2011a: 16-17) confers that:

Contracts are means of coming to terms with future risks and uncertainty. They allocate risks by providing for future contingencies and set obligations for each party and each state in the future as well as remedies for breach of contracts. Generally, there are three motives

for entering into a contract: sharing of risk, transfer of risk, alignment of incentives, or to minimize transaction costs. Empirical research has shown that where the problem of lack of commitment exists and is significant, it leads to disruption in economic, political and social interaction among people. Long-term contracting will not be possible and parties to exchange opt for spot market or very short-term transactions. Considering these issues, one can appreciate the strong emphasis that the Quran [as well as the Messenger (saw)] has placed on trust, trustworthiness (see chapter 8 verse 27 and chapter 4 verse 57) and on the need to fulfil terms and conditions of contracts, covenants, and promises one makes. These rules solve the problem of credible commitment and trust, thus facilitate long-term contracts.

This brings to the discussion the post production end where there are other rules of market behavior. Rules regarding distribution and re-distribution, circulation of wealth, rules in relation to consumption behavior as well as ordainments for sharing risks.

### ***Markets***

The rules that govern the market relate to the appropriate behavior of all participants in the market. The Quran acknowledges the need for markets and affirms their existence, placing emphasis on contracts of exchange and trade. As a rule, the Quran places emphasis on market transactions based on mutual consent, therefore, based on freedom of choice and freedom of contract, which, in turn, requires acknowledgement and affirmation of private property rights. The model implemented by the Prophet (saw) operationalized the conception of exchange and trade as well as the use of market as a mechanism for this purpose. Thus in an Islamic economic system, market is only an instrument of the system and not the whole system itself; well supervised and well regulated. Supervised and regulated in terms of the rules that govern market behavior. The rules come from the life of the Prophet (saw). The rules include:

- ❖ No interference with supply;
- ❖ No interference with demand; and no interference in exchange transaction;
- ❖ Full access to the market by all buyers and sellers;
- ❖ Shariah approved sources of factors and products before they enter the market;

- ❖ Provision of full information regarding qualities, quantities and prices of factors of production and product to all buyers and sellers—before the start of price bargaining process;
- ❖ Provisions of full weights and measures; there is no hoarding of commodities, if two people in market are negotiating, third person cannot interject himself;
- ❖ “There is no ‘Ghash’ meaning there should not be any kind of misrepresentation of the product.
- ❖ No Gharar and a strict prohibition of speculative activities;
- ❖ “The freedom of annulment” i.e. ‘Khiyarat’. There are various kinds of such freedoms provided to both parties (depending on the fiqh) to annul contracts.
- ❖ “Full and transparent Information”. Everything about the product must be known and nothing should be hidden. Anyone who enters the market is informed fully of prices and products.
- ❖ “No collusion among the sellers or buyers” or else they will violate the rule of ‘No Ghash’.

Among the other main reasons given in defense of the existence of interest bearing debt system are that of (i) ‘Moral hazard’ due to asymmetric information where one side of transaction has information which the other side does not have. (ii) ‘Cost of monitoring’. For example if borrowing money is required, the creditor has a problem of trusting on the information which the borrower puts forward as a reason to borrow or even if he does not explain there is still a risk. Collateral is asked, worth more or less the amount borrowed and further if whatever profits are made, a fixed amount is asked over the principle when the money is returned. Because of moral hazard interest rate is justified. Then comes the cost of monitoring where even though the money is loaned, the creditor still worries and may need to monitor the activities of the borrower for the safe return of the loaned money (with interest). Since monitoring is costly, sometimes called as ‘costly state verification’, it is hard for creditor to verify the state or monitor. The monitoring is thus delegated called ‘delegated monitoring’.

In an Islamic system, there would be no problem of ‘Moral hazards. First, due to property rights protection as well as clear exchange of property rights alongside the rule of being ‘faithful to contracts’, the occurrence of moral hazard will be diminished if not completely cured. In fact adherence to all the rules discussed above assures against any mal-practices. All in all, any form of conduct leading to instantaneous property rights without commensurate

equity created by individual's own labour is prohibited. This type of market that complies with the prescribed rules produces price for factors and outputs that are just as a result of free and informed bargaining process. The absence of the internalization of above rules makes contracts very costly to form, verify, negotiate, renegotiate and implement. "A further implication of the compliance with the above rule is the possibility of coming up with a contract where the parties to a contract trust each other. They can agree to enter into a simple contract and commit to revising its terms and conditions as contingencies arise" (Shaukat and Alhabshi, 2015).

### ***Rules regarding Consumption***

A further set of rules decouple the relationship usually assumed in the secular thought between consumption and income that as income grows so does consumption. For those who have internalized the Islamic economic rules, this is only true to a limited extent because there are limits to their consumption. That is, at low levels of income, consumption grows with income but after a threshold is reached, consumption levels off as additional income earned are channelled back to the economy through investment or transfers to more needy (see chapter 7 verse 31; chapter 25 verse 67; chapter 23 verse 64; chapter 17 verse 16; chapter 34 verse 34; chapter 17 verse 26-27). The limit on personal consumption is derived from the rules governing consumption behavior i.e. the rules prohibiting overspending (Israf), wasteful and destructive (Itraf) and ostentatious and opulent spending (Itlaf) [see chapter 2 verse 190, 195; 16 verse 97; chapter 4 verse 37; chapter 34 verse 34; chapter 17 verses 27-30].

### ***Distribution and Re-distribution***

As mentioned earlier, due to the fact that some members of the society may be physically or otherwise unable to access resources to which they are entitled— as per the property rights rules of Islam (see chapter 6 verse 165; chapter 43 verse 23; chapter 16 verse 71), inequalities between income and wealth arise. The inequalities could also arise due to the presence of the idiosyncratic risks which when materialize play havoc with people's income and wealth. The most important economic institution that operationalizes the objective of managing any ensuing inequalities is that of the distribution/re-distribution rules of Islamic economic. The Islamic view holds that it is not possible to have many rich and wealthy people who continue to focus all their efforts on accumulating wealth without simultaneously creating a mass of

the economically deprived and destitute. The rich consume opulently while the poor suffer from deprivation because their rights in the wealth of the rich and powerful are not redeemed.

To Shaukat et al., (2014), *wide spread poverty is a prima facie evidence of rule non-compliance*. To avoid this Islam—as mentioned above—prohibits excessive wealth accumulation and imposes limits on consumption after maintaining modest living standards. The surplus must be returned to the members of the society who, for a variety of reason, are unable to work. Further Mechanisms for redeeming the rights of the less able in the income and wealth of the more able are the network of mandatory and voluntary payments such as Zakat (2.5% on wealth), Khums (20% of income), and payment referred to as ‘Sadaqat’ (see chapter 9 verse 60; chapter 22 verse 41; chapter 2 verse 110, 261; chapter 34 verse 39; chapter 57 verse 18; chapter 73 verse 20).

### ***Circulation of Wealth***

Moreover, even after these rights are redeemed, the remaining wealth is not to be accumulated, as wealth is considered as the life blood of the economy and means of support to the society (see chapter 2 verse 254; chapter 29 verse 61; chapter 14 verse 32; chapter 16 verse 14; chapter 45 verse 13; chapter 22 verse 36-37; chapter 2 verse 180, 215; chapter 62 verse 10; chapter 16 verse 6; chapter 17 verse 70; and chapter 7 verse 32). Therefore, it must not be hoarded (see chapter 4 verse 37; chapter 34 verse 15-16; chapter 9 verses 34-36). This will have immediate implications for investment, capital formation, growth and development. As mentioned earlier, to allow a healthy circulation of wealth, the Islamic economic system envisions a financial system based on risk and return-sharing alongside the prohibition of interest bearing transactions in which rent is collected as a percentage of an amount of principal loaned for a specific time period. All this without the full transfer of the property rights over the money loaned to borrowers. When such transaction prevail in a system, the result is a culture of risk transfer and risk shifting and less risk sharing (Mirakhor and Shaukat, 2012, 2013). The overwhelming emphasis the Quran places on the contracts of exchange as the alternative to the interest rate-based debt contract is a clear instruction that the financial system must be structured on risk sharing rather than risk shifting or risk transfer.

All is all, an Islamic state is rule compliant state where a collection of societies of ‘momins’/believers have internalized the rules. These rules are not only generational, dynamic but are universal and immutable in their essence and results at any time and age while. The

startling aspect of these rules is their all-inclusive nature without necessity (though preferring) an entry into an Islamic doctrinal system. The rules show equal effects to all who comply.

## CONCLUSION

From the above discussion, it can be summarized that the institutional framework of the Islamic economy is composed of a collection of institutions—rules of conduct— to deal with allocation of resources, production and exchange of goods and services, and distribution/redistribution of resulting income and wealth. The main objective of these institutions is to achieve social justice and unity alongside economic prosperity. Important among their functions is the reduction in uncertainty for members of the society; allowing them to overcome the obstacles to decision making caused by paucity of information. Such rule compliance will at once enhance coordination and predictability in the societal behaviour. Rules specify what kind of conduct is most appropriate to achieving just results when individuals face alternative choices and must take action. They impose restrictions on what the society's members can do without upsetting the social order on whose existence all members count. This also helps them in deciding on their own actions and forming their expectations of other's responses and actions when in situation of uncertainty or facing risks.

Risk and uncertainty are undeniable facts of life. As was discussed earlier, uncertainty stems from not only the lack of information but also from ignorance of knowing the response and behaviour of others under such conditions. The question arises as to why risk and uncertainty exist. This question becomes more acute for those who believe in the Supreme Creator of all things. Since it is believed that existence of risk and uncertainty is a source of difficulty for humans, a Creator-centric question also arises: why create risk and uncertainty for humans? Bartholoemu (2008: 230) argues that *“a plausible argument for the necessity of risk is that it serves as an important ingredient in the recipe of full human development. It provides the fertility and diversity of experience to develop our skills and personalities.”*

The Qur'an, on the other hand, provides a more compelling explanation: humans are subjected to tests throughout their lives to allow them a sense of the degree to which they, individually and collectively, are rule compliant (see for example, chapter 2 verse 155; chapter 7 verse 130; chapter 76 verse 2; chapter 29 verse 2; chapter 9 verse 126; chapter 11 verse 7). Without risk and uncertainty, testing would not be possible. To ease the intensity of anxiety in dealing with tests and, therefore, reduce uncertainty and demand on humans'

cognitive ability, compliance with the (economic) behavioural rules prescribed by Quran reduces risk and uncertainty.

The result is better coordination in society's behaviour. It can be stated that such rule compliance while promoting coordination in actions, determines the degree of certainty in the formation of expectations, prevents conflict, reconciles differences, facilitates cooperation, promotes social integration and solidarity and strengthens social order. *The result is that the behaviour of the society as a whole immediately becomes increasingly predictable in all aspects; making the system simple to manage and control.*

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**PRODUCTIVITY OF ISLAMIC AND CONVENTIONAL BANKS IN MALAYSIA  
SURROUNDING 2007 - 2009 GLOBAL FINANCIAL CRISIS**

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**ABSTRACT**

*Purpose – This study aims to evaluate and compare the productivity change of the Malaysian Islamic and conventional banks by using a data set which covers 17 Islamic banks and 21 conventional banks from 2004 – 2013.*

*Method – To estimate total productivity change of both Malaysian Islamic and conventional banks, we employ the Malmquist Productivity Index method.*

*Data – Malaysian Islamic and conventional banks over the period of 2004 – 2013.*

*Findings – The empirical findings indicate that the Malaysian Islamic banks have been relatively more productive compared to their conventional counterparts.*

*Originality – This is the first time a productivity analysis of Malaysian Islamic banks being compared with conventional banks in the aftermath global financial crisis.*

**Key Words:** *Malmquist Productivity Index, Total Factor Productivity, Malaysian banks, Islamic bank*

## INTRODUCTION

Despite its infancy age, the Islamic banking sector has achieved tremendous growth especially in the past global financial crisis. In Malaysia, for example, the market share of Islamic banks in term of total assets has increased from 15.5 per cent in the year 2007 to 25 per cent in the year 2013 (Figure 1). Foundation for the establishment of Islamic banking sector in Malaysia is due to the strong effort by its government in becoming the hub for Islamic financial services (Abdul Alim 2014). As Islamic banks are acquiring the Malaysian banking sector market share from the conventional banks, important question raised here whether Islamic banks are more productive than its conventional counterparts?

Although Islamic banks recorded positive growth during this period, it is important to highlight that from 2007 to 2009, the progress of Malaysian banking sector has been sluggish, due to the impact of global financial crisis. Data shows that percentage of Malaysian banking assets growth in 2008 is only 3.91 per cent compared to 14.74 per cent in 2007. Similar trend can be observed in terms of percentage of Malaysian banking deposits growth in 2007 which stood at 6.83 per cent compared to 16.52 per cent in 2006. Corresponding to the reduction in growth of banking asset and deposits, the percentage of loans growth have also reduced to 5.68 per cent in 2009 compared to 11.09 per cent in 2008. These scenarios may have impact on the productivity of the Malaysian banking institutions and this also motivates this study.

By employing the Malmquist Productivity Index method, this study provides empirical evidence on the productivity of Malaysian Islamic and conventional banks. Although studies examining the productivity of banking institutions are numerous, to the best of our knowledge, only limited number of publication can be found comparing the productivity of Malaysian Islamic and conventional banks taken into consideration the period of pre and post 2007 – 2009 global financial crisis.

## LITERATURE REVIEW

Numerous papers can be found examining bank productivity in a cross country setting. Recent papers concerning this field have been focusing on the productivity of banks following the financial crisis. In general, these literature suggest that banks have faced a deterioration of productivity levels during the crisis period. This can be observed in number

of literature namely Kevork et al. (2017) which involves Eastern European countries, Degl'Innocenti et al. (2017) which involves 28 European Union countries, Bahrini (2015) which involves Gulf Cooperation Council (GCC) countries banks. Similar observation could be found in the literature which focus Islamic banks in Southeast Asian countries (Kamarudin et al. 2017) and Qatar (Abdul-Wahab & Haron 2017).

Despite declining trend of bank productivity, Nurboja & Košak (2017) which examined ten South East European Union countries revealed that banks' cost efficiency in the region has improved during the 2008 global financial crisis. This supported the study by Rosman et al. (2014) which found that Islamic banks were able to sustain operations during the crisis period. Abdul-Majid et al. (2011) revealed the possibility of increase in efficiency might be due to cost-cutting initiatives by the banking institutions.

With regards to Islamic banks, recent studies on bank productivity have put emphasize on comparing Islamic banks' productivity with the conventional banks. Abbas et al. (2015) which examined productivity change of Pakistan Islamic and conventional banking sector from 2005 to 2009 revealed that Islamic banks have higher productivity index in 2007 and 2008 compared to conventional banks. In contrast, in 2009, the index revealed that conventional banks have higher productivity change. In different study, Khan & Shah (2015) that compared the productivity of Islamic banks, Islamic windows and conventional banks in Pakistan from 2007 – 2011 revealed that the Islamic banks have the highest productivity score. In a different study, Rodoni et al. (2017) compared the efficiency and productivity of Islamic banks which are based in Indonesia, Malaysia and Pakistan. The research revealed that among those three countries, Pakistan Islamic banks have the highest efficiency rate followed by Malaysia and Indonesia.

Based on the review, study that compares the productivity of Malaysian Islamic and conventional banks surrounding the recent 2007-2008 global financial crisis is missing from the literature. Therefore, our study tends to fill in this gap.

## **METHODOLOGY**

### ***Data collection***

The present study gathers data on Malaysian Islamic and conventional banks from the period of 2004 – 2013. The data that are used for this study are derived from the Bankscope

database. Should the database is not complete, the study used the financial statement published in the website of each individual banks.

The number of observations varied across time especially for Islamic banks. This is due to bank entry during the period under study. In total, the observation involves a sample of 21 conventional banks and 17 Islamic banks.

### ***Specification of input and output***

An intermediation approach that has been widely used in banking literature (Wahid 2016; Kamarudin et al. 2017; Sealey & Lindley 1977; Sufian & Kamarudin 2017), is adopted in this study due to its suitability with Islamic banks which act as an intermediary between the depositors and the borrowers. Three inputs and three outputs are used in this study. On one hand, the inputs that we consider are total deposits (X1), personnel expenses (X2) and fixed assets (X3). The outputs, on the other hand, are loans (Y1), investment (Y2) and non-interest income (Y3). Table 2 presents the inputs and outputs that are used to measure the Malmquist Productivity Index.

### ***Data analysis method – Malmquist Productivity Index***

In measuring productivity, there are at least three indices that have been widely used, namely, Fisher (1922), Törnqvist (1936) and Malmquist (1953) indices. The latter is based on non-parametric method while the earlier two indices are parametric method. In this regards, both methods differ in two ways. Firstly, the differences are in term of their behavioural assumptions, while secondly, whether they identify random errors or noise in the data.

According to Malmquist (1953), total factor productivity is a measurement of changes between total output relative to total inputs. Griffel-Tatje and Lovell (1996) highlighted that the Malmquist productivity index has number of advantages compared to other productivity indices. Firstly, the Malmquist productivity index eliminates the requirement for assumptions of profit maximization or cost minimization. Secondly, this index does not require inputs' price and outputs' price. Lastly, the Malmquist productivity index may further be decomposed into technical efficiency change and pure technical change.

In this study, we employ the output orientation analysis due to its suitability given the objectives of banking sectors in developing countries (Casu et al. 2004; Jaffry et al. 2007). Following Färe et al. (1994) and Fukuyama (1995), this study measures the following items:

1. Total factor productivity index (TFPCH)
2. Technology change index (TECHCH)
3. Technical efficiency change index (EFFCH)
4. Pure technical efficiency change index (PTECH)
5. Scale efficiency change index (SECH)

According to Färe et al. (1994), the Malmquist index can be written as:

$$M(x^{t+1}, y^{t+1}, x^t, y^t) = \frac{D_0^{t+1}(x^{t+1}, y^{t+1})}{D_0^t(x^t, y^t)} \times \left[ \left( \frac{D_0^t(x^{t+1}, y^{t+1})}{D_0^{t+1}(x^{t+1}, y^{t+1})} \right) \times \left( \frac{D_0^t(x^t, y^t)}{D_0^{t+1}(x^t, y^t)} \right) \right]^{1/2} \quad (1)$$

$M$  is the productivity index between years'  $t$  (previous period) and  $t+1$  (recent time period) where recent time period production point  $(x^{t+1}, y^{t+1})$  corresponds with the previous time period production point  $(x^t, y^t)$  and  $D_s$  are output distance functions. On one hand, any value which greater than 1.000 will indicate growth of total factor productivity, whereby any value lower than 1.000 will indicate regress of total factor productivity between two periods. On the other hand, any value equivalent to 1.000 represents no change in term of total factor productivity.

The relationship between the Malmquist productivity index and its two sub-indices can be written as:

$$M_0 = \text{Efficiency Change} \times \text{Technical Change} \quad (2)$$

where:

$$\text{Efficiency Change} = \frac{D_0^{t+1}(x^{t+1}, y^{t+1})}{D_0^t(x^t, y^t)} \quad (3)$$

$$\text{Technical Change} = \left[ \left( \frac{D_0^t(x^{t+1}, y^{t+1})}{D_0^{t+1}(x^{t+1}, y^{t+1})} \right) \times \left( \frac{D_0^t(x^t, y^t)}{D_0^{t+1}(x^t, y^t)} \right) \right]^{1/2} \quad (4)$$

The EFFCH index can be further decomposed into its mutually comprehensive components of PTECH ( $\Delta \text{PureEff}^{t,t+1}$ ) and a component of SECH ( $\Delta \text{Scale}^{t,t+1}$ ). This is in accordance to the recommendation by Färe et al. (1994) as presented below:

$$\text{Efficiency Change} = \Delta \text{PureEff}^{t,t+1} \times \Delta \text{Scale}^{t,t+1} \quad (5)$$

where:

$$\Delta PureEff^{t,t+1} = \frac{D_{VRS}^{t+1}(x_j^{t+1}, y_j^{t+1})}{D_{VRS}^t(x_j^t, y_j^t)} \quad (6)$$

$$\Delta Scale^{t,t+1} = \frac{D_{CRS}^{t+1}(x_j^{t+1}, y_j^{t+1})/D_{VRS}^{t+1}(x_j^{t+1}, y_j^{t+1})}{D_{CRS}^t(x_j^t, y_j^t)/D_{VRS}^t(x_j^t, y_j^t)} \quad (7)$$

Since 2004 is the reference year, the Malmquist productivity index and its components in this year take an initial score of 1.000. Hence, bank with efficiency score lower than one in subsequent year indicates that it is operating below the frontier, whereby bank with efficiency score greater than one indicate that it is operating above the frontier.

### ***Research procedure***

In this study, the output-oriented Malmquist productivity index is employed to measure the banks' productivity changes. The VRS technology is used to compute TFPCH(Mo) to EFFCH and TECHCH as shown in equation (2). Subsequent to that, as proposed by Färe et al. (1994), the EFFCH is segregated into an element of PTECH and SECH as given in equation (5). The Malmquist productivity index will permit us to calculate TFPCH levels between two data points by computing the distances ratio of each data point relative to a common technology. The indices in Malmquist productivity index analysis are constructed on an evaluation of banks' types (Islamic - conventional).

## **DESCRIPTIVE ANALYSIS**

Table 3 highlights inputs and outputs that are used for analysis of Malmquist Productivity Index.

In general, it can be observed from Table 2 that the trend in banking business for both Malaysian Islamic and conventional banks showed an upward trend between the years 2004 – 2013. Furthermore, in contrast to the conventional banks, it is found that on average the inputs and outputs for Malaysian Islamic banks were lesser.

## DATA ANALYSIS

### *Productivity of islamic and conventional banks; an analysis based on the number*

We investigate the productivity of Islamic banks in comparison to conventional banks by highlighting the number of banks facing progress or regress in its TFPCH index. The results are tabulated in

where Panel A is for conventional banks while Panel B is for Islamic banks.

As the results indicate in Panel A, in 2005, 16 (76.19 per cent) conventional banks have experienced progress in their productivity before the numbers declining slowly to 9 banks (42.86 per cent) in 2006 and 1 bank (4.76 per cent) in 2007. In 2008, the number of conventional banks that progress in its productivity increased tremendously to 18 (85.71 per cent) before a temporary regress in 2009 to 9 banks (42.86 per cent). This supports the study of Kevork et al. (2017); Degl'Innocenti et al. (2017); Bahrini (2015); Kamarudin et al. (2017) and Abdul-Wahab & Haron (2017).

If anything is possible, the reduction in number of productive conventional banks could possibly due to the effect of the 2007 – 2009 global financial crisis that reached Malaysia a bit later compared to the Western countries. Despite of the reduction, the number of productive banks from 2010 to 2012 has progressed to 12 institutions (57.14 per cent). Later, in 2013, only 8 conventional banks (38.10 per cent) have progress in its productivity.

Moving on to findings of Islamic banks, as detailed in Panel B, it can be observed that the numbers of productive banks are increasing from year to year beginning from 2005 with 1 bank (50 per cent) being productive to 10 banks (58.82 per cent) in 2010. However, in 2011, the number of productive Islamic banks has experienced temporary reduction with only 7 (41.18 per cent) Islamic banks were productive. This is then followed by an increase in 2012 and 2013 to 13 banks (76.47 per cent) and 11 banks (64.71 per cent) respectively.

### *Productivity of Islamic and conventional banks, and its decompositions*

Table 5 highlights the TFPCH of Islamic and conventional banks, and the decompositions of TFPCH into TECHCH and EFFCH. The EFFCH is then further decomposed into PTECH and SECH.



With regards to the conventional banks, the TFPCH was on a downward trend from the year 2005 to 2007. However, in the year 2008, the TFPCH of conventional banks increased from 0.817 in 2007 to 1.322 in 2008. The TFPCH of conventional banks reduced again in 2009 before increased once again in the year 2010. In 2011, the index reduced to 0.994 before an increased in the year 2012. Finally, in the year 2013, the TFPCH index reduced to 0.975.

With regards to Islamic banks, the TFPCH for Islamic banks indicates that Islamic banks have been productive in all year under study except 2011. From 2005 to 2007, the TFPCH for the Islamic banks recorded a positive growth. In the year 2005, the TFPCH of the Islamic banks stood at 1.049. While in 2006 and 2007, the TFPCH for Islamic banks stood at 1.090 and 1.814 respectively. In the year 2008, the index reduced tremendously from 1.814 in 2007 to 1.016. Nevertheless, this reducing trend was just for one year as in the following year of 2009 and 2010, the TFPCH for Islamic banks increased to 1.083 and 1.276 respectively. This is then followed by another reduction of Islamic banks' productivity in the year 2011 to 0.972. In the last two years of observation, the TFPCH of Islamic banks recorded an upward trend, an increase to 1.076 in the year 2012 and 1.270 in the year 2013.

The trend of TFPCH for Islamic and conventional banks under the period of study can be found in Figure 2.

In comparing the Islamic and conventional banks, we calculate the mean of productivity index and its decompositions for both Islamic and conventional banks. Although the findings reveal that both types of banks have exhibited progress in TFPCH, the TFPCH for Islamic banks have progressed by 18.0 per cent (1.180). This is higher than conventional banks that progressed by 4.5 per cent (1.045) only. This finding suggests that Islamic banks have higher productivity compared to conventional banks. This result is in line with the findings from (Abbas et al. 2015).

The decomposition of the TFPCH index into its TECHCH and EFFCH components reveals that, on one hand, the progress in the Islamic banks' TFPCH was solely attributed to the 24.2 per cent (1.242) increase in EFFCH, as the TECHCH seems to have a slower increasing rate of 3.5 per cent (1.035) during the period under study. On the other hand, the progress in the TFPCH of conventional banks was solely attributed to the 5.4 per cent (1.054) increase in TECHCH, as the EFFCH seems to have a slower increasing rate of 2.0 per cent (1.020) during the period under study.

Further analysis on the decomposition of the EFFCH index into its PTECH and SECH components reveal that the managerial factor is considered as the principal source of progress in EFFCH for Islamic and conventional banks. This infers that although both types of banks have been managerially efficient in controlling their operating costs, these banks have been operating their business at the non-optimal scale of operations.

## CONCLUSION

The primary objective of this study is to evaluate and compare the productivity change and its decompositions between Malaysian Islamic and conventional banks. In order to address this objective, we estimate total productivity change of both Malaysian Islamic and conventional banks by employing the DEA-based Malmquist Productivity Index method on a data set of 17 Islamic banks and 21 conventional banks over the period of 2004 – 2013.

The empirical findings reveal that the Islamic and conventional banks have experienced progress in their TFPCH index. In addition, the findings also pointed out that the progress in TFPCH of Islamic banks is due to the fact of increase in its EFFCH index. In contrast, the growth in TFPCH of conventional banks is due to the increase in its TECHCH index. Furthermore, the findings seem to suggest that both Islamic and conventional banks are efficient in term of managing their operating costs but they fail to operate at an optimal scale of operations.

Based on the above, the empirical findings from this study are useful for related parties such as regulators, bank managers and researchers. First, this study supports regulators impetus towards mergers activities between banks. Mergers help banks to gain economies of scale as larger banks have the ability to increase output and reduce average costs. Second, the finding that is gained from this study offers assistance for the bank managers in Islamic and conventional banks to understand which element in bank efficiencies has more influence on bank productivity. This allows bank managers to take accurate precaution in order to address the issue of productivity. Lastly, very few studies have focused on examining the productivity of Malaysian Islamic and conventional banks especially surrounding the crisis period. Hence, researchers in this area could utilize findings of this study in order to fill up research gaps in this field.

**Tables**

**Table 2: Inputs and outputs for Malmquist Productivity Index**

<b>Inputs</b>	<b>Outputs</b>
Total deposits (X1)	Loans (Y1)
Personnel expenses (X2)	Investment (Y2)
Fixed assets (X3)	Non-interest income (Y3)

**Table 3: Input and output for analysis of Malmquist Productivity Index**

	<b>Conventional Banks</b>		<b>Islamic Banks</b>	
	<b>Mean</b>	<b>SD</b>	<b>Mean</b>	<b>SD</b>
<b>2004</b>				
Total loans	20,530,066	27,244,941	5,171,898	3,491,094
Investments	6,581,163	8,237,801	2,502,429	917,429
Non-interest income	492,166	729,472	27,018	19,855
Total deposits	27,490,205	35,761,175	9,538,527	2,940,851
Personnel expenses	254,826	342,919	80,253	19,251
Fixed assets	248,680	346,989	72,517	24,749
<b>2005</b>	<b>Mean</b>	<b>SD</b>	<b>Mean</b>	<b>SD</b>
Total loans	25,994,682	29,797,723	3,330,875	3,807,881
Investments	5,934,342	6,548,543	1,452,555	1,389,512
Non-interest income	571,058	997,405	28,084	41,869
Total deposits	32,562,873	36,445,638	6,322,861	6,254,531
Personnel expenses	237,179	289,833	48,518	55,969
Fixed assets	263,549	318,590	31,851	33,518
<b>2006</b>	<b>Mean</b>	<b>SD</b>	<b>Mean</b>	<b>SD</b>
Total loans	25,189,040	32,578,061	2,437,279	2,926,926
Investments	6,263,073	7,544,578	876,953	1,019,978
Non-interest income	424,248	539,502	28,067	33,268
Total deposits	33,249,418	40,349,537	4,780,731	5,159,556
Personnel expenses	274,446	345,801	31,583	51,036
Fixed assets	216,931	283,373	22,943	28,972
<b>2007</b>	<b>Mean</b>	<b>SD</b>	<b>Mean</b>	<b>SD</b>
Total loans	26,064,932	32,263,842	3,127,149	2,716,806
Investments	5,836,558	7,140,545	1,068,912	1,302,909
Non-interest income	563,501	742,954	40,753	42,622
Total deposits	39,863,475	46,325,907	5,985,002	5,211,503
Personnel expenses	337,662	396,111	39,798	53,620
Fixed assets	193,118	245,977	20,995	30,319
<b>2008</b>	<b>Mean</b>	<b>SD</b>	<b>Mean</b>	<b>SD</b>
Total loans	28,665,121	36,550,838	5,390,659	5,131,247

Investments	8,308,051	9,596,630	1,362,192	1,416,372
Non-interest income	524,965	602,223	30,695	35,449
Total deposits	41,203,962	49,618,845	8,459,475	6,771,694
Personnel expenses	357,489	418,723	36,623	56,474
Fixed assets	203,432	265,501	18,403	33,376
<b>2009</b>	<b>Mean</b>	<b>SD</b>	<b>Mean</b>	<b>SD</b>
Total loans	30,527,623	39,034,827	6,798,291	6,615,737
Investments	9,467,129	12,001,098	1,988,132	2,344,560
Non-interest income	466,381	556,250	37,567	32,692
Total deposits	45,096,464	54,233,542	10,824,310	9,331,692
Personnel expenses	397,358	521,358	49,607	60,883
Fixed assets	208,406	285,209	20,628	35,467
<b>2010</b>	<b>Mean</b>	<b>SD</b>	<b>Mean</b>	<b>SD</b>
Total loans	34,103,455	42,600,810	8,424,918	8,709,670
Investments	9,624,259	12,387,410	2,579,068	3,593,811
Non-interest income	600,062	853,063	44,613	44,583
Total deposits	47,555,644	56,370,493	12,568,279	11,616,363
Personnel expenses	441,415	575,024	66,454	101,668
Fixed assets	209,047	277,096	23,254	44,606
<b>2011</b>	<b>Mean</b>	<b>SD</b>	<b>Mean</b>	<b>SD</b>
Total loans	39,665,788	51,512,260	10,915,985	12,704,053
Investments	10,835,284	14,144,274	3,039,593	3,314,735
Non-interest income	650,845	860,429	44,873	43,919
Total deposits	55,147,248	67,342,259	16,517,251	17,040,773
Personnel expenses	428,411	477,897	62,011	81,309
Fixed assets	211,833	278,684	23,482	49,379
<b>2012</b>	<b>Mean</b>	<b>SD</b>	<b>Mean</b>	<b>SD</b>
Total loans	45,154,767	57,873,956	15,118,709	21,429,876
Investments	13,487,808	16,656,317	4,006,308	4,091,697
Non-interest income	846,581	1,526,771	75,160	92,588
Total deposits	60,968,124	73,484,831	19,159,512	20,727,347
Personnel expenses	574,323	758,099	72,297	93,018
Fixed assets	237,756	310,598	13,784	17,417
<b>2013</b>	<b>Mean</b>	<b>SD</b>	<b>Mean</b>	<b>SD</b>
Total loans	58,013,348	73,520,766	16,507,699	20,373,368
Investments	16,113,138	21,793,863	3,820,557	3,669,011
Non-interest income	808,925	1,309,399	120,038	160,651
Total deposits	76,738,458	93,936,839	22,694,531	27,416,887
Personnel expenses	758,727	1,177,431	78,755	107,188
Fixed assets	376,765	621,153	23,008	50,593
<b>All Years</b>	<b>Mean</b>	<b>SD</b>	<b>Mean</b>	<b>SD</b>
Total loans	33,390,882	44,859,286	8,874,452	13,048,481
Investments	9,245,080	12,654,382	2,438,119	3,010,233

Non-interest income	575,299	823,194	49,232	72,536
Total deposits	45,987,587	58,550,032	13,008,518	15,917,268
Personnel expenses	406,184	593,997	56,597	78,697
Fixed assets	236,952	335,842	21,902	37,669

Source: Bank financial statement and Bankscope database. All figures are in thousands ringgit Malaysia (RM).

**Table 4: Percentage of TFPCH**

<b>Panel A: Conventional Bank</b>							
Year	No. of banks	Progress		Regress		No change	
		#	%	#	%	#	%
2004-2005	21	16	0.76	5	0.24	0	0.00
2005-2006	21	9	0.43	12	0.57	0	0.00
2006-2007	21	1	0.05	20	0.95	0	0.00
2007-2008	21	18	0.86	3	0.14	0	0.00
2008-2009	21	9	0.43	12	0.57	0	0.00
2009-2010	21	12	0.57	9	0.43	0	0.00
2010-2011	21	12	0.57	9	0.43	0	0.00
2011-2012	21	12	0.57	9	0.43	0	0.00
2012-2013	21	8	0.38	13	0.62	0	0.00

<b>Panel B: Islamic Bank</b>							
Year	No. of banks	Progress		Regress		No change	
		#	%	#	%	#	%
2004-2005	2	1	0.50	1	0.50	0	0.00
2005-2006	4	2	0.50	2	0.50	0	0.00
2006-2007	10	5	0.50	5	0.50	0	0.00
2007-2008	12	6	0.50	6	0.50	0	0.00
2008-2009	17	8	0.47	9	0.53	0	0.00
2009-2010	17	10	0.59	7	0.41	0	0.00
2010-2011	17	7	0.41	10	0.59	0	0.00
2011-2012	17	13	0.76	4	0.24	0	0.00
2012-2013	17	11	0.65	6	0.35	0	0.00

Source: Author's own calculation.

**Table 5: TFPCH of Islamic and conventional banks, and its decompositions**

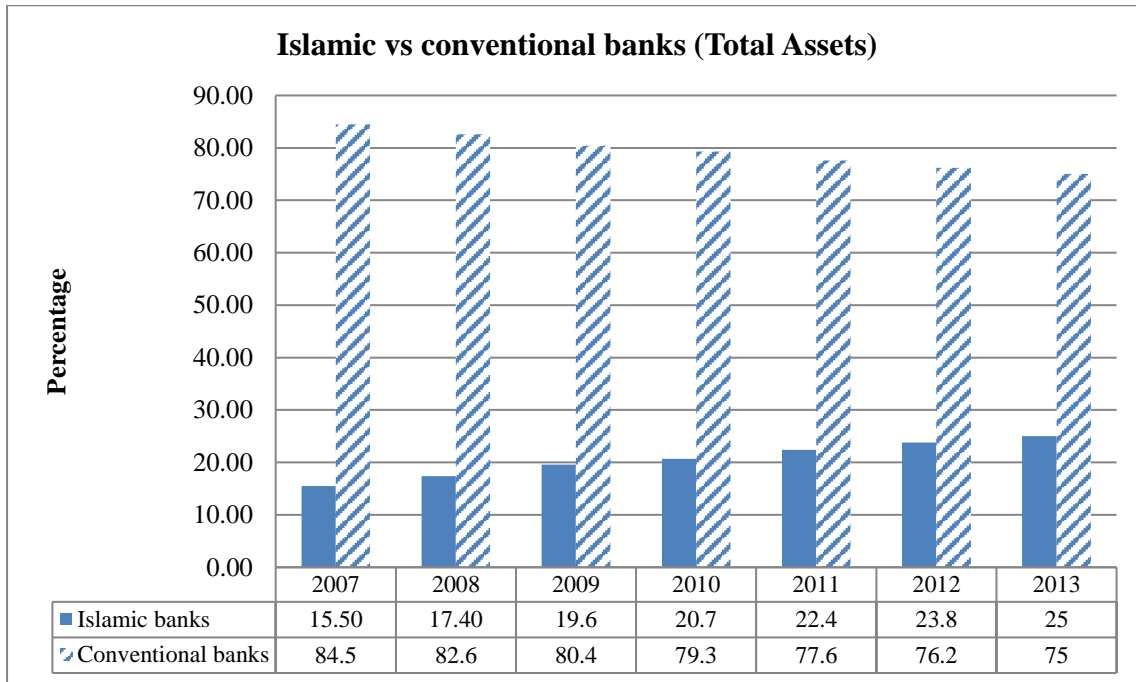
Type	Years	Obs.	Tfpch	Techch	Effch	Ptech	Sech
Panel A: Conv. Banks	2005	21	1.170	1.259	0.948	0.994	0.945

	<b>2006</b>	21	1.070	1.041	1.024	1.018	1.005
	<b>2007</b>	21	0.817	0.673	1.228	1.025	1.202
	<b>2008</b>	21	1.322	1.429	0.911	1.047	0.865
	<b>2009</b>	21	0.948	1.006	0.945	1.015	0.927
	<b>2010</b>	21	1.007	0.843	1.219	1.007	1.204
	<b>2011</b>	21	0.994	1.050	0.945	0.956	0.988
	<b>2012</b>	21	1.103	1.191	0.948	1.040	0.903
	<b>2013</b>	21	0.975	0.997	1.010	0.984	1.021
	<b>Mean</b>		<b>1.045</b>	<b>1.054</b>	<b>1.020</b>	<b>1.010</b>	<b>1.007</b>
<b>Panel B: Islamic Banks</b>							
	<b>2005</b>	2	1.049	1.442	0.743	1.061	0.695
	<b>2006</b>	5	1.090	0.875	1.222	1.042	1.168
	<b>2007</b>	10	1.814	0.567	3.040	2.887	1.104
	<b>2008</b>	12	1.016	1.313	0.789	1.081	0.856
	<b>2009</b>	17	1.083	0.906	1.184	1.144	1.043
	<b>2010</b>	17	1.276	1.015	1.285	1.028	1.259
	<b>2011</b>	17	0.972	0.932	1.033	1.027	1.006
	<b>2012</b>	17	1.076	1.120	0.929	0.966	0.959
	<b>2013</b>	17	1.270	1.192	1.107	1.054	1.045
	<b>Mean</b>		<b>1.180</b>	<b>1.035</b>	<b>1.242</b>	<b>1.211</b>	<b>1.041</b>

*Source: Author's own calculation*

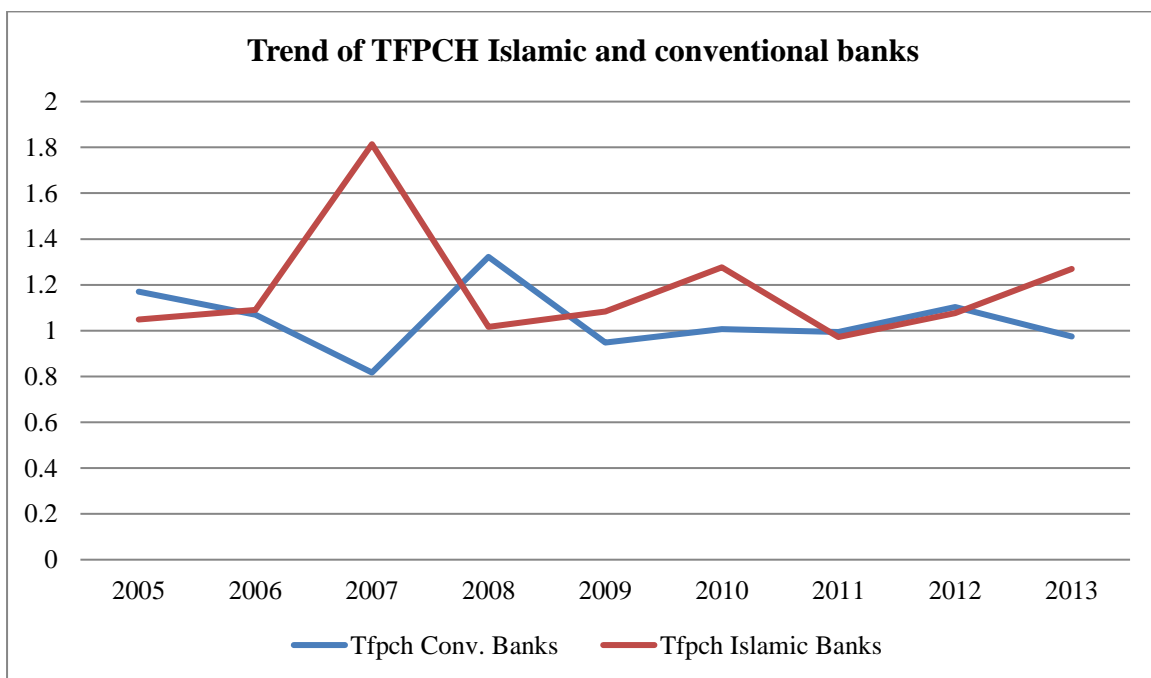
**Figures**

**Figure 5: Market share (total assets) Malaysian Islamic and conventional banks from 2007 - 2013**



*Source: Financial stability and payment systems report of the Central Bank of Malaysia with author's amendment*

**Figure 6: Trend of TFPCH Islamic and conventional banks**



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## STAKEHOLDERS' PERCEPTIONS OF CSR REPORTING IN EMERGING ECONOMIES: THE CASE OF LIBYAN OIL AND GAS INDUSTRY

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### ABSTRACT

*The concerns of this paper have been raised from the affect of stakeholders' attributes on the level of Corporate Social Responsibility Reporting CSR. The purpose of this paper is to examine, from a Libyan stakeholders' perception, the potential factors that may affect the level of CSR reporting issued by Oil and Gas companies in Libya. This paper is a part of a larger research that followed a mixed methodology consisting of quantitative and qualitative approaches. However, this paper will consider a quantitative approach. Questionnaires survey method was conducted to investigate different stakeholders' perception of CSR reporting and identify current stakeholders' attributes regarding CSR reporting within the Oil and Gas industry in Libya. The findings of this paper will be useful for IOSs corporations to understand the Libyan stakeholders' priorities CSR activities, and their attributes to affects CSR reporting within Oil and Gas industry. Findings suggest a lack of power to stakeholders whilst they have urgency and legitimacy attributes. Mandatory CSR reporting is advocated by stakeholders. The need for a regulatory body to administer such a function is discussed. This paper is the first to investigate stakeholders' attributes in regards to CSR reporting issues within Oil and Gas industry in emerging economy.*

**Keywords:** *Corporate Social Responsibility Reporting (CSRRep), social and environmental responsibilities, stakeholder theory, stakeholders in Emerging Economies, Oil and Gas industry.*

### INTRODUCTION

Whilst accounting can be defined as a “set of socially conditioned practices which have various significant impacts on the operation of our society” (Bebbington, 2004, p 16) corporate social responsibility (CSR) provides a further societal dimension regarding a

business approach for addressing the social and environmental impact of corporate activities (Du and Vieira, 2012). CSR reporting can be defined as “the process of communicating the social and environmental effects of organisations’ economic action to particular interest groups within society and to society at large” Gray et al. (1996, p 3) aligning corporate values and behaviour with the expectations of stakeholders (Silberhorn and Warren, 2007). The process of communication of CSR can be achieved in variety of ways including via the company’s annual report.

Neoclassical theory propagated by Friedman (1962) argues that the social responsibility of business is to make profit for the investors. However, Davis (1973) argues that CSR involves the firm’s consideration of, and response to issues beyond the narrow economic, technical and legal requirements of the firm, thereby effecting social benefits alongside traditional economic gains, thus organisations have wider responsibilities than simply making profits for shareholders (Gray et al., 1996). These responsibilities include activities regarding aspects of workplace safety, employee training and development, engaging with local communities and environmental concerns (Mathews, 1997). Paradoxically Wood and Jones (1995) argue that such behaviour will enable them to achieve a competitive advantage through developing lasting productive business relationships. However, motivation of CSR engagement can be driven by corporate self-interest (Moon, 2002), such as creating positive corporate image to their stakeholders (Belal and Owen, 2007) building a reputation of quality, reliability and honesty through an explanation of their social responsibility attributes (McWilliams and Siegel, 2001).

Generally, CSR activities and reporting practices are on a voluntary basis in many developed and developing countries and are not required by law (Bouten et al., 2011; Deegan, 2002). Ethical responsibility recognizes “that corporate integrity and ethical behavior go beyond mere compliance with laws and regulations” (Carroll, 1991, p 41) whilst philanthropy is an entity’s desire to promote the welfare of others, (Carroll, 1991, p 41) neither driven by legal or ethical imperatives.

### ***Libyan context***

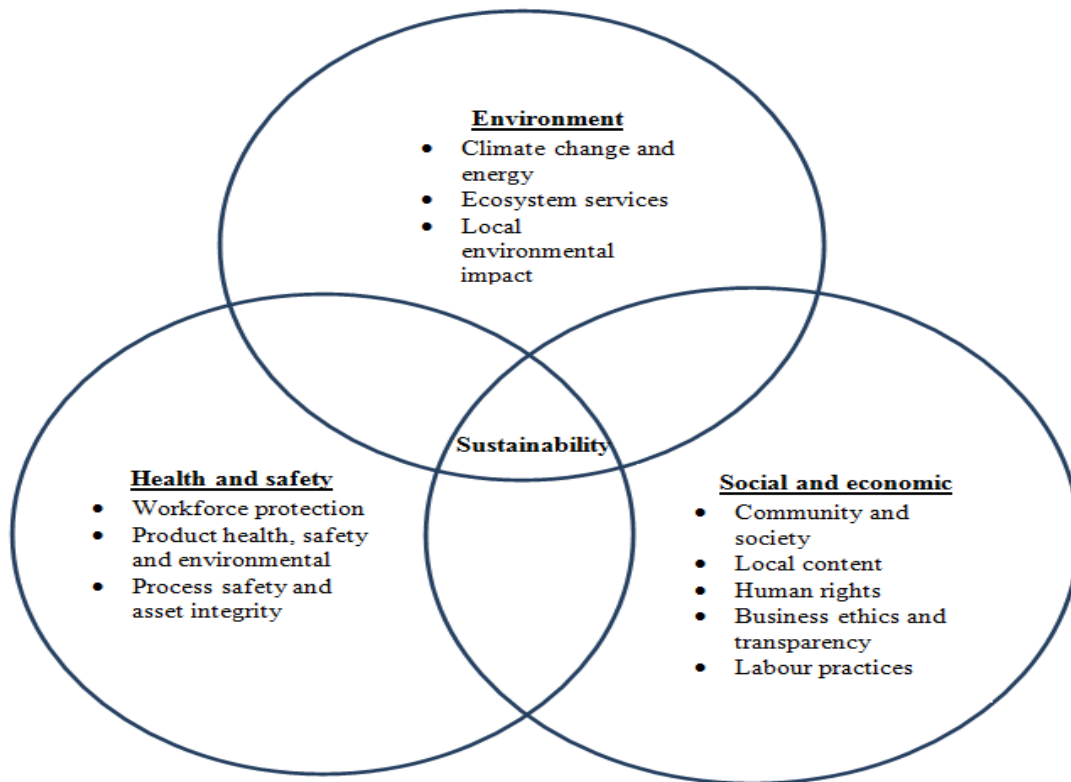
The paper aims to address the limited knowledge regarding stakeholders’ perceptions of CSR reporting in developing countries, with reference to the oil and gas industry in Libya. Stakeholder perception of CSR has been widely investigated in developed economies;

however, very little work has been done for developing economies. This paper will consider stakeholder perspectives from a number of vistas including the motivations for organisations to report, the governance required for such reporting, the necessity for a mandate on reporting and finally the purpose of reporting on CSR issues. Stakeholder abilities as outlined by Mitchell et al., (1997) will be tested within the Libyan context to evidence stakeholder power, urgency and legitimate rights to CSR information. Consideration will also be given to the specific issues concerning external and internal stakeholders. A focus on examining managerial perceptions about CSR reporting practices will add value to the existing literature (e.g. Balel and Owen, 2007) and explore the motivations and barriers of managers behind undertaking such practices.

### ***CSR Guidelines***

Frynas argues that “the oil and gas companies would benefit from a more robust system [of social and environmental industry standards] that’s relevant to them” (Frynas, 2009, p 69). The International Petroleum Industry Environmental Conservation Association (IPIECA) provide companies with guidance of a voluntary sustainability reporting system (IPIECA et al., 2010) reporting on environmental, health and safety, social and economic performance, as shown in Figure 1, and will be used as a point of reference in regard to stakeholders’ perceptions.

**Figure 1: CSR dimensions based on IPIECA et al. (2010) framework**



**Source: Adapted from IPIECA et al. (2010) framework**

## **THEORETICAL FRAMEWORK**

Stakeholder theory is the most widely accepted and frequently used framework within literature (e.g. Depoers et al., 2016; Dong et al., 2014; Uwuigbe and Olusanmi, 2013; Wang and Juslin, 2013; Viveros, 2017) identifying the corporate constituencies (stakeholders), the influences they have on the firm and the best way of responding to these influences (Andriof et al, 2002), assisting in stakeholder management (Donaldson and Perston, 1995) protecting the reputation of companies (Spence, 2011). A stakeholder is defined as: “Any group or individual who can affect or who is affected by the achievement of the firm’s objective” (Freeman 1984, p 46). Stakeholders may have a legitimate claim on the firm, such as employees, managers, suppliers, shareholders, customers, and investors (Hill and Jones, 1992) or be seen as secondary stakeholders including non-governmental organisations, trade union and the media (Eesley and Lenox, 2006). Maingnan and Ferrell (2004) categorised the stakeholders into internal e.g. employees and external e.g. local residents.

O'Dwyer et al. (2005a) argues that the perspectives of non-managerial stakeholders have been largely ignored in CSR literature (see also, Momin, 2013) such as the local community (McWilliams and Siegel, 2001). Local communities may not be a constituent body on their own but may rely on NGO support to scrutinise the activities of companies and develop strategies that may influence companies to act in a socially responsible way (Doh and Guay, 2006). Governments require information to ensure that companies are operating according to agreements as set and to the benefit of society.

In assessing stakeholder influence Mitchell et al. (1997) identify three critical factors: power to influence the company, urgency of the stakeholder's claim on the company to undertake immediate actions and legitimacy of the stakeholder's relationship to the company. Stakeholder ownership of such attributes affects their salience and the degree to which managers give priority to competing claims of stakeholders. Their model leads to three categories and different classes of stakeholders from latent (possessing only one attribute) thus having low salience in the eyes of managers, expectant (possessing two of the attributes) and highly salient stakeholders (possessing all three attributes). This paper will utilize Mitchell et al's (1997) framework to understand the salience of stakeholders within Libyan CSR reporting.

## **RESEARCH METHODOLOGY**

A quantitative approach is adopted in this study to investigate stakeholders' perceptions of CSR reporting in developing countries. The questionnaire survey developed within the methodology is designed based on themes considered within extant literature. The questionnaire considers CSR reporting in the Libyan Oil and Gas industry applied to internal and external stakeholders. From a functionalist standpoint, the quantitative questionnaire is used to understand CSR reporting in the Libyan Oil and Gas industry comparing the different stakeholders' viewpoints with a specific interest in internal and external stakeholders. The questionnaire approach to CSR reporting research is used in this area by many academics researchers (e.g. Al-Khater and Naser, 2003; Mahmood and Humphrey, 2013).

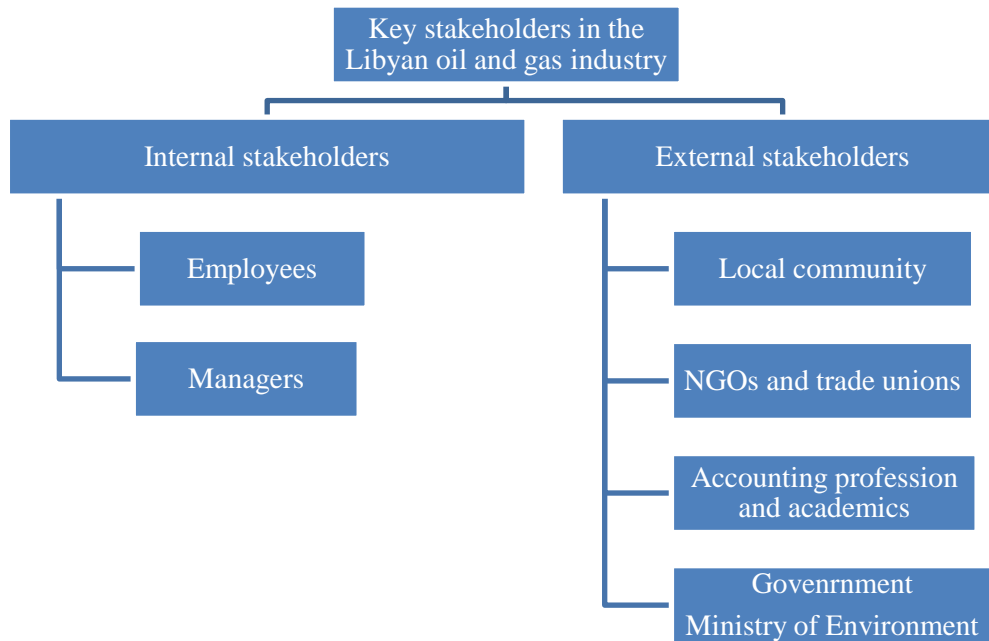
### ***Libyan Oil And Gas Industry Vs Stakeholders***

To consider CSR reporting in an emerging economy context the researchers considered the Libyan Oil and Gas industry a highly significant sector to that economy generating 95 per cent of export earnings, one-quarter of its gross domestic product (OPEC, 2014; World Bank,

2014) providing employment to 20% of the populace (Edwik, 2007). The industry is state-owned and controlled by the Libyan National Oil Corporation LNOC, and dominated by several international oil companies (IOCs) engaged in exploration/production agreements with the LNOC.

The study requires the identification of stakeholders which is dependent on each organization’s context (Jonker and Foster, 2002). The stakeholders in the study were selected based on prior literature (e.g. Al-Khater and Naser, 2003; Huang and Kung, 2010; Naser and Abu Baker, 1999). The researcher considered the difference between the internal and external stakeholder groups, due to their differing areas of interest. The stakeholders identified are shown in Figure 2.

**Figure 2. Stakeholders regarding CSR in Libyan oil and gas industry**



Employees are of particular significance in the oil and gas industry due to the environmental and health and safety aspects. Employees in Libya are largely dependent on the trade unions which are controlled and administered by the government (ITUC, 2007). Prior studies recognise the importance of union involvement in CSR issues (Preuss, 2008; Hughes, 2001; Utting, 2000). Another key stakeholder group are managers who are not only affected by CSR policies as employees but also may affect such policies affecting stakeholder groupings (Neu et al., 1998).



Local communities will be particularly affected if neighbouring the pipeline sites being interested positively in the provision of employment and development programmes in health, education, and transportation systems, but also negatively in regard to clean and healthy environments (Tuodolo, 2009). Often the needs of local communities are supported by NGOs aiming is to secure a socially and environmentally responsible approach to operational activities (Arenas et al., 2009; Vlor, 2005).

The Libyan Ministry of Environment (MOE) is one of the primary stakeholders being given responsibility for protecting the environment. Accounting professionals also have a role to play in the reporting to stakeholders (Kuasirikun, 2005). Within Libya the Libyan Accountants and Auditors Association (LAAA) is responsible for establishing and monitoring accounting standards and practices (Shareia, 2010). Academia can also have a significant influence not only in accounting practice but also accounting education (Pratten and Mashat, 2009).

### RESEARCH SAMPLE

The target population of the Oil and Gas companies in Libya is all companies involved in Exploration Production. The questionnaires were hand-delivered to the respondents and collected after an allocated time, in line with similar research studies on corporate responsibility in Arabic countries (Al-Khater and Naser, 2003; Al-Razeen and Karbhari, 2004). A total of 700 questionnaires were distributed to the research participants out of which 360 were returned with 347 usable questionnaires during that period (a 51.4 per cent response rate). The questionnaire was developed after pilot studies using 25 research UK research students and then in Arabic with 25 respondents in Libya.

Table 1 shows the number of participants asked to take part in the study and those who responded as well as the number interviewed.

**Table 6. Sample Size by Respondents Groups.**

Respondent Groups	Questionnaires remitted	Questionnaires completed (% of sample)
Employees	200	90 (25.9%)
NGOs and Trade Union	50	35 (10.1%)
Accounting professional and Academics	100	53 (15.3%)

Local communities <sup>35</sup>	300	158 (45.5%)
Managers	50	11 (3.2%)
Total	700	347 (100%)

The normality assumption is tested statistically using the Kolmogorov/Smirnov test which confirmed that the CSR reporting characteristics data do not satisfy the assumption of normality, making it necessary to perform non-parametric methods of analysis (Kruskal-Wallis test and Mann-Whitney tests). For internal validity, the result of the questionnaires was checked for internal consistency using the Cronbach Alpha coefficient test and found to be internally consistent. In respect of the external validity, the results of the current study, can be generalised and considered<sup>35</sup> representative of the Oil and Gas industry in emerging economies. However, the scope to generalise the findings of the current research to other industries or to developed countries is considered to be limited.

## FINDINGS

### *Stakeholders' perception*

Data collected regarding stakeholder perceptions (Table 2) provided information on the mean score and standard deviation but also information regarding whether there were differences in the mean scores<sup>36</sup> between all stakeholder groups (Kruskal-Wallis test) and also between internal and external stakeholder groups (Mann-Whitney test). Secondly data is analysed pertaining to perceptions of the stakeholders' status regarding such reporting information utilising Mitchell et al.'s (1997) model.

Regarding the motivation for reporting all stimuli are scored high in terms of importance but there is little between the ethical, international and national stimulus. There is similarity between the stakeholders' groups ( $P > .05$ ) in regard to each motivation whilst there is also no statistically significant difference between internal and external stakeholders' perceptions. In terms of governance the role of the accounting profession and industry standards are ranked similarly and seen as important per the high means with again no differences between the stakeholder groups or between internal and external stakeholder groups. The results are weighted heavily in favour of mandatory disclosure with substantive differences in the mean although again no differences between stakeholder groups nor internal/external groups.

<sup>35</sup> The target group of the local communities who are neighbouring the Oil and Gas operation activities (e.g. the pipeline sites)

<sup>36</sup> The questionnaire used a Likert scale with 4 being strongly agree and 0 being strongly disagree.

Regarding reporting purposes respondents attached high scores to all of the suggested purposes with the highest score to assisting governments. Interestingly two of the stakeholder groups most affected by oil and gas corporation activities, employees and the community, scored the lowest. The Kruskal-Wallis test indicates that there is a significant difference between stakeholders' perceptions between two groups (the local community and NGOs) at  $p < .05$  with no significant differences between internal and external stakeholders.

**Table 2: Stakeholder perspectives regarding CSR reporting.**

CSR Motivations				Kruskal-Wallis Test all stakeholder groups		Mann-Whitney test P-values internal v external stakeholders		
	Mean	Std. Dev.	Rank	$\chi^2$	Sig.	Mann-Whitney U	Z	Sig.
CSR as an ethical consideration	2.9683	.94449	2	7.835	.166	11,739.5	-.850	.396
CSR reporting due to international pressure	2.9424	.96596	3	2.146	.829	12,320.0	-.129	.898
CSR reporting due to national pressure	2.9712	.93071	1	9.727	.083	12,074.0	-.438	.662
<b>CSR Reporting Governance</b>								
Should be governed by accounting profession	3.0346	.93361	2	5.229	.389	11,317.0	-1.379	.168
Should meet industry standards	3.0692	.90971	1	2.595	.762	12,149.5	-.344	.731
<b>Mandatory v voluntary reporting</b>								
CSR reporting should be mandatory	3.0749	.94357	1	2.816	.728	11,831.0	-.740	.459
CSR reporting should be voluntary	2.2248	1.34987	2	5.701	.336	11860.5	-.680	.496
<b>Purpose</b>								
To assist managers	2.9424	.85823	3	1.077	.956	12,139.0	-.361	.718
To assist employees	2.9135	.91140	4	4.482	.482	11,928.0	-.619	.536
To assist government	3.0951	.81152	1	3.661	.599	12,154.0	-.342	.732
To assist local communities	2.9107	.91587	5	11.90	.036	11,748.5	-.842	.400
To assist NGO's	3.0231	.91205	2	12.11	.033	11,795.0	-.784	.433

**Stakeholder characteristics regarding CSR**

In order to measure stakeholders' influence in regard to CSR reporting the framework provided by Mitchell et al. (1997) is utilised.

**Table 3: Stakeholder group influence regarding CSR reporting**

Statements Stakeholders	Statistical test	Statement (Power) (1)	Statement (urgent) (2)	Statement (legitimate right) (3)
Managers	Mean	2.2727	2.8182	3.2727
	Std. Deviation	1.19087	1.16775	.90453
	Mean Ranking	<b>3</b>	<b>2</b>	<b>1</b>
employees	Mean	2.1444	3.0667	3.1111
	Std. Deviation	1.15691	.85853	.94148
	Mean Ranking	<b>3</b>	<b>2</b>	<b>1</b>
NGOs	Mean	2.3333	3.2500	3.2917
	Std. Deviation	1.20386	.98907	.75060
	Mean Ranking	<b>3</b>	<b>2</b>	<b>1</b>
Accounting & Academics	Mean	2.4151	3.3019	3.2075
	Std. Deviation	1.32192	.74897	.81709
	Mean Ranking	<b>3</b>	<b>1</b>	<b>2</b>
Member of local community	Mean	2.2089	2.9747	3.0570
	Std. Deviation	1.23667	.95737	.95266
	Mean Ranking	<b>3</b>	<b>2</b>	<b>1</b>
Trade Union	Mean	1.9091	2.9091	3.0000
	Std. Deviation	1.37510	1.22103	1.00000
	Mean Ranking	<b>3</b>	<b>2</b>	<b>1</b>
All stakeholders	Mean	2.2248	3.0605	3.1153
	Std. Deviation	1.22647	.92450	.91454
	Mean Ranking	<b>3</b>	<b>2</b>	<b>1</b>

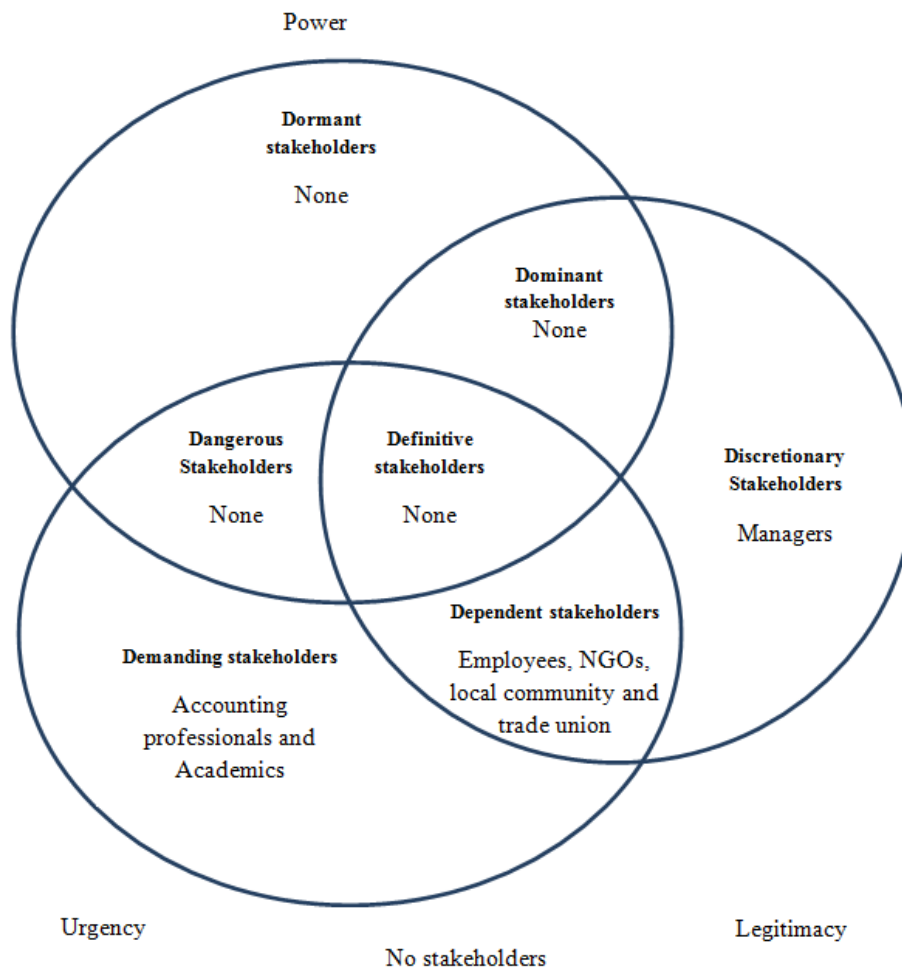
Table 3 shows that all stakeholders perceive that they have limited or no power to influence and affect the Oil and Gas companies regarding CSR reporting activities (2.2248). In contrast stakeholders believe strongly they have a legitimate right to the information (3.1153) as well as recognising an urgency in receiving this information (3.0605). The Kruskal-Wallis test findings (Table 4) indicate that there is no significant difference among different stakeholder groups regarding their power, urgency and legitimacy. Likewise the Mann-Whitney test show that both internal and external stakeholders feel powerless due to their lack of capacity to control the main Oil and Gas companies' resources and activities.

**Table 4: Test of correlation of stakeholder groupings**

Attributes	Kruskal-Wallis test for stakeholder groups		Mann-Whitney test for internal/external stakeholders		
	X <sup>2</sup>	Sig	Mann-Whitney U	Z	Sig
1. Power	3.335	.649	11,758.0	-.806	.420
2. Urgency	6.719	.242	12,077.5	-.432	.666
3. Legitimacy	1.962	.854	12,204.5	-.275	.784

The results in Table 4 are applied to Figure 2 to identify Libyan stakeholders' influence to CSR, showing that no stakeholder groups are able CSR reporting. Most stakeholder groups are identified as dependent stakeholders, including employees, NGOs, the local community and trade unions, who have urgent claims but limited legitimacy, depending upon others to carry out their concerns over CSR issues (e.g. NGOs for local community and trade unions for employees). However, NGOs and trade unions believe they have little or no power to influence the Oil and Gas companies to satisfy the claims of these stakeholder groups. Managers are seen as discretionary stakeholders, who possess legitimate rights to CSR reporting, but have neither power to influence nor a great urgency for the information. Meanwhile accounting professionals and academics have been identified as demanding stakeholders, having only urgency in wishing to affect CSR reporting activities but neither power nor legitimacy, thus only indirectly impacting CSR reporting.

**Figure 3: The abilities of stakeholders in the Libyan Oil and Gas sector, according to Mitchell et al.'s (1997) model**



## DISCUSSION AND CONCLUSION

In regard to motivation for CSR reporting the stakeholders' high scores for provides evidence for catalysts for reporting with only minor differences between national, ethical and international perspectives. Ethical drive, without external pressure from stakeholders, would lead to a voluntary performance. Stakeholders emphasise IOCs ethical responsibility to overcome the current absence of an effective legal obligation to report CSR information. This is consistent with Wartick and Cochran (1985) that CSR rested on organisations having an implied set of obligations in the form of a social contract.

International pressure to report being scored high indicates that participants believed that with IOCs operating within a global sphere then the CSR international norms should

impact on the local context. The negative global impacts of IOCs through environmental disasters have affected IOCs reporting mechanisms with corporate demands being placed on them regarding their CSR. International influences are also affected by the differing ethnicity of IOC employees bringing multinational experience to the Libyan context. International pressure may also be expected due to universal guidelines such as the IPIECA framework. This concurs with Golob and Bartlett (2007) regarding such international frameworks being suitable globally. This also aligns with Belal and Owen (2007) who argues that companies operating in developing countries will be put under pressure to comply with the requirements of international social accounting standards/codes due to external market forces. The national pressure can be explained by the fact that the international requirements for CSR may not fully address specific local social and environmental issues and perceived present failure of IOCs to fulfil their local CSR activities and reporting requirements. The Kruskal-Wallis test reveals similar motivations between the stakeholders' groups which is consistent with Al-Khater and Naser (2003) who demonstrated a high degree of consistency among stakeholders' responses in Qatar.

Regarding governance the stakeholders scored highly for both the accounting profession and the International Standards bodies. However, in the Libyan context, the LAAA have been responsible for establishing and monitoring accounting standards and practices in Libya for more than three decades (Ishmela, 2010; Shareia, 2010). Logically, the adoption of any CSR standards should be adopted and monitored by the LAAA, who may also influence companies to use such standards. Whilst stakeholders perceive the need for the accounting profession involvement this should be countered by the perceived weakness of the accounting profession in Libya, regarding their inability to serve the business community their not playing any major role in governing and developing accounting professionals (Ishmela, 2010) and their lack of awareness of the importance of CSR disclosure (Lodhia, 2003).

Industry standards being significant governance follows increased pressure from stakeholders to adopt these standards (Ballou et al., 2006). Also industry standards may be scored high due to uncertainty that individual local standards set may be effective. The Libyan Oil and Gas industry is a member of IPIECA and thus aware of CSR practice guidelines as contrasted with the LAAA. Industry standards being significant governance follows increased pressure from stakeholders to adopt these standards (Ballou et al.,



2006). Also industry standards may be scored high due to uncertainty that individual local standards set may be effective. The Libyan Oil and Gas industry is a member of IPIECA and thus aware of CSR practice guidelines as contrasted with the LAAA.

Regarding the purpose of CSR reporting the major group who benefit from such information is seen as the government. This high score can be explained by the fact that international companies in Libya are controlled and supervised by the Libyan government. It can be argued that government has the power to set and enforce regulations for CSR reporting information, and to punish those that do not abide by these regulations. This could drive IOCs to disclose CSR information beyond merely ethical obligations to ensure that their existing in the market is not threatened and not endanger maintaining an operating license within the country.

The importance of NGOs and the difference in stakeholders' perceptions regarding the use of information by NGO's may be explained in regard to the community stakeholder group. Local communities felt strongly that they are better being represented by NGOs whereas other stakeholders, such as employees, do not see the importance of NGOs.

Regarding managers being scored highly and ranked third is that they are perceived to have the power to be effective in making decisions and planning for future CSR activities. This result contradicts Al-Khater and Naser's (2003) study, which had managers being awarded the lowest mean score in the Qatari environment explained by this study's selection of investor and stakeholder groups which is weighted towards shareholders which is not so relevant in Libya due to it's different economic system compared with Qatar. Employees received one of the lowest scores and are consistent with the findings of prior studies (Al-Khater and Naser, 2003; Naser and Baker, 1999). This finding is also consistent with Jaggi and Zhao (1996), who believed that respondents think that employees have no rights to neither access such information nor benefit from such information, whilst Wang and Juslin (2013) argue that employees are less important stakeholders, compared with managers and shareholders, who have significant power in making decisions. This is also due to the high score given to trade unions, who act as the representative of the employees.

Local community as a stakeholder is seen to benefit least from CSR reporting information. These results are consistent with the findings of prior results (Al-Khater and Naser, 2003; see also Jaggi and Zhao, 1996). The Kruskal-Wallis test result reveals that

there is not a general agreement amongst the research participants regarding the benefits to the local community. The possible explanation for this result may be due to the high mean score of the NGOs, who act as the representatives of the local community. Thus the local community may feel less influential to change Oil and Gas related decisions; therefore, they rely on NGOs to act on their behalf.

Regarding stakeholder influence in regard to CSR reporting there is a general perceived lack of power amongst stakeholders which is consistent with prior literature (e.g. Doh and Guay, 2006). This is concerning as CSR activities are affected by the relational attributes of stakeholders and their ability to pressurise and influence (Jamali, 2008). On the other hand, the majority of stakeholder groups believe they have legitimate rights and that CSR is an urgent issue. More interestingly, most of stakeholders' rate sense of urgency as second most important behind legitimacy, whereas accounting professionals and academics prioritise urgency for CSR reporting, perhaps recognising that they have limited rights due to their indirect contact to the operations of the Oil and Gas industry.

Stakeholders' attributes may also shape the level of CSR reporting practices in the Oil and Gas sector in Libya. For example, if stakeholders have limited or no power to influence CSR, no urgency to respond to CSR requirement and low legitimate rights for CSR reporting, the stakeholders are most likely to be less active in advocating CSR reporting. It is noted that there are three main identified types of stakeholders in the Libyan context, discretionary, dependent and demanding stakeholders with no power but with urgency and legitimacy. However, if stakeholders have one or more attributes such as urgency to claim or legitimacy right for CSR information, then the stakeholders in Libya are more likely to be more active regarding such reporting. Therefore, it can be argued that the legitimate rights and an urgency of need regarding CSR issues might affect Oil and Gas companies in Libya regarding acting in social and environmental ways, despite the stakeholders' lack of power.

Moreover, the awareness of professional stakeholders such as the (LAAA) can enforce CSR reporting practices. For example, CSR issues are complex and dynamic in nature (Halme and Laurila, 2009), this complex nature may require stakeholders to have special skills and qualifications. Therefore, the actual CSR information practices can be improved through the higher awareness and quality of professional stakeholders.

However, the views of the research participants indicate that there is limited role for the LAAA in enforcing, preparing and auditing CSR issues in Oil and Gas companies due to their weaknesses in focusing on the complex and dynamic nature of CSR. It can be concluded here that the LAAA as a key stakeholder should be given more attention in terms of ongoing training to develop accounting in general and CSR reporting in particular, to enforce the CSR reporting practices in the Libyan Oil and Gas context. Given the negative perception regarding the awareness as well as skills of the (LAAA) accounting professionals in Libya it is unlikely that they can force CSR reporting in the Libyan Oil and Gas industry to be more effective in the near future.

One other theme in the findings is the importance of surrogate parties such as NGOs and Trade Unions. Some stakeholders who prioritise themselves as low in regard to CSR as compared with other key stakeholders, allow others (e.g. NGOs and trade unions) to require and use such information to provide benefits on their behalf. This may be due to a dependency culture and or their lack of power to influence IOCs and also the lack of knowledge about CSR of these stakeholders (employees and the local community).

The finding of this study will provide interesting background information for further study in this area of research in Libyan context. Further research is suggested into the forms of CSR activities and reporting within IOCs and also the reporting mechanisms between the IOCs and the government. The form of research could also be taken to other industries where CSR is critical and also to other developing countries.

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تطبيق الدية كتعويض عن حوادث السير المرورية في سلطنة عمان: دراسة حالة المدينة تكافل

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**ملخص**

في الأساس الدية أصلاً عقوبة للقتل الخطأ وكذلك عقوبة بديلة في حالة القتل العمد، في الوقت الحاضر فالدية تختلف قيمتها وآلياتها وتطبيقها. في مصر على سبيل المثال رأت لجنة الفتوى أن أفضل طريقة لتقييم حياة الإنسان وأعضائه عن طريق سعر الذهب. بينما أصدر المفتي الأكبر في سلطنة عمان فتوى بمقار الدية خمس عشرة ألف ريال عماني (بما يعادل مائة وخمسة عشرة ألف رنجت ماليزي). تهدف هذه الورقة لدراسة إطار الدية كعقوبة أصلية في حالات الحوادث وبشكل خاص ما يتعلق بحوادث الطرق. ستنظر الورقة في مجال التأمين الإسلامي (التكافل) وكيف يتم تطبيقه فيما يخص سياسة تأمين المركبات المتعلقة بمطالبات التعويض سواء للجروح الشخصية أو الوفاة. كجزء من طموحنا لإيجاد نماذج لماليزيا من حيث آلية الدية فضلا عن حل للمطالبة بتعويض الإصابات الشخصية الناجمة عن حوادث السير في ماليزيا، فإننا نختار عمان كحالة للدراسة. ولهذا الغرض سيتم استخدام (تكافل المدينة) كنموذج لهذه الدراسة لأنها أول شركة تكافل يتم الترخيص لها في عمان منذ العام 2014م. الطريقة المستخدمة هي الملاحظة والمقابلة الشخصية مع إدارات الشؤون القانونية والتعويضات في تكافل المدينة. قابلنا العديد من الموظفين خلال زيارتنا البحثية لمسقط في أبريل 2017م. ويستند هذا المرجع على وثائق في (مدينة تكافل) كما يستند على وثيقة سياسة التأمين الموحد للسيارات التي أنتجتها وعممتها هيئة السوق المالية العمانية. يتوقع أن المقارنة مع النظام الماليزي ممكنة حتى يتسنى العثور على حلول تطويرية للمطالبات الناتجة من حوادث السير والتي هي في تصاعد في ماليزيا.

**المقدمة**

تعد حوادث المرور وتعويض الضحايا من الحوادث المرورية من القضايا التي لاقت عناية بالغة من قبل المشرعين نظرا لخطورتها لما تسببه الحوادث من خسائر في الارواح والاموال، لذلك فقد اصدرت الدول العديد من التشريعات

التي توفر الحماية للأشخاص ، وبما يضمن لضحايا الحوادث المرورية الحصول على التعويضات المناسبة ، وقد اصدر المشرع العماني منظومة قانونية تنظم احكام الحوادث المرورية وقواعد التعويض عن الاضرار الجسمانية.

وتلعب شركة المدينة تكافل دورا كبيرا وبارزا في التغطية التامينة للمتضررين من حوادث السير، اذ تغطي صورا تامينة متعددة ومن اهمها التامين الإجباري والتعويض للوفاة والاضرار البدنية ، وتمارس نشاطها وفقا للقوانين المقررة في الدولة ، وما تتميز به الشركة انها تعمل وفقا لاحكام الشريعة الإسلامية ، وما يعرف في فقه الشريعة التكافل والذي يرجع في اساسه إلى التعاون والتكافل في تحمل الخطر وتفتيت الاضرار التي تصيب الجماعة ، وقد اعتمدت الدية كتعويض للاصابات في الحوادث المرورية بما يتفق مع احكام الشريعة الإسلامية.

ونتناول دراسة هذا الموضوع في ثلاثة مباحث خصص المبحث الأول للتنظيم القانوني لتعويض الضحايا الحوادث المرورية في سلطنة عمان، وخصص المبحث الثاني الدية كإطار لتعويض عن الحوادث المرورية في شركة المدينة تكافل، والمبحث الثالث: التعويض بالدية ومقدارها في المدينة تكافل.

### **المبحث الأول: التنظيم القانوني لتعويض الضحايا من الأضرار الناتجة من الحوادث المرورية في سلطنة عمان**

تملك سلطنة عمان منظومة قانونية متكاملة ، والتي تهتم بمعالجة الحوادث المرورية وما يتصل بالتعويضات عن الاضرار الجسمانية الناشئة عن الحوادث المرورية ، والتي من خلالها حقق المشرع العماني الحماية القانونية للانسان وكفل له الحصول على التعويض المناسب للضرر الذي يلحق به من جراء الحوادث المرورية وما يترتب على تلك الحوادث من فاة الأشخاص والاصابات البدنية التي تعطل منفعة الانسان باعضائه فيحرم من حياته العادية ومن دخله الاقتصادي ، ولمواجهة كل ذلك وبما يحقق مصلحة الضحايا اقر المشرع عدد من التشريعات ومنها قانون المرور وقانون تأمين المركبات الذي يعد قفزه نوعية كبيرة في اضعاف الحماية التشريعية للمتضررين من الحوادث المرورية والحصول على التعويضات عن الاضرار الناتجة عن الحوادث المرورية، كما لا يقل اهمية من تلك التشريعات الوثيقة الموحدة لتأمين المركبات وغيرها من التشريعات المتصلة بقواعد التعويضات للمصابين ، وقد راعى المشرع العماني احكام النظام الاساسي للدولة الذي اوجب على السلطة التشريعية مراعاة احكام الشريعة في اصدار القوانين.

ونقسم الدراسة في المبحث إلى ثلاثة مطالب:

المطلب الأول: خلفية عن التشريعات المتصلة بموضوع الدراسة في سلطنة عمان.

المطلب الثاني: الإطار القانوني لتعويض الأضرار الجسمانية لضحايا حوادث المرور.

المطلب الثالث: الأضرار التي توجب القوانين تغطيتها.

المطلب الرابع: الدية واصلها في الشريعة الإسلامية والقانون العماني

**المطلب الأول: خلفية عن التشريعات المتصلة بموضوع الدراسة في سلطنة عمان.**

ان حوادث السيارات وتعويض الضحايا من المشكلات التي لاقت اهتماما كبيرا من قبل المشرع العماني لذلك قامت الدولة باصدار التشريعات التي توفر حماية للضحايا من الحوادث المرورية وتكفل لهم الحصول على

التعويضات المناسبة فاصدرت الجهة التشريعية في سلطنة عمان منظومة من القوانين التي صدرت في فترات مختلفة، ومنها قانون التأمين وكان اول قانون للتأمين هو قانون شركات التأمين رقم 1979/1م وقانون تأمين المركبات رقم 1994/34م الصادر في 12 ابريل سنة 1994م، والمعدل بالمرسوم السلطاني رقم 34/2007 وهو قانون خاص ينظم عملية تنظيم المركبات في الدولة ومن اهم ما تضمنه اجبارية التأمين، كما تضمن احكاما خاصة تتعلق بشروط وضوابط المركبات، وقواعد تأمين المركبات الصادر بالقرار الوزاري رقم 99/95 والمعدل بالقرار الوزاري 166/98.

ثم صدر بعد ذلك المرسوم السلطاني رقم (خ) 8/2000 الخاص بوثيقة التأمين الموحدة على المركبات في 4/مارس 2008/ ولم يقتصر الامر في تنظيم التأمين على تلك القوانين التقليدية التي تشترك فيها مع الدول المختلفة في اصدار مثل هذه القوانين ، فاصدرت الدولة قانون التأمين التكافلي والذي كان يعد مطلبا ملحا للمواطن العماني كونه القانون الذي يتفق مع الشريعة الاسلامية ، وهو قانون التكافل الصادر بالمرسوم رقم 2016/11 الصادر في 6مارس 2016 والذي ينظم قواعد التأمين التي تتوافق مع احكام الشريعة الاسلامية. كذلك ايضا قانون المرور الذي في نصوصه قواعد تتعلق بالتأمين، ومن القوانين التي تتصل بالتعويض قانون الديات والاوروش رقم 75/34 وتعديلاته بمرسوم سلطاني رقم 83/2 وتعديله الاخير بالمرسوم السلطاني رقم 83 / 2008) وقانو الجزاء رقم 74/7 والمعدل بالمرسوم رقم 2011/4 والذي تناول بالاضافة الى الناحية الجنائية التي تتعلق بالجريمة ، تناول الجانب المدني المتعلق بالتعويض عن الاضرار.

كما صدر بعد ذلك قانون المعاملات المدنية بالمرسوم السلطاني رقم 2013/29 ، والذي اشار إلى التعويض عن الضرر بصفة عامه ، فنصت المادة ( 176 ) من المشروع :على ان كل إضرار بالغير يلزم فاعله ولو كان غير مميز بالتعويض .

(2) إذا كان الإضرار بالمباشرة لزم التعويض وإن لم يتعد ، وإذا كان بالتسبب فيشترط التعدي . ونصت المادة ( 181 ) " يقدر التعويض في جميع الأحوال بقدر ما لحق المضرور من ضرر وما فاتته من كسب بشرط أن يكون ذلك نتيجة طبيعية للفعل الضار . ومما لا شك ان هذه المنظومة من القوانين قد غطت الجوانب المختلفة للقضايا المرورية والتعويضات ، اذ توفر الحماية القانونية لضحايا الحوادث المرورية وتكفل لهم التعويض المناسب عن كل الاضرار الجسمانية من وفاة واصابات بدنية تلحق بهم ، كما تحمل في طياتها العقوبة التي تحد من الحوادث المرورية.

#### المطلب الثاني: الإطار القانوني لتعويض الاضرار الجسمانية لضحايا حوادث المرور.

اولا: إجبارية التأمين في سلطنة عمان .

يعد التأمين الإجباري من حوادث المركبات من الأنظمة الحديثة ، وذلك بغية حصول ضحايا الحوادث المرورية على التعويضات العادلة عن الاخطار والاضرار الجسمانية التي تلحق بهم بسبب الحوادث المرورية اذ يعد التأمين الإجباري ، الأداة التي حددها القانون لحصول المتضررين من حوادث المرور على التعويضات الجارية للاضرار المادية والمعنوية وجعلت تلك القواعد من النظام العام.

ولأهمية هذا النوع من التأمين ، اوجب المشرع العماني على كل مالك مركبة التأمين الإجباري لصالح الطرف الثالث "الغير" وذلك بقصد حماية الغير وحصوله على التعويض الازم عن كل الاضرار الناجمة من الحوادث المرورية ، ويعتبر عقد التأمين الالزامي من المسؤولية عن حوادث السيارات من العقود الهادفة الى تغطية مسؤولية المؤمن له عما يحدثه للغير من ضرر بواسطة مركبته ، وبموجبه تلتزم شركات التأمين بتغطية الاضرار التي تحدثها السيارة المؤمن عليها ، بغض النظر عن قائدها أو مستعملها وقت ارتكاب الحادث سواء اكان السائق اثنا الحوادث مالك السيارة أو حارسها أم غيرهما.

حيث تنص المادة الثانية من قانون المركبات رقم 34 لسنة 1994م على ان (يجب تأمين جميع المركبات لصالح الغير وفق احكام هذا القانون والقواعد التي يصدر بها قرار من الوزير لتنظيم ابرامه ويجب ان يغطي هذا التأمين كل ما يقع للغير- بمن يكون منهم من ركاب المركبة المؤمنه- من وفاة واصابات بدنية ومصاريف العلاج من الحادث وما يقع لممتلكات الغير من اضرار مادية ( باستثناء ما يكون من هذه الممتلكات لدى المؤمن له او من في حكمه برسم الأمانة او في حراسته او حيازته) وذلك من حوادث المركبة التي تقع في السلطنة"

وقد اصدر المشرع في سلطنة عمان وثيقة التأمين الموحدة خ/2019/19، التي وضعت الضوابط والقواعد التي تكفل للمضمر الحصول على حقه بسهولة ويسر ، وضمن مائة الجهة الضامنة والمسؤولة على التعويض.

وللتاكيد على اجبارية التأمين على المركبات ، فقد اشترط قانون المرور العماني للترخيص لسير المركبة التأمين من المسؤولية في الفقرة الرابعة من المادة الثالثة منه التي تنص على انه(يشترط للترخيص بتسيير المركبة الالية استيفاء الشرط التالي:

(4) "التأمين من المسؤولية المدنية الناشئة عن حوادث المركبة لصالح الغير طوال مدة الترخيص طبقا لاحكام القانون الخاص بذلك.

وقد اصطلح على وصف تأمين المركبات على انه تأمين من المسؤولية وهو تعبير عن تنظيم قانوني جعل من مطالبة المتضرر بنا على المسؤولية المدنية الناجمة عن الحادث الخطر محل التغطية في مثل هذا النوع من التأمين كاصل عام <sup>kk</sup> ، وبموجب التأمين تلتزم شركات التأمين التقليدية والإسلامية بدفع التعويضات عن الاضرار التي تصيب الضحية من وفاة واضرار جسمانية و الذي يحدث بسبب المركبات،ومن القوانين التي تعد اطارا قانونيا لتعويض الضحايا بما يتفق مع احكام الشريعة الإسلامية التكاملي ، والذي يوجب على الشركات الإسلامية والتي تعرف بشركات التكافل ان تمارس نشاطها وفقا لاحكام الشريعة الإسلامية ، وحددت التشريعات المنظمة للتأمين على المركبات ،نوعين من المجالات التي يجب تغطيتها والمتمثل في مجال الاشخاص والمركبات، فمن حيث الاشخاص والمركبات تنص المادة الثانية من قانون المركبات على ان " يجب تأمين جميع المركبات لصالح الغير وفق احكام هذا القانون..... وذلك من حوادث المركبة التي تقع في السلطنة وفي نطاق اية حدود جغرافية اخرى يتفق على مد التأمين اليها.."

kk -- اثر شمول إصابات السائق المسؤول عن الحادث في تأمين المركبات الالزامي دراسة في القانون الاردني، أسيد حسن الذبيات، باسل محمودالنوايسه/مجلة علوم الشريعة والقانون، المجلد 42، العدد 2015، 1، ص5،

والمركبة كما تنص المادة الاولى من القانون هي " اية مركبة لنقل الركاب او البضائع او دراجة او عربة او مقطورة سواء كانت تندفع بصورة ميكانيكية او بصورة اخرى ( غير استخدام الدواب في الجر) وتستعمل او من المنوى استعمالها على الطريق داخل حدود السلطنة. " اما الاشخاص فهم المتضررون من الغير او ما يسمى بالطرف الثالث والمقصود به.

#### اساس المسؤولية للحوادث المرورية: ا

مرت المسؤولية عن حوادث السيارات بمراحل متعددة و متدرجة من التشدد والتخفيف ، فقد كان الخطأ هو اساس المسؤولية في حوادث السيارات كما هو الامر في صورة المسؤولية التقصيرية وهو الخطأ واجب الاثبات، وهو ما كانت تذهب اليه كثير من التشريعات ، ولكن ذلك الاساس لم يستمر واتجه البحث عن اساس اخر يقف الى جانب المضرور اكثر من وقوفه الى جانب المتسبب بالحادثة، ، "فقد لاحظ بعض القضاة و الفقهاء، والبرلمانيين في كثير من الدول ان المطالبة بالتعويض عن الأضرار الناجمة عن الحوادث المرورية تمر بمراحل واجراءات معقدة ، لذلك طالب البعض منهم تطبيق نظام اخر لا يعتمد على الخطأ لحل المشاكل والقضايا المرورية والتعويض عنها ، ومنه اصبح جبر الضرر وقيام المسؤولية يقتصر على توافر عنصرين لاغير هما وجود الضرر من جهة شخص معين ، وعقد تامين ساري المفعول وقت الحادث.

وتم التجاوب مع ذلك من قبل الهيئات التشريعية في كثير من الدول وذلك بالاخذ بمبدأ الضرر كاساس للمسؤولية، اذ يتطلب لقيام المسؤولية توفر عنصر الضرر، فهو لوحدة كاف لقيام مسؤولية المتسبب في الحادث<sup>ll</sup>. وبالنسبة للوضع القانوني في سلطنة عمان فان المسؤولية تتحدد وفقا للقواعد العامة في القانون المدني ، والجناي وما جاء من قواعد المحكمة العليا يستدل منها ان اساس المسؤولية الخطأ المفترض والزامية التامين على السيارات لمصلحة الغير<sup>mm</sup>

وتخضع الحوادث المرورية التي تنشأ عنها وفاة او اصابات جسمانية للمسؤولية الجنائية، فتقوم المسؤولية الجنائية لقائد المركبات في الحوادث المرورية، والمحكمة التي تنظر قضايا الحوادث المرورية في سلطنة عمان هي المحكمة الجزائية ، والتي فصلت في كثير من القضايا المتعلقة بالحوادث المرورية<sup>nn</sup>.

وقد نص قانون الجزاء العماني، في المادة (254) على ما يلي: يعاقب بالسجن من ستة اشهر إلى ثلاث سنوات، وبالغرامة من عشرة ريالات إلى خمسمائة ريال أو باحدى هاتين العقوبتين فقط من تسبب في قتل إنسان عن إهمال أو قلة احتراز أو عدم مراعاة الأنظمة" وسبب الحوادث المرورية التي فصلت فيها المحاكم الجنائية الاهمال وقلة الاحتراز أو عدم مراعاة الأنظمة .

كما جاء في المادة (58) ما يلي: كل جريمة تلحق بالغير ضررا ماديا أو معنويا يحكم على فاعلها بالتعويض عن طلب المتضرر" لذلك فان السلطات القضائية بالسلطنة بدءا من المحاكم الابتدائية الى محاكم الاستئناف وإلى المحكمة

<sup>ll</sup>/التعويض عن الاضرار الجسمانية الناجمة عن الحوادث المرورية في الجزائر . موقع الانترنت .fdsd.univ\_guelmadz/sites . جلسة 2004/12/29م قرار رقم330 في الطعن رقم 2004/338م"مسؤولية(جظاًمفترض) واجب العناية والانتباه وعدم التهور

والتزوي في -قيادة المركبة يقوم بافتراض قانوني يقع على عاتق كل من يقوم بقيادتها وفق مايستخلص من نص المادة 1/50 من قانون المرور وذلك حرصا على سلامة وحياة واجسام وممتلكات الذين يشاركون في استعمال الطريق.<sup>mm</sup>

<sup>nn</sup> -انظر مجموعة الأحكام الصادرة عن هيئة توحيد المبادئ والدائرة الجزائية مع المبادئ المستخلصة منها والصادر من المكتب الفني للمحكمة العليا بوزارة العدل في سلطنة عمان لسنة 2004 م . وقد اكد ذلك السيد الياس في المقابلة التي اجريت معه في شركة مدينة تكافل ويخضع المتسبب للحوادث لقانون الجزاء العماني



العليا،تنزل أحكامها وتوقع عقوبتها على الاحداث المرورية بناء على منطوق ومفهوم المادتين. كما أن قانون المرور العماني اعتبر المسؤولية لقائدي المركبات في المادة (1/50) جنائية حيث جاء فيها ما يلي: "مع عدم الاخلال بالتدابير المقررة في هذا القانون أو بأية عقوبة أشد واردة في قانون آخر يعاقب بالسجن مدة لا تزيد على سنة وبغرامة لا تزيد على خمسمائة ريال أو باحدى هاتين العقوبتين كل من ارتكب فعلا من الأفعال الآتية:  
1- سيطرة مركبة على الطريق بسرعة أو تهور أو بدون ترو أو تحت تأثير خمر أو مخدر أو أية مؤثرات عقلية أخرى أو قام بالتجاوز في مكان خطر، أو ممنوع التجاوز في مكان خطر أو ممنوع التجاوز فيه أو بطريقة تشكل خطورة أو تعرض حياة الاشخاص أو أموالهم للخطر، فإذا نتج عن ذلك وفاة شخص، أو إلحاق أذى به نجم عنه مرض أو تعطيل عن العمل لمدة تكون العقوبة فيه السجن مدة لا تقل عن سنة، ولا تزيد على خمس سنوات.  
على أن الأحكام القضائية في الأحداث المرورية التي تصدرها المحاكم القضائية بالسلطنة تعتمد على هذه المادة في قانون المرور وعلى المادتين المذكورتين سابقا في قانون الجزاء العماني"<sup>90</sup>

كما استقرت المحكمة العليا في السلطنة على اختصاص المحكمة الجنائية،النظر في قضايا الحوادث المرورية،وما اكده السيد الياس من المدينة تكافل PP ، وهذا على خلاف القانون المالي الذي يعتبر القضية مدنية وتنتظرها المحكمة المدنية.

#### المطلب الثالث: الأضرار التي توجب القوانين تغطيتها .

حرص المشرع العماني على تحديد الأضرار التي يغطيها التأمين الاجباري ، والتي عادة تصب في حياة الانسان او جسمه ،وكذلك الأضرار المادية للمركبة فالهدف من التأمين هو حماية الانسان المضرور في حالة حصول حادث من المركبة تؤدي الى وفاته او اصابته باضرار بدنية ، اذ تنص المادة الثانية من القانون على ان " يجب ان يغطي هذا التأمين كل ما يقع للغير- بمن يكون منهم من ركاب المركبة المؤمنة- من وفاة واصابات بدنية ومصاريف العلاج من الحادث وما يقع لممتلكات الغير من اضرار مادية:

والاضرار التي يغطيها التأمين وتتكفل بها شركات التأمين هي :

- الوفاة:تعد حياة الانسان اغلى شيء في الوجود ، لذلك فقد حرص لمشرع على ذكر الوفاة كاول الحالات التي يجب ان يغطيها التأمين والنتيجة من حوادث المركبات.
- الأضرار البدنية ، هي كل ما يصيب الانسان من اضرار جسمانية من جروح ورضوض وعجز كلي او جزئي او ما يسبب الاعضاء المختلفة في جسم الانسان ، ونشير هنا الى ان بعض التشريعات كما الجزائري يدخل الضرر الجمالي والتشويه ضمن التغطية التأمينية،وضرر التالم.<sup>99</sup>

<sup>90</sup> - الشيخ أحمد بن سعود السيابي امين عام بمكتب مفتي عام السلطنة لمسؤولية الجنائية لقائدي المركبات،ورقة امين عام الافتاء في سلطنة عمان ،السابق في بحث الفاه في مؤتمر مجمع الفقه الاسلامي الدولي في دورته (21) بالرياض بعنوان (المسؤولية الجنائية لقائدي المركبات) <http://2015.omandaily.om/?p=519> 1

<sup>99</sup> -القالبة الشخصية في شركة المدينة تكافل والتي تمت بتاريخ18يونيو 2017 الساعة من9-11 صباحا.واجرى المقابلة الدكتورة زبيدة اسماعيل.اكاديمية الدراسات الإسلامية .جامعة ملایا.  
<sup>99</sup> - علاوة بشوع،التأمين الإلزامي من المسؤولية المدنية عن حوادث السيارات في الجزائر،رسالة ماجستير ،كلية الحقوق ،جامعة منتوري قسنطينية،2006،2005.

- ومن الاضرار التي يلزم المؤمن بتعويضها نفقات العلاج، اما القانون الماليزي والمسمى بالقانون العام الصادر في 1984 حدد اربعة انواع من الاضرار التي يمكن المطالبة بها وهي:

- (1) الألم والمعاناة وفقدان وسائل الراحة، (2) فقدان الأرباح في المستقبل، (3) فقدان الكسب (4) نفقات الرعاية المستقبلية<sup>٢٢</sup>.

الاضرار المستبعدة من الضمان :

اورد المشرع العماني ،عدد من الحالات التي استثنائها من التعويض وهي حالات ترجع الى مخالفات ارتكبتها المؤمن له وهي وفقا لنص المادة 15 من قانون تأمين المركبات وهي:

أ- اذا ثبت ان التأمين قد عقد بناء على ادلاء المؤمن له ببيانات جوهرية كاذبة او اخفائه وقائع جوهرية ،مما يؤثر في قبول الشركة تغطية الخطر او على سعر التأمين او شروطه. ب- اذا نشأ الحادث عن استعمال المركبة في غير الغرض المرخصة من اجله او في سباق او منافسة او اختبار للسرعة، او عن قبول ركاب اكثر من او وضع حمولة تزيد على المقرر لها ، او نشأ لأن حمولتها كانت غير محزومة بشكل فني او بسبب تجاوزها حدود الطول او العرض او العلو المسموح بها. ج- اذا كان سائق المركبة سواء المؤمن له او شخص اخر يقودها بموافقة غير حائز اصلا على رخصة قيادة لنوع المركبة سارية المفعول - دون ان يكون قد جرد منها او سحبت منه بموجب امر صادر من الجهات المختصة- او كان واقعا تحت تأثير مسكر او مخدر.

-اذا ثبت ان الحادث أو الوفاة او الاصابات البدني قد نشأت عن عمل ارتكبه المؤمن عن قصد ،ولا يترتب على حق الرجوع المقرر للمؤمن وفقا لاحكام هذا البند والشروط الواردة بهذه الوثيقة أي مساس بحق المصورور قبل المؤمن له،

وفي هذه لحالة حافظ المشرع على حقوق الضحايا في الحصول على التعويض اولا، وفي نفس الوقت لم يحمل الشركة المسؤولية وتحمل التعويض بسبب يرجع الى خطأ المؤمن له ، لذلك منح القانون للشركة الحق في الرجوع على المؤمن له في اخذ ما دفعته الشركة من تعويض بدلا عن المؤمن له.

- ويتضح من النص ان القانون ضمن حق الضحية في الحصول على التعويضات الجابرة للاضرار المادية والمعنوية الناتجة من الحوادث المرورية ، اذ لم يجعل من الخطاء او المخالفة من المؤمن له مساس بحق المضورور او الضحية ،فاوجب التامين الإجباري على ملاك المركبات بما يضمن لضحايا الحوادث المرورية الحصول على التعويضات الازمة ،والزم الشركات بدفع التعويض المقرر للطرف الثالث الضحية كماضمن للمؤمن الحصول على مادفعه من تعويض في حال تم دفع التعويض للمؤمن بدون حق، فجعل للشركة بعد ذلك الرجوع على المؤمن له.

المطلب الرابع: الدية واصلها في الشريعة الإسلامية والقانون العماني :

<sup>٢٢</sup> civil law Act 1956 (67 Aet

تعد الدية في الشريعة الإسلامية من الاسس التي يعوض بها ضحايا القتل والاضرار البدنية المختلفة ومنها الاضرار بسبب الحوادث المرورية، لذلك نقسم الدراسة في هذا المطلب إلى مايتي:

الفرع الأول: الدية في الشريعة الإسلامية

الفرع: الدية في القانون العماني.

الفرع الأول: الدية في الشريعة الإسلامية.

اولاً: ماهية الدية والاصل الشرعي لها ومقدارها في الشريعة الإسلامية.

التعريف بالدية:

تعد الدية عقوبة اصلية للقتل الخطأ وعقوبة بديلة للقتل العمد في الشريعة الإسلامية ، واصل مشروعيها القرآن الكريم في قوله تعالى " ..وَمَا كَانَ لِمُؤْمِنٍ أَنْ يَقْتُلَ مُؤْمِنًا إِلَّا خَطَأً وَمَنْ قَتَلَ مُؤْمِنًا خَطَأً فَتَحْرِيرُ رَقِيَّةٍ مُؤْمِنَةٍ وَدِيَةٌ مُسَلَّمَةٌ " سورة النساء اية 92، والسنة النبوية التي فصلت في اصل الدية ومقدارها واحكامها المختلفة.

وعرفت الدية بانها: المال الذي يدفع للمجني عليه او لورثته من بعده وسواء اكانت الجناية على النفس او ما دون النفس ، وسواء اكانت الجناية خطأ او عمد، وعرفت ايضاً انها "مال مقدر بجناية في النفس ومادونها للمجني عليه على جانبيها"<sup>ss</sup> ، فالدية هي المقابل المالي المقدر من قبل الشرع اخذاً بمبدأ تكافؤ الدم والنفس في الإسلام وقد قدرت في الشرع فلايزاد عليها ولاينقص منها عملاً بالسنة الشريفة : المسلمون تتكفأ دماءهم، وتسري على جميع المسلمين لافرق بين كبير وصغير وقوي وضعيف.<sup>tt</sup>

وقد سمي المال في القرآن الكريم دية في قوله تعالى: ودية مسلمة....) اما دية الجروح فيطلق عليه بالاروش

والسنة النبوية وهي المصدر الثاني للتشريع فصلت في احكام الديات، حيث حددت اصل الدية ومقدارها وتحملها وكثيراً من المسائل التي تتعلق بها، ومن الاحاديث النبوية. ماروى عن ابي هريرة رضي الله عنه ان رسول الله صلى الله عليه وسلم قال "من قتل له قليل فهو خير النظيرين إما ان يودي وإما ان يقاد"<sup>uu</sup> ومن ادلة المشريعة في السنة الاحاديث الواردة في مقدارها<sup>vv</sup> ، عن ابي هريرة رضي الله عنه انه في عام فتح مكة قتلت خزاعة حبراً من بني ليث "فقام رسول الله وقال "من قتل له "" وقال " مَنْ قُتِلَ لَهُ قَتِيلٌ ، فَهُوَ بِخَيْرِ النَّظَرَيْنِ إِذَا أُنْ بُعِطِي الدِّيَّةَ ، وَإِذَا أُنْ يُقَادَ أَهْلُ الْقَتِيلِ " <sup>ww</sup>.. قال "

ثانياً الأصل في الدية ومقدارها في الشريعة الإسلامية.

العلامة. محمد بن يوسف اطفيش، كتاب شرح النيل شفاء الغليل ، دار القلم بيروت /مكتبة الارشاد جدة/ الطبعة الثانية، 1392-1972، ج15، ص6.<sup>ss</sup>

<sup>tt</sup> قرار رقم 136 في الطعن رقم 2003/321

<sup>uu</sup> جمال الدين لزليعي، نصب الراية في تخريج احاديث الهداية، 1415هـ/1995م، دار الحديث، ج6 ص375

<sup>vv</sup> -المرجع السابق

<sup>ww</sup> -عبد الله محمد بن اسماعيل بن ابراهيم البخاري، اعتنى به ابو عبد الله محمود، صحيح البخاري، ط1403، 1/2003م، مكتبة الصفاء، ميدان الازهر القاهرة. رقم الحديث 6880 ص327. وانظر محمد بن علي الشوكاني، نيل الاوطار شرح منتقى الأخبار من احاديث سيد الاخير، طبعة الاخير، مصطفى البابي الحلبي زاولادة. القاهرة ، ج7، ص65. المرجع السابق، والزليعي، فخر الدين عثمان نصب الراية لاحاديث الهداية، ج4

اتفق الفقهاء على أن الاصل في الدية الاابل لورود الاحاديث الصحيحة التي نصت على ثبوت الدية فيها ، و استدل الفقهاء على هذا الاصل، من الاحاديث النبوية الشريفة ، من ذلك ماروي عن عبد الله بن عمر رضي الله عنه ان رسول الله صلى الله عليه وسلم قال " إن قتل خطأ العمدة قتل السوط والعصا وفيه مائة من الإبل أربعون منها في بطونها أولادها " اما غير الاابل فقد اختلف فيها الفقهاء، وهي الذهب والفضة والغنم والبقر، والحلل،<sup>xx</sup>، ومن الاحاديث الدالة على ثبوت الدية في الاابل بلاخلاف ، ما ورد في كتاب رسول الله لعمر بن حزام ".....وفي النفس مائة من الاابل"<sup>yy</sup>

والدية باعتبارها تعويضا شرعيا تغطي الأضرار البدنية من عجز دائم وتقويت منفعة او جمال او آلام وغير ذلك من الأضرار البدنية ، ويحكم معها بنفقات العلاج ، وغير ذلك ، وتقدير الدية في الفقه الإسلامي يكون بقدر الضرر ، فالاصل في أعضاء البدن أنه اذا فوت جنس منفعة على الكمال وازال جمالا ، تجب فيه الدية كاملة، والقاعدة في الفقه الإسلامي أن لكل ضرر ارش فالضرر سواء كان جسديا او ماليا معوض عنه.<sup>zz</sup>

### المطلب الثاني: الدية في قانون الديات والاوروش العماني.

#### اولا: تنظيم الدية في القانون العماني.

تختلف التشريعات في تنظيم الدية بين تنظيمه ضمن القانون الجنائي وبين تنظيمها في قانون خاص وقد اختار المشرع العماني تنظيم الدية باصدار قانون خاص بالدية والاوروش ، على خلاف بعض التشريعات التي تنظم احكام الدية ضمن القانون الجنائي، ، حيث اصدر مرسوم سلطاني سمي بقانون الديات والاوروش، محدد نطاق سريانه ومقدار الدية التي تدفع في حال القتل الخطأ والاوروش ، مستمد ذلك من الشريعة الاسلامية ، وما يجب الاشارة اليه ان القانون قد تم تعديله ثلاث مرات بما يتناسب مع مقتضيات الزمان و الظروف الاقتصادية في المجتمع ، فقد صدر اول قانون للدية في عام 1975، با المرسوم السلطاني رقم 74 لسنة 1975م ، ثم عدل بالمرسوم رقم 2 لسنة 1982 والمتضمن تعديل المادة رقم 3 المتعلقة بمقدار الدية ثم التعديل الاخير الذي صدر بالمرسوم السلطاني رقم 118 لسنة 2008م والذي عدل مقدار الدية الى 15000 ريال عماني بالنسبة للرجل ودية المرأة 7500 ريال عماني.

وبذلك فان المشرع العماني قد وضع قاعدة واضحة الحدود في مقدار الدية والتي تطبق كما نص عليه في المادة الثالثة "بان تكون الديات والاوروش شاملة وجابره لجميع الاضرار المادية والمعنوية" .

#### ثانيا: الاصل الشرعي في الدية ومقدراها في القانون العماني.

الاصل في الدية في الشريعة الإسلامية الاابل باتفاق الفقهاء ، والاصل المختلف فيه هو الذهب والفضة والبقر والغنم والحلل، كما اشرنا إلى ذلك - عندفقهاء الشريعة الإسلامية ، ، والاصل في الدية في سلطنة عمان الاابل ، كما جاء في مقابلة امين عام الافتاء وهو ان المشرع العماني جعل الاابل هي الاصل في الدية ومقدارها مائة من الاابل والذي تقدر قيمتها 15 عشر الف ريال عماني وهو ما اعتمدته السلطة التشريعية في المرسوم السلطاني الهاص بالديات والاوروش.

<sup>xx</sup> -ابن قدامة المرجع السابق، وانظر محمد بن يوسف اطفيش لتفصيل في الدية النفس، شرح كتاب النيل وشفاء العليل، المرجع السابق ج15،

<sup>yy</sup>

. - الدية بين العقوبة والتعويض، المرجع السابق ص 583.<sup>zz</sup>

و بين كيفية تقدير الدية بالريال العماني ، بالقول ان تقدير الدية بالريال العماني كان على اساس متوسط سعر الناقدة وهو 150 ريال عماني وبضربها في 100 من الابل تساوي 15000 الف ريال ،وهذا المبلغ هو ما يتناسب مع المقدرة و الحالة الاقتصادية للفرد في المجتمع العماني ، ولم يتم اعتماد الذهب كاساس للتقدير لقيمتة المرتفعه،وقد جعل دية المرأة النصف من دية الرجل عملا بالسنة النبوية ورأي الفقه الإسلامي. <sup>aaa</sup>

المبحث الثاني: الدية كإطار للتعويض عن الحوادث المرورية في شركة المدينة تكافل ونقسم المبحث إلى مطلبين:

المطلب الاول: التعريف بالشركة ومبادئها وصور التكافل فيها

المطلب الثاني: الأضرار التي تغطيها المدينة تكافل للمضرور .

المطلب الثالث: الدية ودورها في اسس تقدير التعويض في القانون العماني والمدينة تكافل

المطلب الاول: التعريف بالشركة ومبادئها وصور التكافل فيها.

اولا: نشأة الشركة.

تعتبر شركة المدينة تكافل اول شركة تامين تكافلي في سلطنة عمان ، وقد استندت الشركة في بداية نشأتها على شركة المدينة للتأمين والتي كانت تمارس التأمين التقليدي ، غير ان الشركة حولت نشاطها من تامين تقليدي الى تامين تكافلي ، وحصلت على الموافقة على انشائها من الهيئة العامة لسوق المال في/2014/1م وذلك بالاسم التجاري " المدينة تكافل"و تعمل وفقانظام التامين التكافلي الذي يتبع احكام الشريعة الإسلامية ، وذلك لتصبح اول شركة في سوق التامين التكافلي في سلطنة عمان، ويستند التامين التكافلي على فكرة التامين في الفكر الاسلامي ويقوم على اساس التعاون والتبرع.

وهناك عدد من الاهداف وضعتها الشركة وتعمل جاهدة على تحقيقها لتقديم خدمة تامينة تغطي قطاع واسع من الخدمات وبما يتوافق مع الشريعة الإسلامية وتعتمد الشركة في مواردها على ما يتم تحصيله من مشاركة المساهمين والتي تعتبر تبرعات وتشكل الصندوق التكافلي والذي بدوره يعوض المستحقين <sup>bbb</sup>

وتعمل المدينة تكافل وفقا لقانون التامين التكافلي ،وهو احد المنظومة القانونية التي تحكم التامين في سلطنة عمان، والذي نظم قواعد واحكام خاصة للقيام بالعمليات التامينة تتناسب مع الاهداف الذي من اجله اصدر المشرع هذا القانون ،ومن الاجهزة الهامة التي تعمل في المدينة تكافل هيئة الرقابة الشرعية التي تتولى الاشراف على اعمال الشركة لمراقبة اعمالها ومدى توافقها مع احكام الشريعة الاسلامية

التعريف بالتامين التكافلي في الفقه الإسلامي والاسس والمبادئ التي تطبقها المدينة تكافل في التامين

مقابلة شخصيته مع الشيخ ماجد امين عام الافتاء بسلطنة عمان، ابريل 2017 قاك بادراء المقابلة الدكتور زبية اسماعيل .اكاديمية الدراسات الإسلامية جامعة ملایا ماليزيا. <sup>aaa</sup>

/ <http://almadinatakaful.com>. <sup>bbb</sup>

التكافلي يقوم على تبرع المشاركين فيه بكل أو جزء من الاشتراكات المقدمة لدفع تعويضات الأضرار التي تقع لبعضهم واقتصار دور الشركة على إدارة أعمال التامين واستثمار أموالها.<sup>ccc</sup>

وقد تكلم الفقه المعاصر عن مشروعية هذا النوع من التامين ، وكذلك المجامع الفقهية، فقد اقر مجمع الفقه الإسلامي المنبثق عن منظمة المؤتمر الإسلامي في دورته الثانية في جدة في ديسمبر 1985/1406، جواز هذا التامين التكافلي والذي قرر "أنه بعد النظر فيما صدر عن المجامع والهيئات بهذا الشأن قرر" ان البديل الذي يحترم أصول التعامل الإسلامي هو التامين التكافلي القائم على اساس التبرع والتعاون، وكذلك الحال بالنسبة لاعادة التامين القائم على اساس التامين التكافلي ، وكذلك إجازة المجمع الفقهي لرابطة العام الإسلامي بمكة المكرمة في 1978، والذي قرر جواز التامين التكافلي بدلا عن التامين التجاري، واستدلوا على شرعيته بعدد من الأدلة منها ، انه من عقود التبرع التي يقصد بها أصالة التعاون وتفويت الاخطار والاشترك في تحمل المسؤولية عند نزول الكوارث وذلك عن طريق اسهام الأشخاص بمبالغ نقدية تخصص لتعويض الضرر الذي يصيب ادهم ، فجماعة التامين التكافلي لا يستهدفون تجارة وربحا من أموال غيرهم وانما يقصدون توزيع الأخطار بينهم والتعاون على تحمل الضرر ، كما ان التامين التكافلي يخلوا من الربا ويقوم على الفكر الإسلامي<sup>ddd</sup>

و المبادئ الاساسية التي تقوم عليها المدينة تكافل، الالتزام باحكام الشريعة الإسلامية في ممارسة نشاطها ، والذي يقوم على فكرة التعاون والتكافل بين الافراد لمواجهة الخطر الذي قد يحدث لاحد اعضائها، عملا بالفكرة الشرعية التي يقوم عليها هذا النوع من التامين وهي " تعاون مجموعة من الأشخاص على تحمل الخطر، والأضرار المحتملة من خلال إنشاء حساب (صندوق) غير هادف للربح له ذمة مالية مستقلة، تجمع فيه الأقساط والإيرادات، وتصرف منه الاستحقاقات من تعويضات ومصروفات، وما تبقى هو الفائض، وذلك وفق نظام الحساب الذي تتوكل في إدارته واستثماره شركة متخصصة وفق أحكام الشريعة الإسلامية:<sup>eee</sup>

وتتمثل الشراكة والتكافل التي تقوم عليه الشركة من خلال جمع اموال الاقساط ووضعها في صندوق واخذ ودفع التعويض للمستحقين الذين تعرضوا لاطار اصابتهم في ابدانهم او اموالهم. ومن القواعد التي تحكم أعمال الشركة هو وجود هيئة شرعية تمارس أعمال الرقابة على أعمال الشرعية للتأكد من تطبيق احكام الشريعة الإسلامية في أعمالها.

وتستخدم الشركة في معاملاتها وادارة مواردها نموذجين هما الوكالة والمضاربة كما جاء في وثيقة التامين "شركة المدينة للتامين شركة خاضعة للشريعة الإسلامية في معاملتها كوكيل للمشاركين في الصندوق التكافلي بإدارة عمليات التكافل مقابل رسوم زكالة ثابتة واستثمار اموال الصندوق التكافل كمضارب.<sup>fff</sup>

صور التامين التكافلي المطبقة في المدينة تكافل.

حقيقة التامين التكافلي ، موسى مصطفى القضاة. مؤتمر شركات التامين التقليدي وشركات التامين التكافلي بين الاسس النظرية والتجربة التطبيقية ، 25-26 ابريل 2011 / كلية العلوم الادارية والاقتصادية والتجارية وعلوم التيسير ، جامعة فرحات عباس سطيف، ص<sup>ccc</sup> 3 . المرجع السابق ص<sup>ddd</sup> 30

eee - التامين التكافلي: الواقع والآفاق" الملتقى الدولي السابع حول: الصناعة التأمينية، الواقع العملي وآفاق التطوير - تجارب الدول جامعة حسيبة بن بوعلي بالشلف كلية العلوم الاقتصادية، العلوم التجارية و علوم التسيير 2012 ديسمبر 04 ، - 03 ، ص 4 -

<http://www.univ-chlef.dz>

<http://almadinatakalful.com/> <sup>fff</sup>. موقع شركة المدينة تكافل الوايب

تقدم المدينة تكافل عدد من الأنشطة او البرامج المتنوعة وبما يتفق مع احكام الشريعة وقانون التكافل وهي في مجموعها تتيح تغطية مجموعة من الحاجات التامينية ومنها :

التامين التكافلي العام: وهو التكافل الذي يغطي عدد من الخدمات والمتمثلة في حماية اموال الاشخاص الاعتبارية من شركات ومؤسسات وحماية اموال الافراد ، وتامين المركبات التغطية التامينية الاجبارية للطرف الثالث والتغطية الشاملة المتمثلة في تغطية المركبة في حال تضررها من الحادث و تعويض مالك قائد المركبة حالة موته او الاصابات البدنية التي قد تحدث له بسبب الخواثر المرورية ، وهناك تغطيات اخرة تقدمها الشركة، ومنها تامين السفر والحريق وتامين المسؤولية ، ومن اهمها والمتصلة بالبحث .التامين الاجباري.للمركبات،:وهو التامين الذي تغطيه شركة المدينة تكافل و المقرر لصالح الطرف الثالث او الغير، وهذا ما جاء في الفصل الثالث من وثيقة التامين الموحد للمركبات وفي الفصل الثالث من الوثيقة التي تنص على ان يغطي التامين الإجباري.

اولا: التامين لصالح الغير(الطرف الثالث) ، وعرف بعض الفقه الغير بانه المتضرر المستفيد من التامين بنص القانون ، وبناء عليه فان مفهوم الغير يتحدد وفق ضاطين:اولهما: كونه متضرر من الحادث المروري الامر الذي يجعله مستحقا للتعويض ابتداء، وثانيهما : ان ينص القانون على استعادته من التامين.

ويقصد بالغير كل شخص غير المومن له ومن في حكمه وغير افراد اسرتيهما ولو كان ذلك الشخص من العاملين لدى المومن له"

والتامين لمصلحة الغير او ممايسمى بالطرف الثالث على وجه العموم، هو نوع من التامين عن المسؤولية ، وهو بهذا عقد يؤمن بموجبه المومن له عن الاضرار التي تلحق به من جراء رجوع الغير بالمسؤولية ، وهو يخضع لمبدأ التعويض في التامين من المسؤولية و تبقى المسؤولية في ذمة المسؤول عن الضرر إنما يتحملها عنه المومن فهو تامين لدين في ذمة المومن له<sup>ggg</sup> ،وبالتالي فان التامين لا يغطي المسؤولية المدنية الناشئة عن الوفاة او الاصابات البدنية لسائق السيارة وقائد المركبة وافراد اسرتيهما كونهما لايعدان من الغير.<sup>hhh</sup>

#### المطلب الثاني:الاضرار التي تغطيها المدينة تكافل للمضروب .

شركة المدينة تكافل كغيرها من الشركات التي تغطي التامين الإجباري ، وهي تعمل وفقا لأحكام الشريعة الإسلامية ووفقا للمنظومة القانونية التي تحكم الأنشطة المختلفة في الدولة فلاتعمل بمعزل عن القوانين الاخرى في البلاد، وهي وان كان تعمل في اطار قانون خاض وهو قانون التكافل ، الا انها تعمل ايضا وفقا للقوانين الاخرى التي تتصل بمجال نشاطها وهو التعويض وتحمل المسؤولية عن المومن له وما يفرضه عليها قانون التامين والمركبات ووثيقة التامين ، والقوانين التي تحدد طرق التعويض ومقداره للضحايا ومنها قانون الدية والاوروش.

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جلسة 2004/6/29 قرار رقم 160 في الطعن رقم 97،98/2004<sup>ggg</sup>  
نشير هنا الى ان قانون التامين المصري الجديد رقم 72 لسنة 2007 لا يستثنى افراد اشرة قائد السيارة ، فهو لم يستبعد الزواصول وفروع قائد السيارة من نطاق المستفيدين من التامين الاجباري ، أي أن التامين يغطي كافة الأضرار التي تحدث لهم من جراء حادث السيارة سواء كانوا خارج السيارة أو ضمن ركابها، وهذا الموقف الذي تبناه المشرع المصري يتفق مع الاتجاه العام للتشريعات الاوربية بصفة عامة ، حيث جاءت تعليمات الجماعة الأوربية الصادرة في 30 ديسمبر 1983 والتي تقضي المادة الثالثة بأن أفراد أسرة أي شخص آخر تتقدم مسؤوليته عن الحادث لايجوز استبعادهم بسبب رابطة القرابة ، من ضمان التامين الإجباري ، وذلك عما يحل بهم من أضرار بدنية. انظر د. احمد شرف الدين ، نماذج التامين الإجباري من المسؤولية المدنية عن حوادث النقل السريع وحوادث المباني ، نادي القضاة 2014، ص 309<sup>hhh</sup>

وعلى ذلك فان المدينة تكافل تغطي الاضرار وفقا لوثيقة التامين الموحدة على المركبات ((فصل 3 من الوثيقة) فقرة 16 من التعريفات الوثيقة الموحد)، والتي تقضي انه "عند وقوع حادث نتج أو ترتب على استعمال المركبة المؤمن عليها يلتزم المؤمن في حدود مسؤوليته المنصوص عليه في الوثيقة دفع جميع المبالغ الملتزم بها قانونا بدفها كتعويض عن الوفاة والاصابات البدنية" التامين على كل ما يقع للغير من وفاة أو إصابات جسمانية وأضرار مادية ومصاريف العلاج، عن الحالات الآتية:-

أ- الوفاة: تعد الوفاة من الاضرار التي يتم تغطيتها في المدينة تكافل، والتي تكون نتيجة الحوادث الناتجة من المركبات، وهو مانصت عليه وثيقة التامين الموحدة ووثيقة المدينة تكافل في الفصل الخاص في التامين على المركبات، وتعتبر الوفاة الناتج عن الحوادث المرورية وفقا لاحكام الشريعة من قبيل الخطأ<sup>iii</sup>، وكذلك في القانون العماني ووفقا لمبادئ المحكمة العليا في سلطنة عمان. <sup>iii</sup>

ب- الاصابات البدنية: وهي الأضرار الجسمانية التي تلحق ضحايا الحوادث المرورية من الطرف الثالث، وتشمل كل ما يصيب المضرور من كسور وجروح وما قد ينتج عن ذلك من تعطل أو تلف للاعضاء او عجز دائم او جزئي، أو أية إصابة بدنية تلحق بأي شخص بما في ذلك ركاب المركبة ما عدى المؤمن له شخصيا وقائد المركبة وقت الحادث وأفراد أسرتهما الوالدان والأولاد والزوج) ويعتبر الشخص من ركاب المركبة إذا كان بداخلها أو صاعدا عليها أو نازلا منها ويعتبر العاملون لدى صاحب المركبة من المشمولين بهذه التغطية باعتبارهم طرفا ثالثا، كما يغطي التامين علاج الاصابات التي تصيب الغير، والنفقات الطبية، والمبالغ المحكوم بها قضائيا من اتعاب المحاماة وغيرها، وهو ما تلتزم المدينة تكافل بتغطية بموجب وثيقة التامين <sup>kkk</sup>

ومن الأضرار التي تقوم المدينة تكافل بتغطيتها الأضرار الجسمانية التي تصيب المؤمن له والمتمثلة في وفاة المؤمن له قائد المركبة ومن في حكمه وأفراد أسرتهما، وكذلك الأضرار البدنية من جروح وكسور للاعضاء والعجز الدائم او المؤقت الذي يصيب قائد المركبة اي من افراد الاسرة .

ويغطي هذا النوع من التامين الحوادث المرورية التي ينتج عنها وفاة المؤمن له و مصاريف علاج المؤمن له وافراد الاسرة من حادث المركبة المؤمنه، و ذلك في حدود المبلغ المحدد في وثيقة التامين.

وتلتزم شركة المدينة تكافل بتغطية هذا النوع من التامين بمقتضى وثيقة التامين بما يسمى بملحق الحوادث الشخصية. وتشمل تغطية الاضرار التي ينشأ عنها الوفاة والاضرار البدنية للسائق والمالك وافراد اسرتها

كما ان من المقرر بموجب المبادئ الصادرة من المحكمة العليا بالسلطنة "ان ما لم ينص المرسوم المذكور عليه في الاصابات والجروح فان المرجع في ذلك احكام الشريعة، فقد نصت المادة الثالثة من المرسوم المذكور على انه: تتحدد الديات والاوروش في الاصابات والجروح على النحو المبين في الملحق المرفق بهذا القانون، وذلك دون الاخلال بالحق في الدنيا والاوروش في الحالات غير الواردة في هذا الملحق

حوادث السير، الشيخ عبد القادر محمد العماري / مجلة المجمع الفقهي ص229، والشيخ عبد الله محمد عبد الله مجلة المجمع الفقهي ص 207 <sup>iii</sup>

. انظر ص15 من البحث.. والشيخ ماجد امين عام الفتوى تاريخ 19 ابريل 2017م <sup>iii</sup>  
المقابلة الشخصية مع السيد الياس رئيس وحدة تقنية المعلومات 18 يونيو 2017م <sup>kkk</sup>



وكذلك من المقرر قضاء ووفقا لما استقرت عليه مبادئ المحكمة العليا" ان عدم النص على بعض الاصابات لايعني عدم التعويض عنها اذ تخضع في هذه الحالة لقياسها بالاصابات الأخرى او لتقدير المحكمة وهذا ما يسمى بحكومة العدل<sup>III</sup>

مما يعني ان الاضرار و الاصابات البدنية من سلطة القاضي التقديرية - يقدرها بحسب قواعد تحديد الضرر والتعويض التي تقرها القوانين المحلية ومنها قانون الجزاء العماني وفقا للمادة (58) والذي نص على سلطة القاضي النظر في التعويض المدني، وكذلك القواعد العامة في قانون المعاملات العماني .، كما يعد من الاضرار او التي تتحملها الشركات الاضرا المعنوية او الادبية<sup>mmmm</sup>

الملاحظ ان المشرع العماني في هذا القانون أشار إلى التعويض عن الاضرار المعنوية، بالنص على اعتبار الدية او الاورش شاملة للاضرار المادية والادبية، واكدت المحكمة العليا ذلك بالقول "يرتبط الضرر الادبي ارتباطا مغنويا بالضرر المادي الناتج من اصابات بدنية سببها الحادث"<sup>nnnn</sup>

وهو ما قد يثير اشكالية في حالة المطالبة بالتعويض عن الاضرار المعنوية الناشئة من الحوادث المرورية.

#### المطلب الاول:الدية ودورها في اسس تقدير التعويض في القانون العماني والمدينة تكافل:

لكل دولة نظامها القانوني الذي به تنظم سلوك ونشاط الافراد في المجتمع، من ذلك تحديد المبدأ الذي يجب الاخذ به ومراعاته عند تقدير التعويض للضحايا في الحوادث المرورية، فهناك من التشريعات من تُدخل في تقدير التعويض عناصر شخصية منها الدخل والعمر والانتاجية ، وتضع معايير محددة يلزم القاضي باتباعها في تقدير التعويض للمضرور ، وبالتالي فان التعويض يختلف بحيث ينظر إلى كل حاله وظروفها ومدى التعطل عن العمل وغير ذلك اذ يتم تقدير التعويض وتقييمه وفقا لطرق حسابية حددها القانون ويلتزم القاضي بها في تقدير التعويض ،ومن ذلك القانون الماليزي الذي جعل من اسس التعويض بالنظر الى الحالة المادية للشخص المضرور وحالته الوظيفية والعمرية والارباح المتوقعه .

وهناك من التشريعات التي تسلك وجهة نظر مختلفة وتضع اسس اخرى للتعويض فتتظر إلى الانسان وحياة الانسان والحق في السلامة الجسدية ، فيستحق التعويض كل انسان تعرض للخطر واصابه ضرر كونه بغض النظر يعمل او لايعمل كبير او صغير ، فيجعل من حياة الانسان وسلامة جسده هدف التعويض ، اي ينظر للانسان كقيمة لا ما كان يقوم به اعمال اوسنه او دخله الاقتصادي المستقبلي ، بل اوجبت التعويض للانسان المضرور وما يسببه الضرر من وفاة او اضرار بدني، فبمجرد المساس بحياته استحق التعويض، فجعلت الدية كتعويض للوفاة وهي مبلغ محدد من المال يعطى لورثة المتوفي ،ولهذا فان تحديد او مقدار التعويض ثابت في حال الوفاة في حوادث السير ، بحيث إذا ادى الحادث إلى وفاة الشخص فان التعويض يكون بمقتضى قانون الديات والاوروش العماني الذي حدد الدية بمبلغ نقدي

<sup>III</sup> -دور التشريع العماني في حمايةتوازن العلاقة بين شركات التامين وعملانها البات وحلول، د. احمد السعدي، ورقة مقدمة ضمن اعمال الندوة العلمية حول شركات التامين وعلاقتها بعملانها المنعقدة في المركز العربي للبحوث القانونية ةالضائية التابع لجامعة الدول العربية، بيروت من 2015/4/29-26م  
جلسة 2004/6/29م الطعن رقم150/2004<sup>mmmm</sup>

محدد لا ينقص أو يزيد ولا يختلف من شخص لآخر، ، والذي نص في المادة الثالثة منه " على ان تكون الديات والأوروش المشار إليها جابرة لجميع الأضرار المادية والمعنوية" ومنها بطبيعة الحال الأضرار الناشئة من حوادث المركبات ، وقد استقر القضاء في عمان على الاخذ بذلك. كما نص على ذلك قانون المعاملات المدنية العماني في المادة 186 منه " تسري الاحكام العامة للفعل الضار على الضرر الذي يقع على النفس وما دونها وفيما يتعلق بالتعويض فتطبق الديات والاوروش مضافا اليها نفقات العلاج الضروري"

وهذه الاسس هي التي تعمل بها المدينة تكافل حيث تعوض ضحايا الحوادث المرورية بالدية في حال الوفاة والاوروش في الاصابات البدنية، كما سنبين ذلك ،، وهذا على خلاف ما يذهب اليه التشريع الماليزي ، الذي لا يأخذ باحكام الدية.

### المبحث الثالث: الدية وتقدير التعويض في شركة المدينة تكافل.

ونقسم المبحث إلى ثلاثة مطالب:

المطلب الاول: الدية ومقدارها كتعويض مستحق للغير في حالة الوفاة والاصابات البدنية في التامين الإجباري في المدينة تكافل.

المطلب الثاني : حالات التعويض بغير الدية في المدينة تكافل.

المطلب الاول: الدية ومقدارها كتعويض مستحق للغير في حالة الوفاة في التامين الإجباري في المدينة تكافل.

تلتزم المدينة تكافل في انشطاتها ومعاملاتها باحكام القوانين المقررة في الدولة ، ومنها قانون المرور وقانون الديات والاوروش ووثيقة التأمين الموحد ومانصت عليه وثيقة تأمين المركبات.

والمدينة تكافل تغطي التامين الإجباري وهي بذلك تكون مسؤولة في تحمل التعويض عن حوادث المركبات لصالح الطرف الثالث، فياتي التامين الإجباري من المسؤولة من حوادث السيارات ليجعل المؤمن شركة التامين ملتزما إلى جانب المدين الأصلي بالتعويض في مواجهة المضرور<sup>000</sup>

الا ان مما يجب الإشارة اليه ابتداء ان قانون المركبات وكذلك وثيقة التامين لم يحددا اوبضعا سقفا محدد لمقدار التعويض الواجب على الشركة دفعه للغير (الطرف الثالث) كتعويض للاضرار الناشئة من المركبات المؤمنه في التامين الاجباري ، لذلك فإن مقدار التعويض يتحدد وفقا للقانون المعني بالتعويض او العقوبة في حال انها حياة الانسان او الوفاة، وكذلك الأضرار البدنية الاخرى التي ينتج عنها الاصابات من جروح وكسور وغيرها، وهو قانون الديات والاوروش والذي حدد مقدار الدية بمبلغ محدد وفقا لاحكام الشريعة الإسلامية.

وبالتالي لا يكون للقاضي سلطة تحديد التعويض بما يخالف قانون الديات في حال ثبوت الوفاة بسبب الحادث المروري سواء بالزيادة او النقصان عن مقدار الدية المقدر في قانون الديات والاوروش .

التعويض عن الأضرار البدنية الناشئة عن حوادث المرور ، دراسة فقهية مقارنة في ضوء قانوني الدية والتامين الاجباري ، عبد المجيد عامر شيبوب، دالر الكتب القانونية، مصر\_ المحلة الكبرى، ص338.000

فما هو المقدار او المبلغ الذي يستحقه الضحية من شركة المدينة تكافل كتعويض لضرر الوفاة او الاصابات البدنية الناشئة من المركبات في حوادث المرور.

اولا : حالة الوفاة.

ا-التعويض بالدية في حالة الوفاة للغير :

أ. الوفاة : تعتبر الوفاة التي تحصل للطرف الثالث "الغير" والناجمة من الحوادث المرورية من الأضرار التي تستحق التعويض ، وكماشرنا ان مقدار التعويض المستحق للغير(الطرف الثالث) في حالة وفاة الضحية لم تحدده وثيقة التامين الموحدة وثيقة المدينة تكافل ، فالحوادث المرورية التي تؤدي إلى وفاة الاشخاص وفقا للقانون يتم نظرها امام المحاكم الجزائية في السلطنة والتي بدورها تقوم باصدار الحكم ،اذ يخضع الحوادث لاجراءات المحاكمة من قبل المحكمة الجزائية التي تصدر حكمها في قضايا حوادث المرور ، وبعد ثبوت الواقعة يحكم القاضي بالدية المقررة في قانون الديات والاوروش ا، وذلك على اعتبار أن الوفاة بسبب الحوادث المرورية هي قتل خطأ وفقا لما ذهب اليه الفقه الاسلامي المعاصر<sup>PPP</sup>ومااستقرت عليه احكام المحاكم ومنها المحكمة العليا في سلطنة عمان ٩٩٩،لذلك فان ما يستحقه الضحية في حالة الوفاة من تعويض هو الدية الشرعية التي تنص عليه الشريعة والقوانين ومنها قانون الديات والاوروش 2008/118، العماني ،ومقدارها 15000ريال عماني للرجل و7500للمرأة.

وقد استقرت المحكمة العليا على الحكم بالدية الشرعية بمبلغ الدية الثابت في القانون وقالمرسوم السلطاني النافذ وقت اصدار الحكم وهو ما اشارت اليه الاحكام الصادرة من المحكمة العليا"فقد جاء في مبادئ المحكمة "والدية شرعا وقانونا هي المقابل المالي المقدر من قبل المشرع اخذا بمبدأتكافؤالدم في النفس في الإسلام وهو بذلك قد سن تنظيميا خاصا فيه التكريم والتشريف للادمي وتميزا له عن الاموال وقطعاللطريق لمايقع من مغالاة في طلبها واعتبارا للطبيعة الخاصة للمتلف في الانسان الذي يصعب تقويمه بالمال ،اذ ان تقدير الضرر الجسماني في غاية الصعوبة ولايتم ذلك تخمينا أورجمنا بالغييب أوقياسا للإنسان بالاموال والماديات فالزيادة على المثل ظلم على المعتدي وفي النقصان حيف على المعتدى عليه ولصعوبة تقدير المثل بين الضرر البدني والمعنوي فقد تولى الشرع امر تقدير المقابل للنفس الذي لايقبل زياد أوتعويضا اخر وبماأقدرت بالشرع فلايزادعليهاولاينقص منها باي حال عملا بالسنة الشريفة "المسلمون تتكفأ

. ثقيل بن ساير الشمري، الاسباب الموجبة للمسؤولية في حوادث المرور ،د. / مؤتمر مجلس الفقه الاسلامي الدولي ، الدورة الاحادي والعشرون.ص268 PPP .

- 18-جلسة الثلاثا الموافق 2004/4/13،قرار رقم 97،في الكعن رقم 2004/71/وجا في الوقائع واتهام النيابة باقدام المتهم(الطاعن -)على قتل الهالكة....اثر حادث مروري فاحث الاصابات التي اودت بحياتها وفق الثابت بشهادة الوفاة ...."

دماؤهم"فالدية تسري على جميع المسلمين لافرق بين صغير وكبير وقوي وضعيف<sup>٣٣٣</sup>، و احوالت الاحكام الصادرة بالتعويض المتضررين الى شركات التامين لدفع الديات والتعويضات المحكوم بها<sup>٣٣٤</sup>

وبطبيعة الحال فإن شركة المدينة تكافل تقوم بتغطية تامين الوفاة الناتجة من حوات السير لمصلحة الطرف الثالث "الغير" وبموجب قانون المركبات الذي يقضي بان"على شركات التامين دفع المبالغ المحكوم بها للمضور كاملة ، ووفقا لنص المادة 12الفقره(ج) من قانو المركبات على ان" . تتحدد مسؤولية المؤمن نحو الغير عن الوفاة والأضرار البدنية من الحادث بكامل قيمة ما يحكم به قضائيا" .

ومبلغ التعويض الذي تقوم المدينة تكافل بدفعه للطرف الثالث في حالة الوفاة هو الدية الشرعية<sup>٣٣٥</sup>، وهي 15 الف ريال عماني للرجل ، ودية المرأة النصف من دية الرجل وهي 7.500 سبعة الاف وخمسمائة ريال عماني، وتخضع الشركة في دفع الدية للتشريعات المقررة في الدولة في سلطنة عمان ومنها قانون الديات والاوروش الصادر بالمرسوم السلطاني رقم 2008/118 الذي نص في المادة الثالثة منه على ان" تكون الديات والأروش المشار إليها جابرة لجميع الأضرار المادية والمعنوية".

وعلى ذلك فان الشركة ملزمة بدفع ذلك التعويض بموجب وثيقة تامين المركبات التي نصت على التزام المؤمن دفع جميع المبالغ الملتمزم قانونا بدفعها كتعويض عن الوفاة و.....<sup>٣٣٦</sup>

وهو ما اكدته المحكمة العليا في سلطنة عمان في كثير من الاحكامعلى الزاميو دفع التامين من قبل شركات التامين وذلك بدفع الدية في الهلاك او الوفاة الناتج من الحوادث المرورية.<sup>٣٣٧</sup>

كما اكد امين عام الافتاءعلى التزام شركات التامين بقانون الديات في دفع الدية كتعويض للوفاة في الحوادث المرورية<sup>www</sup>

وتلتزم الشركة بدفع التعويض لكل المصابين في حال تعدد حالات الوفاة، واكد ذلك، السيد الياس "بالقول ان شركة التامين تقوم بدفع الدية في حال الوفاة، لكل المصابين او المتوفين وان تعدد في الحادث الواحد ، و اشار الى ان الشركة في واحد من الاحداث المرورية دفعت مبلغ وقدره ....150000، لعدد 12 متوفي في حادث واحد.

<sup>٣٣٣</sup> .انظر الجلسة رقم 131 في الطعن رقم 2003/321 و الاحكام الصادرة في بئرار رقم 83/ في الطعن رقم 2004/51، ورقم 160/ في الطعن رقمي 2004/97، 2004/98. مجموعة الاحكام الصادرة من هيئة الدائرة الجزائية المكتب الفني للمحكمة العليا بوزارة العدل.  
<sup>٣٣٤</sup> .انظر المرجع السابق. ومن الدول التي تأخذ بالدية الامارات العربية، انظر الطعن رقم 384 لسنة 26 القضائية جلسة 2008/2/26 مدني. الدية الشرعية عن جريمة القتل الخطأ عقوبة اصلية القضاء بها واجب وتعويضا مستحقا لورثة المتوفى ترضية لهم ، ولهم مطالبة شركة التامين امام المحكمة المدنية بآداء هذا التعويض أساس ذلك القرار الوزاري رقم 54 لسنة 1987 في شأن توحيد قانون التامين على السيارات والمسؤولية المدنية والمادة 26 من قانون السير والمرور لسنة 1995. قضاء محكمة تمييز دبي والمحكمة الاتحادية العليا ومحكمة النقض المصرية في الحوادث المرورية والمسئوليتين المدنية والجمانية الناشئة عن حوادث السيارات، إعداد المحامي عيسى بن حيدر، دار النهضة العربية . القاهرة 2015م. ص 496  
 . المقابلة الشخصية مع السيد الياس 18 يونيو 2017.<sup>٣٣٥</sup>

الفصل الثالث اولا من وثيقة التامين الاجباري الموحدة ، ووثيقة التامي الاجباري الصادرة من المدينة تكافل.<sup>٣٣٦</sup>  
<sup>٣٣٧</sup> جلسة الثلاثا 2004/10/12 فرار رقم 184 في الطعن رقم 2004/152 م اذ يقضي المبدأ "عند وفاة المضور فان لورثة دعويين احدهما موروثا والاخرى شخصية وان في الاولى يكون تعويضها الدية الشرعية ..... و ضرورية ان يغطي التامين لصالح الغير كل ما يقع للغير من وفاة واصابات بدنية ومصاريح العلاج"  
المقابلة الشخصية من الشيخ ماجد امين عام الافتاء بسلطنة عمان 17 يونيو 2017.<sup>www</sup>

اما بالنسبة لدية المرأة فقد اكد الشيخ امين عام الافتاء أن مقدار الدية او قيمة الدية للمرأة هو حصولها على النصف من دية الرجل، وهذا ماجاء في السنة واخذا برأي فقهي على ان دية المرأة ، على النصف من دية الرجل عملا بحديث رسول الله ( دية المرأة نصف دية الرجل...)<sup>xxx</sup>

ويستحق الدية ورثة المتوفى بغض النظر عن عمر المتوفى صغير او كبير، غني او فقير او حالته الاقتصادية يعمل او لا يعمل ، كما ان الدية واحدة بالنسبة للمسلم وغير المسلم<sup>yyy</sup>، فالدية كما هو معلوم في الشريعة بدل عن التلف ، ويتم تقاسم وتقسيم الدية بين الورثة وفقا للانصبة الشرعية، وهذا ماجرى به قضاء سلطنة عمان<sup>zzz</sup>.

اما بالنسبة للتعويض عن الوفاة في القانون الماليزي، فانه لا يخذ بالدية للتعويض عن الوفاة ، وانما بمبلغ محدد هو عشرة الاف رنجت ، وتعويضات اخرى باسس معينة، ويوجب القانون مراعاة عدة اعتبارات عند الحكم بالتعويض ، منها سن المتوفى ان كان فوق سن الخامسة والخمسين ، لا يمنح اي تعويض عن ايرتات مستقبلية ، بعكس اذا كان سن المتوفى ثلاثون سنة او اقل او اكثر الى سن الخامسة والخمسون فانه يحسب له سنوات الخدمة التي يتم شراؤها له، وايضا نفقات الجنازة، ومطالبة الممتلكات، ومطالبة الإعالة.

والمستحق للتعويض في القانون الماليزي الزوج والزوجة والطفل ، وفي حال ما اذا كانت الضحية او المتوفى قاصر ولم يتزوج فيكون التعويض لو اديه ويقسم المبلغ بينهم بالتساوي<sup>aaaa</sup>.

ثانيا : الاصابات البدنية.

يقصد بالاصابات البدنية كل الأضرار الجسمانية التي تصيب الانسان بسبب الحادث المروري ، والتي تؤدي إلى تلف او تعطيل الاعضاء الجسمانية من جروح وكسور وعجز دائم او مؤقت ، وهذه الاصابات المختلفة تغطي بموجب التأمين الإجباري للغير، و بحسب قانون المركبات ووثيقة التأمين الاجباري ، وشركة المدينة تكافل تقوم بتغطية كافة الاضرار التي تلحق بالغير الناشئ من الحادث المروري، والتي يتسلمها المضرور من الشركة مباشرة، أو التي تحكم بها المحكمة، ونشير هنا إلى ان قانون التأمين المركبات ووثيقة التأمين الموحدة لم تحدد او تضع معايير خاصة لتقدير تعويض الحوادث البدنية اذ تركت الامر لسلطة القاضي التقديرية<sup>bbbb</sup>،

ويتم احتساب التعويض إما على اساس كل جرح وفقا لقانون الديات والاوروش والذي حدد مقدار التعويض لكل الاعضاء وفقا لحساب الدية الكبرى او على اساس تقدير القاضي للتعويض وفقا لقواعد التعويض في التشريعات المقررة في الدولة . وهو الاصل في التعويض للاضرار التي تقع على النفس وما دونها عملا بنص المادة 186 من قانون

. المقابلة الشخصية مع الشيخ ماجد امين عام الافتاء بسلطنة عمان 17 يونيو 2017 والمقابلة الشخصية من السيد الياس مدير تقنية المعلومات 18 يوليو 2017.<sup>xxx</sup>

. المقابلة الشخصية مع الشيخ ماجد امين عام الافتاء بسلطنة عمان 17 يونيو 2017.<sup>yyy</sup>  
جلسة الثلاثا الموافق 2004/6/29م ، قرار رقم 160 في الطعين رقمي 2004/97 ، 2004/98<sup>zzz</sup>

7،11 المادة civil low Act 1956 (67 Aet)<sup>aaaa</sup>

وهذا على خلاف ما هو مقرر في بعض التشريعات العربية كالتشريع الجزائري الذي يحدد معايير والتي على اساسها يقدر القاضي التعويض وهو ما اشار اليه الامر ملحق القانون 31/88، والذي يعتمد الاجر والدخل المهني للضحية كاساس لحساب التعويض المستحق وبما لا يتجاوز مبلغ الاجور والمدخيل المهنية المتخذة كاساس لحساب التعويض مبلغا شهريا مساويا لثمان مرات الاجر الوطني الادنى المضمون عند تاريخ الحادث، لمزيد من التفصيل انظر، احمد طالب ، التعويض عن الاضرار <http://fdsp.univ-guelma.dz/sites/default/files/mem/master2016/m201650.pdf><sup>bbbb</sup>

المعاملات المدنية التي تنص على ان " تسري الاحكام العامة للفعل الضار على الضرر الذي يقع على النفس أو ما دونها وفيما يتعلق بالتعويض فتطبق الديات والاوروش مضافا اليها نفقات العلاج الضروري"<sup>cccc</sup>

وهذا مايجري به العمل بالمدينة تكافل اذتقوم بتغطية الاصابات وفقا لقانون الديات والاوروش ، وذكر على سبيل المثال كسر عظام الوجه 10% من الديةوفي حالة الاعاقة يعوض المضرور سواء كان ذكرا او انثى بدية كاملة<sup>ddd</sup>.

وإما بناء على مايقدره القاضي من تعويض للاصابات الناشئة من الحوادث المرورية في حال تم نظر القضية المرورية وتعويض الضحايا امام المحاكم الجزائية ،، وقد عالج المشرع العماني مسألة التعويض عن الاضرار التي تلحق بالشخص ضمن قانون الجزاء والذي اعطى فيه للقاضي الجزائي سلطة الحكم بالتعويضات المدنية بناء على طلب المتضرر(م56،58، 59من قانون قانون الجزاء).

، وبالتالي فان للقاضي سلطة تقدير التعويض عن الاصابات البدنية الناشئة عن الحوادث المرورية، وفقا للقانون الجزائي في النصوص المتعلقة بالتعويضات الخاصة بالشق المدني.

او يتم تقدير التعويض بما تضعه التشريعات المدنية من قواعد عامه للتعويض ،والمنصوص عليها في قانون المعاملات العماني ، فالمشرع العماني لم يضع معايير خاصة للقاضي يتبعها لتقدير التعويض عن الاضرار الجسمانية الناتجة عن الحوادث المرورية ، فيكون تقدير التعويض المستحق للضحية من الحوادث المرورية من سلطة القاضي التقديرية..

وكما جاء في الاحكام الصادرة من المحاكم الجزائية في سلطنة عمان والتي تقضي التعويض للمجني عليه في الاصابات البدنية للمتضررين من الغير في الحوادث المرورية بنا على تقدير القاضي دون الاخذ بما يقره قانون الديات والاوروش في الاصابات ،وقد ايدت المحكمة العليا تلك الاحكام مما يعنى ان للقاضي سلطة تقديرية ، في تقدير مقدار التعويض وفقا للقوانين المقررة في الدولة.

وقدصدر عن المحكمة العليا عدد من الاحكام التي قضت بدفع تعويضات للضحايا عن الاضرار التي سببتها الحوادث المرورية، من ذلك الحكم الصادر من المحكمة العليا في الطعن رقم (2004/150) بقبوله شكلا وموضوعا وتصحيح الحكم المطعون فيه في شقه المدني الذي يلزم الطاعة(شركة التامين) بأن تؤدي للمطعون ضدها تعويضا ماديا وادبيا مبلغ 64000 الف ريال عماني<sup>eeee</sup>.

وبذلك يكون المشرع العماني قد سار وبما يتفق مع القواعد العامة في التعويض في دفع التعويض عن الاضرار الجسمانية

اما عن كيفية تقدير التعويض في القانون المالي في الاضرار الجسمانية فقد وضع القانون قواعد ومعايير

<sup>cccc</sup> (1012). المرسوم السلطاني رقم 29/2013 باصدار قانون المعاملات المدنية" الجريدة الرسمية العدد 1012.

. المقابلة الشخصية مع السيد الياس مدير تقنية المعلومات 18 يوليو 2017. <sup>ddd</sup>

جلسة 29/4/2004 في الطعن رقمي 150/2004 و 151/2004. <sup>eeee</sup>.

للتعويض عن الاضرار البدنية والتي يبستند عليها القاضي لتحديد تلك التعويضات حيث يقضي القانون على ان يكون التعويض محددًا على اساس الدخل الشهري والاجر والنظر الى الحالة الاجتماعية للضحية وسنها<sup>ffff</sup>. فالاساس في تقدير التعويض هو النظر الى الدخل الاقتصادي والايراد المستقبلي والعمر الالام النفسية وما فقده من راحة ، لذلك فان ما يحصل عليه المصاب في الحوادث المرورية يختلف من شخص لآخر ، والاضرار الواجب التعويض عنها تشمل، الألم والمعاناة وفقدان وسائل الراحة، فقدان الأرباح في المستقبل، فقدان الكسب، ونفقات الرعاية المستقبلية.

### المطلب الثالث : حالات التعويض بغير الدية في المدينة تكافل.

1- تكاليف مصاريف علاج الاصابات التي تلحق الطرف الثالث من الحادث

وهي المصاريف التي ينفقها المضرور في معالجة نفسه والتي تشمل في العادة اجور الاطباء والمستشفى والمعينة والعمليات الجراحية والتحاليل والعلاجات وغيرها من المصاريف العلاجية ، وهو ما توجهه بوليصة التأمين وتنص عليه وثيقة تأمين المركبات في شركة المدينة تكافل. والتي تقضي بحق المصاب في حوادث المرور الحصول على مصاريف العلاجات والنفقات الطبية التي تلحق به من الحادث، اذ نصت الوثيقة على التزام المؤمن بدفع مصاريف علاج الاصابات التي تلحق الطرف الثالث من الحادث(ف3/ج وثيقة تأمين المركبات) ، أو أي اصابه بدينه تلحق بأي شخص بما في ذلك ركاب المركبة (ماعدى المؤمن له شخصيا وقائد المركبة وقت الحادث وأفراد اسرتيهما الوالدان والاولاد والزوج" ويعتبر الشخص من ركاب المركبة اذا كان بداخلها او صاعدا عليها او نازلا منها ويعتبر العاملون لدى صاحب المركبة مشمولين بهذه التغطية باعتبارهم طرفا ثالثا، ويتم سداد المصاريف العلاجية بحسب قواعد السداد الموضحة في وثيقة تأمين المركبات.

2-:المبالغ المحكوم بها قضائيا وتشمل(التعويضات-المصاريف القضائية-المصارف القانونية)

وهي المصاريف القضائية التي انفقها المضرور امام المحاكم للحصول على حقه في التعويض من الجهة المسؤولة في دفع التعويض وهذه النفقات يحددها القاضي وفقا لسلطته التقديرية :

3-التعويض عن الأضرار المعنوية:

الضرر المعنوي او الادبي، عبارته عن الالم والحزن الذي يصيب الانسان سواء كان ناجما عن أضرار جسدية سببت له الألم، او المساس بالشعور والعاطفة والكرامة والاعتبار الشخصي والحق في الحياة والشرف.<sup>gggg</sup>

ومن الضرر الموجب للتعويض الضرر المرتد،وهو الضرر الذي تترتب عنه اضرار تصيب الغير ، بحيث يتأثر المضرور ماديا ومعنويا، في نفس الوقت كالأضرار التي تلحق ذوي الحقوق بسبب وفاة احد عائلهم لإثر حادث المرور والتي تتجسد في خسارة مالية لإضافة الى أضرار معنوية تمثل في المشاعر التي يكتون بها<sup>hhhh</sup>

والضرر الادبي كما عرفته المحكمة العليا هو كل ضرر يؤذي الانسان في شرفه أو يصيب عاطفته ومشاعره ، ويكفي في تقدير التعويض عن الضرر الادبي أن يكون مواسيا للمضرور<sup>iiii</sup>

.civil low Act 1956 (67 Aet) 7،11 <sup>ffff</sup>.

قرار رقم 186 في الطعن رقم 2004/157.<sup>gggg</sup>

. المرجع السابق ص 31<sup>hhhh</sup>

وبالنسبة لموقف القضاء العماني من التعويض عن الأضرار الأدبية، فقد صدرت كثير من الأحكام التي تقضي بدفع تعويضات للضرر الأدبي، فمما جاء من مبادئ المحكمة العليا في سلطنة عمان " أن الذي يحكم التعويض ومقداره هو المادة (58) من قانون الجزاء بحسبان أن المؤمن له هو المسؤول عن الضرر فتحكم العلاقة بينه وبين المضرور القواعد العامة في التعويض ولأجل القول بأن قانون تامين المركبات بوصفه القانون الخاص الذي يحكم المسألة هو الواجب التطبيق، علاوة على أن القانون الأخير نفسه لم يقل بالحكم بالتعويض عن الضرر الأدبي والمعنوي...". ومما جاء في منطوق حكم للمحكمة العليا في الطعن رقم 150/2004) قبوله شكلا وموضوعا وتصحيح الحكم المطعون فيه في شفه المدني بالزام الطاعنة بأن تودي الى المطعون ضدها تعويضا ماديا وادبيا مبلغ 64000 الف ريال عماني "...

وجاء في مبادئ المحكمة " يدخل في التعويض عن الضرر المعنوي الذي لحق المجني عليه في حساب التعويض العام في أغلب التشريعات ويتمثل عادة في الألام الجسمية والجروح والألام النفسية والمعاناة التي يمر بها المصاب بسبب المساس بتوازنه الجسماني ومن المضايقات الناجمة عن حرمانه من شباع حاجاته الطبيعية المألوفة في الحياة وتمتعته بحياة عادية" وايضا في القرار رقم 186 في الطعن رقم 157/2004: لا قارب الهالك المطالبة بالتعويض عما يصيبهم من ضرر ادبي بسبب موت الهالك وأن التعويض لذي يستحق للورثة نتيجة ما اصاب اشخاصهم من أضرار مادية أو ادبية بسبب موت مورثهم ليس ثمة ما يمنع الحكم بينه وبين الودية والأورش.

والحكم بالتعويض عن الضرر المعنوي وتقديره ومدى تحققه من عدمه يتوقف على سلطة القاضي التقديرية، فهناك من الأضرار الأدبية يحكم فيها للمضرور بالتعويض المادي دون الادبي. وتشتت التشريعات لانتقال التعويض عن الضرر المعنوي الى الغير إن يكون قد تحدد بمقتضى اتفاق أو طالب الدائن به أمام القضاء وهو ايضا ما اكدته المحكمة العليا في احكامها<sup>kkkk</sup>.

اما بالنسبة للضرر المرتد، فيعد من الأضرار التي يستحق المضرور عنه تعويضا يقدره القاضي اذا توافرت شروط التعويض لهذا النوع من الضرر، وهو ما اكدت عليه المحكمة العليا، كما جاء في احكامها<sup>kkkk</sup>، في القرار رقم 184 في الطعن رقم 152/2004، فقد ورد في الوقائع "فمناطق القضاء به (الشخص المرتد) أن يثبت المضرور أن الفعل الضار الذي اتاه الجاني على مورثه قد اخل بمصلحة مالية له وان يكون الضرر قد وقع بالفعل وان يكون في المستقبل حتميا والعبارة في تحقق الضرر المادي للشخص الذي يدعيه نتيجة وفاة شخص اخر هي ثبوت ان المتوفي كان يعوله فعلا على نحو مستمر دائم وان الاستمرار على ذلك كانت متحققه وعندئذ يقدر القاضي ما ضاع على المضرور من فرصة كسب بفقدان عائله ويقضي له بالتعويض على هذا الاساس، ولما كان لم يثبت الطاعن أن مورثه كان يعولهم ولم يكن ذلك متصورا اساسا بالنظر لصغر سنه وعدم عمله اذ كان لا يزال طالبا.... وبالتالي لا يستحق الطاعن تعويضا عن الضرر المرتد لانقضاء الضرر كما اسلفنا مما يجعل مآل هذا الطعن إلى الرفض<sup>kkkk</sup>.

:التغطية التامينة للمؤمن وافراد اسرته.

جلسة الثلاثا 2004/10/12، قرار رقم 186 في الطعن رقم 157/2004، المرجع السابق<sup>kkkk</sup>.  
في هذا الشأن تقول المحكمة العليا في القرار رقم 186 في الطعن رقم 147/2004، إذا ثبت الجق بالتعويض عن الضرر المادي لمضرور فإنه ينتقل إلى خلفه فيستطيع وارث المضرور ان يطالب بالتعويض الذي كان لمورثه أن يطالب به لوبي حيا، ويحق للورثة الحلول محل المورث في الدعوى بعد وفاته أثناء نظرها، ولا يعد هذا لحق الذي انتقل إلى الورثة من قبيل الودية المقررة لهم نتيجة وفاة مورثهم.<sup>kkkk</sup>  
قرار رقم 160 في الطعن رقم 97/98/2004، منشورات، المكتب الفني وزارة العدل.<sup>kkkk</sup>



جعل قانون المركبات هذا النوع من التأمين اختياريًا للمؤمن له، ويغطي هذا النوع من التأمين، تحت ما يسمى بتأمين ملحق الحوادث الشخصية وبالنسبة لقواعد تحديد التعويض عن وفاة المؤمن له والاصابات البدنية لصاحب المركبة، نصت وثيقة التأمين الموحدة على المركبات الصادرة بالقرار الوزاري رقم 2008/8 على ان اساس ونسب تعويض الاصابات البدنية التي تصيب مالك المركبة وقائدها وأسرتيهما قياسا على اساس مبلغ عشرة الاف ريال عماني.

وتقضي المحكمة العليا بشأن تعويض المؤمن له ومن في حكمة عن الاصابات التي لحقت به من جراء الحادث ان تقدير التعويض بناء على نسبة العجز يكون في حال التأمين الاختياري وفق ملحق الحوادث الشخصية.

ويحتسب له التعويض عن الوفاة بمبلغ مقدر في وثيقة التأمين ومقداره 10.000 عشرة الاف ريال عماني، وللمرأة ايضا 10,000 عشرة الاف ريال وهو في هذه الحالة قد ساوى المرأة مع الرجل في هذا التأمين .

وفي حالة الاصابات الاخرى، فقد وضع له سقف محدد يستحقه المؤمن له في حال الاصابات البدنية والعجز الدائم والمؤقت ، كما جاء في وثيقة التأمين وبالتفصيل التعويض لكل عضو من اعضاء جسم الانسان وبنسب تختلف من عضو الى اخر .وقياسا إلى الاساس في التعويض والمقدر بعشرة الاف ريال عماني .

ويقضي ملحق الحوادث الشخصية بان التأمين الاجباري يغطي ما ينتج عن حوادث المرور من وفاة او اصابات بدنية لمالك المركبة وقائدها واسرتيهما في الحدود الموضحة في الملحق، وتشمل التعطية الاصابات العجز الكلي المستديم وهو الذي تسببه الاصابة وينتج عنها إما فقدان تام مستديم للقدرة على الكسب او العمل أو على استخدام الاعضاء المصابة ويعوض المصاب وفقا لجدول اساس ونسبة التعويض المحدد في الوثيقة .

وفي التعويض عن العجز ايضا وضعت الوثيقة سقفا واحدا يتم احتساب التعويض على اساسه هو نسبة العجز مضروبة في عشرة الاف ريال عماني.

اما مصاريف العلاج فقد وضعت الوثيقة حد اقصى للمبلغ وهو عشرة الاف ريال عماني / ومصاريف الاسعافات الأولية بحد اقصى 400 ريال اربعمائة ريال<sup>III</sup>

### الخاتمة:

وبذلك نصل في خاتمة البحث إلى ان المشرع العماني قد اختط لنفسه منهجا واضحا في تعويض الضحايا في الحوادث المرورية مراعيًا في ذلك عقيدة المجتمع وما توجبه الشريعة الإسلامية من الاحكام، ومنها ما يتعلق بالتعويض عن ضرر النفس والاضرار الجسمانية ، ومراعيًا كذلك حماية وسلامة وحقوق الضحايا المتضررين من الحوادث المرورية وما توجبه المقتضيات الاقتصادية والاجتماعية للمجتمع . وبخصوص التعويض عن الأضرار المادية والمعنوية التي تلحق بالانسان فقد جعل الدية كإطار للتعويض عن الوفاة الناتجة من الحوادث المرورية ، وهو التعويض الذي يحفظ للانسان قيمته واحترامه وكرامته بعد الوفاة.

III. وثيقة التأمين الموحدة على المركبات خ/2016/19.

والمدينة تكافل لا تخرج عن احكام الشريعة والقوانين المقررة في الدول وتقوم بالتعويض ايضا بمقتضى القانون المذكور للاصابات البدنية من جروح وكسور وغيرها من الاصابات الجسمانية، وتغطي عدد من الانشطة التامينية، التي تتفق مع احكام الشريعة الإسلامية ، وغير ذلك بسبب الحوادث المرورية وعمل بقانون تامين المركبات .

فتجعل من اسس التعويض الدية الشرعية المقررة في قانون الديات والاوروش ، فالدية هي التعويض المستحق في حال الوفاة الناشئ من الحوادث المرورية والذي تقوم بدفعه المدينة تكافل ، وفي حالات الاصابات البدنية يتم دفع التعويض بموجب قانون الديات والاوروش وبموجب التعويض المحكوم به وفقا للقوانين المقررة والتي حددت قواعد التعويض المدني. اذ تجعل الدية الاطار العام الذي تعوض به الضحايا المنتسبين اليها عن كل الأضرار التي تلحق بهم في حال الوفاة .

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## أثر الاجراءات الحماية المتبعة علي مخاطر نظم المعلومات المحاسبية الالكترونية دراسة حالة (مصرف ليبيا المركزي)

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### المستخلص

تهدف هذه الورقة للتعرف علي أثر الاجراءات الحماية المتبعة علي مخاطر نظم المعلومات المحاسبية الالكترونية في مصرف ليبيا المركزي، ولقد أتبعت الدراسة المنهج الوصفي التحليلي لوصف وتحليل أثر الاجراءات الحماية المتبعة علي مخاطر نظم المعلومات المحاسبية في مصرف ليبيا المركزي، وقد بلغت عينة الدراسة 1000 من العاملين بمصرف ليبيا المركزي، ولقد إستخدم الدراسة الإستبانة لأحصائية للتوغل بعمق في فهم ظاهرة البحث محل الدراسة ولتعرف علي مدى تأثير إجراءات الحماية المتبعة في الحد من مخاطر نظم المعلومات المحاسبية الالكترونية في مصرف ليبيا المركزي. وتكمن أهمية هذه الدراسة في كونها تركز على أثر اجراءات الحماية التي يتبعها مصرف ليبيا المركزي في الحد من مخاطر نظم المعلومات المحاسبية الالكترونية داخل النظام. ولقد توصل الدراسة إلي العديد من النتائج من بينها مدى تأثير اجراءات الحماية المتبعة على مخاطر نظم المعلومات المحاسبية الالكترونية في مصرف ليبيا المركزي وذلك من وجهة نظر عينة الدراسة، كما تبين أن اجراءات الحماية المتبعة على مخاطر نظم المعلومات المحاسبية الالكترونية تسهم في جعل المعلومات ملائمة لحاجات صناعات القرارات ومستخدمي البيانات المحاسبية وتعمل على زيادة كفاءة التقارير المالية في خدمة مستخدميها وتحسين قدراتهم وكفاءاتهم، كذلك تساعد في التعرف على أوجه التشابه والاختلاف بين أداء البنوك. ولقد إستخدم الدراسة الأستبانة الاحصائية والتي تتكون من 3 محاور من عدد 46 فقرة، كما إعتمدت هذه الدراسة علي نتائج التحليل العاملي ومصفوفة التدوير وتحليل الاتساق الداخلي حيث يعتبر التحليل العاملي تقنية إحصائية متعددة المتغيرات، والذي يستخدم للتحقق لمجموعة تتكون من عدد كبير من المتغيرات وتقليلها إلى عدد قليل نسبيا من المتغيرات الافتراضية. ولقد أوصت الدراسة بضرورة تعزيز أثر الاجراءات الحماية المتبعة ضد مخاطر أمن نظم المعلومات المحاسبية في المصرف ليبيا المركزي من شأنه ان يعزز ثقة النظام المالي في المصرف ويعكس علي مدى صدق البيانات المالية والتي ينتجها النظام داخل المصرف ، وكذلك فان توفر اسس ضوابط الحماية الازمة لحفظ النظام المحاسبي تساعد ادارة العليا المصرف في اتخاذ القرارات سليمة تنعكس ايجابا علي داخل بيئة النظام المصرفي مما يعزز العلاقة بين المصرف المركزي وباقي المصارف التجارية.

### المقدمة

مما لاشك فيه أن الطفرة التكنولوجية التي شهدها العالم وخاصة في أواخر القرن الحادي والعشرون قد شمل كافة أنواع العلوم التكنولوجية وخاصة العلوم المرتبطة بالعلوم المالية مثل المحاسبة وتكنولوجيا المعلومات. وكذلك فإن علم المحاسبة كغيره من العلوم المالية أصبح مؤثر بشكل شديد في الحياة العامة في الوقت الحالي حيث أن نظم المعلومات المحاسبية توفر العديد من المزايا وتساهم في تخطي الكثير من العقبات التي من شأنها أن تسهل إدخال المدخلات

وتشغيلها العمليات وإستخراج النتائج في أي وقت كما في الطريقة المحاسبية التقليدية (القشي والعبادي، 2009م، ص718). ولقد ساهم المحاسبون في تطوير مفهوم المحاسبة من خلال إمكانية الربط بنظم المعلومات المحاسبية حيث تقوم علي حقيقة مفادها أن المحاسبة هي مجموعة من الإجراءات التي يمكن من خلالها تجميع وتبويب وتخزين المعلومات المحاسبية من خلال نظم المعلومات (حسام عبد الله أبو خضرة، نظم المعلومات المحاسبية، دار الفرقان للنشر والتوزيع، عمان، 2003).

### مشكلة الدراسة

إن مصرف ليبيا المركزي يسعى إلي التطوير في النظم المحاسبية وكذلك في أطر تقديم الخدمات المصرفية الأخرى وتوفير نظم معلومات تتيح نقل وتبادل المعلومات بسهولة ويسر بين المصارف المختلفة وبالتالي فمن المفترض دراسة كافة المشاكل المتعلقة بالمخاطر المصرفية وكذلك إجراءات الحماية والضمان التي تكفل سلامة تلك النظم المصرفية وحمايتها وحفظ سلامة بياناتها. فضلاً عن أن الأهمال في تطوير تلك النظم المحاسبية ومخاطر ربطها إلكترونياً قد يهدد أيضاً سلامة وصحة البيانات الموجودة في تلك النظم.

### هدف الدراسة.

مدي تساهم الإجراءات المتبعة في مصرف ليبيا المركزي في تقليل مخاطر نظم المعلومات المحاسبية الألكترونية؟

### فرضية الدراسة.

توجد علاقة سلبية بين إجراءات الحماية المتبعة في مصرف ليبيا المركزي ومخاطر نظم المعلومات المحاسبية

### أهمية الدراسة.

وتبرز أهمية الدراسة من خلال العوامل التالية:

1. شيوع تعرض النظم المحاسبية الإللكترونية للمخاطر التي تعتبر تهديداً مباشراً لمدي لنظام المحسبي وصحة ومصادقية البيانات والمعلومات المالية.
2. إبراز أهمية مخاطر أمن المعلومات وضرورة التشديد في إجراءات الحماية الخاصة بنظم المعلومات المحاسبية.
3. تسلط هذه الدراسة الضوء علي إجراءات الحماية في المصرف المركزي ضد المخاطر التي يتعرض لها القطاع المصرفي. وبالتالي فإن المصارف يمكنها الإستفادة من نتائج هذه الدراسة علي الأجل الطويل.
4. تؤدي هذه الدراسة إلي إستمرار الرقابة ضد المخاطر التي من الممكن أن يتعرض لها النظام المحاسبي الأمر الذي يعزز من ثقة الجهاز المصرفي بشكل كامل علي إجراءات الحماية المتبعة ضد المخاطر.

### الاطار النظري:

تعتبر نظرية النظم من أبرز النظريات التي أقرت بتكوين إطار نظري عام لموضوع النظم المحاسبية وذلك بغرض التعرف علي تراكيب وتكامل تلك النظم مع بعضها البعض، ومن الجدير بالذكر أن هذه النظرية تعتبر بمثابة الأساس الذي يمكن أن نستخلص منه الكثير من المفاهيم والمصطلحات والتطبيقات المرتبطة بنظم المعلومات المحاسبية مثل مفهوم المعلوماتية ومدي تطورها ومفهوم تصميم نظم المعلومات وإرتباطها بمفهوم المحاسبة ومفهوم بناء النظم

وكيفية مواكبة التطوير الواقع في تحديث نظم المعلومات المحاسبية. وتجدر الإشارة إلي أنه يجب لتحديد مفهوم النظم توافر العديد من العناصر الرئيسية مثل تصميم النظام لتحقيق هدف معين مع ضرورة وجود أجزاء لهذا النظام بالاعتماد علي ضرورة وجود علاقات تفاعلية بين أجزاء هذا النظام (عصام ، عامر ، الشنطي ، تحليل وتصميم نظم المعلومات 2008 ، ص 11).

#### الشروط الواجب توافرها في أمن نظم المعلومات المحاسبية وأساليب الرقابة عليها

مما لاشك فيه أن هناك شروط يجب توافرها في أمن نظم المعلومات المحاسبية لكي يكون نظاماً فعالاً وكذلك فإن أساليب الرقابة عليها متنوعة ومتعددة، وتجدر الإشارة إلي أن العديد من المؤسسات بدأت تهتم في الأونة الأخيرة بمسألة أمن نظم المعلومات المحاسبية وذلك وفقاً لما مرت به العديد من المؤسسات من التجارب التي أثرت بشكل كبير علي نظم المعلومات المحاسبية الإلكترونية. الأمر الذي أشار إلي حقيقة مفادها أن الإجراءات الواجب توافرها في أمن نظم المعلومات المحاسبية الإلكترونية يجب أن تكون إجراءات تتسم بالتعقيد وأن تكون الإجراءات الحماية في ضوء ما تتعرض له المؤسسات من مخاطر وتهديدات. وبالتالي فإن هناك العديد من الشروط الواجب توافرها في أمن نظم المعلومات المحاسبية الإلكترونية ومن بينها ضرورة إتباع سياسة حماية معينة تهدف إلي دعم نظم المعلومات المحاسبية الإلكترونية بحيث يتم تحديد هذه السياسة وفقاً لما تمر به المؤسسة من تحديات. وكذلك يجب علي الإدارة العليا أن تدعم أمن نظم المعلومات المحاسبية الإلكترونية مادياً وأن توفر لها ميزانية كافية.

وتجدر الإشارة إلي أنه يجب تحديد موظف مسئول عن أمن نظم المعلومات المحاسبية الإلكترونية وأن يتم تخصيص مكان ثابت له وخطة عمل موضح فيها طرق المراقبة والحماية، ومن الضروري أن يتم تحديد ماهية الحماية اللازمة لأمن نظم المعلومات المحاسبية الإلكترونية في المنشأة وكذلك الآليات والإجراءات والوسائل التي يمكن إتباعها بتنفيذ المنظومة الأمنية والحماية لنظم المعلومات المحاسبية الإلكترونية.

ومن الملاحظ أنه يجب علي الشركات الكبرى أن تعمل بشكل جاد علي حفظ نسخ إحتياطية من نظم المعلومات المحاسبية الإلكترونية لحمايتها من مخاطر التلف. بالإضافة إلي ضرورة تشفير تلك المعلومات بطريقة لا يمكن لأي شخص الإطلاع عليها إلا من يملك حق فك الشفرة وهو من تقع عليه المسؤولية كاملة. وبالتالي فإن في حالة مواجهة المخاطر الحقيقية يمكن الإستعانة بالنسخ الإحتياطية بغرض الرغبة في إستمرار العمل ومواجهة مخاطر التوقف عن العمل.

ولقد أشارت العديد من الدراسات حول العديد من الوسائل الرقابية التي من خلالها يمكن حماية أمن نظم المعلومات المحاسبية الإلكترونية فمنذ التقدم التكنولوجي الواسع والتحول من الأنظمة الدفترية القديمة إلي الأنظمة المحوسبة المتقدمة إلكترونياً أصبحت العديد من المنشآت تتطلع إلي ضرورة تطبيق مستوي مناسب من الرقابة بما يساهم في توفير الحماية لنظم المعلومات المحاسبية الإلكترونية. وبالتالي فإن الرقابة علي النظم المحاسبية الإلكترونية يمكن أن تشمل ثلاث أقسام متتالية:

#### أ. الرقابة علي المدخلات

حيث تهدف إلي التأكد من أن كافة البيانات تم إدخالها بشكل سليم وفي الوقت المناسب وذلك للتأكد من حسن سير عملية تشغيل البيانات وللتأكد من أنه لا يوجد العديد من الأخطاء وخاصة في مرحلة المدخلات. وتجدر الإشارة إلي أن الرقابة علي المدخلات ينبغي الحصول عليها قبل الشروع في تشغيل العمليات بوقت كافي وذلك لأنه في حالة إكتشاف أخطاء فإنه مازال هناك متسع من الوقت لإمكانية تعديل البيانات وتصحيح الأخطاء. ومن ناحية أخرى فإن البيانات التي تم إدخالها بصورة صحيحة يجب إعادة فحصها مرة أخرى خشية وجود تكرار بها. وكذلك فإن عدم وجود أخطاء في نظم المعلومات المحاسبية الإلكترونية يساهم في تقوية هذه النظم والتعرف علي الثغرات الأمنية بها. وبالتالي فإن المدخلات الخالية من الأخطاء والصحيحة تؤدي حتماً إلي مخرجات خالية من الأخطاء وأن تكون صحيحة.

### ب. الرقابة علي تشغيل البيانات

يري الدهراوي (2003) أنه يتبغي التعرف والتأكد من سلامة البيانات وخاصة في فترة تشغيل البيانات أي ما يطلق عليه معالجة البيانات وتتسم هذه الفترة بتفعيل العديد من الإجراءات الرقابية من بينها ضرورة عمل إختبار شامل يقضي بصحة عمليات المعالجة بحيث تمكن نظم المعلومات المحاسبية الإلكترونية من رفض المخرجات غير الصحيحة، وكذلك من الضرورة إستمرار عمليات المعالجة وخاصة إذا كانت المعالجة ترتبط بشكل كبير في المساهمة في إقبال القوائم المالية والحسابات الختامية. ومن ناحية أخرى فإن يمكن الإستعانة بالعديد من البرامج التي من شأنها أن توقف أي برنامج يحاول التدخل في عملية معالجة البيانات.

### ت. الرقابة علي المخرجات

من الملاحظ أن الرقابة علي المخرجات من شأنها أن تتأكد من أن نتائج المخرجات سوف تكون جيدة وصحيحة في منتهي الدقة الأمر الذي يقضي بضرورة منح هذه المخرجات فقط للأشخاص الذين يملكون حق الإطلاع علي تلك المخرجات. وتجدر الإشارة أن الرقابة علي المخرجات تتوقف في المقام الأول علي الرقابة علي المدخلات ومرحلة معالجة البيانات فإذا كانت البيانات جيدة ودقيقة في المرحلتين فإن هذه البيانات سوف تكون جيدة في مرحلة المخرجات.

### إجراءات الحماية المتبعة لتجنب مخاطر أمن نظم المعلومات المحاسبية

مما لا شك فيه أن التطور المذهل في نظم المعلومات المحاسبية الإلكترونية قد صاحبه تطور كبيراً في مجال أمن نظم المعلومات المحاسبية الإلكترونية، الأمر الذي ألقى بظلاله علي دور المؤسسات التي ترغب في حماية أمن نظم المعلومات المحاسبية الإلكترونية الخاصة بها حيث تسعى كافة الشركات والمؤسسات أن توفر قدراً ملائماً من الحماية اللازمة لأمن نظم المعلومات المحاسبية الإلكترونية، وبالتالي فإن من أبرز الوسائل التي تستخدم في مجال أمن نظم المعلومات المحاسبية الإلكترونية هي طريقة جدران النار وتتطلب هذه الطريقة عدة وسائل تكنولوجية حديثة فضلاً عن العمالة المدربة وتقضي هذه الطريقة بعدم السماح للعديد من الأشخاص من الوصول إلي أجهزة الكمبيوتر التي تحتوي علي نظم المعلومات المحاسبية الإلكترونية. وكذلك فإن توفير العديد من البرمجيات التي من شأنها أن تفسد عمل

الفيروسات وتعطل أداؤها فضلاً عن ضرورة إقتران الأمر بالعديد من الإجراءات الحمائية الأخرى وخاصة تلك الإجراءات المرتبطة بتشغيل نظم المعلومات الحاسوبية الإلكترونية. وبناء علي ماتقدم فإن كافة المؤسسات يقع علي عاتقها إتباع العديد من الإجراءات من ضمنها الآتي:

### 1. تعهدات الإدارة

حيث أن الإدارة العليا هي الجهة المنوط بها تفعيل أمن نظم المعلومات الحاسوبية الإلكترونية، وبالتالي فهي المسئول الأول عن توفير مخصصات مالية تكفي لتعزيز إجراءات الحماية وتطبيق أمن المعلومات بشكل كبير. وكذلك وضع اللوائح والسياسات الخاصة بأمن نظم المعلومات الحاسوبية الإلكترونية وأيضاً يقع علي عاتق الإدارة العليا عبء إختيار الموظفين الذين ستحملون هذه المسئولية الكبيرة بناء علي تاريخهم الوظيفي واسهاماتهم في العمل وأن يكون مشهود لهم بالثقة والامانة.

### 2. البدء في تنفيذ الإجراءات

من المؤكد أن الإدارة يقع عليها عبئ إختيار الأفراد وكذلك يقع عليها عبئ تدريب الأفراد علي المهارات المختلفة عند حدوث المخاطر أثناء التشغيل فكافة المنشآت تعاني من عدم وجود خبراء يستطيعون مواجهة المخاطر الأمر الذي يلقي بظلاله علي أهمية بذل الإدارة العليا لمزيد من الجهود من أجل خلق جيل جديد يمارس دوراً كبيراً في البدء في تنفيذ إجراءات حماية أمن نظم المعلومات الحاسوبية الإلكترونية.

### 3. معاقبة الموظفين المقصرين

من المؤكد أن الإدارة لن تستطيع أن تنفذ إجراءات الحماية لأمن نظم المعلومات الحاسوبية الإلكترونية من خلال العاملين الذي يقومون بكسر هذه التعليمات وعدم الإكتراث بها، فضلاً عن قيام العديد من المديرين التشغيليين بعدم الإلتزام بالقواعد الملزمة لحماية أمن نظم المعلومات الحاسوبية الإلكترونية. وبالتالي لايمكن أن يطبق نظام أمني إذا لم يكن هناك إلتزام حقيقي به، ومن ناحية أخرى يجب أن تتناسب العقوبة مع حجم الضرر الذي تسبب به الموظف.

### 4. تفعيل خطة الأمن

من الضروري أن تقوم الإدارة العليا بتفعيل خطة الأمن، فأى مؤسسة أو منشأة قادرة علي وضع خطة شاملة للأمن. وتعمل المؤسسة أو المنشأة علي تفعيل إحدوي طرق الحماية لتأمين أمن نظم المعلومات الحاسوبية الإلكترونية ولكن المؤسسة غالباً ما تسهو عن وجود ثغرة أمنية كبيرة يستغلها المهاجم لكي يخترق نظام أمن نظم المعلومات الحاسوبية. وتجدر الإشارة إلي أن هناك العديد من الأنظمة التي تقضي بضرورة إغلاق الأبواب وتطبيق طريقة الجدران النارية، فالمهاجمين يبحثون دائماً عن ثغرة أمنية واحدة لكي يخترقون منها ويتسللون إلي نظم المعلومات الحاسوبية الإلكترونية الأمر الذي يعرضها للتخريب أو التوقف عن العمل. وحتى تصبح المؤسسة مؤمنة بالكامل ضد أي ثغرات أمنية فإنه ينبغي تحقيق الأهداف الرئيسية لأمن المعلومات السالف ذكرها السرية والموثوقية والتحقق من



Raymond R, الهوية الشخصية وسلامة المحتويات وخواص عدم الإنكار وكذلك ضرورة إستمرار الخدمات (Panko, 2004).

## 5. دورة الحماية الشاملة

مما لا شك فيه أن أي منشأة تطبق دورة الحماية الشاملة يجب أن تمر بالعديد من المراحل منها التخطيط والحماية والإستجابة.

### أ. التخطيط

ولقد أشار Panko و Raymond (2004) أن تطبيق إجراءات الحماية الشاملة يتطلب إغلاق أبواب المؤسسات في وجه المهاجمين مع تعزيز الرقابة الشاملة وتدريب المراقبين علي تحمل كافة أوجه المخاطر المحتملة الأمر الذي يشير إلي إحصائية إنتظار المهاجم اللحظة المناسبة ليكتشف الثغرة الأمنية التي يستطيع من خلالها إختراق أمن نظم المعلومات المحاسبية الإلكترونية. ويشمل تحت هذه المرحلة العديد من المراحل التالية:

### 1- تحليل المخاطر

حيث يجب علي المؤسسة تحديد ميزانية تقديرية لما يمكن أن تساهم به المؤسسة في حماية أمن نظم المعلومات المحاسبية، وبالتالي فإن علي المؤسسة أن تعد دراسة واقعية عن أنواع حجم المخاطر التي يمكن أن تتعرض لها المؤسسة في ظل الظروف الراهنة. وتجدر الإشارة إلي أنه يتم تحليل المخاطر التي تهدد أمن نظم المعلومات المحاسبية الإلكترونية من خلال العديد من الخطوات من بينها دراسة واقع التهديدات وحصصها فضلاً عن تحليل كل تهديد علي حدة وإحتمال حدوث أسوء المخاطر وعن السيناريو الأمني الذي تتبعه المؤسسة من أجل تفعيل إجراءات الحماية الشاملة. ومن ناحية أخرى فإنه في حالة مواجهة المخاطر علي الأغلب تكون مكلفة جداً.

### 2- تفعيل سياسات الحماية

حيث تقوم المؤسسات بمنح العاملين إجازة دورية من أجل كشف الموظفين الذين يحاولون تخريب نظم المعلومات المحاسبية الإلكترونية أو إكتشاف الموظفين الذين يدخلون بيانات غير صحيحة من خلال نتائج أعمالهم، فضلاً عن أهمية حماية أجهزة الحواسيب الخاصة بكافة العاملين.

### 3- تفعيل السياسات والإجراءات التي تؤدي إلي تشديد الرقابة والفحص

وهي مرحلة إقرار السياسات واللوائح والنظم التي من خلالها يمكن تفعيل النظم الحمايية التي تساهم في إحكام الرقابة تفعيل مستوى الفحص لأمن نظم المعلومات المحاسبية الإلكترونية، وتجدر الإشارة إلي أن نظم المعلومات المحاسبية الإلكترونية تحتاج إلي إستمرار فحص طرق الحماية الشاملة للثبوت من أن الطرق المطبقة هي أفضل وسيلة يمكن الحصول عليها في ظل إستمرار الحماية.

## ب. تفعيل الحماية

من المؤكد أن أمن المعلومات يكون متاحاً في مرحلة وضع وتفعيل السياسات للتعرف علي الثغرات الأمنية والتعرف علي المراحل التي يمكن من خلالها الإستعانة ببعض البرامج بما يلاءم إجراءات الحماية المختلفة ولا ينبغي أن يتوقف أيضاً التأكد والتثبت من سلامة وصحة أمن المعلومات (Panko, Raymond R, 2004, p38).

## ت. الإستجابات

وتقضي هذه العملية بأنه إذا نجح المهاجمون من إختراق كافة الأنظمة وأخترقوا أمن نظم المعلومات المحاسبية الإلكترونية فإنه يستحيل عودة العمل علي النظام القديم إذ أن أمن نظم المعلومات المحاسبية الإلكترونية قد تم إختراقه الأمر الذي من المفترض أن يستتبع العديد من الإجراءات الصارمة لتثبيد إجراءات الرقابة من جديد والعمل بأساليب رقابية شديدة الصرامة من شأنها أن تقضي بتتضييق الخناق علي المهاجمين (Panko, Raymond R, 2004, p39).

1. ضرورة إختيار العمالة المدرية ذات الخبرة الواسعة في التعامل مع نظم المعلومات المحاسبية الإلكترونية وأن تتوفر فيهم كافة الشروط ليتحملوا مسؤولية حماية نظم المعلومات المحاسبية الإلكترونية.
2. تحديد الإجراءات المتبعة بخصوص تشغيل البيانات وتحديد الصلاحيات.
3. تفعيل إجراءات الحماية الخاصة بنظم المعلومات المحاسبية الإلكترونية ومنع إختراقها من كافة المخاطر التي تحيط بها.
4. ضرورة عمل أكواد مشفرة لايمكك حق الإطلاع عليها إلا المسؤول عن أمن نظم المعلومات المحاسبية الإلكترونية ويعاقب في حالة حصول أحد الأشخاص من العاملين أو من غير العاملين علي هذه المعلومات الهامة.
5. ضرورة الإحتفاظ بنسخ إحتياطية للبيانات علي أن تكون في مأمن حتي يسهل الإطلاع عليها بعد ذلك.
6. ضمان إجراءات السلامة والحماية تضمن بلا شك عدم توقف العمل وضمان عدم توقف نظم المعلومات المحاسبية الإلكترونية عن العمل وتوفير الخدمات اللازمة.

وكذلك فإن المخاطر التي تتعرض لها نظم المعلومات المحاسبية الإلكترونية تعتبر من أبرز العوامل في تدني أداء تلك المنظومات المالية الامر الذي يؤدي إلي تعطيل النظام ككل وكذلك فإن المخاطر قد تتسبب في حدوث خسائر كبيرة.

ولقد أكد أبو موسي (2004) أن المخاطر التي تهدد أمن نظم المعلومات الإلكترونية تنقسم إلي العديد من الأقسام (من حيث مصدر المخاطر، والمتسبب فيها، والتعمد من عدمه، النتائج المترتبة عليها وأخيراً المخاطر وعلاقتها بنظم المعلومات المحاسبية الإلكترونية).

## معاملات الثبات (كرونباخ ألفا) لجميع فقرات مجالات الدراسة والأداة ككل

الرقم	المجال	معامل (كرونباخ ألفا)	معامل الارتباط بين التطبيقين
1	مخاطر أمن نظام المعلومات المحاسبية	0.80	*0.55
2	أسباب حدوث مخاطر أمن نظم المعلومات	0.74	*0.53
3	إجراءات الحماية المتبعة ضد مخاطر نظم المعلومات	0.78	*0.54
	الأداة ككل	0.85	*0.56

\*دالة إحصائية عند مستوى الدلالة ( $\alpha \geq 0.05$ ).

يظهر من جدول رقم (1) أن قيم معاملات ثبات (كرونباخ ألفا) لمجالات الدراسة تراوحت بين (0.74-0.80) ، كما بلغ معامل (كرونباخ ألفا) للأداة ككل (0.85) وهي قيم مرتفعة لأغراض التطبيق؛ إذ أشارت معظم الدراسات إلى أن نسبة قبول معامل الثبات (0.60) (الشريفيين والكيلاني، 2007) وتراوحت معاملات الارتباط بيرسون لمجالات الدراسة ما بين (0.53-0.56) وهي قيم دالة إحصائية عند مستوى الدلالة ( $D = 0.05$ )، وهذا يدل على ثبات تطبيق أداة الدراسة.

## نتائج تحليل الاتساق الداخلي والثبات لمحور المخاطر

## جدول (2)

## Item-Total Statistics

مجال نظم المعلومات	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Cronbach's Alpha if Item Deleted
A1	50.4000	72.287	.209	.799
A2	50.2091	71.244	.401	.785
A3	50.1591	71.093	.336	.789
A4	49.9227	69.094	.451	.781
A5	50.0318	70.250	.419	.784
A6	49.9773	71.018	.339	.789
A7	49.8545	70.508	.348	.788
A8	49.8955	70.231	.395	.785
A9	50.1364	71.004	.322	.790
A10	50.0409	69.793	.359	.788

## نتائج تحليل الاتساق الداخلي والثبات لمحور الإجراءات

يتضح من الجدول السابق أن جميع العبارات (في جميع المحاور) قيمة معامل الثبات (ألفا) في حالة حذفها أقل من قيمة ألفا للمحور ككل مما يعني أن جميع العبارات (داخل المحاور المختلفة) تسهم في زيادة الثبات وغيابها عن المحور يؤثر سلباً على ثبات المحور، أي أن جميع عبارات الاستبانة ثابتة وتؤثر في ثبات المحور ككل.

## الجدول (3)

## Item-Total Statistics

مجال المخاطر الإلكترونية	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Cronbach's Alpha if Item Deleted
C1	39.93	54.667	.144	.795
C2	40.02	51.786	.401	.771
C3	40.09	51.252	.428	.769
C4	40.12	51.526	.389	.772
C5	40.23	50.621	.407	.771
C6	40.27	51.417	.419	.770
C7	40.28	50.594	.482	.764
C8	40.35	50.428	.441	.767
C9	40.18	50.958	.371	.774
C10	40.28	51.019	.499	.764
C11	40.29	50.623	.487	.764
C12	40.24	51.874	.403	.771
C13	40.23	52.058	.368	.774
C14	40.51	49.924	.419	.770

يتضح من الجدول السابق أن جميع العبارات (في جميع المحاور) قيمة معامل الثبات (ألفا) في حالة حذفها أقل من قيمة ألفا للمحور ككل مما يعني أن جميع العبارات (داخل المحاور المختلفة) تسهم في زيادة الثبات وغيابها عن المحور يؤثر سلباً على ثبات المحور، أي أن جميع عبارات الاستبانة ثابتة وتؤثر في ثبات المحور ككل.

## التحليل العاملي لمحور مخاطر نظم المعلومات المحاسبية الإلكترونية:

من خلال مصفوفة الارتباط (Correlation Matrix) يتبين وجود علاقات ارتباطية طردية وعكسية بين المتغيرات المختلفة وكذلك علاقات ارتباطية قوية لكنها قليلة وعلاقات متوسطة وضعيفة وربما يعزى ضعف العلاقات إلى مقياس ليكرات الخماسي المستخدم في الاستبانة، عدد فقرات التي أستخدمها لقياس مخاطر نظم المعلومات المحاسبية فقرات في الاستبانة. كما هو موضح في الجدول رقم (4) وقد تم حذف السؤال 7 و10 لأنه تشعباتها أقل (0.40) بحث تم تسمية العنصر الأول والذي يحتوي على السؤال (5,6,8,9) مخاطر الاختراقات الخارجية. وفي المقابل العنصر الثاني الذي يحتوي على الأسئلة (1,2,3,4) مخاطر اختراقات الموظفين.

الجدول (5)  
مصفوفة الارتباط

Correlation Matrix<sup>a</sup>

	A1	A2	A3	A4	A5	A6	A8	A9
A1	1.000	.474	.600	.570	.239	.175	.249	.167
A2	.474	1.000	.607	.655	.336	.203	.255	.225
A3	.600	.607	1.000	.611	.331	.249	.210	.232
A4	.570	.655	.611	1.000	.340	.258	.301	.248
A5	.239	.336	.331	.340	1.000	.671	.682	.683
A6	.175	.203	.249	.258	.671	1.000	.688	.756
A8	.249	.255	.210	.301	.682	.688	1.000	.695
A9	.167	.225	.232	.248	.683	.756	.695	1.000

a. Determinant = .012

من الجدول التالي الذي يوضح (KMO واختبار "بارتلنت" نجد أن قيمة مقياس "اولكن" تساوي (0.842) وهي أكبر من (0.5) وهذا يدل على زيادة الاعتمادية للعوامل التي نحصل عليها من التحليل العاملي، وكذلك نحكم بكفاية حجم العينة، كما نجد قيمة الاحتمال (P-value) من اختبار "بارتلنت" تساوي (0.00) وهي أقل من (0.05) وهذا يعني أن مصفوفة الارتباط لا تساوي مصفوفة وحدة، وأنه يوجد ارتباط بين بعض المتغيرات في المصفوفة، لذلك يمكن إجراء التحليل العاملي للبيانات.

الجدول التالي مقياس "كايزار" مير أوكن "للحكم على مدى كفاية العينة واختبار "بارتلنت" للبيانات.

## الجدول (6)

مقياس "كايزار" مير أوكن واختبار "بارتلنت" للبيانات

## KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.842
Bartlett's Test of Sphericity	Approx. Chi-Square	954.994
	df	28
	Sig.	.000

**Communalities**

	Initial	Extraction	Anti-image
A1	1.000	.629	0.821a
A2	1.000	.679	0.825a
A3	1.000	.723	0.811a
A4	1.000	.731	0.837a
A5	1.000	.746	0.890a
A6	1.000	.794	0.839a
A8	1.000	.758	0.856a
A9	1.000	.805	0.840a

Extraction Method: Principal Component Analysis.

من الجدول التالي والذي يوضح مصفوفة المكونات (مصفوفة العوامل) بعد التدوير يبين معامل الارتباط البسيط بين العامل والمتغير للعوامل التي تم استخلاصها بعد التدوير ونجد أن قيم التشبع (الارتباطات) مرتبة تنازليا لكل عامل من العوامل المستخلصة.

**الجدول (7)**  
**مصفوفة المكونات (مصفوفة العوامل)**

**Rotated Component Matrix<sup>a</sup>**

	Component	
	مخاطر الاختراقات الخارجيه	مخاطر اختراقات الموظفين
A9	.891	
A6	.884	
A8	.856	
A5	.827	
A3		.838
A4		.834
A2		.810
A1		.788

Extraction Method: Principal Component Analysis.

Rotation Method: Varimax with Kaiser Normalization.

a. Rotation converged in 3 iterations.

من الشكل (7) والذي يوضح رسم بياني لركام الجذور التحليلية المقابلة للعوامل المختلفة وبين هذه الشكل الجذور التحليلية لكل عامل تم استخلاصه، ويوضح حقيقة أن كمية التباين التي يعزى إليها التغير (الجذور التحليلية) في كل من هذه العوامل تتلاشي نجد مع استخلاص العوامل المتعاقبة، ومن الشكل يتضح أن الركام يبدأ في الظهور بين

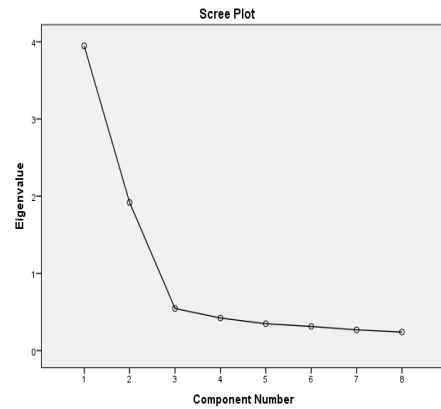
العامل الأول والثاني كما نجد أن العامل الثالث يقابل جذر أقل من (1) وبالتالي يتم الاحتفاظ بالعوامل الأول والثاني فقط.

### Correlation Matrix<sup>a</sup>

	C9	C12	C13	C10	C11	C3	C7	C5	C4	C1	C8	C6
C9	1.000											
C12	.706	1.000										
C13	.772	.688	1.000									
C10	.713	.764	.724	1.000								
C11	.719	.736	.765	.662	1.000							
C3	.271	.188	.251	.222	.278	1.000						
C7	-.184	-.202	-.123	-.216	-.087	-.006	1.000					
C5	.707	.740	.679	.659	.738	.330	-.166	1.000				
C4	.662	.665	.666	.655	.730	.278	-.151	.638	1.000			
C1	.587	.566	.573	.548	.560	.163	-.067	.534	.499	1.000		
C8	.241	.214	.222	.235	.198	.236	.095	.214	.265	.181	1.000	
C6	.181	.116	.191	.159	.227	.135	-.001	.200	.185	.125	.151	1.000

a. Determinant = .001

### الشكل رقم (1) Scree Plot



التحليل العاملي لمحور  
الاجراءات الحمائية  
المتبعة.

من خلال مصفوفة الارتباط (Correlation Matrix) يتبين وجود علاقات ارتباطية طردية وعكسية بين المتغيرات المختلفة وكذلك علاقات ارتباطية قوية لكنها قليلة وعلاقات متوسطة وضعيفة وربما يعزى ضعف العلاقات إلى مقياس ليكارث الخماسي المستخدم في الاستبانة، كما هو موضح في الجدول التالي:

من الجدول التالي الذي يوضح (KMO واختبار "بارتلنت" نجد أن قيمة مقياس "اولكن" تساوي (0.929) وهي أكبر من (0.5) وهذا يدل على زيادة الاعتمادية للعوامل التي نحصل عليها من التحليل العاملي، وكذلك نحكم بكفاية حجم العينة، كما نجد قيمة الاحتمال (P-value) من اختبار "بارتلنت" تساوي (0.00) وهي أقل من (0.05) وهذا يعني أن مصفوفة الارتباط لا تساوي مصفوفة وحدة، وأنه يوجد ارتباط بين بعض المتغيرات في المصفوفة، لذلك يمكن إجراء التحليل العاملي للبيانات. الجدول التالي مقياس "كايزار مير أوكن" للحكم على مدى كفاية العينة واختبار "بارتلنت" للبيانات.

### مصفوفة الارتباط

### الجدول رقم (8)

### KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.	.929
Approx. Chi-Square	1492.309
Bartlett's Test of Sphericity Df	66
Sig.	.000

الجدول (9)  
مقياس "كايزار مير أوكن واختبار "بارتلت" للبيانات

## Communalities

	Initial	Extraction	Anti-image
C9	1.000	.763	0.947a
C12	1.000	.771	0.914a
C13	1.000	.755	0.930a
C10	1.000	.734	0.929a
C11	1.000	.766	0.915a
C3	1.000	.365	0.862a
C7	1.000	.401	0.715a
C5	1.000	.722	0.942a
C4	1.000	.674	0.953a
C1	1.000	.493	0.975a
C8	1.000	.496	0.840a
C6	1.000	.249	0.872a

Extraction Method: Principal Component Analysis.

وتم تدوير العوامل تدويراً متعامداً Orthogonal Rotation بطريقة تعظم التباين التي تُنسب إلى كايزر Varimax with Kaiser Normalization أسفر التحليل عن (2) عوامل جذرها الكامن Eigenvalue أكثر من واحد (مقياس جتمان)، فسّرت (49%) من التباين الكلي؛ وعند دراسة محتواها من أجل تسميتها، اتضح أن محتوى معظم العوامل مختلط من جوانب متعددة. بعد دراسة مكونات العوامل المستخلصة، اتضح أن العوامل السبع تتسم بالتركيب البسيط Simple Structure طبقاً لمقياس ثرستون Thurston، والتركيب البسيط هو جعل التشعبات في كل عامل أكثر ما يكون، وعدد العوامل ذات التشعب العالي لكل متغير اقل ما يكون؛ وعلى أساس الفقرات المتشعبة بنسبة أكثر من (0.40) في أحد عوامل تمت تسمية العوامل الثلاث بالأسماء الآتية: (1)، (2) ومن خلال نسبة التباين المُفسر، والجذر الكامن لكل عامل، يمكن القول أن العاملين المستخلصة من التحليل العاملي الاستكشافي مقبولة إحصائياً، ومن خلال الأسماء التي أعطيت لكل عامل يمكن القول أيضاً أنها عوامل مقبولة منطقياً. والجدول التالي يتضمن خلاصة نتائج التحليل العاملي للمقياس.



الجدول (10)  
مصفوفة المكونات (مصفوفة العوامل)  
Component Matrix<sup>a</sup>

	Component	
	قرارات ودعم الإدارة العليا للبنك	سياسات وقواعد
C11	.875	
C9	.871	
C13	.868	
C12	.862	
C5	.850	
C10	.848	
C4	.821	
C1	.700	
C8		.627
C7		.601
C3		.486
C6		.429

Extraction Method: Principal Component Analysis.

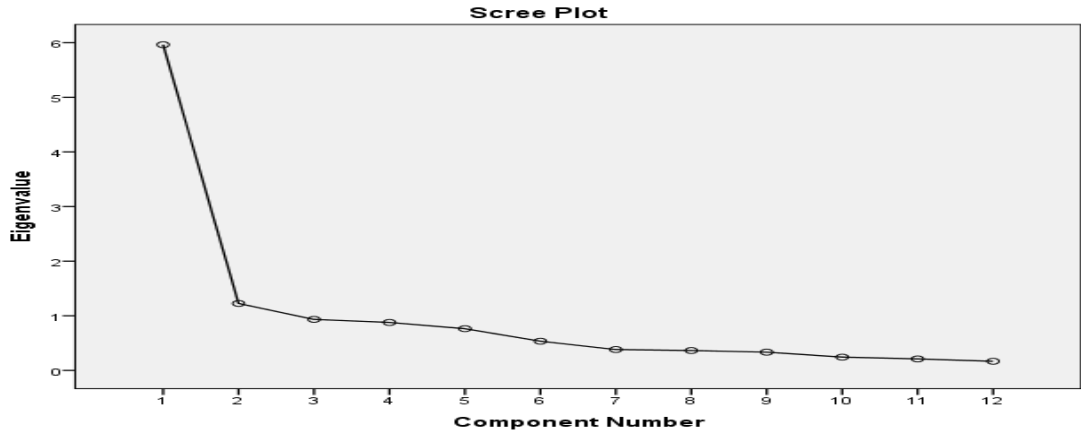
a. 2 components extracted.

وقد اختيرت الفقرات في ضوء محكين أساسيين، هما: أن يكون تشعب الفقرة على العامل الذي تنتمي إليه أكثر من (0.40)، وأن يكون لتشعب الفقرة على أي عامل آخر أقل من (0.40) وقد انطبق هذان المحكان على (14) فقرة من فقرات المجال. وقد تم حذف السؤال 2,14 لأنه تشعباتها أقل (0.40) حيث تم تسمية العنصر الأول والذي يحتوي على السؤال (1,4,5,9,10,11,12,13) قرارات ودعم الإدارة العليا للبنك. وفي المقابل العنصر الثاني الذي يحتوي على الأسئلة (3,6,7,8) سياسات وقواعد

من الشكل (10) والذي يوضح رسم بياني لركام الجذور التحليلية المقابلة للعوامل المختلفة وبين هذه الشكل الجذور التحليلية لكل عام تم استخلاصه، ويوضح حقيقة أن كمية التباين التي يعزى إليها التغير (الجذور التحليلية) في كل من هذه العوامل تتلاشي نجد مع استخلاص العوامل المتعاقبة، ومن الشكل يتضح أن الركام يبدأ في الظهور بين العامل الأول والثاني والثالث كما نجد أن العامل الرابع يقابل جذر أقل من (1) وبالتالي يتم الاحتفاظ بالعوامل الأول والثاني والثالث فقط.

## الشكل رقم (2)

## Scree Plot رسم بياني



لذلك

سيكون لدينا نموذجين للتحليل الانحدار وفقا لنتائج التحليل العاملي

1- أثر إجراءات الحماية المتبعة على مخاطر الخارجيه

2- أثر إجراءات الحماية المتبعة على مخاطر أخطاء الموظفين

## التوزيع الطبيعي

بغرض التعرف على التوزيع الطبيعي لبيانات أفراد العينة تم تطبيق الاختبار (Kolmogorov-Smirnov Z)

على جميع مجالات الدراسة، جدول (2) يوضح ذلك، واستخراج منحنى التوزيع الطبيعي لكل متغير من متغيرات الدراسة:

## جدول رقم (11)

( على جميع مجالات الدراسة Kolmogorov-Smirnov Z نتائج تطبيق الاختبار )

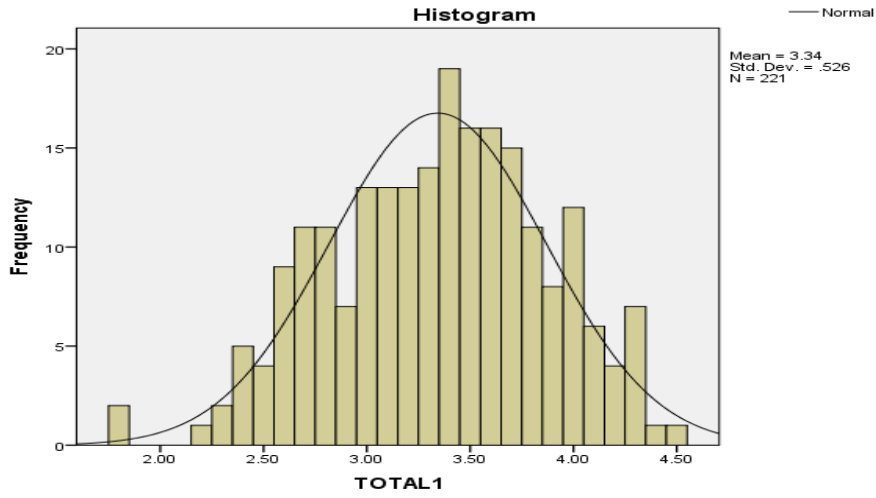
الدلالة الإحصائية	Kolmogorov-Smirnov Z	المجال
0.47	0.85	مخاطر أمن نظام المعلومات المحاسبية
0.31	0.96	أسباب حدوث مخاطر أمن نظم المعلومات
0.14	1.15	إجراءات الحماية المتبعة ضد مخاطر نظم المعلومات

يظهر من جدول (11) أن قيمة الاختبار (Kolmogorov-Smirnov Z) لمجالات الدراسة تراوحت بين 0.85-

1.15) وهي قيمة مقبولة وتؤكد أن التوزيع كان طبيعي، وتوضح الأشكال (3) التوزيع الطبيعي لبيانات الدراسة.

التوزيع الطبيعي لمخاطر أمن نظام المعلومات المحاسبية.

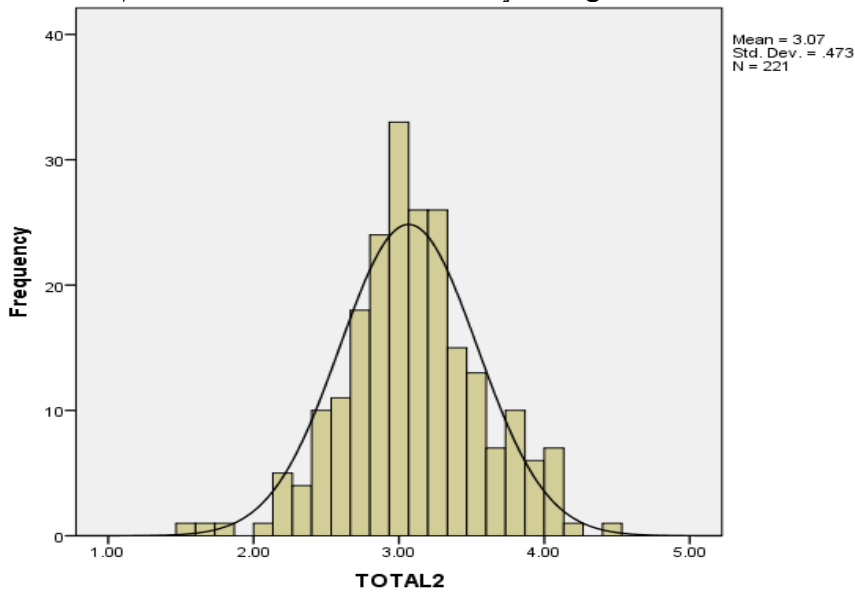
الشكل رقم (3)  
التوزيع الطبيعي لمجال مخاطر أمن نظام المعلومات المحاسبية



التوزيع الطبيعي لمجال أسباب حدوث مخاطر أمن نظم المعلومات.

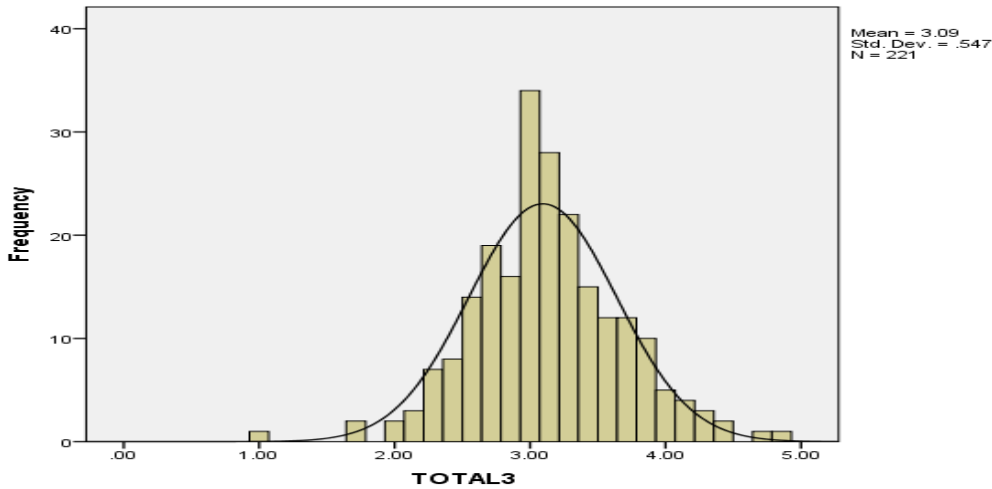
الشكل رقم (4)

التوزيع الطبيعي لمجال أسباب حدوث مخاطر أمن نظم المعلومات



التوزيع الطبيعي لمجال إجراءات الحماية المتبعة ضد مخاطر نظم المعلومات

الشكل رقم (5)  
التوزيع الطبيعي لمجال إجراءات الحماية المتبعة ضد مخاطر نظم المعلومات المحاسبية



مناقشة نتائج الدراسة

للتحقق من صحة هذه الفرضية تم تطبيق معادلة الانحدار البسيط والذي أظهرت نتائجه أن قيمة معامل الارتباط (R) بلغت (0.744) وهي قيمة دالة إحصائياً وتدل على أن هناك أثر للإجراءات الحماية المتبعة على مخاطر نظم المعلومات المحاسبية الالكترونية، وبلغت قيمة (R-square) (55%) وهذا يفسر ما نسبته (55%) من التباين الحاصل في متغير مخاطر نظم المعلومات المحاسبية الالكترونية، في حين (45%) من الاختلافات ناتجة من عوامل أخرى لم يتم أخذها في عين الاعتبار في هذا النموذج، وهذا يدل على أثر سلبي ودال إحصائياً للأثر إجراءات الحماية المتبعة على مخاطر نظم المعلومات المحاسبية الالكترونية، جدول (13) يوضح نتائج معادلة الانحدار البسيط لدراسة أثر إجراءات الحماية المتبعة على مخاطر نظم المعلومات المحاسبية الالكترونية.

الجدول رقم (12)

نتائج معادلة الانحدار البسيط لدراسة أثر إجراءات الحماية المتبعة على نظم المعلومات المحاسبية

الدالة الاحصائية	f	القوة التفسيرية R(2)	الارتباط R(	الدالة الإحصائية	T	$\beta$	الفرضية
0.00	270.801	0.553	0.744	0.00	- 16.456	- 0.488	إجراءات الحماية المتبعة

وفقاً لنتائج التحليل العملي فإن إجراءات الحماية المتبعة تمثلت بعاملين مستخلصه في قرارات ودعم الإدارة العليا و سياسات وقواعد الحماية كمتغير مستقل. أما مخاطر نظم المعلومات المحاسبية تقسم الى عاملين وهما مخاطر الاختراقات الخارجية و مخاطر الاختراقات الموظفين للتحقق من صحة هذه الفرضية تم تطبيق معادلة الانحدار المتعدد المتدرج والذي أظهرت نتائجه أن قيمة معامل الارتباط (R) بلغت (0.903) وهي قيمة دالة إحصائياً وتدل على أن هناك أثر للإجراءات الحماية المتبعة على مخاطر نظم المعلومات المحاسبية الالكترونية، وبلغت قيمة (R-square) (81%) وهذا يفسر ما نسبته (81%) من التباين الحاصل في متغير مخاطر نظم المعلومات المحاسبية الالكترونية، في حين (19%) من الاختلافات ناتجة من عوامل أخرى لم يتم أخذها في عين الاعتبار في هذا النموذج،

وهذا يدل على أثر إيجابي ودال إحصائياً للأثر إجراءات الحماية المتبعة على مخاطر نظم المعلومات المحاسبية الالكترونية، جدول (12) يوضح نتائج معادلة الانحدار البسيط لدراسة أثر إجراءات الحماية المتبعة على مخاطر نظم المعلومات المحاسبية الالكترونية.

**الجدول رقم (13)**  
نتائج معادلة الانحدار البسيط لدراسة أثر إجراءات الحماية المتبعة علي الأخرقات الخارجية

الفرضية	$\beta$	T	الدلالة الإحصائية	الارتباط )R(	القوة التفسيرية )R( 2 )	f	الدلالة الاحصائية
قرارات ودعم الإدارة العليا للبنك	-0.899	-29.892	0.00	0.903	0.816	483.550	0.00
سياسات وقواعد الحماية	-0.018	-0.597	0.551				

دالة إحصائياً عند مستوى الدلالة ( $\alpha \leq 0,05$ ).

ومما سبق تقبل الفرضية بصيغتها المثبتة والتي تنص " يوجد أثر ذو دلالة احصائية عند مستوى الدلالة ( $\alpha \geq 0.05$ ) للأثر إجراءات الحماية المتبعة على مخاطر نظم المعلومات المحاسبية الالكترونية في مصرف ليبيا المركزي"، واتفقت هذه النتيجة مع دراسة (الغويل، 2013)، ودراسة (العبيدي، 2012) ودراسة (الساكني، العواودة 2011). وأظهرت نتائجها أن قيمة معامل الارتباط (R) بلغت (0.33) وهي قيمة دالة إحصائياً وتدل على أن هناك أثر للإجراءات الحماية المتبعة على مخاطر نظم المعلومات المحاسبية الالكترونية، وبلغت قيمة

(R-square) (11%) وهذا يفسر ما نسبته (11%) من التباين الحاصل في متغير مخاطر نظم المعلومات المحاسبية الالكترونية، في حين (89%) من الاختلافات ناتجة من عوامل أخرى لم يتم أخذها في عين الاعتبار في هذا النموذج، وهذا يدل على أثر سلبي ودال إحصائياً للأثر إجراءات الحماية المتبعة على مخاطر نظم المعلومات المحاسبية الالكترونية، جدول (15) يوضح نتائج معادلة الانحدار البسيط لدراسة أثر إجراءات الحماية المتبعة على مخاطر نظم المعلومات المحاسبية الالكترونية.

**الجدول (14)**

نتائج معادلة الانحدار البسيط لدراسة أثر إجراءات الحماية المتبعة علي مخاطر إخرقات الموظفين

الفرضية	$\beta$	T	الدلالة الإحصائية	الارتباط )R(	القوة التفسيرية )R( 2 )	f	الدلالة الاحصائية
قرارات ودعم الإدارة العليا للبنك	-0.321	-4.862	0.00	0.333	0.111	13.618	0.00
سياسات وقواعد الحماية	-0.038	-0.38	0.561				

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## ISLAMIC (RISK SHARING) FINANCE FOR SECURING ‘HALAL TAYYAB’ AND ECONOMIC SUSTAINABILITY

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*Preliminary Draft*

### ABSTRACT

*The sensitivity of halal lifestyle is second to none for Muslim savers and investors. The same carries strength directly Quran Al Kareem itself. Recently the notion has rightly grown in to an impactful industry in itself, projecting the sub serviance to the Maqasid pillars. Nevertheless what appears to exist is the presence of cognitive dissonance in fully understanding the Quranic notion of Halal as part of the holistic concept of Halal Tayyab. It is noteworthy that Quran itself renders the believers to prefer Halal Tayyab. The current paper will not only highlight the apparent dissonance among scholars and masses but will establish Islamic finance as the providing the missing link to complete Halal Tayyab from only Halal. The same is then advocated as a prime scheme towards achieving a sustainable ‘Halal Tayyab Global Economy’ enshrined on the supportive institutional framework of Islam.*

**Key Words:** *Halal, Halal Tayyab, Islamic Finance, Risk Sharing, Economic Sustainability, Halal Tayyab Economic System.*

### INTRODUCTION

The value of the halal industry is almost double the Islamic financial industry. Consequently, the former has reached a global size of over \$2.3trillion since 2012 while the halal (Islamic) financial industry is about to go over \$1.6trillion (effectively making a combined volume of halal/Islamic industry over \$4trillion).





1.

**Sizeable and growing Muslim population**

"Muslim population worldwide (2012) = 2.1 billion  
Forecasted to grow at twice the rate by 2030 representing 27% of global population"

Source: Pew Research Centre

2.

**Growing economic development in Muslim countries**

"Between 1990 and 2010, GDP per capita for Muslims worldwide has grown at a Cumulative Annual Growth Rate (CAGR) of 6.8% (Global CAGR: 5.0%)."

Source: United Nation and IMF

3.

**Emergence of potential Halal markets in Non-Muslim countries (China & India)**

"Chinese Halal markets is worth US\$2.1 billion and growing at 10.0% annually."

Source: Islamic Association of China

Given the doctrinal, religious, genus operational and objectives similarities, surprisingly the two industries are operating independent of each other. This implies that ordinary Muslims are more concerned with what they eat or wear than the "halalness" of the financial products they use. Nevertheless, there is an increasing realization that both fall in the same Shariah ambit and be converged for what should be unified growth and development. The purposed unification should be referred to as a move towards the promotion and realization of a 'New Age Halal Tayyab Islamic Economics system'. In order to understand the same, it is pivotal to grasp the key distinction of Halal and Halal Tayyab. There appears to be a cognitive dissonance among scholars and masses, implying both the notions as same. A number of Quranic verses talks about halal and simultaneously prefers for believers "Halal Tayyab"<sup>mmmm</sup>. It is unlike Quran to use words in the same verses that mean the same thing. Quran is believed to the language of Allah swt, making it error free. Examining the classical Arabic lexicon and the grammatical/historical Quranic Arabic jargon, it is safe to argue that Halal Tayyab refers to a sort and nature of consumption that ideally ensure not only the bodily and biological, but also physiological and spiritually satisfaction. Halal alone though sufficient but does not necessarily maintain the full given satisfaction cycle. As a result, in nearly each verse of Quran, ordaining for Halal lifestyle, there is a preference to go beyond and attain the full physical and spiritual satisfaction i.e. attaining "Halal Tayyab".

<sup>mmmm</sup> See, For example, Al- Baqara: Chapter 2: Verse 168 ; An-Nahl, Chapter 16: Verse 114; Al-Isra: Chapter 17: Verse 70; Al-Maeda, Chapter 5, Verse 4; Al-Maeda, Chapter 5, Verse 88 Al-Araf, Chapter 7, Verse 32; Al-Mumenoon, Chapter 23, Verse 51, Taha, Chapter 20, Verse 81; Al-Anaam, Chapter 6, Verse 145.

The significance of Halal/Halal Tayyab starts from the Quranic/Islamic notion of Meethaq—the Primordial Covenant. Akin to Halal and Halal Tayyab, Meethaq must also be necessarily differentiated with Aqad. Whereas Aqad refers to a contract signifying the muamalat dynamics between humans, Meethaq is a contractual relationship between Humans and the creator, Allah swt. Unlike Aqad, Meethaq governs the relationship and dynamics of Allah towards Humans and vice versa. Moreover, all the Uqud (plural of Aqad) are also governed under the same Meethaq; the former being a direct colliery of the later. It can hence be stated that Meethaq governs not only the relations between creator and humans but also human vs humans. Both structures being accountable as per the terms and conditions of Meethaq. While the insights of meethaq governing Mualamat can be left for another time, the governance model via the same between Allah swt and humans could give some insight to the importance of Halal Tayyab.

A number of verses in Quran signify and remind the believers of the importance and strength of the ‘primordial covenant’: “Meethaq”<sup>nnnn</sup>. It ordains the behavioral terms and conditions between Allah swt and believers. Compliance with the same is the epitome of this sacred relationship nexus. Among the list of dos and don’ts, the most relevant here is the Meethaq term dictating Allah swt as the sole provider and sustainer. In exchange to the same, it is the sole responsibility of believers/humans to follow the rules of Allah and validate the sustenance, from Allah, as not only Halal but preferably as ‘Halal Tayyab’. If such are the ordainments for the sustenance model under Meethaq then the consumption/investment function of believers become strictly contingent to it. This also provide a solid testing grounds for scrutinizing the current function in Muslim societies. As article of faith, Muslims consumers are highly sensitive towards the halalness of what they spend/consume. A fine demonstration is the consumption of chicken which has to be ascertained as Halal.

However, the assertion is no guarantee of Halal Tayyab as preferred by Quran and implied by Meethaq. The way it is slaughtered, cooked and consumed can all be in line with faith but this would only rightly provide bodily satisfaction and not necessarily psychological/spiritual; given when one realizes that the same chicken was bred in a non-

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<sup>nnnn</sup> See, for example, Al-Quran: Al-Baqara: verse 27; 63; 83; 93;84 Al Maidah: verse 7; 70;14;12; 13 Al Rad: verse 25; 20 Al-Nisaa: verse: 21; 90; 154-155 Al-Imran: verse: 81;187 Al-Ahzab : verse 7 Al Hadid : verse : 8

Halal way, for example, the poultry farm financed all or some portion of the farm via interest bearing debt financing. Realization of the fact instantly creates doubt on the 'wholesome halalness', depriving one from maintaining the complete cycle of satisfaction; securing 'Halal Tayyab'. The rejuvenation of Islamic finance serves well to provide the missing link and complete the desired cycle of securing Halal Tayyab. The same chicken which was unable to reach the status of Halal Tayyab can now be termed as fully tayyab with the adoption of Islamic financing. Nevertheless, as mentioned earlier, it is a disconcerting reality that both while serving a unified objective, are somehow not unified but growing separately at their distinct rates. The value of the halal industry is almost double the Islamic financial.

The thrust for unifying the bifurcated segment of halal industry becomes even more crucial given the realization that Islamic financial institutions are looking for genuine Islamic investment assets (which at present are scarce) and the halal producers and manufacturers are too in serious need for capital. The unified halal industry can effectively absorb all the available funding from Islamic financial institutions while securing Halal Tayyab. The same becomes more attuned for serving financial inclusion and entrepreneurship via Islamic finance given most halal producers happen to be small and medium size enterprises. There are some early signs of realization of the need for convergence of these two industries. Malaysia, which is among global centers of excellence for the Islamic financial services industry, is also emerging as a leader in the promotion of halal goods and services. For the convergence to accelerate, incentives should be given to halal manufacturers for maintaining a Shariah compliant balance sheet. At present, most halal manufacturers are not Islamic finance clients or users. This is primarily because the users of halal goods and services are not necessarily those who subscribe to Islamic financial services, due to the dichotomy of "consumer Islam" and "financial Islam." Hence, those companies already involved in the halal sector are not compelled to adopt Islamic finance. Since around 80% of companies producing halal products are controlled by non-Muslims, there is no religious impetus for them to participate in Islamic finance.

In most countries, conventional financing is well established, and halal producing firms tend to be averse to switching unless there are substantial economic or monetary benefits. The convergence between the two industries is inevitable but it will largely be regulation-driven; although both industries are by and large demand-driven than supply driven.

Once the competition in the halal industry increases, it is expected that convergence will become a supply driven phenomenon, as many halal manufacturers will start marketing themselves as not only halal but also Halal Tayyab. The synergistic convergence of these two powerful and rapidly growing industries will form the basis of a new HALAL TAYYAB ECONOMY.

### Permissible + Universal Values



It is pertinent to mention that the crucial prerequisite for understanding the Halal Tayyab of Islamic Finance is the realization of a new age Islamic finance version 2.0 which is focused on Al-bay (risk sharing) in finance, as per Al-Quran ch 2 verse 275, and less focused on no riba alone. The modality of the current Islamic finance version 1.0 which is more drive by later and less on Al-Bay. The model could argued as Halal but not Halal Tayyab<sup>0000</sup>. Studies have shown, for example, IMF, 2016, that the current operational trajectory is Islamic finance akin to conventional. After taking financial risks, they too are either transferring of shifting them. The following sections will advocate how the risk sharing based Islamic, while following the ordainments of Meethaq of the human side, has the necessary configuration and a complimentary institutional infrastructure that help secure the Tayyab of Halal. Nevertheless, to further supplement the significance of Islamic finance, section two will first establish how the interest bearing debt financing and ensuing financialization is a clear demonstration of the violation of Meethaq—repugnant to halal and halal tayyab— via the verse 276 of chapter 2 of Al-Quran.

### THE BLACK SWANS AND THE NON-LINEAR<sup>PPPP</sup> DESTRUCTIVE DEBT DYNAMICS

<sup>0000</sup> For detailed discussion on the notion of Risk Sharing based Islamic finance in securing Halal Tayyab, see Shaukat.M and Bushra.S (2017). On the significance of Islamic finance in securing Halal Tayyab. In press.

<sup>PPPP</sup>In 'Nonlinear dynamics', the systems that depict non-linearity may be thought of as any collection of parts whose interactions and connections are described by nonlinear rules or equations. That is to say, the equations' variables may

Scholarship has argued that the interest bearing debt financing has contributed to the financialization of the economy<sup>9999</sup> (Shaukat et al., 2013). To Askari et al., (2012: xii), “when risk transfer is combined with high leverage, the growth of interest-based debt contracts and their pure financial derivatives—those with little or no connection to real assets—outpace the growth of the real sector leaving the liabilities in the economy a large multiple of real assets needed to validate them. This phenomenon has been coined as “financial decoupling” or “financialization”, whereby finance is no longer anchored to the real sector”. Argitis (2010) has termed it as a wave of ‘Neo-liberalism’; suggesting that policy structure has increased the share of national income and profits going to rentiers, bankers and other groups of financial capitalists. Consequently, it has become more a ‘rentier economy’ than ‘value addition economy’ (Bogle, 2012). According to Bogle (2012: 6), “trading in S&P 500-linked futures totaled more than \$60 trillion in 2011, five times the S&P 500 index total market capitalization of \$12.5 trillion. The credit default swaps alone had a notional value of \$33 trillion. Add to this total a slew of other derivatives, whose notional value as 2012 began totaled a cool \$708 trillion. All this in comparison to \$150 trillion: the aggregate capitalization of the world’s stock and bond markets”. The loss of J P Morgan of about US\$ 5.8 billion in July 2012 is a gain of hedge funds who bought its structured products.

The above developments validate the presence of what the noble laureate James Tobin (1984) termed as ‘paper economy’. Tobin (1984) suggests “we are throwing more and more of our resources into financial activities remote from the production of goods and services, into activities that generate high private rewards disproportionate to their social productivity: a ‘paper economy’, facilitating speculation which is short-sighted and inefficient” (see also Mirakhor and Bacha, 2013). Bogle (2012: 4-5), in his latest book titled “*The Clash of Cultures: Investment v/s Speculation*”, has described this unprecedented surge in financialization and speculation as Capitalism’s ‘mission aborted’.

“The general mission of the markets was/is capital formation, involving allocation of investment capital to most promising industries and companies, both existing and

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be multiplied together, raised to powers, and so on. As a consequence the system's parts are not necessarily linked in a proportional manner as they are, for example, in a bathroom scale or a thermometer; doubling the magnitude of one part will not double that of another—nor will outputs be proportional to inputs. Not surprisingly, trying to predict the precise long-term behavior of such systems is often futile (see Paulos, 2003: 172-174).

<sup>9999</sup> See also Epstein (2002), Askari et al., (2011, 2012), Hasan (2008, 2010a, b, 2011a, b) and Mirakhor (2010, 2011a).

upcoming. However, out of \$33 trillion stock trading in financial markets, only 0.8% or \$250 billion of the financial activities fulfill the original mission and the rest 99.2% or \$32.73 trillion, some 130 times the volume of equity capital, aborts it”.

Hans Tietmier, the former President of Bundesbank, warned in international fora that “financial decoupling” was increasing the risks in global finance, (Menkoff and Tolksorf, 2001). These warnings were not attended to and consequences followed (Epstein, 2006). According to Turner (2012), both economic history and theory make it close to certain that we could not have achieved the economic transformations of the last 200 years without the development of modern financial systems. It is hence argued that financial deepening has an important role to play in the economic development process. However, the fact that ‘financial deepening’, is beneficial across some range of increasing financial intensity, does not mean that it is limitlessly good.

The above can be supported by a recent study, (Cecchetti and Kharroubi, 2012) that investigated ‘if finance really good for growth’, regardless of the size and growth of the financial sector? For an answer, the authors came to two important conclusions. First, with finance you can have too much of a good thing. At low levels, an increase in the size of the financial sector accelerates growth of productivity. But “there comes a point - one that many advanced economies passed long ago - where more banking and more credit are associated with lower growth.” Second that when the financial sector accounted for more than 3.5% of total employment, further development of finance tended to damage economic growth<sup>\*\*\*\*</sup>. Consequently, the study stressed to a pressing need to reassess the relationship of finance and real growth in modern economic systems. Already, financialization has oriented the economies from a *saving-investment-production-export* to a *borrowing-debt-consumption-import* orientation (Askari et al., 2012). To Rajan (2005), such dynamics have indeed made the world more risky and the system in turn has become highly sensitive to register events that can be termed as the ‘black swan’ events (Taleb, 2007/2012a).

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<sup>\*\*\*\*</sup>The study also contended that finance, literally bids rocket scientists away from the satellite industry”. It competes for people with high qualifications as well as for buildings and equipment. “The result is that people who might have become scientists, who in another age dreamt of curing cancer or flying to Mars, today dream of becoming hedge fund managers”. See also Sheng (2009) and Caldentey and Vernengo (2010) for similar conclusions as well as for the effects of such developments.



When risks become high, so does the lack of ability to understand, control and mitigate the risks. This is a situation where risks get transformed into their stronger cases of ‘uncertainty’ and ‘ambiguity’. Frank Knight explained that, at times, decisions are made based on available probability distribution of expected events. This is decision making under risk. Unlike risk however, uncertainty describes a situation where a known probability distribution is not available but it is still possible to make decisions with some subjective estimates of probability of outcomes of actions or decisions (Knight, 1921). In the 1960s this view was modified to cover circumstances under which human cognitive ability and information availability are so constrained that even subjective assessment of outcomes was not possible. Ambiguity arises under such circumstances where the intensity of “ignorance” can create paralysis in the decision making (Ellsberg, 1961; Erbas and Mirakhor, 2007 and Mirakhor and Shaukat, 2012). The result is an ideal recipe for the occurrence of those events which were deemed as highly improbable or never occurring. As a result an important concept has been added to the economic vernacular; termed as ‘Black Swan’ events. Taleb (2007/2010) the inventor of the term refers to them as those events which (i) usually lie outside the realm of regular expectations, because nothing in the past can convincingly point to its possibility. As a result, the probability of the occurrence of such events is extremely low (ii) even though they have a low probability of occurrence, however, when they do occur, the events carry an extreme impact (iii) lastly, in spite of its outlier status, human nature makes us concoct explanations for its occurrence after the fact, making it explainable and predictable.

Recently, the global system has experienced events that would have been thought of as low probability events not long ago. These include, inter alia, the down grading of U.S from its ‘AAA’ rating, the looming collapse of the much hailed Eurozone, the effort by Switzerland to convince the world that Swiss franc is not a safe haven, the Brazilian suggestion of bailout of advanced economy by emerging markets, China’s contemplation of buying Italy’s debt, and the Libor rate fixing. Cyprus’s provocation of removing deposit guarantees on certain amounts of deposits. The list can go on. However, looming in the back ground of the present uncertainties in the global economy, there is a potential event termed as “*the mother of all black swans*” the effects of which may be chaotic to global economy: contagion-riddled events of *sovereign default*.

It can be observed that the occurrence of black swans and non-linearity of the debt dynamics is a pure demonstration of the Qur’ānic concept of “YAMHAQ”. Allah swt tells us about the debt dynamics in Verse 276 of Chapter 2 of the Qur’ān: “*Yamhaqhu Allah o ar-Ribā wa Yurbias ṣadaqāt*” (Allah swt annuls, obliterates *ar-Ribā* and increases *ṣadaqāt*). The part that is most relevant here is the first part of the verse “*Yamhaqhu Allah o ar-Ribā*”. Reference, for example, to *Al-Mu’jam Al-Waseet*, Maqayees al-Lughah and *Mufradaat al-Qur’ān* reveals that “Yamhaq” that makes the ‘Mahq’ of *ribā* means to Decrease, to Destroy completely, to take away the blessings from a thing, to negate or cancel out the positive impact of a thing, or to erase suddenly. It is thus a state of sudden and rapid decline, with the speed of destruction picking up acceleration (Shaukat, 2013).

In order to give evidence of the adverse and non-linear debt dynamics, that is to signify the Qur’ānic ‘*Mahq*’ in full operation in the global economy, the findings of Reinhart and Rogoff (2008, 2009a, b, 2010a, b, 2011, 2012) and Kaminsky and Reinhart, (1999) put forward among the most finely textured, historical, analysis of the financial crisis<sup>ssss</sup>. The data covers seventy countries in across all regions. The range of variables encompasses external and domestic debt, trade, GNP, inflation, exchange rates, interest rates, and commodity prices. The coverage spans eight centuries, going back to the date of independence or well into the colonial period for some countries. The authors showed that crises whatever label they carried— exchange rate crisis or banking crisis – have been at root debt crises (Reinhart and Rogoff, 2009).

The authors refers to the non-linearity of such consequences as the “*Deadly Ds*”: Sharp economic ‘*downturns*’ follow banking crises; with government revenues dragged down, fiscal ‘*deficits*’ worsen; deficits lead to more ‘*debt*’; as debt piles up rating ‘*downgrades*’<sup>tttt</sup> follow and ‘*defaults*’ ensue; the result of a vicious ‘*debt circle*’ (see also Mauldin and Tepper, 2011). The studies revealed that three years after a financial crisis, central government debt increases, on average, by about 86 percent; implying that the

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<sup>ssss</sup>The authors introduced a comprehensive new historical database for studying banking crises, inflation, currency crashes and debasements—unsurprisingly, currency and inflation crisis go hand in hand. Default through inflation has been more prevalent since World War I, as fiat money became the norm and links to gold eroded. Median inflation rates before World War I were well below those of the more recent period: 0.5 percent for 1500–1799 and 0.7 percent for 1800–1913 versus about 5 percent for 1914–2009 (see Reinhart and Rogoff, 2011).

<sup>tttt</sup>For a detailed discussion —based on historical evidence— on how a debt defaults translates into increasing country risk and eventually rating downgrades see Reinhart et al., (2003).



fiscal burden of banking crisis extends far beyond the common cost of the bailouts. Moreover, real housing price declines average *35 percent*, stretching out over six years. Equity price collapses on average *56 percent* with the downturn spanning around *4 years*. Similarly profound are the unemployment rates which rises an average of *7 percent*, lasting over four years. In some cases these unemployment levels reach as high as in the range of *20 percent* to over *50 percent* including youth unemployment. Such scenarios are presently pervasive in a number of European centers, for example, the case of PIIGS nations<sup>uuuu</sup>. Moreover, real GDP per capita falls (from peak to trough) an average of over *9 percent* or more, the duration of the downturn averages at least two-three years and production levels decline exponentially.

Thus far the search for ways and means of reducing the instability of the interest-based debt system has focused only on improving regulatory/supervisory structure and few reforms of financial system. Much less effort has been devoted to finding an alternative paradigm. Askari et.al, (2012: ix) suggests:

Reforms are little more than a “bandaging” of the current financial system: higher levels of capital; breaking up of financial institutions; regulation to include all financial institutions; measures to limit risk taking and to increase transparency, and more. But it is difficult to see how any of these changes will eliminate the likelihood of future financial crises. Higher capital requirements would reduce bank lending, money creation and leveraging, but there is always a chance that bad loans could still wipe out a bank’s capital. Similarly, limiting the size of financial institutions would reduce, but not eliminate, systemic risk and the need for bailouts. Increasing transparency in the packaging, pricing, and settling of derivatives would afford investors more information on pricing and reduce, but again not eliminate, systemic risk. And on and on.

Question arises as to whether there is such an alternative to the present dominant global finance system. *Perhaps a more practical alternative would be to step back from targeting the interest rate mechanism and focus on the incentive structure that has rendered the interest rate based debt financing such a destabilizing force in the global system. This can be accomplished by reorienting the system from relying on risk transfer and risk shifting to risk sharing- the essence of Islamic finance.*

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<sup>uuuu</sup>Eurozone as a whole has an unemployment rate of 12% (World Economic Report, 2013).

## ISLAMIC FINANCE IS RISK SHARING AND A RULE-BASED SYSTEM

To help the humans follow the terms of Meethaq with regards to Halal Tayyab sustenance, driven by the Qur'ān and the *Sunnah*, the Islamic economic system is a rules-based system. There is network of prescribed rules that governs the socio-economic-political life of the society. Compliance with these rules renders the society a union of mutual support by requiring humans to share the risks of life. The adoption of these set of rules are expected to lead to a dynamic and growing economy, without which the higher objectives of Islam cannot be achieved (Shaukat et al, 2014). The objective of Islamic finance is to promote sustained growth and full employment thus contributing positively to poverty alleviation and, ultimately, to economic and social justice. The epistemological root of risk sharing, as the organizing principle of the Islamic financial system, is discernible from chapter 2 verse 275 of the Qur'ān. This verse, in part, decrees that all economic and financial transactions are conducted via contracts of exchange (*al-bay'*) and not through interest-based debt contracts (*al-ribā*). It can be argued that risk sharing – the crux of Islamic finance – serves as one of the most important desiderata of Islam i.e. the unity of mankind.

Since in the Verse the contract of exchange appears first and the prohibition of *ribā* thereafter, it can be argued that requiring contracts to be based on exchange constitutes a necessary condition and “no-*ribā*” the sufficient condition of existence of an Islamic financial system. Together, these conditions constitute the organizing principle of that system. The necessary condition (*al-bay'*) and sufficient condition (no *ribā*) must be met for a contract to be considered Islamic. “A careful consideration of all the permissible contract modes that have reached us reveals them to be basically risk sharing contracts. The instruments designed to financially empower them must also be risk sharing instruments” (Mirakhor, 2010, 2011a, b).

Classical Arabic Lexicons of the Qur'ān define contracts of exchange (*al-bay'*) as contracts involving exchange of property rights claims in which there are expectations of

gains and probability of losses<sup>vvv</sup>. By entering into contracts of exchange, parties improve their welfare by exchanging the risks of economic undertakings, thus allowing division of labour and specialization (see Mirakhor, 2011a). The understanding of *al-bay'*, the exchange of one set of property rights claim for another, as the necessary and “no-*ribā*” as the sufficient condition has important implications. Exchange requires the freedom to contract for the parties involved and this implies freedom to produce, which then calls for well-protected property rights to allow and facilitate production. For exchange to take place, there is a need for markets and then for rules that govern behaviour of market participants. Rules need enforcement and regulation to keep the flow of information smooth thus reducing transaction costs.

Over the past three decades an important field of enquiry has developed in economics, called the ‘New Institutional Economics’ (NIE), that has made significant contribution to understanding how economic system function. Most importantly, the NIE has focused on reasons why some economies perform strongly while others lag behind with substantial margins. The reasons, the NIE explains is the “institutional scaffolding” of the economy. NIE defines institutions as rules and norms governing economic behavior in the society. Accordingly how well the economy performs depends crucially on the rules governing economic behavior. Principles among these are: rule of law, well defined property rights, and a high degree of trust, efficient contract enforcement, and good governance.

An economic expertise-dominated view of the relevant verses of the Qur’ān reveals a comprehensive set of rules governing the structure and operations of an economy; including rules that extend well beyond what the NIE would consider needed for a well-functioning economy. The Qur’ān makes clear that the compliance with the prescribed rules is the guarantor of: better socio economic justice and cohesion, unity and order in any human collectivity and economic growth and stability (see for example chapter 5 verse 2; chapter 3 verse 103; chapter 8 verse 46). The promise made in the verse 96 of chapter 7 of the Qur’ān (see also chapter 65 verse 2; chapter 65 verse 3; chapter 5 verse 65-66; chapter 12 verse 90’ chapter 5 verse 66; chapter 8 verse 53; chapter 10 verse 9; chapter 2 verse 25; chapter 16 verse 97; chapter 24 verse 55; chapter 40 verse 40). Conversely all prohibited behavior are those that ultimately lead to social injustice and

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<sup>vvv</sup> See, for example, Al-Tahqiq Fi Kalamat Al-Qur’ān Al-Karim; Lisan Al-Arab; Mufradat Alfaz Al Qur’ān, Arabic Lexicon, among others. These sources define *al-bay'* as “*mubadalati al-maali bi al-maal.*” In English this can be rendered as “*the exchange of one set of property rights claim for another.*”

disintegration. Central among the rules that constitute the full institutional framework of an Islamic economic system, alongside the application of sharing risks and no *ribā*, are rules governing:

Full and transparent observance of Property rights. In Islam, there are only two ways in which individuals can gain legitimate property rights. Individuals can gain property rights through a combination of their own creative labour and other resources or through transfer—via exchange, contracts, grants or inheritance—from others who have gained property rights title to an asset through their own labour (see chapter 53 verse 40; chapter 17 verse 26; chapter 24 verse 22; chapter 30 verse 38; chapter 4 verses 11-12). Fundamentally, therefore, work is the basis of acquiring rights to the property<sup>www</sup>. The fourth rule governing property rights forbid instantaneous property rights claim without commensurate work. The exception is transfer via gifts from other who have gained legitimate property rights claim on the asset transferred. The prohibition covers theft, bribery, gambling, interest from money lent, or, generally, income and wealth obtained from sources and activities not permitted by Sharī'ah (see for example chapter 5 verse 38; chapter 2 verse 188 and 275; chapter 5 verse 90).

Faithfulness to terms and conditions of contracts. Islam forcefully anchors all social-political-economic relations on contracts. More generally the whole fabric of the divine law is contractual in its conceptualization, content and application. Its very foundation is the primordial covenant between the Creator and the humans (Mirakhor, 2011a) [see chapter 7 verses 172-173]. The covenant imposes the obligation on humans to remain faithful to its affirmations that they recognize the supreme Creator as its Cherisher Lord. In verse 152 of chapter 6 the Qur'ān urges the believers to fulfil the covenant of Allah. This is extended to the terms and conditions of all contracts through another clear verse of chapter 5 verse 1 in which believers are ordered to be faithful to their contracts. They are ordered to protect faithfulness to their covenants and what has been placed in trust with them as a shepherd protects sheep (see chapter 23 verse 8; also chapter 17 verse 34; chapter 2 verse 2; chapter 16 verse 91-92; chapter 3 verse 61). So much so that the Qur'ān has dedicated the longest verse on the

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<sup>www</sup>The concept of work in Islam (called *'amal*) is far broader and has different characteristics and objectives than that understood in the Western economic tradition. In Islam, work ethic is defined by the Qur'ān itself, which mentions the word *'amal* in 360 verses. A closely related concept of *fi'l* (also translated as work) is mentioned in an additional 109 verses. All these verses stress the need for work and action by human beings (Islamreligion.com, accessed on 10, August, 2013 at 15:45).

importance of contracts and their fulfilment (see chapter 2 verse 282), thus believers do not treat obligations of contracts lightly. They will take on contractual obligations only if they intend fully to fulfil them<sup>xxxx</sup>. Hence, their commitments are credible (Mirakhor, 2010).

Sharī'ah approved sources of factors and products before they enter the market;

Provision of full information regarding qualities, quantities and prices of factors of production and product to all buyers and sellers—before the start of price bargaining process;

“There is no ‘Ghash’ meaning there should not be any kind of misrepresentation of the product.

No Gharar and ‘Maisir’ and a strict prohibition of speculative activities;

Full and transparent Information”. Everything about the product must be known and nothing should be hidden. Anyone who enters the market is informed fully of prices and products.

As well as rules on distribution and re-distribution. This is in consideration of the inequalities that are created due to the fact that some members of the society may be physically or otherwise unable to access resources to which they are entitled to as per the property rights rules of Islam (see chapter 6 verse 165; chapter 43 verse 23; chapter 16 verse 71). The inequalities could also arise due to the presence of the idiosyncratic risks which when materialize play havoc with people’s income and wealth (Mirakhor and Shaukat, 2012; Mirakhor et al., 2012, 2013 and Mirakhor and Shaukat, 2013). The most important economic institution that operationalizes the objective of managing any ensuing inequalities is that of the distribution/re-distribution rule of Islamic economic paradigm. For example, the Mechanism for redeeming the rights of the less able in the income and wealth of the more able are the network of mandatory and voluntary payments such as Zakat (2.5% on wealth) and payment referred to as ‘*ṣadaqāt*’ (see chapter 9 verse 60; chapter 22 verse 41; chapter 2 verse 110, 261; chapter 34 verse 39; chapter 57 verse 18; chapter 73 verse 20).

Among the other main reasons given in defense of the existence of interest bearing debt system are that of (i) ‘Moral hazard’ due to asymmetric information where one side

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<sup>xxxx</sup> This has implication for the cost and efficiency of transactions as it eliminates informational problems as well as moral hazards and adverse selection (see Mirakhor, 2011a: b).

of transaction has information which the other side does not have. (ii) ‘Cost of monitoring’. For example if borrowing money is required, the creditor has a problem of trusting on the information which the borrower puts forward as a reason to borrow or even if he does not explain there is still a risk. Collateral is asked, worth more or less the amount borrowed and further if whatever profits are made, a fixed amount is asked over the principle when the money is returned. Because of moral hazard interest rate is justified. Then comes the cost of monitoring where even though the money is loaned, the creditor still worries and may need to monitor the activities of the borrower for the safe return of the loaned money (with interest). Since monitoring is costly, sometimes called as ‘costly state verification’, it is hard for creditor to verify the state or monitor. The monitoring is thus delegated called ‘delegated monitoring’<sup>yyyy</sup>.

In an Islamic system, there would be no problem of ‘Moral hazards. First, due to property rights protection as well as clear exchange of property rights alongside the rule of being ‘faithful to contracts’, the occurrence of moral hazard will be diminished if not completely cured. In fact adherence to all the rules discussed above assures against any mal-practices. All in all, any form of conduct leading to instantaneous property rights without commensurate equity created by individual’s own labour is prohibited. This type of market that complies with the prescribed rules produces price for factors and outputs that are just as a result of free and informed bargaining process. The absence of the internalization of above rules makes contracts very costly to form, verify, negotiate, renegotiate and implement. “A further implication of the compliance with the above rule is the possibility of coming up with a contract where the parties to a contract trust each other. They can agree to enter into a simple contract and commit to revising its terms and conditions as contingencies arise” (Mirakhor, 2011a: 17).

### ***Enhanced Coordination and Predictability***

From the above discussion, it can be summarized that the institutional framework of the Islamic economy is composed of a collection of institutions–rules of conduct– to deal with allocation of resources, production and exchange of goods and services, and distribution/redistribution of resulting income and wealth. The main objective of these

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<sup>yyyy</sup> The banks are the one to whom this delegation is made to as they have ‘economies of scale’ which is their job and they can get such information easily.

institutions is to achieve social justice and unity alongside economic prosperity. Important among their functions is the reduction in uncertainty for members of the society; allowing them to overcome the obstacles to decision making caused by paucity of information. Rules specify what kind of conduct is most appropriate to achieving just results when individuals face alternative choices and must take action. They impose restrictions on what the society's members can do without upsetting the social order on whose existence all members count. This also helps them in deciding on their own actions and forming their expectations of other's responses and actions when in situation of uncertainty or facing risks.

Risk and uncertainty are undeniable facts of life. As was discussed earlier, uncertainty stems from not only the lack of information but also from ignorance of knowing the response and behaviour of others under such conditions. The question arises as to why risk and uncertainty exist. This question becomes more acute for those who believe in the Supreme Creator of all things. Since it is believed that existence of risk and uncertainty is a source of difficulty for humans, a Creator-centric question also arises: why create risk and uncertainty for humans? Bartholomew (2008: 230) argues that *"a plausible argument for the necessity of risk is that it serves as an important ingredient in the recipe of full human development. It provides the fertility and diversity of experience to develop our skills and personalities."*

The Qur'ān, on the other hand, provides a more compelling explanation: humans are subjected to tests throughout their lives to allow them a sense of the degree to which they, individually and collectively, are rule compliant (see for example, chapter 2 verse 155; chapter 7 verse 130; chapter 76 verse 2; chapter 29 verse 2; chapter 9 verse 126; chapter 11 verse 7). Without risk and uncertainty, testing would not be possible (Mirakhor, 2009). To ease the intensity of anxiety in dealing with tests and, therefore, reduce uncertainty and demand on humans' cognitive ability, compliance with the (economic) behavioral rules prescribed by Qur'ān reduces risk and uncertainty. The result is better coordination in society's behavior. It can be stated that such rule compliance while promoting coordination in actions, determines the degree of certainty in the formation of expectations, prevents conflict, reconciles differences, facilitates cooperation, promotes social integration and solidarity and strengthens social order. *The result is that the behavior of the society as a whole immediately becomes increasingly predictable in all*

*aspects; making the system simple to manage and control.* Consequently, the physics as well as the mechanics of a risk sharing based Islamic financial system also provide the dynamics that warrants a much stable and progressive economic order: The basis of a ‘Halal Tayyab Islamic Economic System’.

#### Reference

\*\*Readers may contact the author for the reference.



## SHARI'AH AUDIT PRACTICE IN OMAN: THEORETICAL REVIEW

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### ABSTRACT

*Shari'ah Governance and audit is one of the vital elements of corporation as it promotes principles of accountability, transparency and Shari'ah assurance of Islamic Financial Institution (IFIs) to the stakeholders. Shari'ah Governance serves as compliance function that provide review to the management on the state of IFIs' Shari'ah compliance. Therefore an IFIs must ensure the Shari'ah compliance function to be carried out through the Shari'ah review and Shari'ah audit functions. The major aim of this study is to review the conceptual framework for Shari'ah governance with special focus on Islamic Banking Regulatory Framework (IBRF) in Oman. Another aim of this study is to outline a process of Islamic auditing and the duties of Shari'ah auditor. The methodology followed in this study is mainly of library work, basically it was based on Holy Quran, Hadiths and related literatures written in conventional and Islamic perspective. The results of this study could serve as a reference point for the regulatory and professional bodies in assessing the implementation of a comprehensive Shari'ah auditing framework.*

### INTRODUCTION

The introduction of the Islamic Banking Regulatory Framework (IBRF) for Islamic Banking by Central Bank of Oman (CBO) on December 2012 has brought immediate attention to both academicians and practitioners alike on the importance of Shari'ah governance. A major challenge for Shari'ah auditors toward the implementation of the IBRF is the requirement for the auditor to possess adequate knowledge of Shari'ah to ensure that Islamic Banks (IBs) operate in accordance with Shari'ah principles. According to CBO (annual report 2016) the Islamic finance industry has grown at a rate of between 15%-20%, a rate easily exceeding the world economic growth rate. It is therefore of crucial importance that Shari'ah auditors are able to achieve their role in ensuring that activities and operations carried out by the IFIs are compliance with Islamic principles as they are in *Quran, Sunnah*, and consensus of Scholars. Other than conventional perspective where the auditor is required to critically examine and evaluate whether the financial statements are prepared in accordance with GAAP and any other

relevant standards. On the other hand, Shari'ah auditing of IFIs requires the Shari'ah auditor ensure that management is not only fully adhering with GAAP and with the relevant reporting framework, but also ensure that management follow the Shari'ah framework to ensure a sound and effective internal control system accordance with Shari'ah principles in achieving the ultimate objective of Shari'ah (Yaacob & Donglah, 2012). The Shari'ah auditor is not only required to conduct a review of IFI activities in accordance with Shari'ah principles; he is also responsible for expressing his opinion on the IFI financial statements (AAOIFI, 2004; Mohammed Sarea & Mohd Hanefah, 2013). To perform his auditing role effectively, a Shari'ah auditor should possess adequate and appropriate Islamic knowledge (AAOIFI, 2004). Yaacob and Donglah (2012) argues that a Shari'ah auditor has a similar role to that of the Muhtasib (Hisbah member), a role that is related to the concept of Taklif (accountability and responsibility) in ensuring that the IFIs strictly follow Shari'ah guidelines.

### **OBJECTIVES OF THE STUDY**

The objective of this paper is to review the conceptual framework for Shari'ah governance with special focus on IBRF in Oman. The specific objective of this paper is:

1. To review the Conceptual framework for Shari'ah audit.
2. To evaluate the Issues and Challenges in Shari'ah Audit.
3. To outline a process of Islamic Auditing and the duties of Shari'ah auditor.

### **METHODOLOGY OF THE STUDY**

The methodology followed in this study is mainly of library work, basically it was based on the conceptual framework for Shari'ah governance and related literatures written in conventional and Islamic perspective. Some information is taken from the practitioner's of many organizations through a primary data collection.

### **ISLAMIC BANKING IN SULTANATE OF OMAN:**

The establishment of Islamic banking in the Sultanate of Oman, stated by the issuing the Royal Decree 69/2012 at the end of 2012 through amending some provisions of the Banking law. In line with that decree the Central Bank Of Oman (CBO) issued the Islamic Banking Regulatory Framework of (IBRF) which applies to Islamic banks and to the Islamic windows of conventional banks that are licensed to operate in Oman. Oman

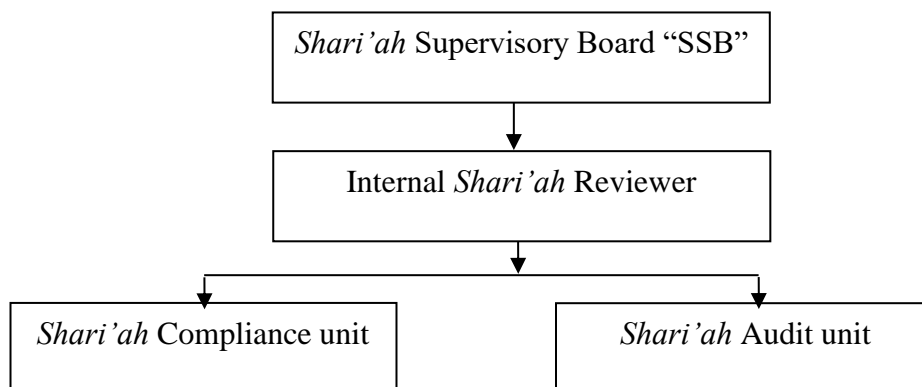
was the last country in the six-nation Gulf Cooperation council (GCC) to introduce Islamic finance. In this section the main elements and features of RFIB will be discussed.

IBRF (2012) defined Shari'ah Governance as a system whereby an Islamic financial institution attempts to comply with *Shari'ah* in all its activities. *Shari'ah* Governance is the hallmark and the differentiating factor for Islamic Banks and Islamic Windows which sets them apart from their conventional counterparts. It is the duty of all the stakeholders particularly the shareholders and the management of the IFIs to strengthen *Shari'ah* Governance framework of their respective institutions. The main objectives of a *Shari'ah* Governance framework are:

1. To provide a structure and a system to govern all the business activities of the IFI in order to ensure *Shari'ah* compliance at all times and at all levels.
2. To enable the IFI to be perceived as *Shari'ah* compliant by the stakeholders including the general public.

The key elements of a *Shari'ah* Governance framework are as follows:

1. *Shari'ah* Supervisory Board (“SSB”)
2. Internal *Shari'ah* Reviewer
3. *Shari'ah* Compliance unit
4. *Shari'ah* Audit unit



### ***Shari'ah* Supervisory Board (“SSB”)**

According to Alman (2012), *Shari'ah* Supervisory Board (SSB) is one of internal governance mechanisms which involves the monitoring of Islamic banks' activities in accordance to the *Shari'ah* (i.e. Islamic law) specifically on its implementation and compliance.

IFIs should establish their own SSBs, which is an independent body of *Shari'ah* scholars specialized in Fiqh al Mu'amalat (Islamic commercial jurisprudence). SSB may include additionally one or more non-voting members who are not specialized in Fiqh al Mu'amalat but have expertise in Islamic banking (or related areas like finance, economics, accounting, law, etc.) and possess basic knowledge of Fiqh al Mu'amalat. The SSB is entrusted with the duty of directing, reviewing and supervising the activities of the IFI in order to ensure that they are in compliance with *Shari'ah* principle (RFIB,2012 , pp.6).

Omani IBRF (2012) identify the responsibilities of the SSB to advise the Board and the management on *Shari'ah* matters in the day to day business of the IFI; review and approve all the policies & procedures, products, processes, systems, contracts and agreements for their *Shari'ah* compliance; review and approve product documentation; conduct *Shari'ah* checks post product approval to ensure implementation of the related guidelines as approved by the SSB; review and approve the work carried out by *Shari'ah* compliance and *Shari'ah* audit functions; guide related parties on *Shari'ah* matters; provide written *Shari'ah* opinion / ruling on matters brought to its attention by the management; and submit a report to the Board of Directors on the IFI's *Shari'ah* compliance to be published as part of the annual report.

### ***Internal Shari'ah Reviewer***

Internal *Shari'ah* Reviewer (ISR) should be appointed by the management in consultation with the SSB. Such appointment should be approved by the Board of the IFI. Internal *Shari'ah* Reviewer is a full time employee and can only work for one IFI at a time. IFIs are required to notify the Central Bank of any resignation or termination of the Internal *Shari'ah* Reviewer immediately when it occurs or cause of action is known, whichever is earlier.

The SSB is assisted by *Shari'ah* review to monitor and oversee the compliance of all actions and commitments of IFIs with SSB ruling. IFIs established an internal *Shari'ah* review structure, generally in the form of review units. With a methodological approach in conducting the review, the internal *Shari'ah* review assesses compliance of all transactions with the fatwas issued by the *Shari'ah* Committee in term of proper implementation by the managers (Hamza, 2013).

Roles & responsibilities for ISR as specified in IBRF to head the Shari'ah compliance unit as well as the Shari'ah audit unit for IFIs; works independently and report to the SSB, with administrative reporting to the CEO; provide a Shari'ah guidance and direction in day-to-day matters to the IFI's management therefore Internal *Shari'ah* Reviewer and all team of *Shari'ah* compliance officers and *Shari'ah* audit officers should have access to all records, documents and information from all sources including professional advisors and the IFI's employees. The management should be responsible to provide all the information relating to the IFI's compliance with *Shari'ah*.

### ***Shari'ah Compliance Unit***

Omani IBRF (2012) required IFIs to introduce a *Shari'ah* compliance unit as part of their *Shari'ah* Governance framework, reporting to the Internal *Shari'ah* Reviewer. *Shari'ah* compliance unit will facilitate the management in ensuring compliance with *Shari'ah* and Islamic banking stipulations of the Central Bank on a day to day basis in all its business activities, operations and transactions. This shall be done through review and approval of the contracts, agreements, policies, procedures, products, process flows, transactions, reports (profit distribution calculations), etc.

*Shari'ah* compliance unit extensively involved before a new product or transaction is approved. New product class or transaction introduced after consulting the *Shari'ah* compliance unit and getting a formal approval from the SSB. *Shari'ah* compliance unit should ensure that it receives regular confirmations from the business departments and branches relating to the *Shari'ah* compliance of key transactions and the actions taken to resolve any observations raised by the *Shari'ah* compliance unit on the operations, products or procedures.

*Shari'ah* compliance also include *Shari'ah* risk control whereby an appropriate senior resource shall identify, measure, monitor, control and manage (with guidance from Internal *Shari'ah* Reviewer) *Shari'ah* compliance unit should be adequately resourced (depending on the size and complexity of the Licensee) to undertake *Shari'ah* research.

### ***Shari'ah Audit Unit***

According to Omani IBRF (2012) IFIs should establish a *Shari'ah* audit unit as part of their *Shari'ah* Governance framework, reporting to the Internal *Shari'ah* Reviewer.

The *Shari'ah* audit unit is responsible to assist the Internal *Shari'ah* Reviewer and the SSB in forming or expressing an opinion on the extent of the *Shari'ah* compliance of the IFIs operations. It examined and evaluated the extent of compliance with *Shari'ah* principles, Fatawa, guidelines and instructions issued by the IFI's SSB through an actual audit of the business transactions.

The scope of work of internal *Shari'ah* audit shall encompass the examination and evaluation of the adequacy and effectiveness of the IFI's system of *Shari'ah* compliance and the quality of performance in carrying out assigned responsibilities. The scope of internal *Shari'ah* audit shall cover all aspects of the IFI's business operations and activities, including review of the products, processes, agreements and systems for assessing the extent of implementation of the *Shari'ah* guidelines and Fatawa issued by the SSB.

Internal *Shari'ah* audit planning process include; obtaining background information about the activities to be audited; establishing internal *Shari'ah* audit objectives and scope of work; obtaining SSB Fatawa; determining the resources necessary to perform internal *Shari'ah* audit; communicating with all the individuals at the IFI who need to know about internal *Shari'ah* audit; writing internal *Shari'ah* audit programs; determining how and when internal *Shari'ah* audit results shall be communicated; obtaining approval of internal *Shari'ah* audit work plan from the SSB (or Internal *Shari'ah* Reviewer on behalf of the SSB) and implementing *Shari'ah* audit programs through actual audit; sharing the draft report with Internal *Shari'ah* Reviewer for clarification and rectification of issues raised; and finalization of internal *Shari'ah* audit report for presentation to the SSB.

*Shari'ah* audit officers collect, analyze, interpret and document information to support their internal *Shari'ah* audit results. Collected information should be sufficient, reliable, relevant and useful to provide a sound basis for internal *Shari'ah* audit findings and recommendations.

The internal *Shari'ah* audit team discusses findings, recommendations and conclusions with the Internal *Shari'ah* Reviewer and appropriate levels of management before issuing

the final written report. On completion of internal *Shari'ah* audit, at least a quarterly written report shall be prepared which must be signed by the Internal *Shari'ah* Reviewer, addressed to the SSB and copied to the management.

The Central Bank of Oman added *Shari'ah* audit as an additional component to its regular annual examination and audit of the Licensees. IFIs should engage an independent third party to conduct an annual external independent *Shari'ah* audit. The purpose of this audit According to Omani IBRF (2012) is to add credibility to the internal *Shari'ah* audit of the IFI through an independent endorsement. This will also enhance public confidence in the *Shari'ah* legitimacy of the IFIs. An independent *Shari'ah* audit shall be similar in scope as internal *Shari'ah* audit. It is not meant to provide an opinion on the *Shari'ah* legitimacy of the SSB's decisions. It will only assess the extent of implementation by the IFI's management of the decisions given by the SSB. Independent *Shari'ah* auditor submits his report to the Board of Directors of the IFI and the Central Bank, with a copy to the SSB and management of IFI.

**Comparative points between Omani IBRF, Accounting and Auditing Organization for Islamic Financial Institutions**

Comparative Points	IBRF	AAOIFs
<b>Appointing of SSB</b>	IFIs should establish their own SSBs, which is an independent body of <i>Shari'ah</i> scholars specialized in Fiqh al Mu'amalat	Every Islamic Financial Institution shall have a <i>Shari'ah</i> supervisory board to be appointed by the shareholders in their annual general meeting upon the recommendation of the board of directors taking into consideration the local legislation and regulations. Shareholders may authorize the board of directors to fix the remuneration of SSB.
<b>Qualification and Experience of SSB Members</b>	SSB is an independent body of <i>Shari'ah</i> scholars specialized in Fiqh al Mu'amalat	The SSB is an independent body of specialized jurists in <i>fiqh al mua'malat</i> , however the SSB may

		include a member other than those specialized in <i>fiqh al mua'malat</i> , but who should be an expert in the field of Islamic Financial Institutions with knowledge of <i>fiqh al mua'malat</i> .
<b>Independence of Shari'ah Board</b>	The SSB shall be independent, objective, competent and appropriately empowered to carry out its responsibilities. Independence is "an attitude of mind which does not allow the viewpoints and conclusions of its possessor to become reliant on or subordinate to the influences and pressures of conflicting interests. It is achieved through organizational status and objectivity"	A <i>Shari'ah</i> supervisory Board is an independent body of specialized jurists in <i>fiqh al mua'malat</i> , the board should not include the directors or shareholders of the Islamic Financial Institutions. The SSB members should not be employee of the same IFI. The SSB members should not involve in managerial or operational decisions of IFI.
<b>Responsibilities of SSB</b>	The SSB shall be the ultimate responsible authority within the Licensee for all <i>Shari'ah</i> related matters. The Board of Directors of the Licensee, which bears the responsibility of overall governance of the institution, shall rely on the SSB for all matters relating to <i>Shari'ah</i> in the normal course of business and operations of the Licensee.	The SSB entrusted with the duty of directing, reviewing and supervising the activities of the Islamic financial institution in order to ensure that they are in compliance with the Islamic <i>Shari'ah</i> rules and principles. The fatawas of the SSB shall be binding for IFI.
<b>Number of SB Members</b>	The SSB should comprise of a minimum of three <i>Shari'ah</i> scholar and may include additionally one or more non-voting members who are not specialized in Fiqh al Mu'amalat but have expertise in Islamic banking (or related areas like finance, economics, accounting, law, etc.)	The <i>Shari'ah</i> Supervisory board shall consist of at least three members. The <i>Shari'ah</i> supervisory board may seek the service of consultants who have expertise in business economic, law, accounting or others.



<b>Duration of SSB</b>	Members of the SSB shall be appointed for a maximum initial term of three years which can be renewed for another 3 -year term.	Not Applicable
<b>Shari'ah Compliance Department</b>	<i>Shari'ah</i> compliance unit will facilitate the management in ensuring compliance with <i>Shari'ah</i> (as manifested by the guidelines and Fatawa issued by the SSB) and Islamic banking stipulations of the Central Bank on a day to day basis in all its business activities, operations and transactions	Not Applicable
<b>Shari'ah Compliance Review</b>	Internal <i>Shari'ah</i> Reviewer shall have the responsibility to head the <i>Shari'ah</i> compliance unit as well as the <i>Shari'ah</i> audit unit of the Licensee. He shall be a qualified <i>Shari'ah</i> scholar. He shall be assisted by a team of <i>Shari'ah</i> compliance officers and <i>Shari'ah</i> audit officers who shall have knowledge and experience of the banking business as well as basic orientation to and understanding of <i>Shari'ah</i> as applied to the banking and audit processes.	The SSB will conduct <i>Shari'ah</i> review to ensure that the activities carried out by an Islamic Financial Institution do not contravene the <i>Shari'ah</i> rules. The <i>Shari'ah</i> review will be carried out through, planning review procedures, executing review procedures and preparation and review of working papers, documenting conclusions and reports.
<b>Internal Shari'ah Audit Unit</b>	Internal <i>Shari'ah</i> Reviewer shall be appointed by the management in consultation with the SSB. Such appointment shall be approved by the Board of the Licensee	Internal <i>Shari'ah</i> review shall be carried out by an independent division/department or part of the internal audit department.
<b>Internal Shari'ah Audit</b>	The <i>Shari'ah</i> audit unit is responsible to assist the Internal <i>Shari'ah</i> Reviewer and the SSB in forming or expressing an opinion on the extent of the <i>Shari'ah</i> compliance of the Licensee's operations. It will examine and evaluate the extent of compliance with <i>Shari'ah</i> principles, Fatawa, guidelines and instructions issued by the Licensee's SSB through an actual audit of the business transactions.	A comprehensive <i>Shari'ah</i> review will be conducted to examine and evaluate the extent of compliance with Islamic <i>Shari'ah</i> rules, principles, fatawas and instructions issued by IFI's SSB.

<p><b>External Shari’ah Audit</b></p>	<p>An external auditor conducts an audit of a Licensee’s accounts in accordance with auditing standards for Islamic financial institutions issued by AAOIFI and International Standards on Auditing and Assurance issued by IAASB where applicable and submits report to the Central Bank</p>	<p>The auditor is responsible for forming and expressing an opinion that, the IFI is working according to <i>Shari’ah</i> rules and principles through audit evidence. The auditor shall be knowledgeable about Islamic <i>Shari’ah</i> rules and principles. However, he would not possess the same level of knowledge as that of SSB member.</p>
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### CONCLUSION

The rapid growth of Islamic Banking in Sultanate of Oman requires having competent Shari’ah internal and external auditors, and to provide the ‘check and balance’ an equally competent auditor who has good knowledge of accounting, auditing and finance with the equally good Shari’ah and fiqh knowledge and understanding. They are known as the Shari’ah auditor. The Shari’ah reviews done by the internal auditors with the help of the Shari’ah advisors are not adequate anymore in current circumstances. Shari’ah compliant test by the external auditors are also in question if the external auditors are not competent in Shari’ah and relies heavily on the Shari’ah reviews done by the internal auditors with the advice of Shari’ah advisors of the IFIs

Since this paper is a conceptual paper, no empirical study has been conducted. Thus, future research should focus on it. I believe that this paper will be the interest of the regulators and the industrial players for developing Shari’ah audit in the future.

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## FINANCIAL IMPACT ON THE ACCOUNTABILITY OF MALAYSIAN STATE ISLAMIC RELIGIOUS COUNCILS (SIRC)

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### ABSTRACT

*This paper aims to identify whether SIRC financial characteristics have a significant impact on the accountability of Malaysian State Islamic Religious Councils (SIRC). The content analysis approach is used to examine the extent and quality of disclosure in the annual reports of SIRC, indicating accountability of SIRC. This paper uses the self-developed disclosure index that applies specifically for SIRC. Multiple regression is used to examine the financial determinants of the extent and quality of disclosure. The result of the regression models revealed that the extent and quality of SIRC disclosure is influenced by organisational characteristic, namely size. This study suggests that disclosure in the annual report, in particular the non-financial performance, increases with the amount of zakat collection, thereby demonstrating SIRC's responsibility. Next, the control variable of accessibility is found to be significantly related to financial statements. Obligated to produce financial statements, SIRC are more likely to disclose more information in the financial statements. This research finding has important implications for regulators, policy makers and top officials in SIRC, by monitoring the quality of disclosure, supporting the notion of public accountability, which appreciates the public's right to get inform about SIRC. Despite the voluntary disclosure of a non-financial report, SIRC should consider producing a comprehensive annual report for the discharge of their accountability and thus, encourage more funding. They should be more transparent to enhance accessibility, concerning the extent and quality of the disclosure.*

**Keywords:** *Financial, impact, accountability, disclosure, State Islamic Religious Councils.*

## INTRODUCTION

Odainkey & Simpson (2013) posit that the establishment of an organisation is essential to characterise the disclosure information. Organisational structure and the obligation of functions are also important to understand the accountability (Lindkvist & Llewellyn, 2003). SIRC are constitutionally under the Ruler's jurisdiction in the state administration as a result of colonialism period in 1874-195. The Ruler shall seek advice from the SIRC. Thus the SIRC has a unique status, which serves as an advisor for the State Ruler

The Federal Constitution of Malaysia resembles British common law, which covers most areas of life and it is applied nationwide. Nevertheless, matters related to Islamic affairs are provided in Article 74 of the constitution, which grants every state the right to interpret *Shariah*. This law is applied to a person practicing the religion of Islam (*Muslims*) in respective regions. Under Islamic jurisdiction are the more social areas of family and religion, for example: marriage, divorce, dowry etc. Revenue likewise comes under their purview and includes: religious endowments (*waqaf*), alms (*zakat*) and treasury (*baitulmal*). Institutions operate within the states except formatters included in the Federal List in the constitution, when they are subject to State List authority like Muslim religious law, Islamic revenues and Malay reservation and custom. Consequently, the administration of Muslim wealth is carried out by the SIRC independently.

The establishment SIRC is headed by the Ruler in each state and the King respectively to administer Islamic law and to establish a state court system applying Islamic jurisprudence<sup>1</sup>. SIRC play charity roles that benefit Muslims and the local community. They are recognised as the highest statutory authority in the state, forming policy for Muslim revenue matters, written in the Ninth Schedule, Federal Constitution. SIRC are responsible for promoting the development of social welfare within the boundaries of Islam. As the SIRC were established in the public service setting, public accountability perspective is pertinent. The public has a right to be fully informed about the performance and condition of the public organisational setting (Coy, Fischer, & Gordon, 2001), this information necessarily satisfying the needs of a broad range of stakeholders. This

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<sup>1</sup> However, in states with Rulers some statutes require that the Chief Minister advise the *Ruler* whereas others permit the SRCs to provide advice. In fact there are still some states, which do not provide clearly for any person to advise the *Ruler*. There is indeed a lack of uniformity in the SRC management structure.

implies the uniqueness of SIRC, which play social roles in religious-based and public service setting. With this wide range functions, funding for SIRC's operations has become increasingly important.

In addition to financial assistance from government, they have other own fundings. Several types of funding characterise the flexibility of SIRC in managing their managerial operations (Siraj, 2012). Despite SIRC being established in accordance with the various state enactments, their main role to increase the well-being of the citizens is challenging, especially as far as financial autonomy is concerned. The financial capacities of SIRC and the huge responsibilities they have been assigned, place demands for even greater efficiency for all SIRC in the foreseeable future (Mahamood, 2000).

Although they are pursuant to the state government, financial provision from the state is limited compared to the federal SIRC. The federal government allocates a financial grant to the federal SIRC as it is governed directly by the Prime Minister's Department, showing that it has financial privilege over other SIRC.

Ministerial Functions Act 1969 (Act 2, amended 1999) declares that statutory bodies have power to lend, borrow, invest, establish subsidiary companies, manage funds and trust accounts, and implement activities and programmes. Although SIRC are entitled to obtain government grants every year, they are nevertheless encouraged to generate their own funds to finance their operations. Such wealth accumulation could enhance them to expedite socio-economic development in their respective states. SIRC are subject to their own incorporation subsidiary legislation that outlines their purpose and powers of autonomy.

Mahamood (2000) argues that funding is one of the long-standing constraints for SIRC, preventing them from functioning effectively where the financial resources are not compatible with expected services, consequently affecting their future. However, the Malaysian government in the Ninth Malaysian Plan (2006-2010) has allocated RM250million<sup>2</sup> (approximately GBP46.7million) specifically for improving the capacities of SIRC, which can benefit by financing their operations. Despite financial assistance from the state government and the federal government (through the state government)<sup>3</sup>, SIRC usually finance their operations using their own income generated

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<sup>2</sup> GBP1 = MYR5.36 on 13 December 2013.

<sup>3</sup> This is an exception for the federal SIRC where it obtains a direct financial grant from the federal government.

from activities such as fees for the administrators of Muslims revenue, rental and investment income from commercial activities, endowed property received and donations from the public. In that case, this triggers the present study to examine whether financial characteristics such as size of SIRC, liquidity, leverage, efficiency and surplus have impact on the corporate disclosure of SIRC. Such disclosure is seen to be an important mechanism so that SIRC are held accountable and be seen as discharging their accountability.

## LITERATURE REVIEW

Many disclosure studies examine the impact of financial motivation on the extent of disclosure in companies (e.g. Aly *et al.*, 2010; Ghazali and Weetman, 2006; Brammer and Pavelin, 2004; Haniffa and Cooke, 2002; Wallace *et al.*, 1994) but a relative lack of studies about non-profit organisations such as local government, higher education institutions, charities, religious and other government agencies (e.g. Arshad *et al.*, 2013; Bakar and Saleh, 2011a; Marcuccio and Steccolini, 2009; Ryan *et al.*, 2002). As Broadbent and Guthrie (2008) state, there is less focus on the financial positions in public sector studies but this has progressed over time. The present study could fill the gap by contributing to such limited literature.

This study aims to examine financial characteristics and whether they have any significant impact on the extent and quality of disclosure. The research hypotheses developed for this study are based on the following characteristics: size, liquidity, leverage, efficiency and surplus. These five characteristics have sub-categories to different types of disclosure, namely: a) annual report, b) non-financial and c) financial statements. Each category has been designated as: a, b and c. Three control variables included are: state-ownership, locality and accessibility.

### *Size/wealth*

Previous studies argued that large organisations are more likely to disclose more information. Gandía and Archidona (2008) stated that wealthy organisations have incentives to increase information disclosure to show their quality of management, which benefits politicians. They may have a promising opportunity for re-election. Similarly, Laswad *et al.* (2005) highlight the concern about political competition through disclosure. A significant and positive association was found in numerous studies such as Wallace *et*

*al.* (1994), Hussainey *et al.* (2011) and Laswad *et al.* (2005). Therefore, from agency theory and political-economic theory, large organisations are more likely to provide more information to report their operations. However, Miniaoui and Oyelere (2013), Atan *et al.* (2012) and Aly *et al.* (2010) found no such association.

Size can be measured using total assets and total sales (Hussainey and Al-Najjar, 2011; Aly *et al.*, 2010 and Wallace *et al.*, 1994). In this study, as the main role of SIRC is on *zakat* rather than sales, size is measured by total *zakat* collection. As the majority of studies have shown, size is significant and positively associated with the extent and quality of disclosure, as this study's hypotheses lists:

H1(a): Annual report disclosure is positively associated with size.

H1(b): Non-financial disclosure is positively associated with size.

H1(c): Financial statements disclosure is positively associated with size.

### ***Liquidity***

It has been argued that high liquidity organisations have higher agency costs, and thus are more likely to disclose more information to reduce such costs. They do this by showing their ability to pay current debt without liquidating other assets to satisfy stakeholders at large, consistent with agency and stakeholder theory. Several studies have examined the impact of liquidity on the extent of disclosure. However, the results are inconsistent. For instance, Wallace *et al.* (1994) found significant negative association, Arshad *et al.* (2013) and Owusu-ansah and Yeoh (2005) found positive association, whereas Aly *et al.* (2010) and Miniaoui and Oyelere (2013) did not find any association. Liquidity is measured by a ratio of current assets to current liability. Based on these discussions, consistent with agency and stakeholder theory, this study hypothesises that:

H2(a): Annual report disclosure is positively associated with liquidity

H2(b): Non-financial disclosure is positively associated with liquidity

H2(c): Financial statements disclosure is positively associated with liquidity



### ***Leverage***

Reliance on debt is an important aspect of examining the financial position of an organisation but it appears to be a little tested variable in terms of being used to explain disclosure in government, unlike studies about companies. From the perspective of agency theory, highly leveraged organisations are more likely to disclose more information due to the increase of agency cost. Indeed, more information disclosed can reduce the agency cost (Debreceeny *et al.*, 2002) while showing an ability to pay debt in a timely manner, in particular to creditors.

Several empirical studies have been conducted examining the association between leverage and information disclosure: the results are mixed. Laswad *et al.* (2005) found significant and positive association between leverage and disclosure whereas a negative association was found by Chiu and Wang (2015). Regarding another aspect, Lampkin and Raghavan (2008) proved that highly leveraged faith-based organisations negatively influenced government funding. Aly *et al.* (2010), Jaffaret *al.*(2007) and Debreceeny *et al.*(2002) found no significant association. Leverage is measured by a ratio of debt to total assets. Based on the findings above, this study hypothesises that:

H3(a): Annual report disclosure is negatively associated with leverage

H3(b): Non-financial disclosure is negatively associated with leverage

H3(c): Financial statements disclosure is negatively associated with leverage

### ***Efficiency***

Efficiency of distribution is the main concern of the public, rather than the contribution funds generated (Wahab and Rahman, 2011; Connolly and Hyndman, 2013), which shows the accountability to the public under the umbrella of public accountability, supporting stakeholder theory. The importance of efficiency has been found to be related to accountability discharge and funding decisions (Brammer and Millington, 2004; Heijden, 2013; Zainonet *al.*, 2011). Both agency and stakeholder theory are pertinent in showing the accountability of the agent to the public.

Previous studies have been conducted using efficiency measures in relation to performance reporting and governance (Atan *et al.*, 2013; Connolly and Hyndman, 2003; Dhanani and Connolly, 2012; Heijden, 2013; Zainon *et al.*, 2011 and Callen *et al.*, 2003).

Nevertheless, to the best knowledge of the author, none have examined the impact of efficiency on the extent of disclosure. With regards to efficiency measurement, Connolly and Hyndman (2004) used a ratio of administration costs to total costs, Heijden (2013) used fundraising ratio expenses over collected funds whereas Sulaiman *et al.*, (2009) used ratios of program expenses to total expenses, investment income to average investment and fundraising expenses to total related contributions. A ratio of fundraising expenses to total expenses, and administrative expenses to total expenses were used in Callen *et al.* (2003). As such, the basis of measuring efficiency is a ratio of expenses to total related expenses.

Despite the difficulty in measuring efficiency, and its sensitivity to, more meaningful information from the audited financial statement can be obtained by knowledgeable users (Connolly and Hyndman, 2013). Consistent with previous studies, efficiency is measured by a percentage of distribution funds to total generated income. Specifically, in this study the funds refer to *zakat* only because the main role of SIRC is derived from the *zakat* collection. This study hypothesises that:

H4(a): Annual report disclosure is positively associated with efficiency

H4(b): Non-financial disclosure is positively associated with efficiency

H4(c): Financial statement disclosure is positively associated with efficiency.

### ***Surplus***

According to agency theory, a profitable organisation has a greater likelihood of disclosing more information to show their accountability to the public because the government is accountable to the public (Ghazali and Weetman, 2006). In the context of government, it refers to a surplus of entrusted funds which can benefit the citizen. On the other hand, it has been argued that less information is pertinent (Naser and Nuseibeh, 2003) probably due to the guarantee of reliance on government funding. Political connection is another contributing factor to such funding, as posited by Ghazali and Weetman (2006), although Mucciarone and Neilson (2011) found no such association. A significant and positive association was found between profitability and the extent of disclosure by Aly *et al.* (2010), Hussainey *et al.* (2011) and Haniffa and Cooke (2002) whereas negative association was discovered by Jaffar *et al.* (2007) and Hussainey and Al-

Najjar (2011). However, Wallace *et al.* (1994) and Miniaoui and Oyelere (2013) found that profitability was not a significant in explaining disclosure.

This study uses a dummy variable of 1 if a surplus is earned, or otherwise zero, as a proxy of profitability. Consistent with the agency theory perspective within the banner of public accountability as argued above, this study hypothesises that:

H5(a): Annual report disclosure is positively associated with surplus

H5(b): Non-financial disclosure is positively associated with surplus

H5(c): Financial statement disclosure is positively associated with surplus

### ***Control variables***

Three factors, namely: state ownership, locality and accessibility, have been found in previous studies which influence disclosure practices. For instance, Abdul-Rahman and Goddard (1998a) found that locality and state ownership influenced SIRC's disclosure. Coy and Dixon(2004) stated that accessibility is another contributing factor to the extent of disclosure but it was less tested (Bakar and Saleh, 2011a). Therefore, this study adopted these three factors as control variables.

**State-ownership;** it is political since the government has power to appoint the CEO and even board members. The appointed civil managers are held accountable to government interests, especially the public domain since political leaders of the government office are very concerned about their voting support. In the presence of government ownership, they are monitored by the public and are exposed to public criticism. Gandía and Archidona(2008)found that political competition positively influenced the extent of disclosure which is consistent with political-economy and stakeholder theory. However, inconclusive results were observed in previous studies on the influence of government ownership and the extent of disclosure. Amran and Susela Devi (2008) found a significant positive association whereas a negative association was identified by Bushman *et al.* (2004)who argued that less disclosure protected politicians and their cronies. However, political connection and cronyism was not proven in Ghazali and Weetman (2006). In this study, state ownership is measured by the SIRC's governing body, either the government or opposition party. A dummy variable is used; one if the SIRC is controlled by the

government party, otherwise zero. This study conjectures that the extent and quality of disclosure is positively associated with state ownership.

**Locality;** Bakar and Saleh (2011b) stated that location can explain the social incentive for disclosure in government. Abdul-Rahman and Goddard (1998a) found that the location of SIRC influenced their accounting practices. Those SIRC located in the city is more influenced by managerialist values with more power in financial decision-making. In contrast, another type of SIRC is characterised as a cultural power elite originating from the Royal family, have limited authority in decision-making. Such differences would indeed influence accounting disclosure practices. Mahamod (2011) found that locality has been proven to determine *zakat* collection, while the amount of distribution heavily depends on the *zakat* collection in which the SIRC is placed. Matsunaga *et al.* (2010) suggest that locality is related to size of NPO. Therefore, this study predicts that the extent and quality of disclosure will be associated with the locality of the SIRC.

**Accessibility,** it plays an important role in informing the public about the daily operations and activities of government entities. As Coy and Dixon (2004) suggest, internet availability is the easiest way to proxy accessibility. Styles and Tennyson (2007) and Bakar and Saleh (2011a) found a significant positive association of disclosure with accessibility. This indicates that the easier it is for the public to get access the annual reports, the higher the incentive to disclose more information in annual reports. This is consistent with stakeholder theory from the public accountability perspective. The public expects that an organisation is transparent and committed to publish information in their annual report. Grosso and Van Ryzin (2012) proved that disclosure is positively associated with the existence of web-reporting. In this study, two measures are used for proxy accessibility. Firstly, the existence of annual report on the SIRC's websites and secondly, availability of the annual report in SIRC to the public on request. Based on the above arguments, this study anticipates that the extent and quality of disclosure is positively associated with accessibility of disclosure.

In general, the current research hypotheses were developed according to identified theoretical perspectives, previous empirical evidence and related factors concerning charities, NPO and public sector in general and in a Malaysian context, in particular SIRC. The measurements of each independent variable for this study are summarised in Table 1.

Table 0: Measurement of independent variables in the regression model

<b>Variables</b>	<b>Measurements</b>
Size	Total <i>zakat</i> collection (log)
Liquidity	Current assets/ Current liability
Leverage	Debt/Total assets
Efficiency	Distribution of <i>zakat</i> funds/ Collection of <i>zakat</i>
Profitability	Dummy variable

## **METHOD**

Disclosure index and regression are carried out to achieve the objective of this study; to identify the determinants of SIRC's annual reports using regression. The self-developed disclosure index is to empirically examine the SIRC's annual reports. The scores of extent and quality of disclosure are used to identify their association with the SIRC specific financial characteristics. There are several steps: determining criteria of the extent and quality of disclosure, the scoring method and addressing issues on validity and reliability, determining the annual reports sample, analysing data and screening data for regression.

## **RESULT AND DISCUSSION**

This section provides the results of regression in order to answer the second objective in this study, specifically to identify the determinants of SIRC annual reports disclosure. Specifically, the purpose is to determine whether specific attributes of SIRC, such as size, liquidity, leverage, surplus and efficiency, have a significant impact on the extent and quality of disclosure. The disclosure refers to two types of reports, namely, annual reports, a combination of financial and non-financial disclosure items in an annual report, and financial statements. The research question for this objective is 'do SIRC characteristics affect their annual reports disclosure'?

*Discriptive statistics*

To evaluate the extent and quality of disclosure, three dependent variables were used respectively for scores of annual reports, and for non-financial and financial statement disclosure. The score is made up of the extent and quality scores. The independent variables employed were SIRC-specific characteristics such as size, liquidity, leverage, profitability and efficiency.

Table 2 presents descriptive statistics of the dependent and independent variables.

**Table 2: Descriptive statistics of variables**

Variables	Mean	Median	SD	Min	Max	Skewness	Kurtosis
<b>Dependent variable (n=72)</b>							
Annual Report	52.20	41.74	15.55	33.31	76.40	0.330	-1.743
Extent	56.79	48.04	15.70	32.17	81.59	0.289	-1.612
Quality	47.61	36.70	15.71	27.80	73.20	0.350	-1.695
Non-financial statement	24.64	0.00	28.99	0.00	68.79	0.374	-1.810
Extent	24.33	0.00	28.63	0.00	66.66	0.373	-1.818
Quality	24.95	0.00	29.53	0.00	70.91	0.408	-1.744
Financial statement	79.76	80.89	4.61	66.61	86.61	-1.479	1.797
Extent	89.24	88.44	6.87	64.34	99.89	-1.418	3.084
Quality	70.28	71.11	4.48	55.56	75.56	-1.903	3.755
<b>Independent variables (n=72)</b>							
Size	7.85	7.89	0.62	6.19	8.71	-1.189	1.684
Liquidity	15.46	8.83	18.58	1.34	89.54	2.604	6.698
Leverage	0.20	0.10	0.26	0.01	1.14	2.136	4.114
Efficiency	0.82	0.84	0.19	0.30	1.20	-0.395	-0.151
Surplus_dummy	0.93	1.00	0.26	0.00	1.00	-3.460	10.255

As reported in Table 2, the mean score of disclosure for financial statement is higher (79.76%) than for the annual report (52.2%). Looking at the components of the annual report, the mean score of the financial statement (79.76%) is much higher than that for non-financial statement items (24.64%)<sup>4</sup>. Likewise, the extent and quality scores of disclosure show a similar trend to the final score of the report. In this study, it is therefore pertinent to investigate three different models of disclosure, which are the annual report, non-financial statement items and financial statements. The results of skewness and

<sup>4</sup> In this study, as for the sampled SIRC' annual reports (n=31), non-financial statement items will be investigated further while the financial statements are included in the entire financial statement variable (n=72).

kurtosis reveal that all continuous variables are not normally distributed, which is similar to the Kolmogorov-Sminov and Shapiro-Wilk tests<sup>5</sup>.

Despite the non-normality of the data, the central limit theorem<sup>6</sup> is pertinent to the theoretical justification (Gujarati & Porter, 2009), so that a normality test can be used. Additionally, prior to the linear regression analysis, all variables in regression models must fulfil several conditions. In particular, empirical studies on accounting disclosure require attention to many issues such as normality of data distribution, outlier and linearity in multiple regression analysis (Cooke, 1998). This study is assumed to have normal data distribution and the parametric tests were pertinent.

### ***Multivariate analysis***

An Ordinary Least Square (OLS) regression was conducted to test the relationship between the dependent variables of the disclosure scores and the independent variables. The regression was initiated with a Pearson correlation test to identify any multicollinearity between independent variables and across variables. A correlations matrix was used to examine the correlations between all the independent and control variables. The results are presented in Table 3.

**Table 3: Pearson correlation matrix across independent variables**

	Size	Liquidity	Leverage	Efficiency	Surplus	Locality	Ownshp	Web Report	Annual Report
Size	1								
Liquidity	0.128	1							
Leverage	-0.166	-0.141	1						
Efficiency	0.053	-.232*	.334**	1					
Surplus	0.057	-0.042	-.280*	-.383**	1				
Locality	-0.064	.280*	.272*	-0.039	-0.152	1			
Ownership	-0.214	-.282*	-0.032	0.162	-0.056	-.407**	1		
Web Report	.494**	-0.12	-0.193	-0.057	-0.024	-.533**	0.189	1	
Annual Report	.513**	0.11	-0.073	-0.016	0.017	-.279*	0.032	.514**	1

\*\* . Correlation is significant at the 0.01 level (2-tailed).  
 \* . Correlation is significant at the 0.05 level (2-tailed).

Table 3 shows the highest correlation is 0.533, which is below 0.7<sup>7</sup>. This indicates that there is no high correlation in any combination of independent variables, and thus

<sup>5</sup> There is a deviation from normal data when the values of Skewness and Kurtosis are more or less than 0, and the data is not normally distributed if the result is significant (Field, 2013).

<sup>6</sup> As the sample size is large, the assumption of normality matters less. The sample size is considered large if it is more than thirty (Field, 2013).

<sup>7</sup> Correlation above 0.7 is defined as highly correlated (Pallant, 2013)

multicollinearity is not a matter for concern. Next, all of the variables were tested in the regression model; the equations are expressed in Models 1, 2 and 3 below:

**Model 1:**  $DAR_s = \beta_0 + \beta_1 \text{Size} + \beta_2 \text{Liquidity} + \beta_3 \text{Leverage} + \beta_4 \text{Efficiency} + \beta_5 \text{Profitability} + \beta_6 \text{Ownership} + \beta_7 \text{Locality} + \beta_8 \text{Accessibility} + \sum_s$

**Model 2:**  $DNFS_s = \beta_0 + \beta_1 \text{Size} + \beta_2 \text{Liquidity} + \beta_3 \text{Leverage} + \beta_4 \text{Efficiency} + \beta_5 \text{Profitability} + \beta_6 \text{Ownership} + \beta_7 \text{Locality} + \beta_8 \text{Accessibility} + \sum_s$

**Model 3:**  $DFS_s = \beta_0 + \beta_1 \text{Size} + \beta_2 \text{Liquidity} + \beta_3 \text{Leverage} + \beta_4 \text{Efficiency} + \beta_5 \text{Profitability} + \beta_6 \text{Ownership} + \beta_7 \text{Locality} + \beta_8 \text{Accessibility} + \sum_s$

where,

$DAR_s$  = Annual Report Score

$DNFS_s$  = Non-Financial Statement Score

$DFS$  = Financial Statement Score

$\beta$  = the constant coefficient

$\sum_s$  = the error term

The above three models are used in the regression equation. Each model is sub-divided into Models a and b for the extent and quality of disclosure respectively. This is because the final score of disclosure is made up of the extent and quality score. The conclusion is based on the robust findings, where these are supported by both Model a and Model b.

Prior to the linear regression analysis, all variables in regression models must fulfil several conditions. In particular, empirical studies on accounting disclosure require attention to plenty of issues such as the multicollinearity and heteroscedasticity in multiple regression analysis (Cooke, 1998). Table 4 addresses such issues in all regression models.



**Table 4: Regression results**

	Expected	Model 1 (AR)		Model 2 (NFS)		Model 3 (FS)		Model 1a		Model 1b		Model 2a		Model 2b		Model 3a		Model 3b		
	sign	coefficient	t-stat	coefficient	t-stat	coefficient	t-stat	coefficient	t-stat	coefficient	t-stat	coefficient	t-stat	coefficient	t-stat	coefficient	t-stat	coefficient	t-stat	
Constant					-2.028		10.996													
Size	+	0.348***	2.563	0.391***	2.927	-0.315**	-2.446	0.37***	2.695	0.320**	2.382	0.403***	3.008	0.377***	2.821	-0.273**	-2.048	-0.229*	-1.892	
Liquidity	+	0.19	1.652	0.158	1.401	0.204*	1.758	0.207	1.785	0.169	1.486	0.153	1.354	0.162	1.433	0.275**	2.283	-0.001	-0.009	
Leverage	-	0.114	0.961	0.129	1.106	-0.107	-0.895	0.13	1.087	0.096	0.817	0.125	1.073	0.131	1.128	0.018	0.145	-0.248**	-2.204	
Efficiency	+	-0.047	-0.375	-0.09	-0.728	0.273**	2.236	-0.008	-0.062	-0.085	-0.684	-0.08	-0.646	-0.099	-0.8	0.379***	3.003	-0.021	-0.186	
Surplus	+	0.009	0.074	-0.02	-0.174	0.189	1.635	0.011	0.096	0.006	0.053	-0.031	-0.262	-0.01	-0.086	0.238*	1.992	0.023	0.210	
State ownership		-0.042	-0.348	0.001	0.01	-0.318***	-2.648	-0.017	-0.14	-0.066	-0.551	0.01	0.082	-0.007	-0.061	-0.168	-1.350	-0.397***	-3.516	
Locality		-0.229	-1.601	-0.218	-1.553	-0.074	-0.575	-0.303**	-2.099	-0.15	-1.06	-0.226	-1.6	-0.21	-1.492	-0.244*	-1.825	0.221*	1.828	
Accessibility		0.207	1.345	0.204	1.354	0.504***	3.919	0.123	0.795	0.286*	1.881	0.186	1.226	0.221	1.465	0.328**	2.467	0.532***	4.404	
significant at *0.10, **0.05, ***0.01																				
F-value		4.099***		4.522***		3.981***		3.885***		4.361***		4.446***		4.532***		3.188***		5.561***		
Adjusted R <sup>2</sup>		25.90%		28.40%		25.10%		24.50%		27.50%		28.00%		28.40%		19.80%		33.90%		
Std. Residual		-3.469		-3.387		-4.476		-3.347		-3.614		-3.453		-3.434		-4.856		-3.91		
Max Cook's distance		0.179		0.175		0.143		0.152		0.203		0.168		0.178		0.107		0.291		
Max VIF		2.263		2.263		1.577		2.263		2.263		2.263		2.263		1.577		1.577		

Based on Table 4, the highest VIF is 2.263, which is below 10. This indicates that multicollinearity is not a concern in all regression models. The highest Cook's distance is 0.203, which is less than 1 and the standardised residual is less than 3.3, indicating no outliers. As such, it can be concluded that heteroscedasticity does not pose any problems in the models. Relevant tests have been inspected to ensure that the underlying assumptions of the OLS regression analysis are not violated.

### ***Financial Characteristics***

Table 4 shows that the F-value for all models is significant at the 1% level. The adjusted R<sup>2</sup> indicates that the independent variables used in the study can explain about 25%, 28% and 20% of the extent and quality of disclosure for annual reports, non-financial and financial statements respectively. It discusses the results of regression according to the eight tested characteristics. These are size, liquidity, leverage, efficiency and surplus; control variables such as state ownership, locality of SIRC and accessibility are taken into consideration.

### ***Size of SIR***

From Table 4, it can be seen that the association between the size of a SIRC and the annual report and non-financial disclosure was positive and significant (at 1% level) in Models 1 and 2. Therefore, Hypotheses 1a and 2a are supported. In particular, the extent of annual reports and non-financial disclosure was statistically significant at 1% in Model 1a and Model 2a, whereas the quality of annual reports was significant at 5% and 1% respectively in Model 1b and 2b. This suggests that the extent and quality of annual reports and non-financial disclosure have the same impact on size. A possible explanation for this positive relationship is due to the fact that the majority of SIRC are led by politicians<sup>111</sup>, a fact which motivates more disclosure for political support. Indeed, this study supports the political economy theory and the agency theory that are consistent with many other studies (Hussainey *et al.*, 2011; Laswad *et al.*, 2005; Christensen and Mohr, 2003; Wallace *et al* 1994).

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<sup>111</sup> Only four SIRC are chaired by the State Ruler while others are led by the Chief Minister or a corporate person.

In Model 3, although size reported a significant result, the negative coefficient contradicts the expected direction. Hypothesis 1c, which predicts a significant and positive association between size and the financial statement disclosure, is not supported by this study. The negative and significant association was also observed between the extent and quality of financial statements in Model 3a and 3b with size. The negative association indicates that the larger organizations tend to disclose less information than small organizations to avoid political intervention from the public. As such, it is inconsistent with the underlying public accountability.

### ***Liquidity***

It was observed that liquidity was significant, at a 10% level, and positively related to the financial statement disclosure in Model 3. The extent of disclosure in Model 3a was also significant at 5% level. However, this was not the case for Model 3b and therefore, the findings are not robust enough to accept Hypothesis 2c. This study suggests that there is a different determinant, of the extent and quality of financial statements, in relation to liquidity. Such determinant between the extent and quality of disclosure is also found by Alotaibi and Hussainey (2016).

In this study, the non-significant relationship was observed for both annual reports and non-financial statements in Model 1 and 2 and their sub-models. Therefore, Hypotheses 2a and 2b are not supported. Likewise, liquidity failed to provide any evidence supporting the relationship between liquidity and disclosure for all models. This non-significant finding indicates that liquidity is not significant and positively associated with the extent and quality of the disclosure of annual reports, and non-financial and financial statement disclosure. This finding is also in line with Aly *et al.* (2010) and Owusu-Ansah (1998).

### ***Leverage***

Leverage was found to be negative and significant (at 5% level) in Model 3b. However, Model 3 in fact was insignificant. Therefore, the findings are not robust enough to support the hypothesis. This study concludes that leverage is not statistically associated with the extent and quality of financial statement disclosure. Hypothesis 3c is rejected, although the

negative relationship confirms the expected positive sign. A non-significant relationship was observed between the annual report and non-financial disclosure and leverage in Model 1 and 2. The non-significant relationship between leverage and disclosure was also documented in the literature (Ntim et al., 2016; Jaffar *et al.*, 2007 and Gordon *et al.*, 2002).

### ***Efficiency***

A significant of 5% level and positive association in Model 3 was found between efficiency and the financial statement disclosure. Although a significant and positive direction was also observed in Model 3a (at 1% level), Model 3b was not significant. This study suggests that the extent and quality of financial statements have a different impact on the efficiency. As the result is supported by Model 3a only, it is concluded that efficiency is not statistically related with the financial statement, rejecting Hypothesis 4c. Other hypotheses 4a and 4b are also rejected.

The non-significance association however, depends on the measurement of disclosure whether the extent, quality or both is used. This finding contributes to the determinants of SIRC efficiency through disclosure, in addition to factors such as a computerised *zakat* system, *zakat* payment and decentralisation (Wahab and Rahman, 2011). The importance of efficiency is highlighted by Heijden (2013) for more effective fundraising. This matter is crucial to attract more funding in the NPO.

### ***Surplus***

This study did not find evidence to support a significant relationship between surplus and the disclosure of SIRC. Although it was found that there was a significant, positive relationship between surplus and the extent of financial statement disclosure at 10% level in Model 3a, basically Model 3 was not significant. Therefore, there is not enough evidence to support Hypothesis 5c. Similarly regarding efficiency, both Hypotheses 5a and 5b are not accepted.

The non-significant relationship was also reported by Chiu and Wang (2015). This is probably due to the different study context and proxy used in this study. They used the amount of profitability to measure profit whereas this study used 0 or 1 to represent the

surplus or deficit respectively<sup>112</sup>. Overall, in this study, profitability appears not to be significantly associated with the SIRC disclosure, which has led to the non-significant difference between surplus and deficit SIRC in disclosure.

### ***Control Variables***

#### ***State-Ownership***

In this study, it was revealed that state-ownership was negative and significant at 1% level in Model 3. This was supported by the quality of financial statement disclosure in Model 3b, but the extent of disclosure in Model 3a was not significant, implying that the extent and quality of disclosure have a different impact (Alotaibi and Hussainey, 2016), particularly on state ownership. Although the variable was significant, the negative coefficient contradicts the expected positive. Therefore, the state ownership variable is not supported, indicating that state-ownership is not related to the financial statement disclosure in Model 3.

In spite of the non-significance, the negative coefficient applies also to the annual report disclosure in Model 1. This suggests that SIRC governed by a government party disclose less information in their financial statements, than SIRC governed by an opposition party. Fundamentally, comprehensive disclosure is limited to minimize the possibility of political action, as posited by Wallace *et al.*, (1994). The non-significance of state ownership is consistent with the findings of Ghazali and Weetman (2006).

A positive prediction was observed for non-financial disclosure in Model 2, which is not significant. The positive sign implies that state-owned SIRC appear to disclose more information in their annual reports than is given in their financial statements, as claimed in political-economy theory. In this study, this theory is not supported. A possible explanation for this positive association is due to the SIRC resolution and accountability index<sup>113</sup> which has led to a transparency of disclosure among them. The non-significance of this factor means that more efforts should be taken by the government to enhance voluntary disclosure by all government agencies, and in particular, by state-owned SIRC.

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<sup>112</sup> The profitability variable was also tested using an Independent t-test, the results indicating that there is no significant difference (p-value=0.682) in disclosure between SIRC with surplus and deficit.

<sup>113</sup> See Section 1.3 for details of the resolution and accountability index.

### ***Locality***

This study did not find any evidence to support the hypothesis that there is a significant association between locality and the disclosure scores of annual reports and both types of sub-reporting, namely, non-financial statements and financial statements. Looking at the sub-models, it was found that the extent of annual reports in Model 1a was significant, at 5% level, and the extent and quality of financial statements respectively in Model 3a and 3b (at 10% levels). This study suggests that the extent and quality of financial statement disclosure might have a similar impact on the locality. However, it was found that the locality was not significant for annual reports, non-financial and financial statements in Model 1, 2 and 3. Therefore, there is not enough evidence to support this variable. The non-significant association contradicts Archambault and Archambault (2003) and Haniffa and Cooke (2002) with an argument indicating that culture has a significant influence on the disclosure. In this study, the locality of SIRC identifies their culture (Abdul-Rahman and Goddard, 1998).

### ***Accessibility***

Only in Model 3 was accessibility found to be positive and statistically significant, at 1% level, for the financial statements. The significant association was also found in the extent, at 5% level, and quality, at 1% level, of financial statements in Models 3a and 3b respectively. Indeed, this finding provides evidence to support the hypothesis that accessibility could enhance disclosure (Coy *et al.*, 2001). The extent and quality of the financial statements is related to accessibility. The positive coefficient suggests that SIRC that prepare annual reports allow easy accessibility to the public and appear to disclose more information. A similar finding was also documented by Bakar and Saleh (2011). The financial statement allows experienced readers to extract information from the audited financial statement to meet their needs (Connolly and Hyndman, 2013).

In conclusion, the results should be taken with caution. Despite the fact that this research has attempted to ensure the reliability and validity of this quantitative study, there are nevertheless several limitations. The slightly low explanatory power of the three different models, about 20%-25%, shows that there are other factors which can explain the SIRC disclosure. For instance, such factors could be the inconsistency of the annual report

publications, the absence of annual reports for several SIRC and the difficulty in quantifying several variables.

The unavailability of information also limited the present study to examining corporate governance mechanisms which might have influenced the disclosure, as proven in many disclosure studies (Ntim *et al.*, 2016; Karaa, 2013; Hyndman and McDonnell, 2009; Hussainey and Al-Nodel, 2008; Barros and Nunes, 2007; Haniffa and Cooke, 2005). However, nowadays SIRC are becoming more active in producing annual reports, and future studies could examine the annual reports of SIRC more comprehensively in relation to corporate governance mechanisms. As an alternative to the limited secondary data, interviews were also conducted (see Chapter 9 for the results). The interviewees were accountants, the National Auditors of SIRC, regulators and the public, which was a means of satisfying the stakeholder theory.

Consistent with the notion of public accountability, Ntim *et al.* (2016) suggest that disclosure should focus not only on the financial performance of the reporting entity, but also on the voluntary disclosure of the non-financial report. Furthermore, they state that such a comprehensive report could satisfy the powerful stakeholders and result in the emergence of new stakeholders to broaden public accountability beyond the private, enabling a more sustainable operation. Supporting the roles of SIRC being accountable to the public, is also in accordance with *Shariah*. The comprehensive report evaluated in this study is thereby pertinent. Other environmental factors, such as political, economic and social issues, could also influence disclosure practices (Hussainey and Al-Nodel, 2008).

## CONCLUSION

The result of the regression models revealed that the extent and quality of SIRC disclosure was influenced by organisational characteristic, namely size. This study suggests that disclosure in the annual report, in particular the non-financial performance, increases with the amount of *zakat* collection, thereby demonstrating SIRC's responsibility, as suggested by political economy theory. This could minimize agency costs, which therefore supports the agency theory consistent with Islamic accountability, with an expectation of full disclosure

(Baydoun and Willett, 2000). This point is supported by Khaled and Nodel (2008), who suggest that the social factors of a religion such as Islam could influence the disclosure.

Next, the control variable of accessibility was found to be significantly related to financial statements. Obligated to produce financial statements, SIRC are more likely to disclose more information in the financial statements. Such accessibility to financial statements allows users to know more about SIRC as a result, and similarly the wide range of stakeholders, supporting stakeholder theory. Requested information might concern the zakat collection and the distribution of funds, disclosed in the notes to the accounts.

These findings have important implications for regulators, policy makers and top officials in SIRC, by monitoring the quality of voluntary and mandatory disclosure, and supporting the whole notion of public accountability. Despite the voluntary disclosure of a non-financial report, SIRC should consider producing a comprehensive annual report for the discharge of their accountability. They should be more transparent to enhance accessibility, concerning the extent and quality of the disclosure. Consequently, dissatisfaction and inquiry about their accountability might be avoided (Wahab and Rahman, 2011), and thus, encourage more funding (Heijden, 2013; Lampkin and Raghavan, 2008; Muda *et al.*, 2006).

To conclude, the main findings in this study are robust in several regression models, since they are supported by the extent and quality of disclosure. Although there was no intention to differentiate the impact of the extent and quality of disclosure, the results showed that the relationship strength and the coefficient signs might also be different between the measurements. The arguments of Alotaibi and Hussainey (2016) and Chakroun and Hussainey (2014) claim that the quantity (in this study is the extent) and quality of disclosure may produce different significant regression results.

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## ASYMMETRIC BEHAVIOR OF GULF COOPERATIVE COUNCIL SHARIAH EQUITY MARKET

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### ABSTRACT

*This paper investigates the nature and behaviour in Shariah market of GCC countries with daily returns spanning from 01/01/2008 to 31/09/2017. In order to model the volatility, GARCH (1, 1), E- GARCH (1, 1) and T- GARCH (1, 1) have been employed. After detecting the ARCH effect, the residuals were modelled with the above tools. The results of GARCH (1,*

*1) were highly significant at 1% significance level. The high significance of  $\alpha$  (ARCH term) and  $\beta$  (GARCH term) implies that past volatility highly influences the current volatility of all the series under study. The asymmetrical GARCH models outperformed the symmetrical GARCH models. By the application of E-GARCH (1, 1) and T-GARCH (1, 1) it was found that that there was leverage effect in the all the indices with few exceptions. The results of T- GARCH (1, 1) showed that there was no asymmetry in the returns of Bahrain and Oman when compared to all other indices. With regard to E-GARCH (1, 1) results it was witnessed that Bahrain, Saudi Arabia, Qatar and United Arab Emirates were highly significant at 1% level with negative coefficients of leverage effect indicating that negative news highly influences the market than positive news, but Kuwait and Oman were the exceptions in the conditional modelling. In both the cases Oman stood out with a negative result. The results of the study provides insight in to volatility structure of Shariah markets more specifically the indices of GCC countries, which is of great help for the investors in Shariah index of GCC countries.*

**Keywords:** *GCC Countries, Shariah index, Conditional Volatility, Asymmetric Volatility*

## PRELUDE

Volatility is a measure of variability in the price of an asset and is associated with unpredictability and uncertainty about the price. Even it is a synonym for risk; higher volatility means higher risk in the respective context. With regard to stock market, the extent of variation in stock prices is referred to stock market volatility. A spiky and rapid movement in the stock prices may throw out risk averter investors from the market. Hence a desired level of volatility is demanded by the markets and its investors. The traditional methods of volatility analysis never considered the effect of conditional volatility, time varying volatility<sup>4</sup> and volatility clustering<sup>5</sup>. It was Engle (1982) who introduced ARCH model in order to capture volatility in the stock market. Later on various extensions of ARCH model were evolved.

Modelling and forecasting stock market volatility is of considerable interest to the practitioners and researchers alike. Researches are abundant in the area of stock market volatility since it plays a major role in decision making. Ordinarily speaking stock return volatility is the variation of stock return in time or it is the standard deviation of daily stock return around the mean value. The study of volatility assumed newer dimension with the seminal work of Engle which introduced the ARCH model for the first time to analyse volatility thread bear and it became the base for various models later in the pursuit of modelling and forecasting stock market volatility. The Auto Regressive Conditional Heteroscedasticity model (ARCH) by Engle (1982) and General Auto Regressive Conditional Heteroscedasticity model (GARCH) by Bollerslev (1986), were adopted by numerous studies undertaken in the context of emerging and developed stock markets. Even though, various extensions of these models were formed the GARCH (1, 1) model is most often considered for modelling and forecasting by researchers. The studies of Akgiray (1989), Pagan and Schwert (1990), Brailsford et al (1996) proved that GARCH models outperformed other competitive models during the period. But Tse and Tung (1992) contradicted earlier studies and proved that exponentially weighted moving average models provide better results than Garch models. With European markets Corhay and Rad (1994) came to

the conclusion that GARCH (1, 1) model better proved its potentiality to predict volatility when compared to other GARCH family models. Andersen and Bollerslev (1998) argued that GARCH models are the best fits for prediction in stock market. In addition to these models Nelson (1991) and Zakoian (1994) proposed Exponential GARCH (E-GARCH) and Threshold GARCH (T- GARCH) respectively. These extensions of GARCH are useful in predicting the leverage effect of the stock returns.

However the application of these models to Shariah market is considerably low as far as existing literature is concerned. Shariah index is nothing but an index comprising representative Shariah compliant shares and it indicates the trend of stocks adhering to the rules of Islamic finance<sup>6</sup>. During the financial meltdown the Shariah compliant stocks and the Shariah indices came out as out performers beating the market in terms of risk and return. Hence it is of interest to study the market performance in terms of volatility of Shariah market. Romli et al (2012) studied the volatility during the financial crisis i.e. during the period 2007 to 2010 on FTSE Bursa Malaysia Hijarah index. The study concluded that the Malaysian Bursa index was less volatile during the crisis period when compared to conventional indices of Malaysia. The Shariah market attained the preference of an “**Out performer**” Akhtar et al (2010) in the market, during the disintegration, but studies and researches are still scarce and scanty more conspicuously on Middle East countries which follow Shariah principle in stricter sense of the term.

Hence this study is an attempt to investigate on the behaviour and characteristics of conditional volatility and then to model the volatility of Shariah in GCC<sup>7</sup> countries. The study also investigates the asymmetry/ leverage effect in the market which eventually analyses the effect of good and bad news on the returns of the securities.

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4 Time varying Volatility: Time-varying volatility implies that the fluctuations in volatility over time is subjected to large swings, with stocks and other financial instruments exhibiting periods of high volatility and low volatility at various points in time.

5 Volatility Clustering: Discussed later on the paper.

6 Rules of Islamic Finance are nothing but Prohibition on Interest, prohibition on Gambling and Speculation and it runs on the principle of equal profit & loss sharing basis.

7 GCC countries or Gulf Cooperation Council is a political and economic union of Arab states bordering the Persian Gulf namely Bahrain, Qatar, Saudi Arabia, Oman, Kuwait and United Arab Emirates. GCC countries are fast growing economies in the world due to their oil & natural gas deposits.



## **DATA, MODEL ESTIMATION, EMPIRICAL FINDINGS & DISCUSSION**

The data set used in this study consist of GCC countries which includes Bahrain, Qatar, Saudi Arabia, Oman, Kuwait and United Arab Emirates spanning from 01/01/2008 to 31/09/2017. The descriptive statistics portrayed above provide a bird's eye view on returns of the series. From table 1 it is clearly evident that returns of Bahrain, Kuwait, Saudi Arabia and UAE are negatively skewed which indicates that negative stock returns are more common than positive returns. In other words it is that, there is a greater probability of large decrease in returns than increase. The kurtosis of all the series depicts that the returns have fatter tail and higher peaks. The low mean and variance shows low expected returns and risk. UAE index show a higher standard deviation or risk in the security when compared to other indices followed by Kuwait index. The Jarque Bera statistics rejects the null hypothesis of normality of the returns and thus all the series are identified with returns not normally distributed.

Any time series data needs assurance of the stationarity i.e. there shouldn't be any unit root issues in the series. But there are evidences where time series data show a non stationarity (Engle & Granger 1987). Hence before going into in-depth modelling of the data it is necessary to check the stationarity property of the series. In order to check stationarity or otherwise KPSS test <sup>8</sup> has been used, which was introduced by Kwiatkowski et al (1992) here. It assumes that the null hypothesis of the series is stationary.



Table 2: The Unit root results of the returns.

Indices	KPSS test statistic
Bahrain	0.446*
Kuwait	0.057*
Oman	0.342*
Qatar	0.031*
Saudi Arabia	0.069*
UAE	0.123*

The unit root results from KPSS test shows that all the series are stationary which accepts the null hypothesis since the  $H_0$  of KPSS is the series are stationary.

Like stationarity issue in a time series data, there exist a requirement prior to volatility modelling that the residuals of the series should be homoscedastic and there shouldn't be any ARCH effect in the series.

In order to check the homoscedasticity of residuals the serial correlation test was conducted and results showed that there was serial correlation within the residuals of all the series up to 32<sup>th</sup> lag. After the test of serial correlation ARCH LM test was conducted to identify the ARCH effect. It is calculated by regressing squared residuals on a constant at P lags.

Table 3: Results of ARCH LM Test.

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE
F - statistics	20.535	50.02736	100.68309	182.772	182.953	81.716
Observed $R^2$	20.773*	48.585*	94.902*	164.425*	164.571*	77.890*

\*significance at 1% level.

From the table it can be inferred that there was an ARCH effect and null hypothesis of no ARCH effect cannot be accepted. Since the F statistics and observed  $R^2$  are significant at 1%, it can be interpreted that there is a further scope for modelling volatility with different ARCH-GARCH models and their extensions. Before attempting the modelling of the volatility the persistence of returns or the volatility clustering if any was traced out. The graph of which is given in annexure. Volatility clustering<sup>11</sup> implies a strong correlation in squared returns. In order to test volatility clustering Ljung Box was employed where n as sample size and k as lag length.

### **MODELLING OF ARCH & GARCH**

With the results of volatility clustering and autocorrelation in residuals, the next step was the need to specify and model the conditional volatility in the market. To fit the best model, Akaike Schwartz Criterion and Schwartz Bayesian Criterion were employed. In order to trace out the persistence in return, volatility clustering is checked at the introduction stage.

The modelling of the returns of all the series were done through extensions of ARCH model and then with different variant forms such as Threshold GARCH (T-GARCH) and Exponential GARCH (E-GARCH). The persistence of autoregressiveness was tested through GARCH (1, 1) model where volatility clustering was identified and depicted in graph (1), (2), (3),(4), (5) & (6)<sup>12</sup> which clearly indicated that these all these indices followed volatility clustering during periods of turbulence where their prices showed wide swings and periods of tranquillity the wide swings were absent. In the attempt to find out the patterns in modelling and Heteroscedasticity in the residuals the ARCH LM test was employed and it was found that there was no homoscedasticity in the returns which gave further scope for modelling of ARCH models and its variants. Thus GARCH (1, 1) model was fitted to the daily return series.

The results are presented in table 4 for all the indices.

Table 4: Results of GARCH (1, 1).

Indices	$\omega$ ( Constant)	$\alpha$ (ARCH term)	$\beta$ (GARCH term)	$\alpha+\beta$
Bahrain	0.019	0.088*	0.899*	0.811
Kuwait	0.012	0.077*	0.922*	0.999
Oman	0.005	0.146*	0.882*	1.028
Qatar	0.002	0.026*	0.969*	0.995
Saudi Arabia	0.019	0.052*	0.925*	0.977
UAE	0.039	0.067*	0.925*	0.989

\*Significant at 1 % level

The results of GARCH (1, 1) of the returns of six indices of GCC showed that all the parameters in the GARCH (1, 1) were highly significant at 1% significance level. The highly significance of  $\alpha$  (ARCH term) and  $\beta$  (GARCH term) implied that past volatility highly influenced the current volatility of all the series under study. As both  $\alpha$  and  $\beta$  were significant, it revealed that the lagged conditional variance and lagged squared variance had impact on current volatility.

From the sum values of co-efficient of  $\alpha+\beta$  of the series it was clearly evident that all the indices showed a value which is close to unity and for Oman it crossed the value of unity. It implies that the volatility of all the series except for Oman was highly persistent with 1% significance level of acceptance.

<sup>10</sup> Serial Correlation Test: In statistics, autocorrelation is a random process which describes the correlation between values of the process at different times, as a function of the two or of the time difference.

<sup>11</sup> Volatility clustering simply means that periods of highs will be followed by periods of highs and periods of lows/tranquillity will be followed by periods of lows.

<sup>12</sup> Graphs are shown in the annexure part of the paper with page no: 15

After processing GARCH (1, 1) model other higher order model<sup>13</sup> were employed to check the significance. Higher order GARCH models either did not converge or the parameters were insignificant at the conventional levels of significance. Hence it was concluded that this model perfectly fitted in the process and is a representative of the conditional volatility process of the daily returns of the series. Further diagnostic checking<sup>14</sup> of the model also revealed that GARCH (1, 1) was a better fit than highest order ARCH models available.

### ***Asymmetrical Response to Arrival of News***

Since the GARCH (1, 1) model is a symmetric one, there was a need to explore asymmetric models because former model depends only on the magnitude and not on the signs of the returns of the series. On the basis of the results of the volatility ARCH/GARCH model, the symmetry effect or leverage effect can be captured through extensions of GARCH family. Some popular extensions are T-GARCH and E-GARCH, Asymmetric Power GARCH etc. and among them T-GARCH and E-GARCH are most popularly used, as they provide reliable results on asymmetric effect of any series.

### ***The T-GARCH Model***

As GARCH model generates only symmetric response function, there was a need for a new model which incorporates the asymmetric effect of the shock in a series. Zakoian (1990) and Glosten et al (1993) independently developed the T-GARCH model.

Table 5 presents the asymmetric effect of daily returns of six indices from 2008-2013. It can be noted that the  $\Upsilon$  (Leverage effect) coefficients of all the series were positive and significant except for Bahrain and Oman. In case of Bahrain and Oman it showed a positive sign with an insignificant P value which implies that there was no asymmetry or leverage effect. The coefficients of Kuwait, Qatar, Saudi

Arabia and UAE implied that there was a asymmetry effect which indicate that positive shocks had large effect on next period volatility than negative shocks.

Table 5: The results of T-GARCH (1, 1) .

Indices	$\omega$ ( Constant)	$\alpha$ (ARCH term)	$\gamma$ (Leverage effect)	$\beta$ (GARCH term)	$\alpha+\beta$	$[\alpha+ \beta+(\gamma /2)]$
<b>Bahrain</b>	0.019	0.091	<b>0.006</b> (0.5019)	0.899	0.990	<b>0.987</b>
<b>Kuwait</b>	0.0117	0.057	<b>0.0383</b> (0.000)	0.921	0.978	<b>0.997</b>
<b>Oman</b>	0.005	0.133	<b>0.022</b> (0.1057)	0.883	1.804	<b>0.988</b>
<b>Qatar</b>	0.003	0.019	<b>0.0382</b> (0.000)	0.958	0.977	<b>0.996</b>
<b>Saudi Arabia</b>	0.0229	0.0101	<b>0.136</b> (0.000)	0.902	0.912	<b>0.980</b>
<b>UAE</b>	<b>0.0393</b>	<b>0.045</b>	0.038 <b>(0.0001)</b>	<b>0.925</b>	<b>0.970</b>	<b>1.433</b>

### *The E-GARCH Model*

The E-GARCH or exponential GARCH was developed by Nelson (1991). Since T- GARCH restricts the sign of variance to positive; E-GARCH uses the logarithm of  $\sigma_t^2$  which makes the conditional variance regardless of the signs of co-efficient in the results.

<sup>13</sup> GARCH (2, 1) was employed and it rejects the homoscedasticity and ARCH test along with Normality test in diagnostic checking.

<sup>14</sup> Diagnostic checking of GARCH (1, 1) model was conducted through testing serial correlation test, ARCH effect and normality test and the model fitted removes all the constraints and is significant at 1% level.

The presence of leverage effect can be detected with the hypothesis  $\gamma < 0$  and if its

$\gamma > 0$  the impact is asymmetric.

Table 5: The results of E-GARCH (1, 1) .

Indices	$\omega$ ( Constant)	$\alpha$ (ARCH term)	$\gamma$ (Leverage effect)	$\beta$ (GARCH term)	$\alpha + \beta$
Bahrain	- 0.117	0.18 4	-0.012*	0.978	1.162
Kuwait	- 0.090	0.14 6	0.037*	0.992	0.992
Oman	- 0.805	0.19 4	0.088*	- 0.836	-0.836
Qatar	- 0.061	0.09 4	-0.033*	0.996	0.996
Saudi Arabia	- 0.098	0.14 9	-0.010*	0.979	0.979
UAE	- 0.089	0.16 8	-0.035*	0.974	0.974

\*Significance at 1% level

From the above table it is clearly evident that as far as leverage effect is concerned Bahrain, Qatar, Saudi Arabia and UAE were significant at 1% level with negative coefficient value. This clearly showed that negative news had more impact on the volatility than positive news/shocks. Kuwait and Oman shows high significance at 1% level with positive coefficient which implies that positive shocks impacted more on the conditional volatility than negative shocks.

## CONCLUDING REMARKS

In this paper, attempts have been made to examine the asymmetric conditional volatility of Shariah index of GCC countries with the daily returns ranging a period of 5 years from 01/12/2008 to 31/09/2017. From the descriptive statistics it was clearly evident that UAE was the riskiest index among all the other indices as its standard deviation was highest. Then the attempt was made to model the volatility with GARCH models after detecting the serial correlation and ARCH effect in the series.

The conditional volatility was measured through GARCH (1, 1) model and its extensions. It was noted from the results of GARCH (1, 1) that all the parameters in the GARCH (1, 1) are highly significant at 1% significance level. The highly significant  $\alpha$  (ARCH term) and  $\beta$  (GARCH term) implied that past volatility highly influenced the current volatility of all the series under study. The asymmetrical GARCH models outperformed the symmetrical GARCH models. On application of E-GARCH (1, 1) and T-GARCH (1, 1) it was found that there was leverage effect in the all the indices with few exceptions. The leverage terms of all the series were positive and significant except for Bahrain and Oman. In the case of Bahrain and Oman it showed a positive sign with an insignificant P value which implied that there was no asymmetry or leverage effect. The coefficients of Kuwait, Qatar, Saudi Arabia and UAE indicated that there was an asymmetry effect, which indicates that positive shocks have large effect on next period volatility than negative shocks. With regard to E-GARCH (1, 1) Bahrain, Qatar, Saudi Arabia and UAE were significant at 1% level with negative coefficient value. This indicates that negative news impacts more on the volatility than positive news/shocks. Kuwait and Oman shows high significance at 1% level with positive co-efficient indicating higher impact of positive shocks impact more on the conditional volatility.

The implication of the study for the investor is that the asymmetric GARCH models of the series can be used by investors to forecast future volatility of the market. Also further studies can be made on the time varying nature and month effect of the indices which can help the investors to take advantage of less risky months and lesser volatility periods.

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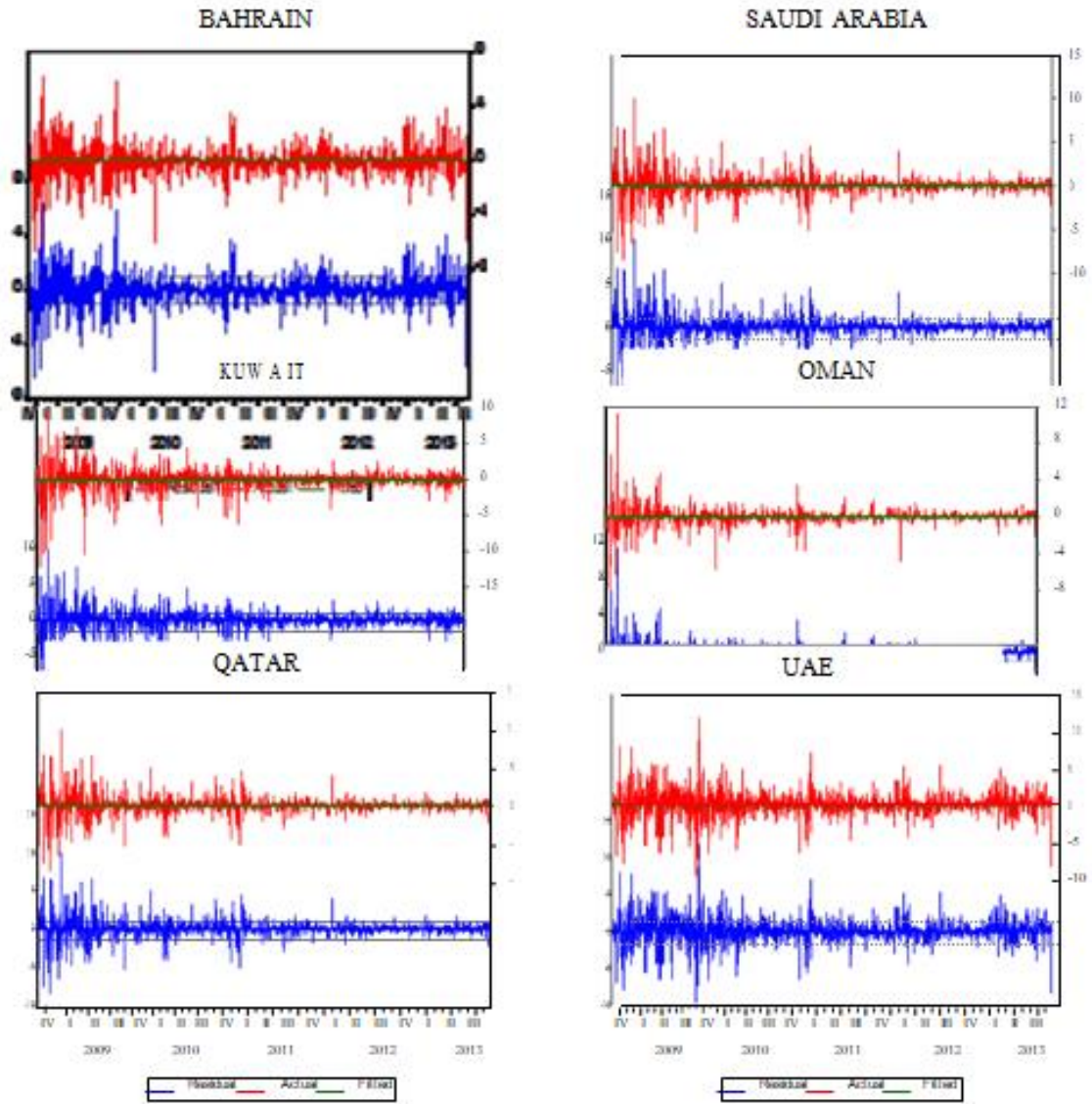
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### ***Annexure***

Graph showing Volatility Clustering of Indices



**DISCOVER WORKAHOLISM AMONG TEACHERS: WORK-LIFE CONFLICT,  
WORK PERFECTIONISM, UNPLEASANTNESS OR WITHDRAWAL  
SYMPTOMS**

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**ABSTRACT**

**Purpose** – *This article aimed to explore the concept of workaholism in the context of Malaysian teachers and to discover which dimensions of workaholism that explain about Malaysian teachers and which gender consider more workaholic.*

**Design/methodology/approach** – *This paper focused on the five dimensions of workaholism: work-life conflict, work perfectionism, unpleasantness or withdrawal symptoms. A questionnaire was translated and adapted for this study was sent to 200 teachers in Penang, Malaysia. A total of 67 percent of teachers responded to the survey. Data were analyzed by using descriptive statistics after going through reliability and validity process.*

**Findings** – *Overall the level of workaholism among teachers are at the moderate level but comparing the two gender, male teachers' level gender is slightly higher than female.*

*The dimensions of workaholism that contribute the highest level are work perfectionism and work addictions while the other dimensions recode the moderate level. The instrument which is used for this research is considered fit for the research because overall Cronbach Alfa value was .84.*

**Research limitations** - *This paper may encourage future research to assess whether various dimensions of workaholism to enhance teachers' productive, creative and innovative behaviour. Future research should also concentrate in depth how the dimensions of workaholism impact the school success. Or identify the traits of workaholic teachers and how to synergize positive values among them to contribute school improvement.*

**Practical implications** – *Half of the teachers' population from this study shows that they are workaholic. These teachers are obsessed with their work that may contribute problem in this profession, their own lives and their family members. If the workaholism is not treated accordingly it may cause mayhem.*

**Originality/value** – *To the author's knowledge, this is the first study to be done in the context Malaysian education setting. The positive component of workaholism that is work perfectionism should be cultivated as a positive value in schools.*

**Keywords** – *Workaholism, Work-life conflict, Work perfectionism, Unpleasantness, Withdrawal symptoms (Chawla, 2003)*

**Paper type** - Research paper

## INTRODUCTION

The PsyCap or psychological capital of the employees is one of the key factor that influence the outcome of an organization (Avey, Luthan & Smith 2010). The destructive form Pscap such as dysthymia or chronic form depression may contribute adversely to the profit of the organization but it may also harm the well-being of the employee (Bakker & Schaufeli, 2008). The employee that is affected by this may be sick psychologically, mentally and physically (Claude, 2016). There are several causes that may lead dysthymia in an organization such as leadership style, work culture and the employee itself. The character and the characteristic of a workaholic employee is the one of key factor to dysthymia.

Workaholism is a form addiction because workaholic employees sacrifice themselves for the sake their job. The employees think about their work at home or while doing personal things. Most of the time these employees' talk to their colleague after work regarding

work and go to work or do work at home even though they are ill (Khare, 2012). Furthermore, these employees use their excessive time on working and they also have difficulties disengaging from work which often elicits negative emotions during and after a work episode (Sussman, 2012). Thus, this will result in negative life outcomes, including high perceived stress, low self-esteem, low life satisfaction, difficulties sleeping, career dissatisfaction and poor performance, delay of planned retirement, work “burnout” and ill-health (Sussman, 2012). These consequences are some form illness for the employees that is not good for the well-being of the employee.

Even though workaholism is considered a form illness, but workaholism also bring good impact on the organization. Workaholism may contribute to values like intrinsic motivation and need, united with organizational identification and job satisfaction (van Beek, et.al. 2012). The intrinsic motivation in the organization has been proven to derive employees’ spontaneous satisfaction that will lead to effective performance Gagné & Deci, (2005). Meanwhile sense of organizational identification easily be a part workaholic employees because in their cognizance, the workplace is everything in their life so the vision of the organization becomes their personal vision (Van Knippenberg et.al. 2006). By achieving the vision of the organization indirectly bring job satisfaction.

## **BACKGROUND**

The concept of workaholism was described as high on work involvement, high on work drive, and low on work enjoyment (Spence and Robbins 1992). Meanwhile Flowers and Robinson, (2002) describe workaholism as “overindulgence in and pre- occupation with work. Other than that workaholism is also described as the compulsive job involvement that have a positive and negative impact in oneself (Sussman, 2012; Gorgievski, 2010; Naughton, 1987). Besides that workaholism is also associated with work perfectionism and achievement-oriented that lead to relentless, bulimic, attention deficit, and savouring (2000). Snir and Harpaz (2004) added that workaholism related to the amount of time dedicated to physical and mental activities related to work. Even though numerous researchers describe the workaholism variously, but the conclusion is workaholism is over worked employee who spent amount less time to his work blindly that causes chaos in personal life and health.

When it comes to measuring the workaholism, there are several sets of questionnaire that were used. Spence and Robbins (1992) introduce Workaholism Battery (WorkBat) that consists of three facets which are work involvement, work drive and enjoyment. Whilst Robinson (1989) focuses his research on Work Addiction Risk Test. For this study Workaholism Analysis Questionnaire (WAQ) was used and the Items were developed based on a literature review of past workaholism research, conducted by one of the research investigators (Shahnaz Aziz et. al., 2013). These items were divided into five construct which are work-life conflict, work perfectionism, work addiction, unpleasantness symptoms and withdrawal symptoms (Shahnaz Aziz et. al., 2013).

### ***Work-life Conflict***

Work-life conflict are also known as work-life imbalance, and work-family balance. Nowadays, work-life conflict have become a hot topic in most organizations and become major challenges for the employees. Greenhaus defines work-life conflict as “the extent to which an individual is equally engaged in and equally satisfied with his or her work role and family role” (Greenhaus, et.al, 2003). Kirchmeyer defined work-life conflict as the same partition of time, energy, and commitment across all life zones in order to achieve satisfaction with these domains (Kirchmeyer, 2000). Work-life conflict occur when exposure at work interfere with person life and affect his work life such as job stress, inflexible working hours and role oppress. The researcher also found that there are many aspects affecting the work-life conflict of a person such as organizational factors, family-related factors and individual contrast (Eby, et. al, 2005). Employees also have gained concern in enhancing their work-life imbalance due to annulling outcomes that affect their lives. Work-life conflict occur when a person does not know when to deal with their life and work problem.

### ***Work Perfectionism***

Another construct of workaholism is working perfectly and it is defined as the employee target to finish the work without any error or perfect in every angle (Gorgievski, Bakker, & Schaufeli, 2010). Workaholics person that derives work, perfectionism are only pertains to the effort to execute tasks with high quality. They were found to have the highest scores in perfectionism toward themselves (Spence and Robbins 1992). Due to perfectionism, it will create difficulties for their co-workers, suffer from perfectionism,

inflexible, and do not delegate. They think that other people may not do it as their expectation and keep it for them to finish it. If the work did not finish perfectly as their expectation, they maybe will stress out and become out of control. They also have issues with work, delegating in which they cannot delegate work to others found positive relationship between workaholism and making unrealistic high standard that they consider it to be a aspect in workaholism. Making an unrealistic high standard may end in elevation performance of oneself thus enhancing greater force to work, and thus workaholism (Clark, Lelchook, & Taylor, 2010).

### ***Work Addiction***

Meanwhile work addiction is related to working excessive hours and this can be seen when an employee enjoy their work on weekends rather than spending time with their family (Shahnaz Aziz et. al., 2013). Porter (2004) distinguishes two motivations for long hours of work, both of which could have different moderating effects. A person can work long hours because of the joy in their work. This is a constructive, highly committed achievement oriented style. A person can also put in the long hours in a compulsive, perfectionist fashion, driven to achieve perfectionistic standards. Besides that these employees think about their work constantly even though when they are not at workplace (Shahnaz Aziz et. al., 2013). They are not able to control themselves when it comes with job related task. The emotion get disturbed when they get frustrated with their work. For them work is their life and life is their work. This addiction can benefit the organization but at the same it can be chaotic to the organizational if the employee conditioned worsen it may lead to depression (Porter, 2004). The organization may lose a valuable staff due to depression.

### ***Unpleasantness symptoms***

Unpleasant feeling is one of the symptom or dimension in workaholism. The person who affected with this feeling are usually when their work or task is being held or discontinued. Workaholics are incapable to control their hard work making them to continue work despite the social or health problem, and experience unpleasant withdrawal symptoms when away from work (Shropshire et. al., 2012, Gorgievski et al., 2010). Unpleasant side effects such as physical and mental cravings and marked symptoms of withdrawal (such as headache and sleeplessness) during holidays and time off (McMillan



et. al., 2001). Unpleasant symptoms also can be defined as negative and unpleasant emotions, including rage, hopelessness, tension, sadness, and nervousness (Jenaabadi et. al., 2016). They also will feel unpleasant when at home because their mind kept thinking about the unfinished work at the office. Unpleasantness and work perfectionism are significantly forecast by territoriality psychological ownership (Dirik et. at., 2016). There are also a few questionnaire in the WAQ that are related to the unpleasantness symptoms in workaholism such as “people will describe me as being impatient and always in a hurry”, “I consider myself to be a very aggressive person”, “I get irritated often with others”, and “I have a need for control over others”. All of this are in the WAQ and it shows that these symptoms are common symptoms in workaholism.

### ***Withdrawal symptoms***

Withdrawal symptoms in this context are taking work to home when leaves the office. He/she will bring back all the work that did not finish, getting it done at home. Usually, they will be marked by withdrawal symptoms such as psychological distress and physical pain (Allsop, Carter, & Lenton, 2010). Other than that, withdrawal from family interaction or activities also might happen. They will ignore their family, friends, and all other people around them that they think will distract them from work and only focus on their work all the time. This kind of workaholic will suffer psychological distress and they will intend to ignore everybody in their life. Some of the example of withdrawal symptoms are “I feel worried when not working”, “I feel uncomfortable when I am not working”, “I feel tired or restless when I am not working”, and “I am unable to relax at home due to obsession at work”. With all the symptoms, to escape their negative emotions, they stay mentally engaged in their work and may even “create” extra work during their hours off (Schaufeli,et. al , 2009;Van Wijhe, 2012). In other words, they spend more time on work related activities than regular daily activities. Usually, this kind of people will lock themselves in a room and work alone. They don’t want any partner, as they do not trust them to finish the work.

### ***Research Objectives***

The main aim of the present study is to conduct a comprehensive examination of reliability and validity of workaholism scales in Malaysian school context from the standing points of teachers. First, the convergent and discriminant validity of the scale



will be assessed. Following this, the subscale reliabilities and intercorrelations will be determined. Besides that the research also will explore level workaholism among teachers in Malaysia.

## RESEARCH METHODOLOGY

### *Data collection*

The data were collected from 167 teachers who are currently teaching the secondary in Malaysia. The questionnaire were uploaded in the website and the selected teachers access the website and answer the questionnaire. Convenience non-probability sampling technique were used whereas the teachers were contact through social media. The criteria for choosing the sample are teachers with more than 2 years experience and not involve administrative post. Actually 300 teachers were identified but the respond was only 167.

## FINDINGS

Before doing detail analysis, the Cronbach Alpha values for the instrument is 0.89. The foremost measure in analysing convergent validity, the data were analysed of the measurement model using a confirmatory factor analysis (CFA) to verify the fit of all the scales. The findings from Table 1 indicated a good model fit ( $\chi^2 = 90.382$ , degree of freedom = 80, GFI = .907, AGFI = .860, NFI = .803, CFI = .971, and RMSEA = .033). Furthermore the loading estimates ranged from .40 to .86 which signify convergent validity was high. The results indicated that model adaptability was good.

Composite reliability (CR) and average variance extracted (AVE) were calculated from model estimates using formulas developed by Fornell and Larcker (1981). AVE and CR should be equal to or greater than .50 and .60, respectively (Boagozzi & Yi, 1988). According to Hair et al, (2010) if all ASV and MSV values are less than their respective AVE values, as displayed in Table 1, the measure of discriminant validity is achieved since all the construct met this requirement.

**Table 1: Factor Loadings of Indicators**

Construct	Indicators	Factor loadings	AVE	MSV	ASV	CR
Work-life Conflict (CON)	C3	.82	.553	.211	.077	.787
	C4	.75				
	C10	.66				
Work Perfectionism (PER)	P2	.54	.529	.287	.137	.573
	P3	.55				
	P4	.76				
Work Addiction (ADD)	A1	.40	.599	.466	.137	.549
	A2	.51				
	A3	.69				
Unpleasantness symptoms (UNP)	U1	.86	.527	.287	.126	.678
	U2	.50				
	U3	.54				
Withdrawal symptoms (WD)	W1	.80	.574	.466	.154	.726
	W2	.68				
	W3	.56				

Discriminant validity of the scale was also tested to determine the extent of distinctness for each construct (Fornell & Larcker, 1981). Table 2 shows the correlations among the construct (ranged from -.09 to .46), which is smaller than the square roots of the AVE. Thus this results confirmed of discriminant validity of workaholism scale.

**Table 2: Intercorrelation between Constructs**

		1	2	3	4	5
1	Work Addiction	(.547)				
2	Work-life Conflict	-.088	(.744)			
3	Withdrawal symptoms	.38**	-.15**	(.689)		
4	Unpleasantness symptoms	.25**	.22**	.29**	(.654)	
5	Work Perfectionism	-.09	.45**	.20**	.43**	(.573)

**Table 3: Comparison Mean and Standard Deviation between Construct**

Dimensions	FEMALE		MALE		OVERALL	
	Mean	SD	Mean	SD	Mean	SD
Work-life Conflict	2.83	.69	2.84	.85	2.84	.84
Work Perfectionism	3.05	.69	3.22	.75	3.10	.71

Work Addiction	2.78	.69	3.02	.65	3.06	.71
Unpleasantness Symptoms	2.04	.63	2.06	.63	2.58	.68
Withdrawal Symptoms	2.45	.65	2.81	.67	2.58	.68
Workaholism Overall	2.63	.45	2.80	.46	2.69	.46

**Table 4: Percentage of Workaholism among Teachers According to Construct**

<b>Dimensions</b>	<b>% Low</b>	<b>% Mediocre</b>	<b>% High</b>
Work-life Conflict	12	59	47
Work Perfectionism	4	55	41
Work Addiction	2	85	33
Unpleasantness Symptoms	41	75	4
Withdrawal Symptoms	11	91	15
<b>Overall</b>	<b>14</b>	<b>73</b>	<b>28</b>

In attempt to find the level of workaholism among Malaysian Teachers in Table 3 reveals that overall the first construct work-life conflict is at mediocre level ( $M= 2.84$ ,  $SD = .84$ ), second construct work perfectionism is at mediocre level ( $M= 3.10$ ,  $SD = .71$ ), work addiction is at mediocre level ( $M= 2.84$ ,  $SD = .84$ ), unpleasantness symptoms is at mediocre level ( $M= 2.58$ ,  $SD = .68$ ), withdrawal symptoms is at mediocre level ( $M= 2.29$ ,  $SD = .68$ ) and overall workaholism is at mediocre level ( $M= 2.84$ ,  $SD = .84$ ). Meanwhile, Table 4, shows that the overall the percentage of workaholism is mediocre and high.

## **DISCUSSION AND IMPLICATIONS**

The results of the CFA of the scale provide adequate evidence of validity of the Malaysian school setting workaholism scale. All the item loaded on their hypothesized factors, accounted for substantial proportion of variance in their indicators. Taken together, these findings demonstrate that the scale poses an adequate level of convergent and discriminant validity. Empirically this findings shows workaholism scale from teachers' standings point showed that appear to measure what it claims to be measuring. Hence conclusively, the results indicate that the workaholism scale was reasonability reliable and valid from the setting of the Malaysian teachers. Meanwhile, the findings

based on the level indicates that most of the teachers in Malaysia often to be interfered by their teaching profession which leads to work-life conflict. These teachers seem to miss out on important personal activities because of work demands that also contribute to work-life conflict. Besides that work-life conflict also resulted in the stress among the teachers and these factors causing work-related insomnia. The work perfectionism is also at the mediocre and high level, which means teachers are often obsessed about goals or achievements at work. The teachers seem to take a long time to finish their work because the work should be perfect. Due to that, teachers feel anxious or nervous about their work. The next construct, work addiction shows that teachers works 60 hours or more per week in and off schools. This indicates that teachers in constantly think and talk about work even during their free time and it seems like they are addicted to their work. Whereas unpleasantness symptoms, seems to mediocre level and this some teachers are always in a hurry to achieve something or very impatient with their work which leads them to an aggressive person. Because of this condition some teachers get irritated with their students and always control them. They also act aggressively if the students cannot control which may lead to violence. The workaholic teachers seem to have the withdrawal symptoms and the is shown when they are unable to relax at home due to preoccupation at work.

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**THIS RESEARCH IS FUNDED BY “TPLN” UNIVERSITI SAINS MALAYSIA**

## **MASLAHAH AS MEASURES FOR ISLAMIC SOCIAL ENTERPRISE PERFORMANCE**

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### **ABSTRACT**

*The Islamic social enterprise research is still in its infancy. Majority of the studies focused on qualitative approach aiming for conceptual framework development. Measures on the performance is a gap in this area. Thus, this study aims to investigate the determinants of islamic social enterprise performance conceptualise as maslahah or welfare of the ummah. Based on literature, maslahah is formulated on four dimensions namely education, employment, dakwah and sadaqah perform by the islamic social enterprises for the ummah. A total of 298 samples are collected from the islamic social enterprises in peninsula malaysia to develop and establish maslahah. Employing the generic firm performance framework, inclusive firm characteristic (size and age), owner/structure characteristic (education and experience of the managers) and firms' strategies (entrepreneurial orientation and enterprise resources) as determinant predictors of maslahah model. Data are analysed using partial least square (pls). The findings indicate that age, size of the firm, education and experience of the managers while innovativeness, pro-activeness and autonomy of the entrepreneurial orientation and financial and physical factors of the enterprise resources all has a significant prediction effect on maslahah. This study confirmed that maslahah is a significant empirical measures of the islamic social enterprise performance.*

**Keywords:** *Islamic Social Enterprise, Maslahah, Social Performance, Entrepreneurial Orientation, Islamic Entrepreneurship*

## INTRODUCTION

Social entrepreneurship emerged from the third sector economy, has been the concern over the past decades as a way of transformative societal change. Social enterprises must adhere to both social and financial goals for performance achievements. Typically, the main aim is to benefit a specific group of people, permanently transforming their lives to a better living standards (Chell, 2007). The third sector economics put the society as the provider and the recipient of economic development for the wellbeing of the people. The Islamic social entrepreneurship (ISE) is an emerging area of interest in academic research. The Islamic social enterprises apply the *Shari'ah* principles as the base for doing business and social activities in achieving the two pronged goals, the enterprise and social wellbeing (*maslahah*). The Islamic concept on *maslahah* is inclusive the values of worldly life and hereafter (Dusuki, 2008; Adib et al., 2014). Most studies of ISE focusing on providing justifications for doing business from the principles and perspectives of al- Qur'an and *Sunnah*. As a result, many evidences and justifications for Islamic social entrepreneurship are derived to support the legitimacy of Islamic social entrepreneurship and its practicability among Muslim entrepreneurs (Sarif et al., 2013).

### Research Objectives

The main aim of the study is to develop the Islamic Social Enterprise (ISE) social performance measures. This social performance measure is conceptualised as *maslahah* (wellbeing) that may be accepted as one of the Islamic Social Entrepreneurship thrust and principles. The specific objectives of the study are:

1. To develop measures of ISE social performance called *maslahah*.
2. To determine the impact of *maslahah* to the ISE performance.

## LITERATURE REVIEW

Studies that attempt to measure the performance of Islamic social enterprise are limited, moreover the majority of the available literature focuses on the conventional



measurement such as the use of financial and non-financial indicators (Alaarj et al., 2016). Bagnoli and Megali (2011) developed a performance measurement for social enterprises based on three dimensions, namely (i) economic-financial performance linked to the determination of general performance (profits, value added and growth), analytic results (production-cost of services, efficiency indicators); (ii) social effectiveness to measure the quantity and quality of work undertaken and also to identify its impact on the intended beneficiaries and the community; and (iii) institutional legitimacy verifying conformity with law and mission statement. Lack of religiosity dimensions in previous work is a gap to be identified and extended. *Al-falah* is developed as a performance measure for Islamic enterprises only (Wahab & Rafiki, 2014; Rafiki & Wahab, 2013; Wahab & Olugbola, 2015). The basic concept of Islamic entrepreneurship stands on mutual relationship, altruism and goodwill, grounded in the principles of unity (tauhid), trusteeship (*khalifah*) and worship (*ibadah*) supported by *nas* (Noruzi, 2011). The Islamic Social Enterprise extends the concept of entrepreneurship to the objectives of social justice and public interest (Al-Alak & Eletter, 2010). Ultimately the goal of ISE is the well-being of the people or *maslahah*.

***Developing Maslahah as measurement of ISE performance.***

Prior literatures on the measurement of social enterprise performance revealed no consensus among the researchers on the appropriate measures of business performance. Thus, Social enterprises need to start measuring their performances in a systemic way, in order to achieve their objectives and ensure accountability towards their stakeholders. For the Islamic social enterprise the elements of religiosity have to be inclusive in the performance measures.

Maqasid *shariah* or the higher objective of *shariah* is viewed by the contemporary Muslim scholars as an alternative tool to emphasize on issues relating to social and economic. Three fundamental principles of *maqasid shariah* are *tawhid* (unity), *khalifah* (vicegerence) and *adalah* (justice) stand as the underpinning soles on the benefits to individual and society at large. Its laws are designed to protect these benefits and to facilitate the improvement of the human life conditions (Kamali, 2012).

The Islamic social enterprise mechanism is based on the guidelines provided by Shariah. The Shariah principles are more than law; it covers the total way of life that includes faith and practices, personal behaviour, legal and social transactions, for a total way of life. In short, Shariah governs all forms of practical actions, comprising ibadat (the law pertaining to devotional matters) and muamalat (the law pertaining to activity in the political, economic and social spheres). The Qur'an explains the completeness of Shariah through the verse below;

*{This day I have perfected your religion for you, completed My favour upon you, and have chosen for you Islam as your religion} [Al-Maa'idah:3]*

This, indeed, is the biggest favour from Allah to the Ummah, for He has completed their religion for them, thus, do not need any other religion or any other Prophet except Muhammad (pbuh). The values as prevailed within the realm of *shariah* are expresses in the details of its transaction together with its role in society. This demands the internalization of *shariah* principles on ISE transactions, in its form, spirit and substance. By so doing, it epitomized the objectives of *shariah* in promoting economic and social justice. In order to full-fill the *shariah* objective of promoting the wellbeing of society, ISE are expected to consciously align their decisions and actions so that these are regarded as socially responsible deeds (Ab Aziz, 2013).

The *shariah* in all of its parts aims at securing a benefit to the mankind and protecting them against harm and evil. This suggested that the fundamental value and objective of *shariah* is the realization of the *maslahah*, or public interest. It is important to highlight that *maslahah* sometimes has the same connotations as *maqasid*, and at times scholars have used the two terms interchangeably (Aris et, al., 2013). Many scholars have agreed that the ultimate objective of *maqasid shariah* is to serve the interests of all human beings and to save them from harm both in this world and the hereafter.

*Maqasid shariah* reflects the holistic view of Islam, which has to be looked at as a whole. It is considered to be the cornerstone or the guiding principle of ISE. The five main goals of *maqasid shariah* are protection of the religion (*din*), intellect (education), offspring (family), life (wellbeing) and property (wealth). Applying the goals and tenets of *maqasid*

*shariah* in ISE measures is considered relevant for social and economic welfare performance measures.

Al-Ghazali (1973) in his concept of *maslahah*, describes it as the preservation of the ends of the *shariah*, that is, the preservation of its objectives. *Maslahah* concept is very relative to the moral economy because it seeks to establish justice, eliminate prejudice and alleviate hardship, cooperation and mutual support within the society, realization of public interest, public benefits and prevent social evils or corruption, securing the benefit and repelling harm (Dusuki, 2010).

*Maslahah* aims at providing services to weaker sections of the population who because of various handicaps such as physical, mental, economic and social, are unable to make use of social services provided by society or have been traditionally deprived of these services (Bharadwaj, Clark and Kulviwat, 2005). The provision of social welfare includes services for children, youth, women, aged, scheduled tribes, other backward classes, minorities, disabled, drug addicts, and economically underprivileged such as destitute and unemployed.

Based on the above discussion this study shed light on the prospects of *maslahah* in social and economic wellbeing and develop *maslahah* as measurements of performance of Islamic social enterprise. The *maslahah* (social performance) dimensions could be conceptualised into four dimensions, namely (i) Education (ii) Employment (iii) *Dakwah* (iv) Donation (*Sadaqah*).

### ***Education***

A vital necessity to perform well at work is *ilm* or knowledge. Islam essentially emphasises knowledge a highly valuable entity. Learning is a never ending process that also includes various training activities. Imparting *ilm* includes knowledge, skills and attitudes (Hassi 2012). The history of Islamic civilisation has narrated the many types of training and knowledge-seeking activities which were the preoccupation of believers in the past. During the Prophet's lifetime for instance, *Dar Al Arqam* served as a robust centre of learning. Individuals and the society at large not only benefit by attaining theoretical knowledge out of the training provided by Islamic tradition, but are also embed with the vitality of practical wisdom on training activities. It has, for one, calls for

the development of concrete actions and behaviours based on the translation of theoretical insights.

It is without reservation that a society is able to prosper when its population is imbued with knowledge through proper education. Societal legacies and values are able to be transmitted through generations as an outcome of this practice (Hashim, 2010). Islam values education highly since Allah says in the Holy Quran:

*“O my Lord! Increase me in knowledge” ( Quran, Taha, 20:144).*

Similarly, Muhammad (pbuh) said:

*“He whom death overtakes while he is engaged in acquiring knowledge with a view to reviving Islam with the help of it, there will be only one degree between him and the Prophets in Paradise”*

[Al-Tirmidhi] Hadith no. 249. Narrated by Al-Hasan al-Basri]

Several Islamic concepts can be directly related to training and professional development. The concept of *Etqan*, consciousness of self-improvement, refers to the ongoing struggle within oneself for self-betterment in efforts to accomplish better work according to Branine and Pollard (2006). The latter contend that this virtue linked to a state of passion for excellence and perfection, namely, *Al Falah* (success). Because of these values, the desire to excel in personal and professional matters constitutes an ideal for Muslims. This implies that workers are required to always do better and improve the quality of their contribution and work outcomes by means of learning new skills and acquiring new knowledge. Islamic social enterprise contribute to society by providing training (not yet employed) and career development training (employed participants).

At the onset, *masajid* (mosques) served as educational institutions where learners acquired basic reading and writing skills and then gradually shifted to madrasas, forms of learning centres (Akdere et al., 2006). Later, mosques were devoted to religious thought whereas teaching institutions emphasized other topics and areas of study (Al-Rawi, 1993). These institutions became universities in major Islamic urban centres such as Fez, Cordoba, Tunis, Cairo, Baghdad, Damascus and Jerusalem to name a few.

Based on this discussion, it can be seen the importance of education as the fundamental variable in the Islamic social enterprise performance measures.

### ***Employment***

*Maslahah* aims at providing services to weaker sections of the population who because of various handicaps such as physical, mental, economic and social, are unable to make use of social services provided by society or have been traditionally deprived of these services (Bharadwaj, Clark and Kulviwat, 2005). The shari'ah recognises various rights of persons with disabilities. The Prophet's behaviour toward disabled people is an example par excellence to be followed. Abdullah ibn Umm Maktum was blind, but the Prophet (pbuh), designated him as the Leader of Madinah many times in his absence. As far as the Prophet was concerned, Abdullah ibn Umm Maktoum's blindness was not a hindrance in his ability to carry out his duties (Yaqut, 2007). Some Islamic jurists consider the disabled to be capable of exercising their political rights on an equal basis with others (Bulliet et al., 2013). They also have the right to participate in as many aspects of the community's life as possible.

Evidences of gender equality in the principal religious texts of Islam, the Quran and Hadith (traditions of the Prophet Muhammad) are observed. The Quran declares the creation of opposite genders as a part of divine scheme, and a matter of reflection.

*"And of all things We created two mates; perhaps you will remember"*

*(Adh-Dhariyat 51:49)*

*"Exalted is He who created all pairs - from what the earth grows and from themselves and from that which they do not know"*

*(Ya-Sin36:36)*

Furthermore, people will be rewarded of their good deeds regardless of their gender. Stated in the Quran:

*"Whoever does righteousness, whether male or female, while he is a believer - We will surely cause him to live a good life, and We will surely give them their reward [in the Hereafter] according to the best of what they used to do."*

(An-Nahl 16:97)

The Quran promotes the idea of equal partnership between men and women.

*“If any do deeds of righteousness, be they male or female, and have faith, they will enter paradise and not the least injustice will be done to them”*

(An-  
Nisaa4:124).

Aside from that, men and women possess equal rights for work and compensation. Badawi (1971) has argued over the role of a woman in that, Islam regards her role in society as a mother and a wife as the most sacred and essential. Nevertheless, Badawi also admitted that no Islamic jurisdiction has prohibited women from acquiring employment, especially in positions which fit women nature and in which society needs the most such as teaching, nursing and hospitality.

Small medium enterprises are one of the biggest employers in the business world. Based on the above, it can be seen that social *maslahah* includes the employment of all Muslims and the disabled in particular. Also included is equality between the opposite genders

Small medium enterprises (SME) are one of the biggest employers in the business worlds. Since ISE are mostly SME in nature, thus employment is inclusive as a variable in *maslahah* performance measures.

### ***Dakwah***

In the Qur'an, Allah SWT has directed to:

*Invite to the way of your Lord with wisdom and good instruction, and argue with them in a way that is best. Indeed, your Lord is most knowing of who has strayed from His way, and He is most knowing of who is [rightly] guided.” (An-Nahl.16:125)*

Based on an innate desire to assist a fellow human being to seek the truth, a Muslim should therefore abandon any ulterior motive and pride and instead purify his intention to obey the commands of Allah. *Dakwah* involves words, actions, and anything that may help an individual to be closer to Allah in mind and spirit.

A generic term for any revival or missionary activity be it among Muslims or non-Muslims, *dakwah* in its literal sense means a "call" or "invitation". *Dakwah* is an obligation for all Muslims which is continuous and ongoing. It is expected for Muslims to identify the chance for propagating and renewing the faith. In essence, *dakwah* is as old as the religion of Islam itself. Nevertheless, some eras in the Islamic history have paid more attention on the matter of *dakwah* for some significant reasons. The contemporary form of *dakwah* mainly focuses on the existing Muslim population. It seeks to revive flagging followers' commitment to the religion (Nagata, 1980).

*Dakwah* also serves as awareness towards the religion. In Islam, this pertains seeking for a deeper comprehension of the Islamic way of life as suggested in the Quran. In Malaysia many private institutions offer rote learning and *hafazan* or verbal recitations also with full comprehension of the Quranic words (*tadabbur*). In contrast to the traditional manner of instruction which emphasises formality, total teacher authority and discouragement of inquisitiveness, the modern *dakwah* encourages debates, asking questions as well as guides who are authoritatively satisfactory. Nagata (1980) further classified the followers of *dakwah* into several ranks. They consisted of middle-class youths and the urban, western- or higher-educated individuals. Furthermore, a small number of groups organised at the national level has successfully organised activities of *dakwah* in Malaysia.

The *dakwah* activity with the greatest impact in Malaysia today is spearheaded by a small number of nationally-organised groups, whose core membership lies in the urban centres and among the more educated sectors of society Nagata, (1980). *Dakwah* in Islam is an orientation towards the tauhidic (oneness of Allah) spirits and goals. Thus, Islamic social enterprises contribute for deeper commitment of the ummah to Islamic way of life based on the Quran and its application to everyday life.

The dimension of propagation deals with *dakwah*. As social enterprises working within the Islamic principles and *shariah*, the message of community wellbeing should be extensively propagated. There should be an increased awareness of the evolving understanding of what it means to work with communities among organisations and the surrounding population. A direct and automatic task of the Islamic social enterprise is relaying the message of Allah and His Prophet (pbuh) through words, deeds and actions, whether visible or indirect.

Dakwah in Islam is an orientation towards the *tauhidic* (oneness of Allah) spirits and goals. Thus, Islamic social enterprise contribute for deeper commitment of the *ummah* to Islamic way of life based on the Quran and its application to everyday life. Thus, *dakwah* is chosen as one of *maslahan* measures.

### **Sadaqah (Donation)**

Islam highly encourages charity to those in needs and less ability in work through *sadaqah* and benevolent loans (Qardul Hasan). Sadaqah signify donation to charity and required that both voluntary donations as charitable contributions.

*“So fear Allah as much as ye can; listen and obey and spend in charity for the benefit of your own soul and those saved from the covetousness of their own souls,-they are the ones that achieve prosperity” (Qur’an, At-Taghabun,: 16)*

In a broader prospective, social entrepreneurship is related to charity work. According to Shaw and Carter (2007), the non- profit sector is differentiated for being vibrant and receptive. However, as the global perspective, the non-profit sector is treated as an imperative entrepreneur, as well as the voice for civil society, which generates a pioneering direction for tackling disparity and deficiency (Davis, 2012; Peredo & McLean, 2006). From Islamic perspective, Allah (SWT) in the holy Qur’an has instructed the mankind to do charity for the poor.

*“Ye will not attain unto piety until ye spend of that which ye love. And whatsoever ye spend, Allah is Aware thereof.” (Al-Im'rān, 3:92).*

Helping the poor has been emphasized in Islam too. The Prophet Muhammad (PBUH) said:

*“A Muslim is the brother of a Muslim. He neither oppresses him nor humiliates him nor looks down upon him. The piety is here, (and while saying so) he pointed towards his chest thrice. It is a serious evil for a Muslim that he should look down upon his brother Muslim. All things of a Muslim are inviolable for his brother in faith; his blood, his wealth and his honour.” (Sahih Muslim Book 31, Number 6219).*

This *Hadith* encourages Muslims to be charitable (*ihsan*) with the community, and Allah promises Paradise as the reward.



The *Hadith* describes the responsibility of Muslim to help others through charitable contributions and donations and stinginess is abomination in Islam.

*“When a human being dies, his work for God comes to an end except for three: a lasting charity, knowledge that benefits others, and a good child who calls on God for His favour.”* (Al-Tirmidhi, Hadith 1376)

Based on above discussion Islamic social entrepreneurship is related to welfare work for *maslahah* objectives. It is the responsibility of every Muslim to contribute in any way to help the needy and the marginalized. As stated in the Quran

*The believers are but brothers, so make reconciliation between your brothers and fear Allah that you may receive mercy.*

*Surat al-Hujurat 49:10*

Brotherhood in Islam is a comprehensive concept that is based upon good character with others, treating others the way we want to be treated, and uniting together upon common values. The strongest level of brotherhood is the sense of community, friendship, and common purpose in Islam for the sake of Allah. At this level, the believers work together towards fulfilling the goals of the *shariah* and living out its divine values. The spirit of brotherhood is the motivation for achieving *maslahah*.

Table 1: *Maslahah* Dimensions as Measures of Islamic Social Enterprise Performance

<b>Dimensions</b>	<b>Reference</b>	<b>Naz</b>
<b>Education and Training</b> The firm provides training on employability (MAS4) Special training on professionalism (MAS5) Provide training on Small Business Creation (MAS2)	(Fatoohi, 2009, Hashim, 2010, Ali, 2005, Akdere et al., 2006, Al-Rawi, 1993)	Quran: “O my Lord! Increase me in knowledge” (20:144),
<b>Employment</b> ISE employs Muslim with disabilities (MAS7).	(Bharadwaj, Clark and Kulviwat, 2005, Yaqut, 2007, Bulliet et al., 2013: 476, Badawi (1971),	Qur’an: 51:49; 36:36; 16:97; 2:187; 24:30–31; 4:124; 3:195; (Abu-Hanifa and Al-

ISE employs single mothers (MAS8) ISE provides job opportunities (MAS9).		Tabary,
<b>Sadaqah (Donation)</b> ISE gives <i>sadaqah</i> to the needy (MAS1) ISE collects <i>sadaqah</i> (MAS3)	Shaw and Carter (2007), Davis, 2012; Peredo & McLean, 2006,	<i>Qur'an</i> , 64: 16; Al-Im'rān, 3:92; Sahih Muslim Book 31, Number 6219; Al-Tirmidhi, Hadith 1376
<b>Dakwah</b> ISE organise dakwah activities to Muslim and non-Muslim (MAS10) Dakwah to specific focus group (MAS6)	Nagata, (1980)	Quran: 16:125

### ***Testing the Maslahah Construct***

The *maslahah* measures are in the range of statement of Likert scale from 1 (strongly disagree) and 5 (strongly agree). Prior measuring with multiple regression method, the factor analysis as well as the reliability and validity of the instrument has been tested. The reliability test results for maslahah construct are depicted in Table 2 below.

Table 2 : Reliability Test of Maslahah Construct

Constructs	Item	Loading (> 0.5)	M	SD	$\alpha$ (> 0.7)	CR (> 0.7)	AVE (> 0.5)
Maslahah (MAS)	MAS1	0.810					
	MAS2	0.821					
	MAS3	Deleted					
	MAS4	0.846	3.421	0.789	0.872	0.906	0.619
	MAS5	Deleted					
	MAS6	Deleted					
	MAS7	Deleted					

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MAS8	0.816
MAS9	0.837
MAS10	0.552

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Note: M=Mean; SD=Standard Deviation,  $\alpha$ = Cronbach's alpha; CR = Composite Reliability, AVE = Average Variance Extracted

The measurement used is five-point scale ranging from 1 (strongly disagree) to 5 (strongly agree), only actual usage used 5 ranking scale.

All the factor loadings of the individual items are statistically significant ( $> 0.5$ ) except for the items MAS3, MAS5, MAS6 and MAS7 which eliminated from the scale due to low loadings.

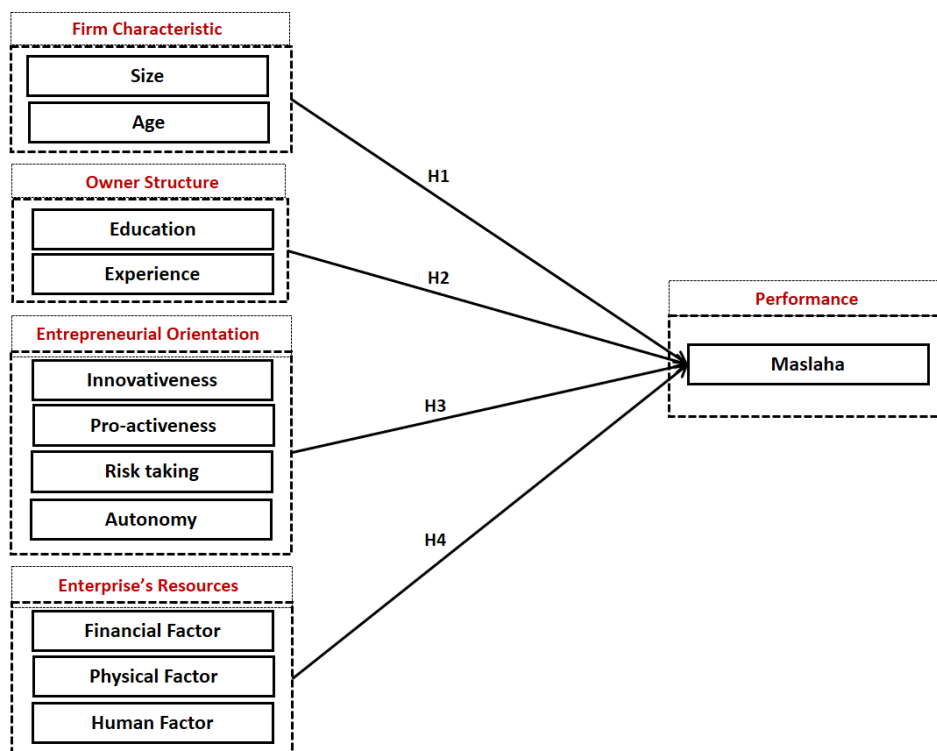
### **ISLAMIC SOCIAL ENTERPRISE PERFORMANCE CONCEPTUAL FRAMEWORK**

Storey's enterprise performance model comprises of three factors, namely the characteristics of the owner/manager, the characteristics of the enterprise and the strategies deploy by the enterprise (Storey, 1994). Abdul Kadir and Sarif (2015) study on the sustainability of Islamic social enterprise found out that enterprise resources namely finance, human, and physical capitals contribute to the survival of the enterprise. This study develop the ISE performance framework by adapting Storey (1994) and Abdul Kadir and Sarif (2015) work as shown on Figure 1. The ISE performance model consists of four constructs; (i) the enterprise owner/manager characteristics, (ii) the enterprise characteristics, (iii) the strategies deployed, (iv) the enterprise resources.

Based on the above discussion, the conceptual model of this study consists of four main constructs as its independent variables. The first construct is firm characteristic, which consists of two sub-constructs such that include firm age and firm size. Owner/manager structure as second construct which consist of two sub-construct like experience and education of owner/manager. Enterprises resource, as the third construct, consists of three sub-constructs, and they are financial factor, physical factor, and human factor. The last independent construct is entrepreneurial orientation, consisting of innovativeness, pro-activeness, risk-taking, and autonomy.

The dependent variable of this study is the performance of Islamic social entrepreneurship, which referred to in this paper as Maslahah. Figure 1 presents the conceptual model of the present study.

**Figure 1: Islamic Social Enterprise Performance Conceptual Model**



***Firm Characteristic***

A firm’s demographic characteristics are those properties traditionally encountered in empirical studies of firm growth, which include the size of the firm (Storey, 1994), the age of the firm (Evans, 1987; Storey, 1994), its legal form (Reynolds and Miller, 1988), and its sector (Cooper et al., 1994)

***Firm size***

Relation to firm size, the general pattern is that smaller firms grow more rapidly than large ones (Storey, 1994; Delmar and Wiklund, 2008). Islam et al., (2011) found that enterprise size significantly linked to better business performance. Larger

enterprises were found to have a higher level of success. Several studies have pointed out the influence of the size of a firm on its performance (Robins and Wiersema, 1995; Ramaswamy, 2001; Frank and Goyal, 2003; Ebaid, 2009; Mishra and Suar, 2010; Salim and Yadav, 2012); that is, a larger firm may have a larger capacity and more capabilities. Firm size indicates a broad resource base, and is thus positively associated with performance. Therefore, the hypothesis is proposed as follows:

*H1.1. Size has a positive effect on maslaha.*

### ***Firm age***

Length time in operation may be associated with learning curve. Old players most probably have learned much from their experiences than have done by new comers. Kristiansen, Furuholt, & Wahid (2003) found that length time in operation was significantly linked to business success. Firm age determines performance. Young firms, given their newness, typically fail more than their older counterparts. By contrast, older firms are typically more successful than young firms due to their experience, greater reliability and legitimacy, acquisition of learning, and first-mover advantage (McDougall and Oviatt, 1996; Kirca et al., 2011). Firm age is determined by the number of years since the establishment of the firm (Ismail et al., 2013). Gunday et al. (2011) categorized firm age into old (i.e., the firm was founded prior to 1975); moderate (founded between 1975 and 1992); and young (founded in 1992 and later). Accordingly, it is hypothesized:

*H1.2. Age has a positive effect on maslaha.*

### ***Owner/manager structure***

Many empirical studies have tended to focus on the relationship between the structure of the owner/manager and firm performance. The psychological characteristics and “antecedent attributes” of owner-managers, including education and experience, have been associated with performance. The most important resource of a firm is owner-managers, whose commitment to growth is pivotal in shaping performance (Blackburn et al., 2013).

### ***Education***

There is no question as to the fact that basic education enhances the overall quality of the owner/manager by providing him/her with basic numeric and literacy skills, thus increasing the chance of survival (Carter and Jones-Evans, 2000; Storey, 1994). The ability to process information and differentiate alternatives is associated with a higher level of education (Rody and Stearns, 2013). Inmyxai and Takahashi (2009) established a positive correlation between firm performance and the education level of the managers. Chan et al. (2005) suggested a positive relationship between firm performance and the education level of managers. Hence, it is hypothesized as follows:

*H2.1. Education has a positive effect on maslaha.*

### ***Experience***

Studies have generally found that owner/managers with more managerial, sector experience or prior experience as owner/manager tend to correlate with greater growth (Storey et al., 1989). A study carried out by Carter and Jones-Evans, (2000) found that SME owner/managers in the UK with little experience at the start-up phase could have problems remaining solvent with an increase in expenditure in relation to their earnings. Kalleberg and Leicht (1991) in their study found no relationship between prior SME experience and firm growth. Storey (1994) found reasonable evidence indicating a negative relationship between being unemployed before starting a business and subsequent business growth. Managers who have previous experience from other companies tend to bring new knowledge and skills to their current firm. Otherwise known as human capital, this knowledge is an asset that supplements the total resources of the firm. Lin (1998) added that such managers tend to make the most suitable choices at the most appropriate time, generate resources, and accurately interpret market trends, thus improving firm performance. Companies lacking in financial capital can turn to their human capital resources to effect superior performance (Rody and Stearns, 2013). Reuber and Fischer (1999) demonstrates that experientially acquired skills or expertise drive better decisions or actions, thereby enhancing firm performance. Hence, it is hypothesized as follows:

*H2.2. Experience has a positive effect on maslaha.*

### ***Entrepreneurial Orientation***

Entrepreneurial orientation (EO) is described by researchers as the methods, practices, and decision-making styles that are adopted by managers to act as entrepreneurs in order to develop new product or services, to move faster than competitors, and to take bold steps to capture opportunities in the market (Lumpkin & Dess, 1996; Morris et al., 2007). The literature reports mixed findings concerning the effect of entrepreneurial orientation (EO) on performance. Therefore in this study four dimension of EO are investigated.

The first dimension is Innovativeness relates to the tendency of a firm to engage in and to support the development of new ideas, originality, experimentation and creative processes, which leads to novel products and services as well as technological breakthroughs (Lumpkin & Dess, 1996). Following the innovation model developed by Miller and Friesen (1982), organisations can be seen as either conservative or entrepreneurial. An enterprise takes on the entrepreneurial model in disregard to market competitiveness and environmental uncertainty in order to create a competitive advantage over its business rivals.

Pro-activeness is the second dimension of EO and it is an opportunity-seeking, forward-looking perspective characterised by the introduction of new products and services ahead of competition, and acting in anticipation of future demand (Rauch et al., 2004). Pro-activeness is perceived by specialists as a key element in incurring first-mover advantage (Davis, 2007; Miller, 1983). An empirical study reveals the significant effect of pro-activeness on business performance among SMEs in Malaysia (Arshad, Rasli, Arshad & Zain, 2014). Similarly, other studies prove the significant effect of pro-activeness on performance (Schillo, 2011).

The third dimension is the risk-taking which defined as the extent to which a firm is willing to make large and risky commitments (Covin & Slevin, 1991). According to Salwa, Shahbudin and Jusoff (2013), the environment of risk has been described in the Holy Qur'an. For example, disobeying Allah's Dominion or taking bribery for own benefit, things which are prohibited in Islam, can be linked to risk-taking that

relates to the loss of *iman* (faith). Arshad et al.'s (2014) study finds a strong association between risk-taking and the business performance of SMEs in Malaysia.

Autonomy is the fourth dimension and it is defined as an independent action of an individual or a team in ensuring ideas and concepts are being carried out till completion (Lumpkin & Dess, 1996). Lumpkin and Dess (1996) consider autonomy as an essential dimension of the entrepreneurial orientation. In addition, Lumpkin, Cogliser and Schneider (2009) consider the theoretical relevance of autonomy as an important element in enterprise-level entrepreneurial behaviour. The level of autonomy of individuals and teams is associated with the high level of organisational performance measures, such as high knowledge-sharing and innovation (Janz & Prasarnphanich, 2005; Smith, 2001). Thus, for an enterprise to achieve a high level of performance, autonomy should be present at the strategic level. Therefore, it is hypothesized as follows:

*H3.1. Innovativeness has a positive effect on maslaha.*

*H3.2. Pro-activeness has a positive effect on maslaha.*

*H3.3. Risk-taking has a positive effect on maslaha.*

*H3.4. Autonomy has a positive effect on maslaha.*

### ***Enterprise Resources and Performance***

Enterprise resources refer to organisational resources and capabilities that include tangible and intangible resources (Barney, 1991). This study focuses on three types of resources; financial, human, and physical resources.

Financial factor is related to the financial capabilities of an enterprise. According to Abdul Kadir and Sarif (2015), financial factor is related to initial fund and operational fund. Since the enterprise is social and based on Islamic principles, donation can also be incorporated among the financial resources that it obtains, either from government support, corporations, or individuals. Abdul Kadir et al.'s (2015) study reveals that financial factors affect the sustainability of Islamic schools.



Physical factor refers to the assets that an enterprise can deploy in order to achieve better performance. The assets include lands, buildings, machineries, and all other tangible assets that the enterprise own and use to achieve its organisational goals. Abdul Kadir and Sarif (2015) declare that physical factors are related to the sustainability of Islamic schools.

Human factor consists of several human resource elements such as attitude, competency, skill, tacit knowledge, and the innovativeness of the people in an organisation (Barney, 1991). Almost all activities of an enterprise depend on its human factor. Employees and organisational knowledge are part of the human factor in an enterprise. Abdul Kadir and Sarif (2015) highlight that human factor is important for achieving sustainability of the Islamic schools in their study. Previous studies have provided empirical evidence that prove human capital efficiency positively influence various forms of organisational sustainability, i.e. the efficiency of an organisation, the value creation of a firm, competitive advantage, as well as firm performance (e.g. Barney, 1991; O'Donnell et al., 2006; Mertins & Orth, 2011). Consequently, the following hypothesis are proposed:

*H4.1. Financial factor has a positive effect on maslaha.*

*H4.2. Physical factor has a positive effect on maslaha.*

*H4.3. Human factor has a positive effect on maslaha.*

## **RESEARCH METHOD**

The study used hypothetical-deductive approach in answering the research questions. The population of this study is the Islamic social enterprises in Peninsula Malaysia estimated about 1200 organizations. A total of 400 questionnaires are distributed, but only 298 are usable (74.5% response rates). For a population  $N=1200$  ; the sample size  $S=291$  suggested by Sekaran (2016). The unit of the analysis is at the firm levels. The respondents are the managers of the organizations. Data are collected by snowballing and purposive techniques. The instrument used is the questionnaire that has been validated by peers, experts and a pilot study to check its validity and reliability. Data are analyzed using Partial Least Squares (PLS) SmartPLS 3.0 (Ringle, Wende, & Becker, 2015). A

descriptive analysis as well as the measurement model and the structural model are conducted. Sources and number of items of each variables are shown in Table 2 below.

Table 2: Source of Measurement and Reliability of Pilot Testing

Construct / Variable(s)	No. of Items	Cronbach's Alpha	Source(s)
Education	1	Not applicable	Rody and Stearns (2013)
Experience	1	Not applicable	Rody and Stearns (2013)
Firm size	1	Not applicable	Mishra and Suar (2010)
Firm age	1	Not applicable	Ismail et al. (2013)
Financial factor	5	0.919	Abdul Kadir et al. (2015)
Physical factor	4	0.911	Abdul Kadir et al. (2015)
Human factor	4	0.906	Abdul Kadir et al. (2015); Yusof et al. (2013)
Innovativeness	8	0.875	Lumpkin et al. (2013)
Pro-activeness	8	0.859	Lumpkin et al. (2013)
Risk taking	5	0.823	Lumpkin et al. (2013)
Autonomy	5	0.967	Lumpkin et al. (2013)
Social performance (Maslahah)	10	0.865	Self-developed supported by literatures

### *Descriptive analysis*

Table 3 presents the mean and standard deviation of each variable in the current study. *Maslahah* recorded the highest mean score of 3.421 out of 5.0, with a standard deviation of 0.789, indicating that the respondents agreed that the firm contributes to the wellbeing of the ummah. Human factor recorded the lowest mean score of 3.07 out of 5.0, with a standard deviation of 0.947.

### *Measurement Model Assessment*

The assessment of measurement model was done through construct reliability as well as validity (including convergent and discriminant validity). For *Construct reliability*, this study tested the individual *Cronbach's alpha* coefficients to measure the reliability of each of the core variables in the measurement model. The results indicate that all the individual Cronbach's alpha coefficients ranging from 0.872 to 0.942 were higher than the suggested value of 0.7 (Kannana & Tan, 2005; Nunnally & Bernstein, 1994). Additionally, for testing construct reliability all the *composite reliability* (CR) values ranging from 0.906 to 0.956 were higher than 0.7 (Werts, Linn, & Jöreskog, 1974;

Kline, 2010; Gefen, Straub, & Boudreau, 2000), which adequately indicates that construct reliability is fulfilled as shown in Table 2. Therefore, the achieved Cronbach's Alpha and CR for all constructs were considered to be sufficiently error-free.

Factor loading was used to test *indicator reliability*. High loadings on a construct indicate that the associated indicators seem to have much in common, which is captured by the construct (Hair et al., 2017). Factor loadings greater than 0.50 were considered to be very significant (Hair et al., 2010). The loadings for all items exceeded the recommended value of 0.5 as shown in Table 2 except for the items INN6, INN7, INN8, INN6, INN7, INN8, RT5, FF5, PF4, MAS3, MAS5, MAS6 and MAS7 which eliminated from the scale due to low loadings. The loading for the remaining items in the model has therefore fulfilled all the requirements.

For testing *convergent validity* (the extent to which a measure correlates positively with alternative measures of the same construct), this study used the average variance extracted (AVE), and it indicated that all AVE values were higher than the suggested value of 0.50 (Hair et al., 2010) ranging from 0.619 to 0.843. The convergent validity for all constructs has been successfully fulfilled and adequate convergent validity exhibited as Table 2 shows.

Table 3: Mean, standard deviation, loading, cronbach's Alpha, CR and AVE

Constructs	Item	Loading (> 0.5)	M	SD	$\alpha$ (> 0.7)	CR (> 0.7)	AVE (> 0.5)
Innovativeness (INN)	INN1	0.900	3.350	0.973	0.939	0.954	0.805
	INN2	0.886					
	INN3	0.891					
	INN4	0.890					
	INN5	0.917					
	INN6	Deleted					
	INN7	Deleted					
	INN8	Deleted					
Pro-activeness (PRO)	PRO1	0.904	3.286	0.925	0.932	0.948	0.785
	PRO2	0.874					
	PRO3	0.881					
	PRO4	0.885					
	PRO5	0.887					
	PRO6	Deleted					
	PRO7	Deleted					
	PRO8	Deleted					
Risk-taking	RT1	0.922	3.215	0.918	0.918	0.942	0.801

(RT)	RT2	0.882					
	RT3	0.884					
	RT4	0.892					
	RT5	Deleted					
Autonomy (AU)	AU1	0.915					
	AU2	0.893	3.295	0.981	0.942	0.956	0.812
	AU3	0.893					
	AU4	0.885					
	AU5	0.919					
Financial factor (FF)	FF1	0.926					
	FF2	0.905	3.150	1.060	0.938	0.955	0.843
	FF3	0.919					
	FF4	0.922					
	FF5	Deleted					
Physical factor (PF)	PF1	0.900					
	PF2	0.898	3.172	0.887	0.886	0.929	0.814
	PF3	0.909					
	PF4	Deleted					
Human factor (HF)	HF1	0.911					
	HF2	0.899	3.079	0.947	0.941	0.955	0.808
	HF3	0.898					
	HF4	0.906					
Maslahah (MAS)	MAS1	0.810					
	MAS2	0.821					
	MAS3	Deleted					
	MAS4	0.846					
	MAS5	Deleted	3.421	0.789	0.872	0.906	0.619
	MAS6	Deleted					
	MAS7	Deleted					
	MAS8	0.816					
	MAS9	0.837					
	MAS10	0.552					

Note: M=Mean; SD=Standard Deviation,  $\alpha$ = Cronbach's alpha; CR = Composite Reliability, AVE = Average Variance Extracted

The measurement used is seven-point scale ranging from 1 (strongly disagree) to 7 (strongly agree), only actual usage used 7 ranking scale.

All the factor loadings of the individual items are statistically significant ( $p < 0.01$ ) except for the items INN6, INN7, INN8, INN6, INN7, INN8, RT5, FF5, PF4, MAS3, MAS5, MAS6 and MAS7 which eliminated from the scale due to low loadings.

Key: INN; innovativeness; PRO: pro-activeness; RT: risk-taking; AU: autonomy, FF: financial factor; PF: physical factor; HF: human factor; MO: monetary; NM: non-monetary

The discriminant validity (the degree to which items differentiate among constructs or measure distinct concepts) of the measurement model was checked using Fornell-Larcker. Results of discriminant validity by Fornell-Larcker criterion shown in Table 3, the square root of the AVEs on the diagonals as represented by the bolded values were

higher than the correlations between constructs (corresponding row and column values). This indicates that the constructs are strongly related to their respective indicators compared to other constructs of the model (Fornell & Larcker, 1981; Chin, 1998), thus suggesting a good discriminant validity (Hair et al., 2017). In addition, the correlation between exogenous constructs is less than 0.85 (Awang, 2014). Hence, the discriminant validity of all constructs is fulfilled.

Table 4: Results of discriminant validity by Fornell-Larcker criterion

<i>Factors</i>		<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>	<i>6</i>	<i>7</i>	<i>8</i>
		AU	FF	HF	INN	MAS	PF	PRO	RT
1	AU	<b>0.901</b>							
2	FF	0.344	<b>0.918</b>						
3	HF	0.183	0.078	<b>0.904</b>					
4	INN	0.485	0.357	0.133	<b>0.897</b>				
5	MAS	0.610	0.386	0.129	0.551	<b>0.787</b>			
6	PF	0.437	0.304	0.116	0.472	0.512	<b>0.902</b>		
7	PRO	0.518	0.368	0.031	0.472	0.523	0.430	<b>0.886</b>	
8	RT	0.389	0.293	0.134	0.299	0.290	0.227	0.331	<b>0.895</b>

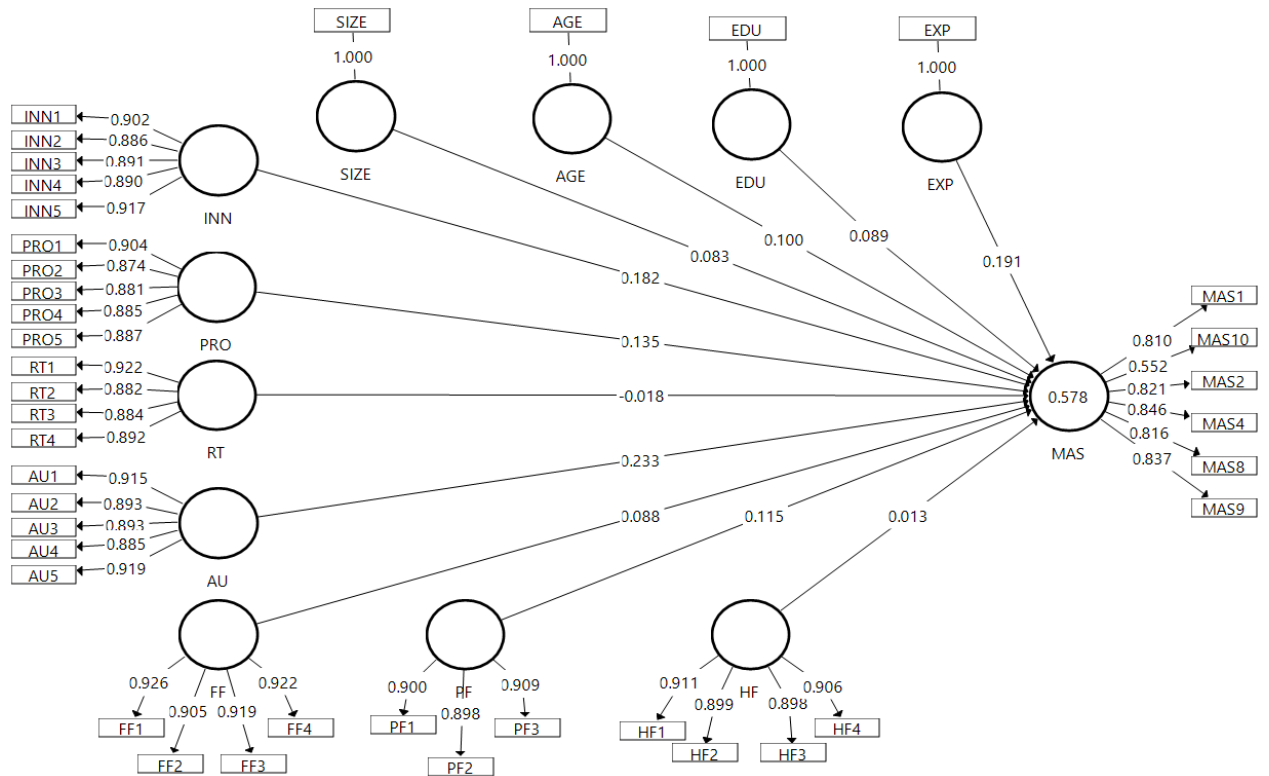
Note: Diagonals represent the square root of the average variance extracted while the other entries represent the correlations.

Key: INN; innovativeness; PRO: pro-activeness; RT: risk-taking; AU: autonomy, FF: financial factor; PF: physical factor; HF: human factor; MAS: maslaha

### ***Structural Model Assessment***

Hair, Hult, Ringle, & Sarstedt, (2017) suggested assessing the structural model by looking at the beta ( $\beta$ ),  $R^2$  and the corresponding t-values via a bootstrapping procedure with a resample of 5,000. Moreover, they recommend reporting the effect sizes ( $f^2$ ) as well as the predictive relevance ( $Q^2$ ). As (Sullivan & Feinn, 2012) argue that the p-value determine whether the effect exists but it does not reveal the size of the effect.

Figure 2: PLS Algorithm Results



Key: SIZE: size; AGE: age; EDU: education; EXP; experience; INN; innovativeness; PRO: pro-activeness; RT: risk-taking; AU: autonomy, FF: financial factor; PF: physical factor; HF: human factor; MAS: maslaha

Figure 2: PLS algorithm results

### Hypotheses Tests

The structural model assessment as shown in Figure 2 and Table 3 provides the indication of the hypothesis tests, with 9 out of the 11 hypotheses are supported. Size, age, education, experience, innovativeness, pro-activeness, autonomy, financial factor, and physical factor significantly predict maslaha. Hence, H1.1, H1.2, H2.1, H2.2, H3.1, H3.2, H3.4, H4.1, and H4.2 are accepted with (  $t$   $p < 0.05$ ), (  $t$   $p < 0.05$ ), (  $t$   $p < 0.05$ ), (  $t$   $p < 0.001$ ), (  $t$   $p < 0.001$ ), (  $t$   $p < 0.01$ ), (  $t$   $p < 0.001$ ), (  $t$   $p < 0.05$ ), and (  $t$   $p < 0.01$ ) respectively. However, H3.3 and H4.3 are rejected.

Note that the standardized path coefficient indicates the strengths of the relationship between exogenous and endogenous constructs, so the direct effects of autonomy on *maslaha* is much stronger than the influence of other variables.

Size, age, education, experience, innovativeness, pro-activeness, autonomy, financial factor, and physical factor explaining 58 % of the variance in *maslahah*. The R<sup>2</sup> values achieved an acceptable level of explanatory power as recommended by Cohen (1988) and Chin (1998) indicating a substantial model.

This study also assessed effect sizes ( $f^2$ ). Effect size  $f^2$  determines whether an exogenous latent construct has a substantial, moderate or weak impact on an endogenous latent construct (Gefen & Rigdon, 2011). Hair et al., (2017) recommend to test the change in the R<sup>2</sup> value. Cohen (1988) suggested a guideline measure the magnitude of the  $f^2$  which is 0.35 (large effects), 0.15 (medium effects), and 0.02 (small effects). The result of  $f^2$  as Table 3 shows, that all relationship with small effect sizes.

Further, by using the blindfolding procedure this study examined the power of research proposed model regarding the predictive relevance. As recommended by Hair et al., (2017) the blindfolding procedure should use only on the endogenous constructs with a reflective measurement. If the value of Q<sup>2</sup> is greater than 0 then the predictive relevance of the proposed model exists for a certain endogenous construct (Fornell, C., & Cha, 1994; Hair et al., 2017). As Table 3 shows that all the values of Q<sup>2</sup> greater than 0 indicate that there is an adequate predictive relevance for the proposed model. For the Q<sup>2</sup> values, Hair et al., (2017) suggested values of 0.35 (large), 0.15 (medium), and 0.02 (small) as a relative measure of predictive relevance, and the result of this study shows that the exogenous have medium predictive relevance.

To measure and assess the degree of multicollinearity, variance inflation factor (VIF) widely used (O'Brien, 2007). There is cause for concern when the largest VIF is greater than 10 (Bowerman & O'Connell, 1990; Myers, 1990). Table 5 shows multicollinearity diagnostic through VIF which indicates that there is no evidence of significant multicollinearity among the study exogenous constructs because all VIF values are less than 10 ranging from 1.068 to 1.845. It means that the variance of exogenous constructs explains in the endogenous construct are not overlapping with each other.

Table 5: *Structural path analysis result*

Hypothesis	Relationship	Std Beta	Std Error	t-value	p-value	Decision	R <sup>2</sup>	f <sup>2</sup>	Q <sup>2</sup>	VIF
H1.1	SIZE→NM	0.083	0.040	2.084	0.019	Supported	0.58	0.014	0.33	1.148
H1.2	AGE→NM	0.100	0.046	2.170	0.015	Supported		0.018		1.326
H2.1	EDU→NM	0.089	0.043	2.052	0.020	Supported		0.015		1.267
H2.2	EXP→NM	0.191	0.042	4.574	0.000	Supported		0.073		1.181
H3.1	INN→NM	0.182	0.046	3.992	0.000	Supported		0.048		1.638
H3.2	PRO→NM	0.135	0.046	2.947	0.002	Supported		0.026		1.639
H3.3	RT→NM	0.018	0.041	0.427	0.335	Not supported		0.001		1.256
H3.4	AU→NM	0.233	0.056	4.143	0.000	Supported		0.070		1.845
H4.1	FF→NM	0.088	0.043	2.030	0.021	Supported		0.014		1.278
H4.2	PF→NM	0.115	0.048	2.405	0.008	Supported		0.020		1.586
H4.3	HF→NM	0.013	0.039	0.338	0.368	Not supported		0.000		1.068

Key: SIZE: size; AGE: age; EDU: education; EXP: experience; INN; innovativeness; PRO: pro-activeness; RT: risk-taking; AU: autonomy, FF: financial factor; PF: physical factor; HF: human factor; MAS: maslaha

## DISCUSSION

The findings indicate that most of the factors are significant determinants of the *masalahah*. Size and age as firm characteristic have positively significant impact on achievement of *masalahah*. This suggests larger and older firms perform better in ISE. Additionally, education and experiences of the owner/managers are giving high impact to the ISE performance. Of all the determinant factors, experience is contributing the highest values compared to others. Managers with higher education levels and higher experience levels are more capable to achieve the *masalahah*. Innovation, proactiveness, and autonomy are highly important determinants of the *masalahah*. Autonomy is also high in its contribution to the EO strategy, though its confidence level has to be treated with



concern. Some of these ISE are not registered, thus autonomy is a sensitive and risky matter. Perhaps the authority bodies should explore on this issue. Other factors like innovation and pro-activeness are significantly impact *maslahah*. A potential explanation is that the managers strives to fulfil the *maslahah* by being innovative and proactive and this is could be done when they have more autonomous power. In other words, the manager of ISE are doing their best to serve the community by employing their innovativeness and other skills. While when it comes to risk-taking, the ISE is entrusted to the manager to serve the *mmah* and any uncounted risk might lead to the risk of losing the fund of the ISE, for this reason, it could be the ISE's manager are very careful and prefer not take high level of risk. This could explain the insignificant effect of risk taking in the study.

Financial factor and physical factors are important determinants of *Maslahah* while the human factor is insignificant. This in agreement with Abdul Kadir and Sarif (2015) who proposed that enterprise resources such as finance, physical and human are important.

### CONCLUSION

This study aims to answer the main research question, "What is the performance measure for the Islamic social enterprise?" Through literature it is found that *maslahah* (wellbeing) is the appropriate concept for Islamic social measures. Two objectives are formulated for answering the research questions, (i) To develop *maslahah* construct/dimension, (ii) to test the impact of *maslahah* on ISE performance. Employing hypothetical deductive approach, the findings confirmed that, education, employment, *sadaqah* and *dakwah* formed the measures for *maslahah*. The impact of *maslahah* on ISE performance indicates that firm characteristic (size and age), owner/structure characteristic (education and experience), entrepreneurial orientation strategy (innovativeness, pro-activeness and autonomy) and enterprise resources (financial and physical factors) are positively related in the causality model of *maslahah*. These findings give insights on the factors that would be beneficial for Islamic Social Enterprise performance. *Maslahah* only captures the social performance measures. Studies on ISE financial performance should be given priority for future research.

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A' Quran Nur Kareem

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## SHARIAH AUDIT TALENT DEVELOPMENT IN MALAYSIAN ISLAMIC FINANCIAL INSTITUTIONS

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### ABSTRACT

*It is undeniable that Islamic Financial Institutions (IFIs) in Malaysia are growing at a faster rate with a positive impact on the national economy. In order to sustain and maintain Shariah compliance in Islamic financial industry, adequate Shariah audit practices are necessary to ensure operation of IFIs are parallel with Shariah guidelines and policies set by the authority. In order to equip Islamic industry practitioners with adequate Shariah audit practices, the Faculty of Economics and Muamalat (FEM), Universiti Sains Islam Malaysia (USIM) has developed a professional Shariah Audit Training (SAT) program for IFIs. SAT is a program that covers various aspects on Shariah audit practices starting from Shariah principles, Shariah governance and assurance, Shariah audit program, Shariah audit process, Shariah audit fieldwork, Shariah risk management and Shariah audit communications. Modules used in SAT have been developed based on a collaboration between academic institutions and industry players in order to ensure the knowledge and the practice in the industry are relevant. The series of trainings conducted in the program are believed to achieve the programme's ultimate objective which is to produce Shariah auditors who are qualified and trained to fill the gap for Islamic finance industry. Objective is to produce talents with adequate Shariah audit knowledge. This study provides the result of the SAT program toward IFIs practitioners' skills and knowledge on Shariah audit practices.*

**KEYWORD:** *Shariah audit program, Shariah governance, Shariah audit process, Shariah audit fieldwork, Shariah risk management, Shariah audit communication.*

## INTRODUCTION

Malaysia aspires to become a leading hub and a referral center in Islamic Finance. Currently, Islamic finance industry in Malaysia comprehensively covers Islamic banking, takaful and capital market. The regulatory regime governing IFIs varies across countries. International organizations have established standards to strengthen and eventually harmonise prudential regulations that are applied to IFIs. This also includes regulations on the practice of *Shariah* audit. *Shariah* audit has emerged as an important mechanism in ensuring *Shariah* compliance in line with the rapid development of IFIs. The demand for *Shariah* audit practices is mainly to strengthen the *Shariah* compliance or *Shariah* non-compliance and enhance the integrity of the IFIs. *Shariah* audit is necessary due to the different nature and characteristics that exists in the Islamic banking practices.

Despite IFIs need to comply with different rules and regulations and also accounting standards and guidelines, there is room for improvement that need to be done to ensure *Shariah* audit is regulated by proper standards or framework that can lead to harmonization of practices among the IFIs. At present, in Malaysia there is neither a framework nor standard that specifically addresses *Shariah* audit practices that can be referred to by the practitioners in implementing *Shariah* audit function in the IFIs. It is argued that *Shariah* auditing profession need standards, both for the established criteria (such as IFRS in financial statement auditing) and audit methodology (such as the corresponding international auditing, review and assurance standards). To make this issue become worst, a previous study by Yaacob and Donglah (2012) found that *Shariah* audit practices are still at a development stage and need further improvement. Thus, there is a need to increase the understanding of *Shariah* audit among internal auditors, enhance the *Shariah* knowledge of internal and external auditors, standardization of *Shariah* audit framework and providing general guidelines to design audit training for *Shariah* audit.

To fulfil the above objectives, the Faculty of Economics and Muamalat (FEM), Universiti Sains Islam Malaysia (USIM) has introduced a professional program called *Shariah* Audit Training (SAT). SAT is an innovative program since *Shariah* audit is a newly developed sub-discipline spinning off from auditing and *Shariah*. The advancement of Islamic finance industry requires a governance system that enhances the quality of delivery of Islamic financial products to cover the rights of the shareholders

and users of the financial products and services. Compliance to *Shariah* is the utmost importance to the Islamic finance industry. This is to achieve zero tolerance risk to *Shariah* breach. *Shariah* audit as a discipline will ensure *Shariah* non-compliance is zero or minimum.

SAT consists of comprehensive modules that are related to *Shariah* audit. It is a program that covers various aspects on *Shariah* audit practices starting from *Shariah* principles, *Shariah* governance, *Shariah* audit program, *Shariah* audit process, *Shariah* audit fieldwork, *Shariah* risk management and *Shariah* audit communications process.

## **SHARIAH AUDIT PRACTICES**

### **Overview of *Shariah* Audit**

Currently, there is no standardized definition of *Shariah* audit issued by the regulated bodies as the IFIs industry is still growing. However, there are few descriptions regarding *Shariah* audit that can be used in identifying *Shariah* audit. For instance, Bank Negara Malaysia (BNM) in *Shariah Governance Framework (SGF)* refer *Shariah* audit as:

*The periodical assessment conducted from time to time, to provide an independent assessment and objective assurance designed to add value and improve the degree of compliance in relation to the IFI's operations, with the main objective of ensuring a sound and effective internal control system for *Shariah* compliance (BNM, 2010).*

Before the issuance of SGF in 2010, several scholars have defined *Shariah* audit based on their understanding and experience. This includes a definition of *Shariah* audit by Prof Dr Abdul Rahim Abdul Rahman which is:

*The accumulation and evaluation of evidence to determine and report on the degree of correspondence between information and established criteria for *Shariah* compliance purposes (Abdul Rahman, 2008).*

Another *Shariah* audit definition is by Associate Prof Dr Nawal Kassim is as follows:

*A systematic process of obtaining sufficient and appropriate evidence to form an opinion as to whether the subject matter correspondence with Shariah rules and principles in broadly accepted by stakeholders and society at large (Kasim et al., 2009).*

The above *Shariah* audit definitions are also in line with the scope for internal *Shariah* review by Accounting and Auditing Organization for Islamic Financial Institutions Governance Standard (AAOIFI) for IFIs (GSIFI-3) No.3 which is to ensure that the management of an IFI discharge their responsibilities in relation to the implementation of the *Shariah* rules and principles as determined by the IFI's *Shariah* Supervisory Board (SSB).

Another related description regarding internal *Shariah* audit is Dr Asyraf Wajdi Dusuki in defining *Shariah* audit as:

*A systematic process of obtaining and evaluating, sufficient and reliable evidence by an internal Shariah auditor, as a basis to form an opinion, as to whether the operations and activities of the entity being audited is incompliance with established Shariah criteria and reporting the opinion hereon to the appropriate authority (Dusuki, 2011).*

Last but not least, the latest *Shariah Governance Exposure Draft* issued by BNM on 2 November 2017 also re-defines the *Shariah* audit as:

*A function that provides an independent assessment on the quality and effectiveness of the IFIs internal control, risk management systems, governance processes as well as the overall compliance of the IFIs operations, business, affairs and activities with Shariah (BNM, 2017).*

Based on the above definitions regarding *Shariah* audit, it can be said in general that *Shariah* audit is a tools or procedure to give assurance to the stakeholders that an organization's operations are in accordance to *Shariah* laws and principles. Although there are a lot of descriptions regarding *Shariah* audit, yet it still lacks harmonized

practices of *Shariah* audit. As the result, *Shariah* audit practices by each IFI currently are different each other.

Thus, a comprehensive scope of *Shariah* audit that cover overall possible aspect regarding *Shariah* matters is needed. For this, in order to identify *Shariah* audit scope, it must consider at least by incorporating basic principles of *Shariah* or known as *maqasid Shariah* regarding the needs to have *maqasid Shariah* in Islamic finance (Lahsasna, 2013). The important elements of *maqasid Shariah* in Islamic finance is preservation of wealth that will result in fulfilling the needs of the stakeholders including society at large.

### ***Shariah Audit Scope***

Currently, *Shariah* audit remains as a control of the IFIs to ensure compliance with the *Shariah* principle itself, making it similar as conventional operational audit. Due to the lack of development of *Shariah* audit job scope, auditors tend to only audit compliance of the IFIs based on the regulations regulated by the IFIs and BNM. Besides, *Shariah* audit scope stated in SGF is mostly based on the conventional audit scope. As IFIs, it is merely taking the conventional system into a permissible system with *Shariah*, so does *Shariah* audit.

This contravenes with the *maqasid Shariah*, which aim to cater the needs of society from essentials (*daruriyyat*), complimentary (*hajiyyat*) and enhancing (*tahsiniyyat*) point of views. For an example, what differ Islamic banking with conventional when both are driven by profit orientation? When the sales person of the IFIs, promote the Islamic products and services using conventional terms to ease up understanding to the customer? When the product development function only focus on developing conventional products, which after that they convert the product to an Islamic products and services in dual banking practices?

Thus, an ideal scope of *Shariah* audit should be including *maqasid Shariah* in its implementations. This is to ensure that *Shariah* audit serve the real role of its existence. Dusuki (2011) stated that the scope of *Shariah* audit should include any areas which could potentially result into *Shariah* compliance issues such as products and services, financial reporting, organizational structure, human resources, processes, marketing and IT. As *Shariah* audit serves the ‘main’ functions of achieving the ‘aim’ of *maqasid Shariah* in the IFIs, thus, a thorough process and procedure in line with the objective are needed.

For example, in *Shariah*, to make profit is acceptable, but to say ‘*what matters is the bottom line*’ is not applicable in Islamic finance. Thus, it might be suitable for a *Shariah* audit function, to provide a check and balance of the progress of the IFIs, whether just merely generating profit as the conventional banks, or has different aim in the end. It is important for a *Shariah* audit function to play proactive roles and not only to ensure operational compliance.

An ideal *Shariah* audit framework should include from the organizational structure of the IFIs, which include the final aim of the existence itself, to the operational process, end to end process of the IFIs that relates to *Shariah* compliance.

### ***Shariah Auditor Backgrounds***

Another important issue faced by Islamic finance industry is talent in to have human capital with adequate on both *Shariah* and audit knowledge. Abdul Rahman (2010) stated that one of the challenges in implementing *Shariah* audit would be to produce competent and independent *Shariah* auditors. This happens as both *Shariah* and audit knowledges are essential to perform *Shariah* audit practices.

Currently, there are lots of debates on the level of competency of a *Shariah* auditor. As there is an inadequate number of practitioners who have both audit and *Shariah* knowledge in Islamic finance industry, the debate focuses on to whether a specialist in audit or a *Shariah* person should be the most qualified person to do *Shariah* audit. Therefore, there is a gap especially on talents to carry *Shariah* audit practices.

Regarding this, Flint (1988) stated that audit competence requires both knowledge and skills, which is the product of education, training and experiences. This is supported by the International Federation of Accountants (IFAC) on *International Education Standard (IES) 8 (Revised) Competence Requirements for Audit Professional*, where an auditor must have the formal education (knowledge) relevant to audit (IES 2), professional skills (IES 3) and be able to apply the professional values, ethics and attitudes (IES 4) to different contexts and organizations (IFAC, 2016). In addition, the Institute of Internal Auditors (IIA) in the *International Standards for the Professional Practices Framework of Internal Auditing* also highlight that internal audit unit should be appropriately staffed in terms of numbers, grades, qualifications and experience, having regard to its responsibilities and objectives (IIA, 2017).

Besides, BNM on *Shariah Governance Exposure Draft* requires *Shariah* auditor must be able to perform on the following *Shariah* audit function (BNM, 2017):

- i. Establish an audit methodology to assess the risk profile and vulnerabilities of each auditable area;
- ii. Generate an audit plan for the assignments to be performed;
- iii. Establish a clear documented audit programs that provide guidance to the internal audit assessment; and
- iv. Communicate results to the board and *Shariah* committee through an audit report, dealing the audit findings and recommendations for rectification measures, as well as the auditee's responses and action plans.

Based on these requirements for *Shariah* auditor, it is clear that *Shariah auditors'* competence is determined by considering a set of relevant attributes such as knowledge, skill and attitudes. Thus, *Shariah* auditors in IFIs must not only have the auditing skills but also need to have an additional *Shariah* knowledge specifically in *fiqh muamalat*. This is to ensure proper *Shariah* audit has been conducted and that the overall operations of IFIs are fully *Shariah* compliant.

Besides, *Shariah* auditor should be properly trained to fulfil all his responsibilities. The effectiveness of internal audit depends substantially on the quality, training and experience of its staff. The aim should be to appoint staff with the appropriate accounting or audit and *Shariah* background as well as having personal qualities and potential to be trained as a *Shariah* auditor. Thus, IFIs should provide the necessary experience, training and continuing professional education on *Shariah* audit. However, a training program on *Shariah* audit should also equip the *Shariah* auditor at least with two basic knowledge which are *Shariah* knowledge and auditing knowledge.

It is ideal for a *Shariah* auditor to be competent in both *Shariah* and audit knowledge. This is because to audit *Shariah* related matters, it needs to know about *Shariah* itself. Some scholars agree that *Shariah* person who has audit knowledge would be the most suitable and competent *Shariah* auditor and some differ in their opinions. Yet, both parties agree that a *Shariah* auditor must possess the knowledge of audit and *Shariah*. This agreement also prove on previous studies conducted where either *Shariah* or auditing alone is not sufficient in conducting *Shariah* audit practices (Lahsasna et al., 2013; Aziz & Faizal, 2012; Shahul, 2008; Grais & Pellegrini, 2006).



Another question arises from this *Shariah* auditor background issue is who is responsible and who is in charge for *Shariah* auditor training and certification? Further question is whether person in charge with *Shariah* auditor background are competent enough to be responsible for recruiting *Shariah* auditor? Is it possible for *Shariah* committee (SC) to be the most suitable people to be responsible with *Shariah* auditor training and certification programs? All of these questions are yet to be answered.

### ***Current Shariah Audit Practices***

As *Shariah* audit is still evolving and expanding, the scope would be different from the conventional statutory audit. As of today, guidelines and framework of *Shariah* audit are still being developed guided by the conventional practices. So do the requirements of the auditors. For example, current *Shariah* internal auditor group's composition in the one of the IFI in Malaysia shows out of five auditors, four of them graduated in accounting or auditing and another in business administration.

Practitioners of *Shariah* audit practices are expected to serve the needs of the stakeholders. As any other organizations, *Shariah* auditing practitioners of IFIs seem to be held accountable not only for the manner in which appropriated funds are utilized, also for the transparency of the financial account.

It is expected that the practitioners of *Shariah* audit practices in Malaysian IFIs are qualified in both *Shariah* and accounting/auditing related subjects. Yaacob and Donglah (2012) stated that *Shariah* auditors should be the one with adequate knowledge, capabilities and independent to carry out the audit. They must have been trained in accounting and finance and auditing as well as *Shariah* and *fiqh*.

Lack of *Shariah* audit practitioners with both qualifications indirectly may distort the growth of *Shariah* audit and even Islamic finance industry itself. This subsequently may fail in determining the vision and mission of Islam that preserved within the IFIs. Due to incompetence *Shariah* auditors, it can lead to financial loss if it involves with financial and purification income by the IFI needs to be done in these cases. Kasim et al. (2009) too mentioned that there is still lack of people who have both *Shariah* and accounting qualifications. The lack of both *Shariah* and audit knowledge has dampened the crucial needs of the *Shariah* auditor.

To overcome such lack especially in *Shariah* knowledge, BNM allows *Shariah* auditor to engage the expertise of IFIs *Shariah* officers in performing *Shariah* audit as

long as the objectivity of the audit is not compromised. IFIs are also allowed to appoint an external party to conduct *Shariah* audit process. This happened as most of *Shariah* auditors in the current Islamic finance industry came from various backgrounds such as accounting, finance, business and other relevant business disciplines. There also many *Shariah* auditors in the current industry practices whom previously have taken *Shariah* related subject during their studies as a minor subject.

Besides, *Shariah* audit is not only to ensure compliance based on internal regulations by IFIs as a current normal practices, but also to ensure that the control of *Shariah* governance is in place as well. When doing current *Shariah* audit practices based on BNM SGF, it cannot be claimed that all *Shariah* matters are considered. For instance, if documentation for opening a *Mudharabah* Account does not specify the profit sharing ratio, a conventional auditor would quickly take that finding as an audit finding. On the other hand, *Shariah* auditor will probe further, whether there is a probability that the customer has already make known verbally by the officer during the account opening before deciding to consider it as an audit finding.

Thus, there is a need for practitioners especially *Shariah* auditor to have such as a *Shariah* audit training to fill the loopholes. Therefore, *Shariah* Audit Training (SAT) developed by the Faculty of Economics and Muamalat (FEM), Universiti Sains Islam Malaysia (USIM) is to produce talents who can fill the gap in the industry.

### **SHARIAH AUDIT TRAINING (SAT)**

*Shariah* Audit Training (SAT) is a professional programme conducted by FEM, USIM focused on *Shariah* audit practices. It is a program with the objective to produce *Shariah* auditors who are qualified and trained to fill the gap for Islamic finance industry to fulfil the human capital requirement of the IFIs. At present, SAT program is accredited by the Finance Accreditation Agency (FAA), an international accreditation agency supported by BNM. SAT is expected to train *Shariah* audit practices for various groups of Islamic finance players such as below:

- i. Islamic banks in the world – in Malaysia alone, there are 16 Islamic banks with hundreds of branches. Other countries with Islamic banks and its branches are

such as Indonesia, Cambodia, Vietnam, Thailand, GCC, Pakistan, Sudan, Iran and United Kingdom.

- ii. *Takaful* institutions – in Malaysia, the number of *takaful* institutions are seven (7). *Takaful* operators also operate in other countries as mentioned above.
- iii. *Shariah* compliant funds – In Malaysia, the number of *Shariah* compliant funds are 29, while the wholesale funds are 17. Each of the funds will be able to use the product in order to perform the audit of the funds. Failaka International, a body tracking the performance of *Shariah*-compliant funds registered 367 funds in the world.
- iv. *Shariah* compliant companies on Bursa Malaysia – At present, there are 839 *Shariah* compliant counters out of 946 counters on Bursa Malaysia as at 31<sup>st</sup> November 2011.
- v. Universities, professional bodies, institutes and training centres offering Islamic finance related courses at undergraduate and postgraduate levels and training programs which the numbers to consist of hundreds of institutions, local and overseas. An estimated number of students all over the world are 30,000.

Six qualified trainers conduct SAT. These trainers are USIM's lecturers with various background related to *Shariah* audit such as *Shariah*, audit, Islamic accounting, corporate and *Shariah* governance.

SAT program consists of eight (8) modules related to *Shariah* audit. These modules covers various aspects on *Shariah* audit practices starting from *Shariah* principles, *Shariah* governance, *Shariah* audit program, *Shariah* audit process, *Shariah* audit fieldwork, *Shariah* risk management until the *Shariah* audit communication. Besides, these modules are been developed based on collaboration between academic institutions and industry players in order to ensure the knowledge and the practice in the industry are harmonized and relevant. The module outline for SAT is summarized in the following Table 1.

**Table 1: Shariah Audit Training (SAT) Module Outline**

<b>Modules</b>	<b>Description</b>
Module 1 - <i>Shariah</i> Principles and Applications in Islamic Banking and Capital Markets	This module covers such as principles of <i>fiqh muamalat &amp; maqasid Shariah</i> , <i>Shariah</i> decision making ( <i>usul fiqh</i> ), Islamic legal maxims, <i>siyasa Shariah</i> and application of <i>Shariah</i> principles and contract ( <i>thathbiq &amp; taqyif</i> ) in Islamic banking products and services and capital market.
Module 2 - <i>Shariah</i> Corporate Governance in Islamic Banking and Capital Markets	This module covers such as corporate governance structures from Malaysian and international regulatory perspectives, roles and functions of <i>Shariah</i> organs, risk governance and internal audit.
Module 3 - <i>Shariah</i> Audit Process	This module covers such as internal control framework, <i>Shariah</i> audit activities, <i>Shariah</i> audit planning and <i>Shariah</i> audit framework
Module 4 - <i>Shariah</i> Audit Program	This module covers such as fundamentals of <i>Shariah</i> audit program, <i>Shariah</i> audit program for Islamic banking, <i>Shariah</i> audit program for governance, <i>Shariah</i> audit program for selected Islamic products and services and <i>Shariah</i> audit program for Islamic capital market.
Module 5 - <i>Shariah</i> Risk Management	This module covers such as fundamentals of <i>Shariah</i> risk, <i>Shariah</i> tolerance level and <i>Shariah</i> risk control measurement.
Module 6 - <i>Shariah</i> Audit Fieldwork	This module covers such as methods in performing <i>Shariah</i> audit fieldwork, approaches in executing <i>Shariah</i> audit fieldwork and also ethical principles in conducting <i>Shariah</i> audit.
Module 7 - <i>Shariah</i> Audit Communication	This module covers such as format of good <i>Shariah</i> audit report, <i>Shariah</i> reporting line (governance), <i>Shariah</i> audit report presentation and also follows up process on <i>Shariah</i> audit issues.
Module 8 - <i>Shariah</i> Audit Case Study Workshop	This module covers on a real scenario case related with <i>Shariah</i> audit practices including conducting <i>Shariah</i> audit process, recognizing and reporting <i>Shariah</i> issues, presenting <i>Shariah</i> audit report and follows up on <i>Shariah</i> issues practices.

Each module has two parts, eight hours for each with a total of 128 hours for 16 days. The schedule is arranged on weekend as it is the most suitable time for trainees to attend the classes. In addition, each module has its own assessment and weightage carrying marks and accumulated at the ending of the coursework. Assessments and weightage for each module are presented in the Table 2.

**Table 2: Shariah Audit Training (SAT) Assessment Types and its Weightage**

Module	Assessment Type	Weightage
Module 1	Quiz	10%
Module 2	Case study	10%
Module 3	Presentation	10%
Module 4	Case study	15%
Module 5	Case study	15%
Module 6	Quiz	10%
Module 7	Presentation	15%
Module 8	Presentation	15%
<b>TOTAL</b>		<b>100%</b>

Certificates of SAT are also awarded and these trainees are recognized as certified *Shariah* audit professional. The grading level for evaluation purpose is presented in Table 3.

**Table 3: Grading Evaluation Level**

Grade	Marks	Points	Classification
A	80-100	4.00	Excellent
A-	75-79	3.75	Credit
B+	70-74	3.50	Credit
B	65-69	3.00	Pass
B-	60-64	2.75	Weak Pass
C	0-59	0.00	Fail

## RESEARCH METHODOLOGY

SAT has been successfully conducted with two IFIs staffs in Malaysia: Bank Muamalat Malaysia Berhad (BMMB) and Malaysia Building Society Berhad (MBSB). BMMB is a full-fledged Islamic banking, established on 1 October 1999 and licensed under the Islamic Banking Act (now known as the Islamic Financial Services Act 2013).

Meanwhile, MBSB is a company that scheduled institution under the repealed Banking and Financial Institution Act (BAFIA 1989), which the status of an exempt finance company that give an authorization to undertake financing business in the absence of banking license granted on 1 March 1972. Recently on 6 November 2017, MBSB acquire Asian Finance Bank (AFB), a commercial bank with banking license that will provide an opportunity for MBSB to emerge as a full-fledged Islamic banking near the future.

The trainees came from different academic backgrounds such as accounting, *Shariah*, risk, finance, business and law. In addition, they are also designated with different scope

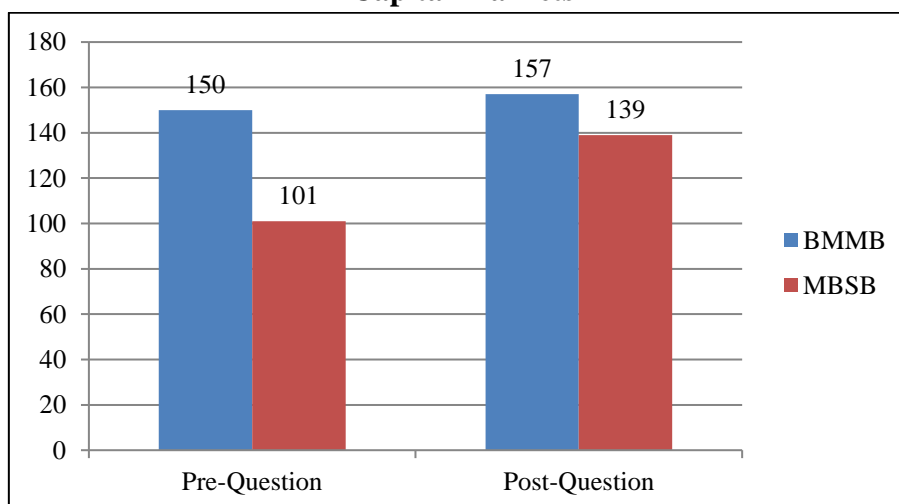
at their IFIs such as *Shariah* audit, *Shariah* risk, *Shariah* review, *Shariah* management and *Shariah* compliance. A number of the trainees were middle-level executives and a few among them were heads of departments and managers. Their experience ranged between three years and ten years in the same or in different banks.

For each module conducted, each trainee was compulsory to take both pre and post questions prepared by trainers for each module except *Module 8 – Shariah Audit Case Study Workshop*. This is because Module 8 was developed and evaluated based on real scenario cases and action and not just on theory as compared to other modules. Therefore, there is no pre and post questions developed for Module 8 and this module is excluded from evaluation process. Back to other modules, these pre and post questions for each module are developed in order to evaluate trainees’ understanding, before and after class for each module presented by trainers. There were a total of 10 questions for each pre and post questions for all 8 modules. For recording process, a score of one (1) was assigned for each correctly answered question, while a score of zero (0) was assigned if the question was wrongly answered. The results from pre and post questions for each module conducted for both IFIs are presented and discussed in the following section.

## RESULTS AND DISCUSSIONS

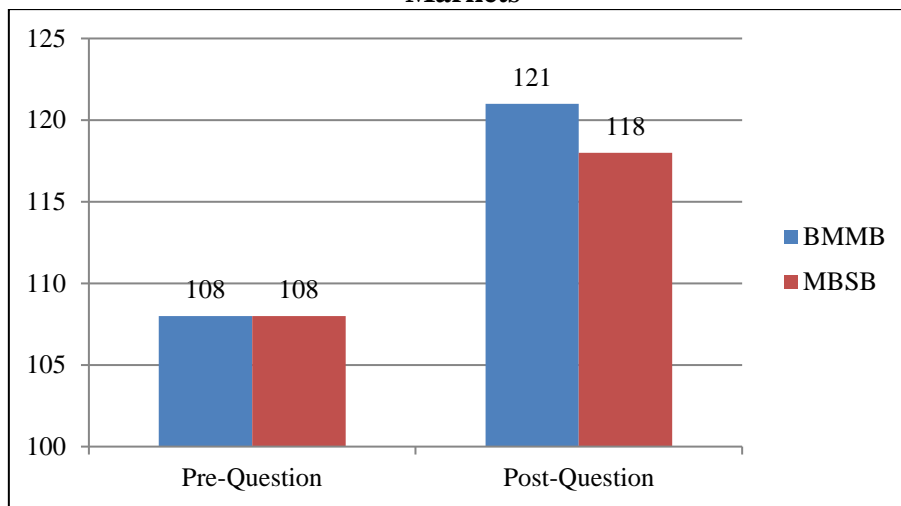
In this section, results and discussions on the impact of SAT conducted toward trainees’ *Shariah* audit knowledge are presented. In this case, presentation of results is based on each module for all eight (8) modules conducted, which are as follow:

**Figure 1: Module 1 - *Shariah* Principles and Applications in Islamic Banking and Capital Markets**



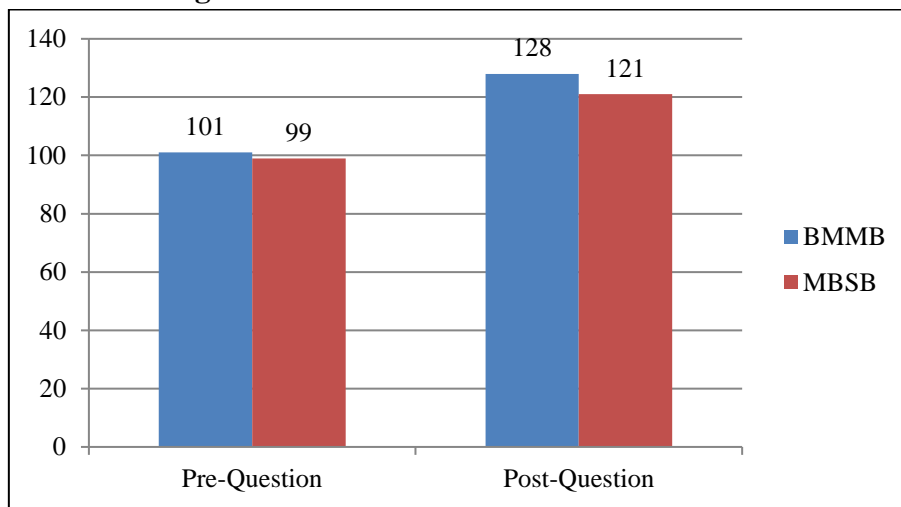
Based on Figure 1 above, it shows that both BMMB and MBSB trainees increased their Shariah audit knowledge for *Module 1 – Shariah Principles and Applications in Islamic Banking and Capital Markets* when the score for post training questions is higher compared with score for pre training. A significant increase is scored by MBSB trainees when they scored 139 for post training questions as compared only 101 score for pre question (an increase about 22.4% from 59.4% to 81.8%). Similarly, a little increase also shown by BMMB trainees when they score 157 for post traing question as compared 150 for pre training question (an increase about 3.9% from 83.3% to 87.2%).

**Figure 2: Module 2 - Shariah Corporate Governance in Islamic Banking and Capital Markets**



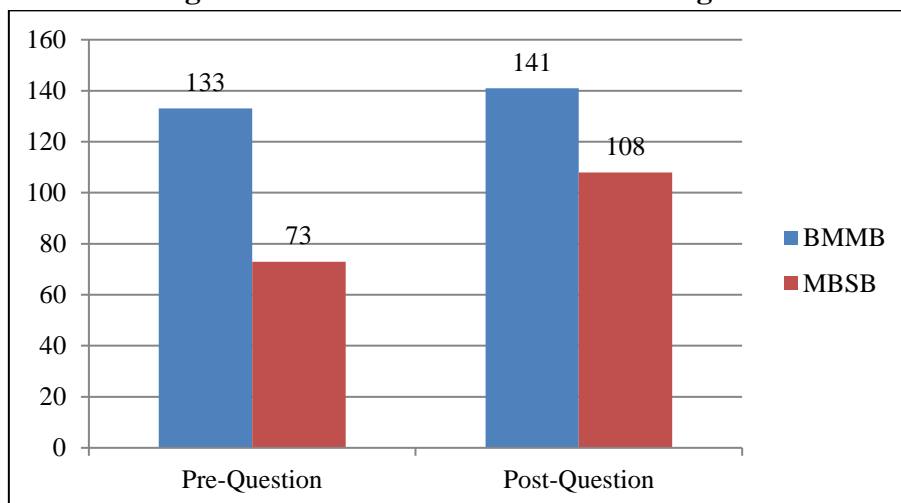
Based on Figure 2 above, it shows that both BMMB and MBSB trainees increased their Shariah audit knowledge for *Module 2 – Shariah Corporate Governance in Islamic Banking and Capital Markets* when the score for post training question is higher compared with score for pre training question. A significant increase is scored by BMMB trainees when they score 121 for post training question as compared only 108 score for pre question (an increase about 7.7% from 63.5% to 71.2%). Similarly, an increase also shown by MBSB trainees when they score 118 for post training question as compared 108 for pre training question (an increase about 5.6% from 60% to 65.6%).

**Figure 3: Module 3 - Shariah Audit Process**



Based on Figure 3 above, it shows that both BMMB and MBSB trainees increased their Shariah audit knowledge for *Module 3 – Shariah Audit Process* when the score for post training question is higher compared with score for pre training question. A significant increase is scored by BMMB trainees when they score 128 for post question as compared 101 for pre training question (an increase about 15.9% from 59.4% to 75.3%). Similarly, a significant increase is also shown by MBSB trainees when they score 121 for post training question as compared only 99 score for pre training question (an increase about 12.2% from 55% to 67.2%).

**Figure 4: Module 4 - Shariah Audit Program**

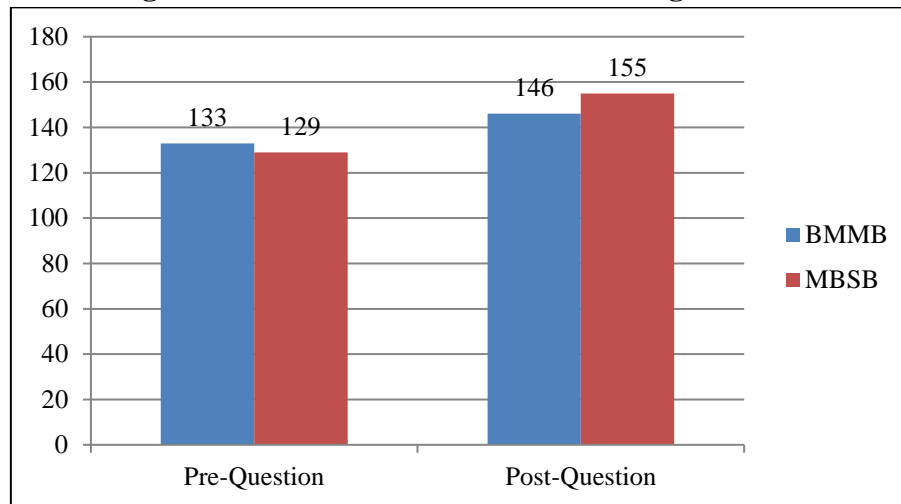


Based on Figure 4 above, it shows that both BMMB and MBSB trainees increased their Shariah audit knowledge for *Module 4 – Shariah Audit Program* when the score for post training question is higher compared with score for pre training question. A



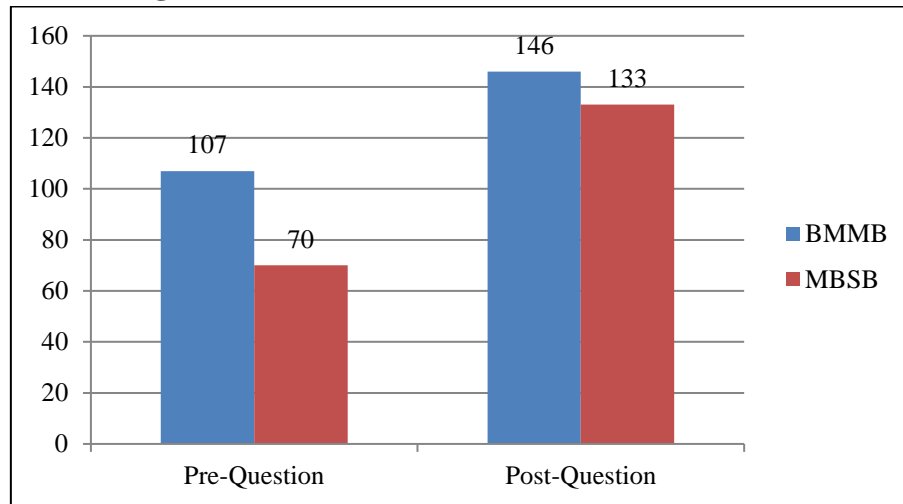
significant increase is scored by MBSB trainees when they score 108 for post training question as compared 73 for pre training question (an increase about 19.4% from 40.6% to 60%). Similarly, a little increase is also shown by BMMB trainees when they scored 141 for post training question as compared only 133 score for pre training question (an increase about 4.7% from 78.2% to 82.9%).

**Figure 5: Module 5 - Shariah Risk Management**



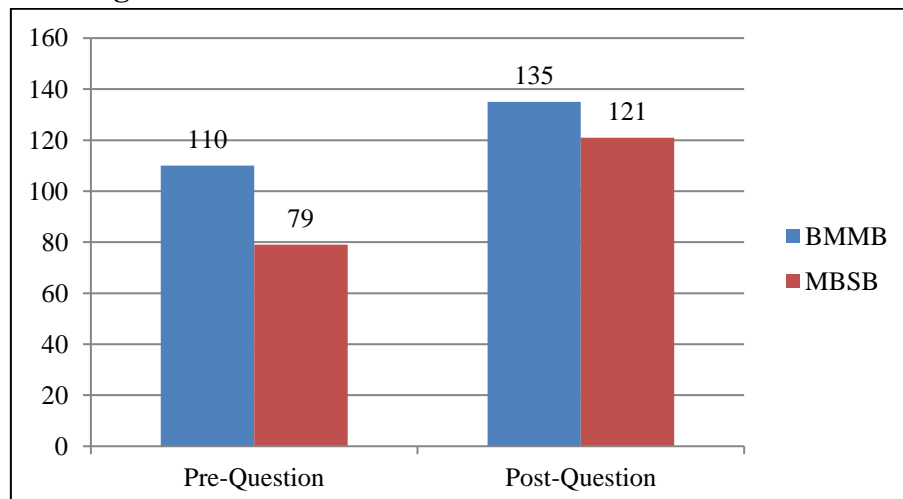
Based on Figure 5 above, it shows that both BMMB and MBSB trainees increased their Shariah audit knowledge for *Module 5 – Shariah Risk Management* when the score for post training question is higher compared with score for pre training question. A significant increase is scored by MBSB trainees when they score 155 for post training question as compared 129 for pre training question (an increase about 10.2% from 75.9% to 86.1%). Similarly, an increase is also shown by BMMB trainees when they score 146 for post training question as compared only 133 score for pre training question (an increase about 7.7% from 78.2% to 85.9%).

**Figure 6: Module 6 - Shariah Audit Fieldwork**



Based on Figure 6 above, it shows that both BMMB and MBSB trainees increased their Shariah audit knowledge for *Module 6 – Shariah Audit Fieldwork* when the score for post training question is higher compared with score for pre training question. A significant increase is scored by MBSB trainees when they score 133 for post training question as compared 70 for pre training question (an increase about 32.7% from 41.2% to 73.9%). Similarly, a significant increase is also shown by BMMB trainees when they score 146 for post training question as compared only 107 score for pre training question (an increase about 23% from 62.9% to 85.9%).

**Figure 7: Module 7 - Shariah Audit Communication**



Based on Figure 7 above, it shows that both BMMB and MBSB trainees increased their Shariah audit knowledge for *Module 7 – Shariah Audit Communication* when the score for post training question is higher compared with score for pre training question. A

significant increase is scored by MBSB trainees when they score 121 for post training question as compared 790 for pre question (an increase about 34.5% from 43.9% to 67.2%). Similarly, an increase is also shown by BMMB trainees when they score 135 for post training question as compared only 110 score for pre training question (an increase about 14.7% from 64.7% to 79.4%).

Overall, it can be concluded that both BMMB and MBSB trainees benefited from SAT program. Specifically, all 7 modules conducted have a positive result in increasing trainees' *Shariah* audit knowledge. BMMB trainees increased their *Shariah* audit knowledge from 70.8% (before SAT program) to 81.8% (after SAT program). Similarly, MBSB trainees also increased their *Shariah* audit knowledge from 43.7% (before SAT program) to 63.1% (after SAT program).

Between all 7 modules, most significant increase in *Shariah* audit knowledge attained by trainees is *Shariah* audit fieldwork scope (23%) for BMMB trainees and *Shariah* audit communication scope (34.5%) for MBSB trainees. Meanwhile, the highest *Shariah* audit knowledge mastered by these trainees is *Shariah* principles and applications in Islamic banking and capital market (87.2%) for BMMB and *Shariah* risk management (86.1%) for MBSB trainees. These findings are based on summary of *Shariah* audit knowledge scores as presented in Table 4.

**Table 4: Tabulation of *Shariah* Audit Knowledge Before and After *Shariah* Audit Training Program**

Modules	BMMB				MBSB			
	Pre- Question Score	%	Post- Question Score	%	Pre- Question Score	%	Post- Question Score	%
Module 1 - <i>Shariah</i> Principles and Applications in Islamic Banking and Capital Markets	150	83.3	157	87.2	101	59.4	139	81.8
Module 2 - <i>Shariah</i> Corporate Governance in Islamic Banking and Capital Markets	108	63.5	121	71.2	108	60	118	65.6
Module 3 - <i>Shariah</i> Audit Process	101	59.4	128	75.3	99	55	121	67.2
Module 4 - <i>Shariah</i> Audit Program	133	78.2	141	82.9	73	40.6	108	60
Module 5 - <i>Shariah</i> Risk Management	133	78.2	146	85.9	129	75.9	155	86.1
Module 6 - <i>Shariah</i> Audit Fieldwork	107	62.9	146	85.9	70	41.2	133	73.9

Module 7 - <i>Shariah</i> Audit	110	64.7	135	79.4	79	43.9	121	67.2
<b>TOTAL</b>	<b>842</b>	<b>(70.8%)</b>	<b>974</b>	<b>(81.8%)</b>	<b>551</b>	<b>(43.7%)</b>	<b>795</b>	<b>(63.1%)</b>

## CONCLUSION

The growth of IFIs as well as *Shariah* audit practices bodes well for the industry and the profession. *Shariah* audit practices cannot just cover operational audit, but it should also cover other audit scopes including *Shariah* matters. Due to this, *Shariah* auditor needs to equip themselves with both *Shariah* and audit knowledge in order to ensure they can carry *Shariah* audit function and scope effectively. Good *Shariah* audit practices will ensure not only *Shariah* compliance status by an IFI, but also will give a credible assurance for IFIs' stakeholders, customers and investors.

The issues and challenges discussed earlier on *Shariah* audit in IFIs must be taken seriously. Good *Shariah* audit practices in IFIs can be ensured by the availability of adequate guidelines or standards especially for *Shariah* audit scope. Currently, the *Shariah* auditors are working based on their own experience to ensure they have covered the area which possesses *Shariah* risk adequately.

For *Shariah* auditor backgrounds, *Shariah* auditors can be adequate in *Shariah* audit knowledge by having a comprehensive training and education such as *Shariah* Audit Training (SAT) conducted by the Faculty of Economics and Muamalat (FEM), Universiti Sains Islam Malaysia (USIM) that ensures credibility of the *Shariah* auditors. SAT modules cover an adequate *Shariah* audit elements such as *Shariah* principles, *Shariah* governance, *Shariah* audit process, *Shariah* audit program, *Shariah* risk management, *Shariah* audit fieldwork and *Shariah* audit communication. This program can enhance the knowledge and skills of *Shariah* auditors in performing their duties as a qualified *Shariah* auditor. A Certified Professional *Shariah* Auditor (CPSA) program too has been launched in Malaysia to overcome this lack of talents in this challenging industry.

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## **ASSESSING THE PRICING OF TRUE SALE-BASED FINANCING IN MALAYSIAN ISLAMIC BANKS: A STRUCTURAL EQUATION MODELING (SEM) APPROACH**

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### **ABSTRACT**

*This study aimed to investigate the impact of charging capital on the Islamic banks' asset holding and its adverse tax treatment could have negative bearing on the pricing of the true sale-based financing, with special reference to the annual profit rate charged on the financing amount. This constitutes one downside of using the true sale debt financing system but on the upside, the absence of Shariah non-compliance risk in the true-sale system and connectivity to the real sector establishes the rationale for pursuing it. The structural equation model (SEM) utilized in this study has captured all of the critical variables under study. The adverse effect of capital charge on business risk, tax expenditure and cost of holding inventories affirm the fact that the use of true sale-based financing will stifle competitiveness of Islamic banks. To subside the situation, Islamic banks should leverage on the use of investment funds (IA) as oppose to deposit funds in their offering of true sale-based financing products as it will release capital charge from bank to the investment account holders.*

**Keywords:** *True sale-based financing, Islamic Pricing, Islamic banking, Structural Equation Modeling (SEM)*

### **INTRODUCTION**

The evolution and development of Islamic financing can be greatly influenced by the regulatory and legal infrastructure of the financial system. While Shariah compliance elements do play a dominant role in defining the nature of Islamic modes of financing, product development is also fine-tuned to observe Shariah compliance within regulatory requirements such as economic capital and tax charges under the respective capital adequacy and tax regimes of sovereign countries. For this reason, the character of sale-based financing such as *murabaha* and *al-bai-bithaman ajil* may have to succumb to

these regulatory requirements with possible adverse impact of its Shariah compliant position. This is due to the fact that Islamic banks have not been able to evident its true label in so far as taking full ownership of the assets they intend to sell on credit term due to these infrastructural impediments. For this reason, the apparent fixation of Shariah compliance parameters to matters relating to contract validity as opposed to risk-taking arrangement seemed to have undermined a critical component of ordinary business conduct, namely the carrying of commercial risk by traders and merchants as amplified by the legal maxim *al-ghurmi bil ghuni* (i.e. profit is accompanied with risk) which applies to the Islamic banking business as well.

In the retail trading business, commercial risk takes the form of price risk or also known as market risk which originates from risks associated with ownership of tradable assets. Traders generally hold inventories before putting up the goods for sale in the marketplace. The holding of inventories evidently suggest that the trader is carrying ownership risk of goods. When the trader takes full ownership of the goods he intends to sell, he exposes himself to commercial risk arising from potential price fluctuations. In a sense, commercial risk appears from the assumption of ownership risk, hence giving rise to price and inventory risk. By doing so, the business is exposed to possible gains and losses as the price of goods moves up and down with the market forces. In an economic downturn, when retail price may fall below cost price, the trader suffers losses. Likewise during booms which saw rising demand for goods and services, sale were often made at windfall profits.

It is unfortunate however to see that prevailing practices in the regulatory assessment of Islamic banking contract, the ownership risk has not been made explicit in Shariah compliance process although the existence of business or commercial risk in contracts can be detected in the subject matter (*mahallul 'aqdi*) of the sale. One of the validity conditions to the subject matter concerns the ability to deliver it (i.e. subject matter) to the buyer under the pretext of possession of goods (*qabd*). More importantly, the seller is required to hold complete ownership (*milkultam*) of the subject matter before he can sell the goods in the marketplace and to effect the transfer the ownership of goods to the buyer at the conclusion of the sale. According to section 4 of Sale of Goods Act 1957, a contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price.



This important condition however has yet to be incorporated in the Shariah parameter of regulatory compliance which falls under the purview of the Shariah Advisory Board of the Malaysian Central Bank (*Bank Negara Malaysia*). Current testing for product Shariah compliance has only positioned the five explicit Shariah rules, namely the prohibitions of interest (*riba*), ambiguities (*gharar*), gambling (*maysir*) and prohibited commodities as the sufficient condition for contract validation. The necessary condition such as the carrying of ownership risk by the selling party has not received its fair share as yet.

### ***True sale-based financing and its associated risks***

A true-sale debt financing contains two parts, namely the 1) true sale i.e. cash purchase component i.e. the purchase and holding of assets by the bank before the credit sale is executed i.e. the on-balance sheet holding of assets and 2) credit sale component i.e. the sale of assets on installment payment system. A contract of *murabaha lil amil bi-shira* is one example, which is *murabaha* by purchase orderer. But it can also take the form of basic *murabaha* where no prior order is made. Hence, when the bank undertakes a true sale position, the subsequent movement of ownership title from the supplier to the bank will evidence the holding of business risk. This risk should provide a premium or an additional profit to the bank to accommodate the business risk it is carrying. True sale debt financing should be relatively free from Shariah non-compliance risk (SNCR) in view that all contract requirements are fulfilled, especially that dealing with asset ownership, ownership risk and the transfer of ownership from the bank to the customer. A celebrated legal case of Shariah non-compliance risk practice can be referred to *Mayban Finance vs Taman Ihsan Jaya*, which ruled the *al-bithaman ajil* contract as invalid due to the ownership issue. The court Judge says, “*This court holds that where the bank purchased directly from its customer (ie PPA) and sold back to the customer with deferred payment (ie PSA) at a higher price in total, the sale is not a bona fide sale, but a financing transaction, and the profit portion of such Al-Bai’ Bithaman Ajil facility rendered the facility contrary to the Islamic Banking Act 1983 or the Banking and Financial Institutions Act 1989 as the case may be*”.(MLJ 2008).

Critics of prevailing Islamic financing have put asset ownership as the pivotal attributes of lawful contract. The concept of *al-bay’* stipulates the foundation of the banking business which the Quran poses as the alternative to *riba* (Quran al-baqarah 275). Unfortunately, asset ownership requirement in a sale and consequently the taking of

ownership risk in *al-bay* were both over-looked by the Islamic banking business and Shariah regulatory parameters as well. As an example, the sale and buy-back transaction through Property Purchase Agreement (PPA) and Property Sale Agreement (PSA) between bank and customer in the Malaysian *al-bai-bithaman ajil* financing showed no evidences of actual purchase between the bank and the developer or even between the bank and the customer as per the PPA. Dahlan and Aljunid (2011), argues on the issue whether or not the customer has acquired full ownership to warrant him becoming the legal owner of the house hence evidencing uncertainty or *gharar*, more particularly *gharar al-fahish* (exorbitant *gharar*). Another observation argued that the bank merely acts as a financing party rather than a selling party and had detached itself from all liabilities pertaining to the good sold. It has largely ignored the Islamic legal maxim of “*al-ghorm bil ghonm*” (no reward without risk) and “*al-kharaj bil daman*” (any benefit must be accompanied with liability) although these two principles form the basis of profit-taking in trading and commerce (*al-bay*).

The Islamic theory of profit can be tracked back to the *Mejelle*, where lawful profit is explained by the acquisition of property (*mal*), work (*kasb*) and liability (*daman*). The acquisition of property in general requires the seller to purchase goods from the supplier, hence garnering ownership control of the property. Doing so, requires the supplier to use his capital to finance the purchase, thus putting the capital at risk. The connectivity between taking ownership and taking risk is therefore established here, in the subject matter of the contract (*mahallul 'aqdi*). In observing ownership requirement of true sale debt financing, Islamic banks are expected to hold more economic capital in view of the higher risk associated with the asset holding (Ariff and Rosly 2011).

The ownership requirement from a sale contract has its origin from hadiths where Jaafar ibn Abi Wahshiyah had reported from Yusuf ibn Mahak, from Hakim ibn Hizam who said he had asked the Prophet: “O Messenger of God, a man comes to me and asked me to sell him what is not with me. I sell him (what he wants) and then buy the goods for him in the market (and deliver them).” The Prophet replied: “Sell not what is not with you.”

### ***Business/commercial risk and capital requirement***

Similar to conventional banking, Islamic banking is driven by profits and earnings that are largely defined by the size of capital it is holding to support the financing activities undertaken by each business units. The risk-appetite policy of the bank is also defined by capital. Like conventional banks, an Islamic bank is also highly leveraged, based on the size of deposits it holds relative to capital. Risks associated with modes of financing are critical to the bank as the more risks it carries will require more capital to back-up the positions taken up.

Capital charge is bank capital needed to support the financing facility extended to customers. The function of capital is to absorb unexpected losses from financing exposure. Suppose, bank's exposure is \$80 million which carries risk at RW =100 percent, based on capital adequacy ratio (CAR) = 8 percent, the capital requirement is  $(0.08 = K/\$80 \text{ million} \times 1.00; K = 0.08 \times \$80 \text{ million} \times 1.00) = \$6.4 \text{ million}$ , which means that the bank is required to hold \$6.4 million of its total capital to back-up the \$80 million facility that it gives away. As the facility is funded by deposits, it is unsafe for allowing the bank to take unnecessary risks that can lead to default. Assuming that a 5 percent probability of default (PD) can result in a \$4 million default and write-off, which is enough to be absorbed by the \$6.4 million capital held against it. But at 10 percent probability of default and \$8 million write-off, the bank is short of \$1.7 million to absorb the loss. Depositors will be the ultimate victims when bank becomes insolvent as they have nowhere to claim their savings.

Capital charges for true sale-based financing can be punitive to Islamic banks as the risk-weights (RW) associated for assets held intended for trading is set at 150 percent and higher depending on the intensity of commercial risk it carries. Bank trading position is the purchase and holding of assets prior to the credit sale. Bearing ownership risk can mean a drop in asset quality when the intended sales may not concluded by clients to whom the bank has no recourse. Based on the same example as above, the capital charge on the true-sale debt financing is  $(0.08 = K/\$80 \text{ million} \times 1.5) = \$9.6 \text{ million}$ . The bank now has to hold \$3.2 million additional capital to back up the same exposure and this will add stress on bank capital requirement.

### ***Commercial risk and taxation***

Government imposes tax on sales and income generated by business and individuals. For example, when a customer purchases a property using a bank loan, he pays the appropriate taxes or stamp duties based on the specified tax rates and value of the property. Likewise, in a true debt financing where the bank buys an asset from a vendor on cash basis and sells it to the customer on credit term, the first purchase by the bank carries a taxable which can be absorbed as cost overhead and eventually passed on to the customer. For the jurisdictions such as the Gulf countries where tax is a non-issue, Islamic banks there can find comfort in buying assets they intend to sell on credit. However, for countries where tax revenues constitute a major income to the government, tax expenses on asset purchases are additional transaction costs that must be strategically positioned for Islamic banks to be competitive.

As a response to the above, tax neutrality status is awarded to Islamic banks in reducing transaction cost of non-true sale debt financing.<sup>114</sup> This applies both to *Al-bai-bithman ajil (BBA)* and *Enah* products since the first purchase where tax is levied on the customer, is initiated between the customer and vendor. In BBA, the bank appoints the customer to purchase the asset from the vendor on its behalf which it (i.e. the bank) later sells on credit terms. Tax expenses is however absorbed by the customer. In *Enah* modes of financing, the tax is borne by the customer at the conclusion of the sale and purchase agreement (SPA).

### ***Deposit funds***

The nature of commercial banks are such that they are not made to undertake sale and purchase business involving assets and commodities sanctioned by Shariah since loans are not funded by bank capital but from deposits. To protect deposits, banks are required to hold ample capital acting as a cushion against unexpected loss.

### ***Commercial risk and pricing***

While the Shariah requires the selling party to take ownership risk to evidence compliance to the twin-principles “*al-ghorm bil ghuni*” (with risk comes profit) and “*al-*

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<sup>114</sup> The cancellation of the inter-conditional clause (ICC) in *inah* sales has positioned it as a true-sale debt financing upon request of bank customer to take possession of the asset sold, which allows the bank to release asset ownership title.

*kharaj bil daman*' (profit is accompanied with responsibility) in a sale, pricing of true-sale debt financing products will carry a business/commercial premium which is unaccounted for in a non-true sale *murabaha* and conventional loans. The sales taxes such as goods and service tax (GST) as required from any true sale is also added to the pricing system.

Table 1: Cost of True Sale Debt Financing

1. Capital charges on business risk	Capital charge at minimum 150% risk-weight
2. Inventory risk	Warehouse overhead
3. Tax charges	Stamp duties and Goods and Service Tax on sale and purchase agreement paid by Bank  Sale of Goods Act 1957

Based on the above, the profit rate charged by Islamic banks on Islamic sale-based financing products can be divided into:

1. True sale-based financing facility  
 $\text{Profit rate (P1)} = \text{Cost of deposits} + \text{overhead (to include inventory costs)} + \text{asset tax charges} + \text{business risk premium} + \text{credit risk premium}.$
2. Non-true sale-based Islamic debt financing facility  
 $\text{Profit rate (P2)} = \text{Cost of deposits} + \text{overhead (without asset tax)} + \text{credit risk premium}.$

As said before, in countries where no taxes are levied on sales, for example in most GCC countries, tax expenses on asset sales and purchases is a major concern to the Islamic banks. But, the capital charges is always critical in risk management as many Islamic banks operate under the Basel standards. As shown in Table, the profit rate for true sale-based financing is higher than the non-true sale-based financing. The business/commercial risk premium and transactions costs related to taxes and inventory management constitutes the additional components of the profit rate.

### ***Commercial risk and impact on competitiveness***

While credit sale without evidencing the true-sale character had given way to the practices of *Enah* financing, the profit rate chargeable on this type of facility is relatively lower than a true sale-based financing, which makes the former a superior option. Prevailing *Enah* and *Tawaruq* or *Commodity Murabaha* facilities are able to avoid the fiscal liabilities and commercial risk associated with the contract as both are able to circumvent price volatilities. Although *Tawaruq* and *Commodity Murabaha* had both substantiated the provisions of property rights, the price risk is relatively absent as the transactions were conducted in rapid sequences which practically leave no possibility of price movement. For example, if the commodity is bought for \$1,000 per ton from Vendor A at 10 am on 1<sup>st</sup> March 2014 and sold to Vendor B at 10.10 am on same day, the price risk is actually zero. Justice Taqi Usmani's commented on the financing modes based on *Murabahah* and *Ijarah*, that "... there should be a gap between purchasing the commodity and selling it to the customer and the risk of owning the commodity during the period should be borne with all its basic components and all its essential consequences." (Siddiqui 2001) The lack of time-gap is attributed to the fact that the *Commodity Murabaha* is designed to secure full principle and profit payments arising from the debt created from the *Murabaha* credit sale. The existence of such financing arrangements have made it difficult to ascertain the commercial viability of true-sale debt financing as Islamic banks will opt for the easier alternative. In other words, when the true-sale debt financing can lead to a higher cost of doing business, it is expected to inflate its term charges (i.e. profit rate) and consequently deemed the facility less competitive to *Enah*, *Tawaruq* and conventional loans.

While the true sale-based financing is relatively more costly than *Enah*, *Tawaruq* and commodity *Murabaha*, Islamic banks that operate under a dual-banking system should be able to identify the benefits from true sale products. For example, one advantage is that banks can say, undertake block purchase of assets and hence enabling them to buy them below the retail price, say at 10 to 20 percent discount. Although the bank will charge a higher profit rate, the cost or acquisition price can be lower than those paid under *Enah*. This should make it possible for Islamic banks to offer the customers a facility with a cost of purchase that is lower than market prices. This should dilute the higher profit rate charge to the true-sale credit facilities. Likewise, under a *Musharaka* agreement the bank

can also pursue a joint-venture project with say, a property developer and underwrite the property before selling them to end-users. This may require Islamic banks to explore potentials business in the physical and financial *Halal* supply chain. For this to happen, one must look at the funding issue which is examined in the final section of the paper.

### ***Components Of Islamic Profit Rate***

When an Islamic sale-based financing arrangement is executed without the true-sale element, the bank will only charge a credit or default risk premium as it (i.e. the bank) only faces credit risk being a major risk from the exposure. In this case, the components of profit rate are as follows:

#### ***Profit rate = cost of funds + overhead expenditures + default risk premium***

- a) The cost of funds constitutes the first component of bank's profit rate. This is income distributable to the depositors, namely the current, savings and investment account holders. Changes in the cost of funds from changes in the official policy rate (OPR) will be reflected to the profit rate charges. For example, a 1 percent increase in the OPR, will increase in cost of funds by 1 percent which raises the profit rate by 1 percent.
- b) Overhead expenditures explain cost of administering the bank such as covering expenses on salaries and bonuses of employees, rents and general administrative expenses of the firm. These overhead costs are imputed in the profit rate, as these banking expenses are transferred to the customers. In this way, a big bank that may benefit from scale economies is likely to charge lower profit rate than a smaller bank as the former holds lower average fixed costs. In true-sale debt financing, the bank may incur inventory costs which will increase overhead costs and price of the facility.
- c) The default risk premium is the additional profit charged by the Islamic bank to the customer arising from the potential loss in the credit exposure. A customer with weak credit rating will have to pay more for the financing amount received compared with one with higher credit standing. Hence, an aggressive bank can pursue a risky financing strategy by extending an unsecured *Murabaha* facility

that gives a higher profit in view of the higher default risk premium. As the true-sale *Murabaha* has a credit component, profit acquired based on potential loss arising from default can be confirmed from the study. More importantly, default risk will rise when the bank is required to release ownership title of asset before full payment is made.

- d) In the true sale-based financing, the holding of asset (i.e. prior to the credit sale) introduces an additional profit component to the profit equation, namely the business/commercial risk premium. It can be measured by the capital requirement on the exposure and introduces an additional cost to the facility as consequence of risk taken by the bank on the purchase of asset from the vendor. In this way the components of profit rate of the true sale-based financing is as follows:

$$\text{Profit rate} = \text{cost of deposits} + \text{overhead expenditures} + \text{tax charges} + \text{default risk premium} + \text{business risk premium}$$

### ***The Profit Rate Model***

The five components of profit rate from a true sale-based financing product can be examined from a theoretical perspective from which certain behavioral character can be postulated. The profit rate model is given below:

$$\text{Profit rate} = f(\text{cost of funds, overhead costs, default risk capital charge, business risk capital charge, tax charges})$$

Profit rate is speculated to be determined by five variables listed above. This is an exploratory study where no substantial research on this area has been conducted, thus the lack of literatures on this aspect of Islamic banking is evident. The model attempts to examine factors affecting the profit rate of true-sale debt financing. Cost of funds is indirectly affected by macro variables such as recession, inflation and monetary policies intended to maintain economic stability. Default risk is influenced by credit standing of the banking customers, collateral and tenure of the facility. The two new variables, namely business risk capital charges (i.e. on trading exposures) and tax expenses (i.e. from the purchases of assets) is a direct consequence of on-balance sheet asset holding to evidence full ownership of the asset by banks. Based on the above, the hypotheses of the study are as follows:



- 1) Hypothesis H1: Cost of Fund has an impact on Profit rate.
- 2) Hypothesis H2: Overhead has an impact on Profit rate.
- 3) Hypothesis H3: Default Risk has an impact on Profit rate.
- 4) Hypothesis H4: Capital Charge on business risk has an impact on Profit rate.
- 5) Hypothesis H5: Tax burden or charge has an impact on Profit rate.

## METHODOLOGY

Data is collected from survey questionnaires. The question items used in this study were a newly developed ones based on reviewed literature, underpinning theories and suggestions from academicians and practitioners. A close-ended 7-point Likert scale has been used in the questionnaire to examine the inter-relationship among dependent and independent variables. Structural Equation Modelling (SEM) technique is employed using the Analysis of Moments Structure (AMOS) version 22.0. The advantage of AMOS in comparison to other software is that it can construct graphic representations of the model.

### *Sampling*

This study employed one-shot time horizon studies over the period of 2014. The sample size of the current study is 250 respondents. The composition of respondents for this study is illustrated in Table 2. The targeted group of respondents ranges from executive to managerial level at the headquarters offices of Islamic banks in Malaysia. All the respondents in this study are Muslims.

This study used samples of 250 respondents which indicate a balanced proportion between male and female. The profiles of respondents are shown below:

**Table 2: Respondent Profiles**

Age	Frequency	Percentage
Below 30	80	32.0
30-40	113	45.2
41-50	49	19.6
Above 50	8	3.2
<b>Total</b>	<b>250</b>	<b>100</b>

Gender	Frequency	Percentage
Male	122	48.8
Female	128	51.2

<b>Total</b>	<b>250</b>	<b>100</b>
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<b>Religion</b>	<b>Frequency</b>	<b>Percentage</b>
Muslim	250	100
<b>Total</b>	<b>250</b>	<b>100</b>

<b>Occupation</b>	<b>Frequency</b>	<b>Percentage</b>
Shariah Committee Member	30	12.0
Auditors	35	14.0
Risk Managers	41	16.4
Shariah & Compliance Officer	52	20.8
Product Managers	34	13.6
Regulators	58	23.2
<b>Total</b>	<b>250</b>	<b>100</b>

<b>Working Duration</b>	<b>Frequency</b>	<b>Percentage</b>
1. years	181	72.4
>10 years	69	27.6
<b>Total</b>	<b>250</b>	<b>100</b>

<b>Qualification</b>	<b>Frequency</b>	<b>Percentage</b>
Post Graduate	56	22.4
Degree	147	58.8
Diploma	6	2.4
Professional Certificate	41	16.4
<b>Total</b>	<b>250</b>	<b>100</b>

### EMPIRICAL RESULTS

The proposed structural model equation for this study is as follow:

$$Pr = \beta_0 + \beta_1 Cf + \beta_2 Oh + \beta_3 Tb + \beta_4 Cc + \beta_5 Dr + \varepsilon$$

Where:

Pr = Profit Rate, Cf = Cost of Fund, Oh = Overhead, Tb = Tax Burden, Cc = Capital Charges, Dr = Default Risk

$\varepsilon$  = error term

Data analysis used in SEM was conducted in two stages. The first stage is the Measurement Model or Confirmatory Factor Analysis (CFA) and second stage is the Structural Equation Model.

### CONFIRMATORY FACTOR ANALYSIS

The Confirmatory Factor Analysis (CFA) was performed to check the reliability and validity of the instrument. Internal reliability test by Cronbach's Alpha indicated that all constructs meet the minimum requirement of above 0.7. The results are also strengthened by the validity test of convergent and construct validity. With reference to Table 3, values of factor loading between latent variables and their indicators as well as the scores of the composite reliability and average variance extracted are presented. It was found that all the 35 item loadings were statistically significant. On top of that scores for Construct Reliability (CR) and Average Variance Extracted indicated an acceptable result. All results for AVE are above 0.5 and CR scored above 0.6. Thus, these provide support to the reliability and validity of the instruments used in this study.

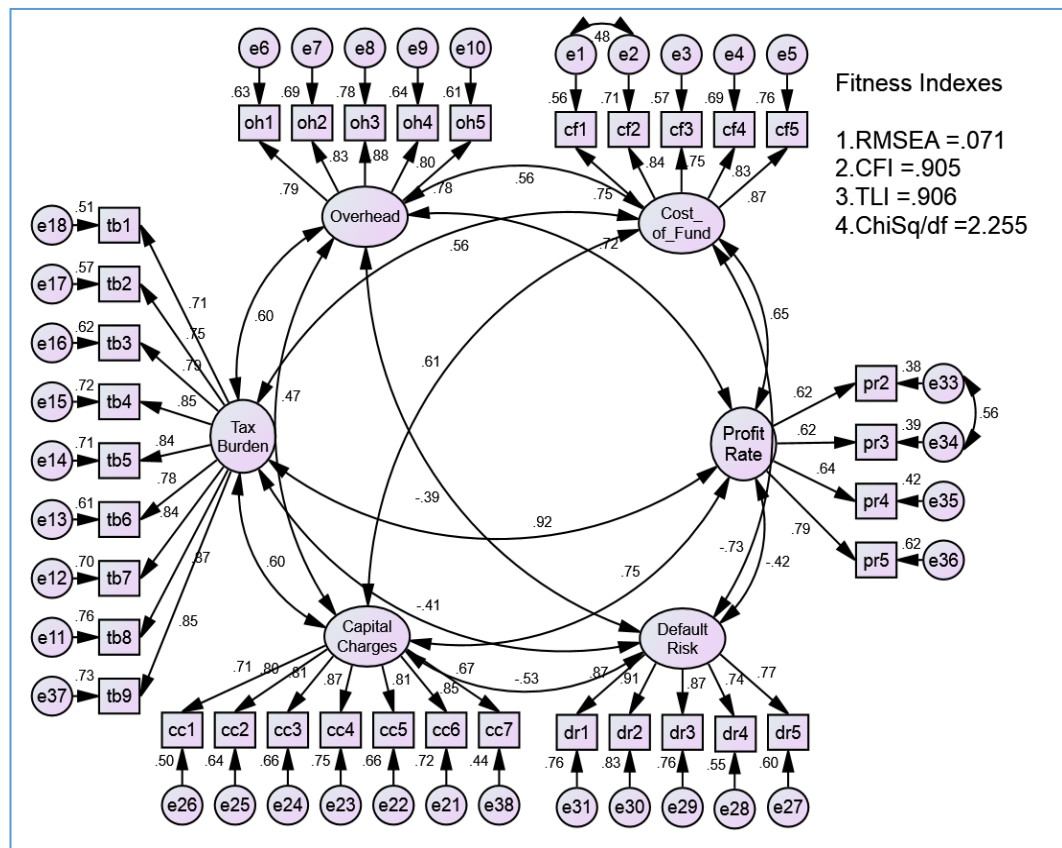
**Table 3: The CFA Results Reporting for the Measurement Model**

Construct	Item	Factor Loading	Cronbach's Alpha (Above 0.7)	CR (Above 0.6)	AVE (Above 0.5)
<b>Cost of Fund</b>	CF1	0.752	<b>0.912</b>	<b>0.906</b>	<b>0.661</b>
	CF2	0.844			
	CF3	0.753			
	CF4	0.833			
	CF5	0.874			
<b>Overhead</b>	OH1	0.794	<b>0.909</b>	<b>0.910</b>	<b>0.669</b>
	OH2	0.828			
	OH3	0.882			
	OH4	0.798			
	OH5	0.784			
<b>Tax Burden</b>	TB1	0.872	<b>0.945</b>	<b>0.946</b>	<b>0.660</b>
	TB2	0.837			
	TB3	0.784			
	TB4	0.844			
	TB5	0.849			
	TB6	0.789			
	TB7	0.752			
	TB8	0.714			
	TB9	0.855			
<b>Business risk Capital Charges</b>	CC1	0.851	<b>0.919</b>	<b>0.921</b>	<b>0.626</b>
	CC2	0.815			
	CC3	0.865			
	CC4	0.810			
	CC5	0.798			
	CC6	0.710			
	CC7	0.667			
<b>Default</b>	DR1	0.773	<b>0.921</b>	<b>0.921</b>	<b>0.70</b>

<b>Risk</b>	DR2	0.874			
	DR3	0.908			
	DR4	0.874			
	DR5	0.743			
<b>Profit Rate</b>	PR2	0.619	<b>0.786</b>	<b>0.918</b>	<b>0.694</b>
	PR3	0.622			
	PR4	0.645			
	PR5	0.785			

Apart from reliability and validity tests, test of the model fit was conducted. Figure 1 illustrates the measurement model for study variables. An indicator that represents the discrepancy per degree of freedom measured in terms of the population, RMSEA, is one of the indicators that were used as reference in this analysis. RMSEA value in this present model is 0.071. This is below the recommended 0.08. The cut off points as suggested by Hair et al. (2006) are 0.08 and 0.07 respectively. In addition to RMSEA, other means that were used in this measurement of model fit exhibit tolerable results which signify that the model under consideration display good fits. For instance, the values of CFI show a good fit of 0.954 (Byrne, 2001). The same thing goes to other indicators – GFI and TLI, all are well loaded, parallel with suggested model fit indices by Hair et al. (2006). Thus, this explains that the model under consideration exhibit good fits.

**Figure 1: The Measurement Model**



### STRUCTURAL EQUATION MODEL (SEM)

The second stage involves using structural equation model. A structural equation model was developed to ensure that all instruments are fit for the model in order to be used to test the hypotheses and to obtain the  $r^2$  coefficient. The endogenous construct in this study is Profit Rate, whereas exogenous constructs include Cost of Fund, Overhead, Tax Burden, Business risk Capital Charges and Default Risk.

### FINDINGS

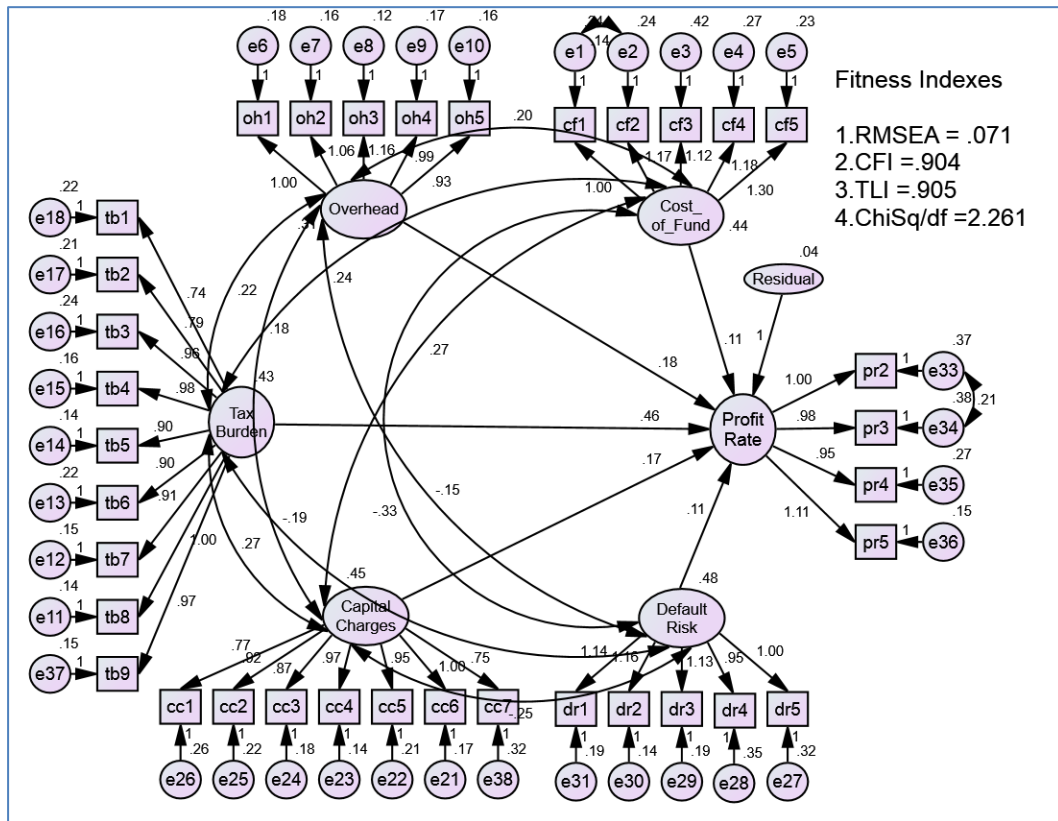
Fit statistics show that the structural model in Figure 2 exhibits an acceptable fit (i.e CFI = 0.904; TLI = 0.905; Chisq/df = 2.261). The fit statistics indices will test whether there is any misspecification or violations of assumptions. Parameters are fixed to specific values of either zero or one. The fixed parameters are strongly supported by literature review.

From Figure 2, the regression weight estimates of Cost of fund is 0.108, Overhead is 0.182, Default risk is 0.108, Capital charges is 0.175 and Tax burden is 0.465

respectively. The value of squared multiple correlation ( $r^2$  coefficient) of the exogenous constructs toward the endogenous construct for the whole model is 0.85, indicating that the contribution of all the exogenous constructs (Cost of fund, Overhead, Default risk, Capital charges and Tax burden) in estimating endogenous construct (Profit rate) is 84%. This value is indicated at the endogenous construct.

According to Zainudin (2012), the value of r-squared ( $r^2$ ) is the most important output in the Regression Weight for the model. From Figure 2, we could conclude that the model is good since it could capture 85% of the estimate on endogenous construct by including certain exogenous constructs in the model. At the same time, the fitness indexes all achieved the required level and the factor loading for all items were also good, being above the required 0.6.

Figure 2: The Structural Equation Model



The result of hypotheses is presented in Table 4 below. The regression weights indicate that Overhead, Tax Burden, Capital Charges and Default Risk are significantly positive related to Profit Rate. All of the hypotheses (H2, H3, H4 and H5) are supported except for H1, the effects of Costs of Fund on Profit Rate. It is found that the respondents believed that costs of funds are largely driven by policy variables as opposed to market conditions that can invariably influence the bank’s performance as hypothesized in this study.

Table 4: The Regression Path Coefficient in the model and its significance

Endogenous		Exogenous	Regression Weight	Standard Error (S.E)	Critical Ratio (C.R)	P-Value	Result
Profit rate	←---	Cost of fund	0.108	0.067	1.627	.104	Not significant
Profit rate	←---	Overhead	0.182	0.059	3.095	.002	Significant
Profit rate	←---	Tax	0.465	0.061	7.556	***	Significant

	-	burden					nt
Profit rate	←---	Capital charges	0.175	0.051	3.452	***	Significant
Profit rate	←---	Default risk	0.108	0.053	2.030	.042	Significant

### ANALYSIS

Our findings suggest that an Islamic bank that drives its business based on the true-sale debt financing model will not be able to provide competitive pricing alternatives relative to prevailing Islamic debt facilities despite its true-label with possible zero Shariah non-compliance risk. The two determinants of profit rate arising from the true-sale model, namely business risk capital charges and tax burden on asset purchases have evidence significant relationship with the predictor variable. It is therefore confirmed that regulatory and fiscal elements do influence the charging of profit rate in Islamic banks. On the former, the use of deposit funds to finance true sale-based financing facilities will carry higher capital charges on the exposures which can add more stress of bank's capital. Banks may have less incentive to offer true sale-based financing instrument as its current risk-appetite may not be able to accommodate business risk as yet. Tax burden is also critical in the offering of true sale-based financing as the cost of transactions can be overwhelming high since the bank is expected to pay off the tax expenses at the point of purchase. Additional cost overheads will also account for inventory costs such as warehousing and insurance. While these costs may later be transferred to the customer, but initial expenditures would be absorb by the bank which have to be budgeted as projected overhead costs. On the default risk, it is believed that default risk will increase under true sale debt financing when the bank is required to release the ownership of the property before full payment is made. This postulate is confirmed as the relationship between price and default risk is significantly related.

### INVESTMENT ACCOUNT (IA)

The way out of these regulatory impediments to the true sale-based financing is to resort to the new legislation on Islamic banking in Malaysia, namely the Islamic Financial Service Act 2013 (IFSA 2013). The new law requires banks to categorize their funding sources into 1) deposit funds and 2) investment funds. Exposures using deposit funds are subject to the regulatory capital charges while those using investment funds are not.



Investment funds are in essence equity funds that can behave similar to mutual funds or unit trust funds whereby capital and income protection are not given to investors (BNM Investment Accounts 2014). The new law will put an end to the use of investment accounts as deposit funds which can somewhat bring possible Shariah non-compliance risk issues when these investment accounts are conceived of as deposit funds which gave depositors legal claim on the principle and earnings. It should also open up new opportunities for Islamic banks to venture into trading arrangements that could spurred the halal supply chain with positive impact on real sector development. Under this new arrangement, Islamic banks that are keen to adopt the true sale-based financing will not be required to hold additional capital to cushion the exposures against unexpected losses as these will be carried by the investment account holders. The matching of risk-appetite of the investors and the true-sale financing and other equity exposures can be made possible through the Islamic Account Platform (IAP) that has received a MYR150 million development budget from the Prime Minister of Malaysia (BNM Financial Stability Report 2014).

### **CONCLUSION AND RECOMMENDATION**

This study is an attempt to verify that the charging of capital on the bank's asset holding and its adverse tax treatment will have negative bearing on the pricing of the true sale-based financing facility. It constitutes one weakness of true sale-based financing system but on the upside, the absence of Shariah non-compliance risk in the product and contact with the real sector establishes the rationale for pursuing it. The Islamic Financial Service Act 2013 introduces many enhancements on Shariah governance one of which is the severe penalties on Shariah non-compliance such as MYR25 million fines and 8 years of imprisonment or both (IFSA, 2013). This puts Islamic banks on guard to avoid falling into non-Shariah compliance status in their effort to minimize contact with regulatory and fiscal requirement of true sale-based financing. It is on this premise that this study seeks to explore the impact of true sale-based financing on the profit rate of the facility by virtue of the ownership risk carried by the Islamic banks. In this study, it is found that true sale-based financing is relatively more expensive than conventional products as well as some Islamic products bearing no true sale character. It was able to show that the use of true sale-based financing can produce adverse impact on competitiveness of Islamic banks. A viable alternative is the application of Investment Accounts (IA) to finance the

true sale-based purchases as business risk will be absorbed by the IA holders while Islamic banks may act as an agent in managing the Investment Account funds.

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## **GREEN BANKING: THE CASE OF COMMERCIAL BANKING SECTOR IN OMAN**

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### **ABSTRACT**

*Financial institutions are in a strategic position which can play a pioneering role in creating and maintaining green revolution for the planet. These institutions can implement a 'go-green' policy for themselves and can encourage client firms for the same by initiating various incentive mechanisms. This paper aims at examining the level of activities and effort put forth by commercial banks in Oman. The research further aims to investigate how far these institutions differ from one another in terms of environmental performance and what are the determinants of their performance. In so doing, we examine the audited financial statement of banks about the environmental disclosure. Our preliminary analysis shows that most banks do not mention anything about the 'environment' or 'green banking' in their financial statements. Thus, we have decided to conduct interview. According to our interviews with 8 individual ranging from Managing Director to Branch managers, of different banks: certain conclusions are obvious: (i) banks environmental initiatives that reflect on their day-to-day activities are confined to recycling and being paperless, (ii) while evaluating loans' proposal, banks do not have a provision to ask about carbon footprint of projects, (iii) most banks however, think that eco-house concept can be effectively implemented through the banking system, and (iv) most banks recognize the needs for separate guidelines from the central banks for banking sector to take care of the environment. The result of this research will help policymakers to formulate policies required for mitigating carbon foot-print in Oman.*

**Keywords:** Green banking, carbon footprint, financial sector, Oman

**JEL Classification:** G20, Q5

## INTRODUCTION

The problem of climate change is one of the crucial issues which compel policymakers involve in rigorous discussion and analysis. It not only affects the lives of the people living in the planet now but also the lives of the future generations. Therefore, solution for addressing the impacts of climate change is an immediate requirement. Unless an appropriate and concerted effort is put forward by every spheres of the economy worldwide, a sustainable solution for climate change induced problem is difficult to come by. Financial institutions are in a strategic position which can play a pioneering role in creating and maintaining green revolution for the planet. These institutions can implement a 'go-green' policy for themselves and can encourage the client firms for the same by initiating various incentive mechanisms.

The Sultanate of Oman has already undertaken numerous initiatives for clean environment as part of the global drive towards a greener planet. For instance, Oman 2020 economic blueprint have all been aimed at achieving a sustainable social and environment friendly path of development. In pursuit of this goal, financial institutions have bestowed with enormous responsibilities as well as sufficient leeway to innovate and find ways for safer and clean environment. This research therefore aims at examining the level of activities and efforts put forth by commercial banks in Oman. The research further aims to investigate how far these institutions differ from one another in terms of environmental performance and what are the determinants of their performance. In so doing, the research applies semi-structured questionnaire and conducts interviews with the top level management of some commercial banks in Oman.

Although it may apparently seem that banking sector has less scope to contribute to the clean environment, this sector actually can be pioneer in green movement. For instance, banks provide finance to various enterprises which may be directly involved with carbon emission. Thus, banks on the one hand can discourage such types of projects that create an apparent threat to the environment by imposing higher cost of funding. On the other hand, they can initiate various initiatives towards clean environment such as allowing concessional loan for eco-friendly projects such as eco-houses, solar energy-related projects etc. Also, banks themselves can restrict carbon footprint by reducing use of paper, consuming less energy etc. This implies that financial institutions can play a pioneering role in creating awareness for clean environment.

Moreover, it may be assumed that Oman is not a country where environmental problem is alarming. While this may be true, the recent emphasis of economic diversification from oil-reliance to other sectors including tourism may create a serious trouble in terms of environmental degradation. Moreover, research has found that Oman at present is a bit conservative in their efforts to redress environmental problem (Rahman, and Miah, 2016). In this circumstance, efforts from all concerned segments of the economy towards curbing GHG emission should be desirable. In this sense, the proposed research is likely to help policymakers to identify factors to be emphasized on for providing sufficient incentives and motivations to financial institutions to ensure their spontaneous strive towards a greener world. Moreover, the research is expected to contribute to the field not only by providing new evidence on the issue but also by advancing the debate on what could be the suitable forms of ‘carrot and stick’ policy for a clean and safer Oman. In this sense, the research is very timely and expected to have some impact on climate change negotiations aiming to mitigate carbon footprint in the planet in general and Oman in particular.

### **PROBLEM STATEMENT**

Climate change is one of the key and defining issues among the sustainability challenges the planet is facing now. It impinges on every aspect of the things that keep us alive as well as the ways we make our living (McCarthy et al. 2001). Some direct and adverse consequences of climate change include droughts, floods, tsunami, water scarcity, rising sea level and the resulting demographic shifts of people living in the crisis prone areas. These consequences undoubtedly threaten sustainable living in this planet which calls for an urgent and collective response from both developed and developing countries. Sir Nicholas Stern (2007) has already warned stating that greenhouse gas (GHG) emissions can be reduced to stabilization level that would cost merely one percent of the global gross domestic product (GDP) if actions are taken immediately. However, maintaining the same level of stabilization would require around 5-20 percent of the global GDP in the case of delay. Thus, an effective response towards climate crisis is a pressing issue which requires policymakers to identify the elements causing GHG emission and formulate policies to curb its level to stabilization.

One of the leading causes of GHG emission is the unwise disposition of chemical compounds from the industrial units. Regulatory authorities across countries pressed

corporations, initially on voluntary basis and later by formulating legal policies, to actively act upon environmental issue. Firms respond to these calls through shifting their means of production from traditional to new low-carbon production technologies. Simultaneously firms disseminate information concerning their commitment towards environment, and potential actions thereof, to different levels of stakeholders. These activities require firms to commit more-than-usual investment and hence, it affects company performance negatively (Freeman, 1994, cited by Ahmed et al., 1998; Ahmed et al., 2003).

However, the other side of the coin is that consumers prefer products of firms that are more environmentally concerned; regulatory authority provides privileged treatment as reward for environmental commitment; civil society and media recognize them as flagship of the clean world. A combined effect of these is more likely to increase bottom line of these firms. Ahmed et al. (1998, 2003) for instance, provided with the evidence that environmentally more conscious companies performed better than companies which were less conscious. Hence, environmental performance is not merely a regulatory burden to organizations; rather it is an opportunity to go beyond limit, if properly practiced.

According to latest annual report of the Central Bank of Oman (CBO), GDP of Oman at current prices have increased to 14.3 percent in 2013 despite the decline in crude oil price, while production increased which resulted in reduced share of hydrocarbon in 2013 (CBO, 2014). However, hydrocarbon still contributes for around half of the GDP of Oman. Oman's financial system, as usual, is dominated by the banking sector. By the end of 2008, more than 90 percent of the financial systems assets were held by 17 commercial banks valuing about OMR15 billion (Bologna and Prasad, 2010). Growth in both deposits with and credit disbursed from the commercial banks remained favorable in recent years. Oman's banking sector comprises, as of the end of 2013, seven local commercial banks, nine foreign banks, two specialized banks and two full-fledged Islamic banks together with six local commercial banks operating separate Islamic windows for banking operations. Commercial banks in Oman serve the country with, as of December 2013, 493 branches excluding nine branches and two representative offices abroad. In 2013, the ratio of bank credit to overall GDP accounted for 49.6 percent while the capital adequacy ratio remained at 16.2 percent against the statutory requirement of 12 percent. The non-

performing loans (NPLs) as a percentage of total credit stood lower at 2.1 percent in December 2013 as compared to 2.2 percent in December 2012 (CBO, 2014).

Overall banking performance in Oman is positive. Total value of assets, credit disbursement and aggregate deposit has reached to OMR 22.4 billion, OMR15.2 billion and OMR15.6 billion, respectively. In 2013, assets, credit and deposit rose by 7.2, 6.0 and 10 percent respectively compared to 2012. Profit from the banks raised to 15.07 percent valuing OMR351.3 million in 2013 (CBO, 2014).

A number of regulatory and supervisory measures have been proactively initiated by the CBO to address recent global financial crisis and also to reform the financial sector of the Sultanate. For instance, the Sultanate has launched a financial stability unit for macro-prudential supervision of the financial system and forming a Higher Committee on Financial Stability (HCFC). However, CBO has yet to develop a set of guidelines to strengthen financial sectors' actions addressing climate change, corporate social responsibility and green banking.

### **RESEARCH OBJECTIVES**

Despite the need and urgency of finding a sustainable solution to tackle environmental problems, research aiming at highlighting the contribution of the financial sector towards their drive of clean environment as well as tracing the elements of this drive is inadequate. This implies that there exists an overall gap of academic research on the concerned issue. This paper therefore, aims to fill this gap by examining the level of environmental performance of leading financial institutions in Oman and identifying factors influencing their performance. Particularly, the proposed research aims to answer the following questions:

- (I) What is the current status of environmental performance of commercial banks in Oman?
- (II) What are the motivating factors that influence environmental performance of these institutions?
- (III) What strategic policy actions to be put forth by policymakers to ensure maximum care towards corporate greening by banks?



## **RATIONALITY OF THE STUDY**

It is evident that environmental issues gained increasing attention due to growing environmental crisis and natural disasters, increasing awareness among decision and policy makers as well as increasing media involvement in favor of environment protection (Leszczynska, 2010). There is considerable level of environmental concerns, though some lacks in environmental knowledge still exist (Said et al., 2003). In addition, awareness to climate change that significantly influence behavioral changes of the managers in the industries is also lacking (Halady & Rao, 2010). As environmental consciousness has positive impact on organizational performance (Ahmed et al., 1998), regulatory actions are required to ensure that financial institutions, one of the largest contributors to the economic development of any country, are acting accordingly to remain proactive towards environment and also to remain competitive in global and regional market. The Gulf Cooperation Council (GCC), due to its strengths in oil production, is the nucleus of global discussions on certain issues. The Sultanate of Oman, being a GCC member, possesses some remarkable characteristic, although it has a less share in oil production compared to other GCC countries. With about seven percent of total population, Oman produces around five percent of total oil produced in the GCC. Oman has a share of 10 percent in GCC intra-trade export, while intra-trade import is around five percent. The economy has constantly the lowest GDP per capita in recent years. In terms of the general index of financial markets in 2011, Oman belongs to the mid-range within GCC index (GCC, 2014). To further increase the financial strength of the economy, Oman has to rely on the operational efficiency and innovativeness of the financial sector. As climate change and relevant global move towards corporate greening is a well-discussed issue, Oman also has to focus to make the financial sector more competitive in the global era of competition.

## **LITERATURE REVIEW**

Global emissions will continue to grow over the next few decades, even if the emission generation is stopped all of a sudden now which is both theoretically and practically infeasible. As 'zero' emission is not possible at current level of technology and consumption pattern of global population, innovative and new ideas, practices and implementation are necessary to reduce the level of emissions from production process, whether it is goods manufacturing or service generating. Although Bettelheim (2009) is



hopeful that beyond 2050 technological advancement must provide most of the (climatic problems') solutions. However, this is not ideal to sit idle, nor are the countries ignoring the issue of emission cut. All sectors of an economy are willing, despite great variety among proposals, to mitigate the emissions as a whole, not by projects (Ward, 2009).

As a response, international body like United Nations also has initiated and implemented multiple interventions to address environment from corporate level. For instance, Principles 7, 8 and 9 of the UN Global Compacts (UN, n.d.) discuss about the environment concern for business and commerce as follows –

*Principle 7: Businesses should support a precautionary approach to environmental challenges;*

*Principle 8: undertake initiatives to promote greater environmental responsibility; and*

*Principle 9: encourage the development and diffusion of environmentally friendly technologies.*

Substantial research have been conducted for environmental awareness, attitude and behavior, consumer attitude, organizational performance; corporate social responsibility (CSR) and their relationship (Ahmed et al., 2003, Ahmed et. al., 1998; Cheah & Phau, 2011; Fraj & Martinez, 2006; Gadenne et al., 2011; Ma et al., 2011; Xu, 1999). Components of environmental awareness are environmental knowledge, values, attitude, willingness to environmental act and actual behavior (Zsoka, 2008). Research finding shows that there is a need to raise awareness and knowledge about energy savings (Ma et al., 2011) and as country's socio-economic condition affects attitude towards environment, there is a need to raise ecological awareness in less developed countries as well (Leszczynska, 2010). Study of Gadenne et al. (2011) showed that general environmental belief does not influence environmental behavior attitude, but environmental behavior attitude significantly influences environmental behavior. However, there is debate on energy conservation whether it is affected by environmental beliefs and attitude or not (Gadenne et al., 2011). Again, people who are involved with and concerned for environment show higher ecological behavior (Fraj & Martinez, 2006). As higher concern affect positive environmental behavior; it however, does not necessarily mean that a lower concern for environment implies neutral or negative environmental behavior. There are evidences that with limited knowledge on specific

issues, support from citizens towards environment is relatively high (for example hydrogen fuel, see Thesen and Langhelle, 2008). Prior awareness has been identified as key determinant of acceptability where awareness is related to gender, age, education and environmental knowledge (O'Garra et al., 2005). For example, knowledge about hydrogen fuel influences acceptance of hydrogen vehicles (O'Garra et al., 2005).

Public environmental awareness is among the most important indicators for displaying national civilization (Xu, 1999, cited in Huang et al., 2006). Japan is among the countries with the highest rate of primary and secondary education enrollment (Unicef, 2010) but its citizen showed little awareness of the energy efficiency of appliances and little awareness of electricity price (Yamamoto et al., 2008). So, in literature, both views are tested and got both positive and negative relation among environmental awareness and environmental action.

Most of these research focus on manufacturing industries, and rightly so because they are notably the most polluting units. Nonetheless, solution for environment problems requires a concerted effort from all organs of an economy, particularly from financial services organizations. For their privileged position in lending, investment, and other financial services, financial institutions can play a pivotal role in helping manufacturing firms to catalyze the necessary transition to an economy that minimizes GHG emissions and relies on energy efficiency as well as low carbon energy sources. Moreover, it is rather their profit impetus than simply the benevolence for which they work towards a clean world.

## **METHODOLOGY**

Data as well as estimators to measure environmental performance for firms engaged in manufacturing activities are available. Such objective measures as the amount of GHG emission, toxic waste released, toxic waste treated or processed, fund allocated to environment protection are widely used in the literature to measure firm's environmental performance (Clarkson et al. 2004, 2008). However, these sorts of estimations cannot be used for financial service organizations due to the nature of their activities which are different from the activities of manufacturing firms. Their environment concerns reflect mostly on their initiative to green financing, paperless communication, setting up solar panel, recycling activities, maximum usage of day light, reduction of gas and petroleum

consumption, spending on green marketing, budget allocation for climate risk fund, assessing environmental risk rating projects and the like.

The prime methodology concern of this research is to code these initiatives undertaken by financial institutions as part of their environmental performance. Hence, the research aims first to follow the methods of Clarkson et al. (2004, 2008) which adopts general guidelines of Global Reporting Initiatives (GRI). According to this index, a comprehensive environmental disclosure index is prepared based on the content analysis of the audited financial statements of commercial banks. However, our preliminary study finds that commercial banks in Oman rarely report their environmental initiatives in the financial statement. With limited data available, this research is not mature yet to conclude from findings. Thus, the research focuses on interview method. Since the variables are not clearly known (for example lack of reporting of environmental initiatives by financial institutions) and the topic is new and unaddressed within Oman, qualitative exploratory research has been conducted (Morse 1991, cited in Creswell, 2009, p.18). A semi-structured questionnaire was designed (Annex 1) to ask bank's policy makers about their existing initiatives and future plan on this issue. This study has been collecting the opinions from individuals whom are knowledgeable about the issue (Sue and Ritter, 2012, pp. 2). Purposively a set of local experts has been selected from financial institutions and different ministries. So far we have finished 8 interviews. The interim results are presented in the following section.

## **PRELIMINARY FINDINGS**

### *Environment in the day-to-day activities of banks*

Most of the respondents have answered 'yes' on the question as to whether their respective bank adopts any measures in their day to day activities that care the environment. In explaining the details, they have hinted various ways of environmental conservation. For instance, most banks emphasize on digitalizing their system so that the use of paper can be reduced. One bank has adopted policy called 'reference management system' in which the bank has changed manual loan approval system to digital one. However, almost all banks have hinted about 'go paperless'. In so doing, they depend on e-channels instead of manual operated system. Also, some of them have adopted a policy in which most printing will be done black-and-white instead of color printing, unless

color printing is seriously required. Mobile banking is also one of the priorities of the bank in the process of digitalization.

*Institutional capacity of banks for environmental awareness*

Opinions divide in this regard. Some managers think that institutional capacity of banks in terms of environmental protection is limited. Board may think about this issue more seriously but not pretty frequently communicated to the managers. However, others argued that banks have enough institutional capacity to address the issue of climate change. Tackling environmental issue is not a matter of choice, but a 'must' with all available capacities. Some managers told that it is the culture of top management to comply with the environmental codes.

*Investigating clients while sanctioning loans*

All the managers anonymously agreed that at present they do not bother their clients asking about impacts of their projects on environment. Some managers have mentioned that they mostly focus on the risk involved with a customer and the interest of the bank which is profitability. In general, loan officers do not usually ask about information or process which is not required by the law or the loan application. The problem is that banks cannot freely ask a client about something which is not required for sanctioning loans. Even if they ask (in most cases they do not), customers are not bound to disclose. Thus, bank managers think that asking a client about the environment aspect is a complete disadvantage given the current rules and regulations applicable for sanctioning loans. Managers have some business practices which may help protecting the environment. For instance, some Islamic banks offer Murabaha (mainly as car loan). In so doing, they do not finance for car which is more than three years old (from production year). This practice can be considered as environment friendly because new cars are equipped more recent technologies which might cut emission compared to an old car. However, some managers have accepted that they exercise this practice for their own business sake, not from environmental awareness.

Some managers have empathized that for housing loans, banks nominated engineers visit the site where the house is planned to be built. The engineers keep visiting the house until completion and they oversee that the construction does not violate any applicable rules. However, it is the owner's responsibility to comply with, if there is any,

environmental standard. Also, the engineers sometimes advise owners to focus on eco-house, but the ultimate compliance with this suggestion depends on the owners' will.

*Compare environmental performance of banking sector with other industries*

In the question as how manager compares the strategic position of banks compared to other industries as far the environmental issue is concerned, opinions mostly dominate the consensus that banks cannot directly take part in environmental protection since this industry is the indirect player in this concerned. Banks do not have direct influence on increasing or decreasing carbon footprint. In this sense, some managers believe that it is the sector other than banking which is directly degrading environment through various ways should extensively be involved with clean projects. Oman as an oil rich country has plenty of environmental issues related to oil extraction, refinery, and export. Apart from oil and gas industries, some have pointed out tourism sector which should be considerably responsible towards environmental protection because this industry has an enormous impact on environment. For instance, even a small coffee shop located in the tourism site may take serious steps towards clean environment by properly managing the garbage it produces. Also, the role of state in cleaning solid and other wastes can have more meaningful contribution towards protecting the environment than it is currently doing.

Contrasting to this majority consensus, few managers have stressed that environmental degradation is real and this sector should be tackled by all sectors together. It's difficult to single out any particular sector in terms of priority. Environmental issue is an issue that affects all across the world. While some sectors are more responsible for polluting the environment, they are doing their part because of various regulations directly addressing them. But the concern is if some sectors do not move at all because the existing regulations do not require them to work focusing on reduction of carbon footprint. This is really the concern.

*The motivating forces for banks' environmental care*

Environmental aspect of banks should fall under the broader corporate social responsibility. Banks as an important player of the society should actively take part in various activities towards greening the society. For instance, tree plantation can be a simple but contributing step for banks towards their move to reduce the carbon footprint.

The business perspective, which may be an active motivation for banks, is that they should take the project 'eco-friendly', for instance eco-house and energy-efficient house.

#### *The role of the Central Bank*

It has been reflected by the opinions of managers that the financial sector currently lacks an organized and unique guideline to be followed. Thus, they have acknowledged the need for a clear instruction from the central bank. In this regards, managers think that the central bank is the guardian-like apex body of the financial industry which should play the key role in forcing and motivating financial institutions or banks in particular to significantly contribute for reduced carbon footprint. The central bank should issue a clear and comprehensive guideline for banks in regards to green banking and finance. Managers think that Ministry of Environment with the collaboration of the central bank can formulate strategies on how to progress towards this end. There is no question on the proposal that governing bodies of banks should be knowledgeable not only about the banking activities but also how their business can minimize the carbon footprint of the environment.

Some managers have further reminded that the central bank is currently issuing various directions for digitalization which help reduce carbon footprint in the atmosphere. However, managers have stated that they would be happy to comply with any specific environmental guidelines issued by the central bank. Of course, such an initiative should be on the voluntary basis at the outset. Central bank can frame a specific time-line within which all the banks should gradually adopt on a mandatory basis.

#### **INTERIM CONCLUSION**

Based on the interview we have found couple of interesting issues related to environmental awareness of banks. First, banks consider environmental issue in part of their corporate social responsibility. Our interviews have revealed that most banks perform some environmental activities. However, these efforts are not communicated through sufficient disclosures either in the financial statement or circulating a separate sustainability report except one bank which takes a rigorous initiative to inform the stakeholders about their efforts towards greening initiatives through circulating a separate sustainability report. Second, Individual bank considers asking clients about their carbon footprint as comparative disadvantage in the sense that requiring more information of

clients' funds use may keep a client away from the banks. Third, most respondents think that banks' role towards environment is indirect in nature. They point out that banks do not directly involve with polluting the environment and hence its role is more timid than other industries which are directly increasing GHG emission. Fourth, majority of the respondents acknowledge the need for a clear and specific guideline issued by the central bank for the banking sector. Unless such an action is put forth and uniformly applied to all financial institutions, individual bank may not find it worthwhile to voluntarily comply with any self-imposed environmental guidelines. However, if such regulation is enacted, the implementation should be gradual.

Based on these findings, several policy prescriptions can be offered. First, the overall performance of banks as to environment initiatives is still at infancy or close to zero for most banks. Thus, government has to create some motivation or soft coercion so that banks increase their awareness towards environment. Specially, banks are to be more lenient and friendly in financing projects which adopt green technologies as well as engaged with projects dedicated to clean environment. Second, government pro-environmental instruction for commercial banks is essential. Like many developing countries, central bank can instruct commercial banks to allocate a specific amount to carbon reducing projects. For instance, loan at a concession rate for building eco-friendly house or energy saving projects can be instructed from the central bank. Moreover, in a saturated loan market like in Oman, solar panel, eco-housing may be promising areas for financing of banks. In addition, external recognition scheme can be an encouraging factor. When any outside body recognizes and appreciates institutional efforts towards environment, institutions are motivated. No doubt, ministry of environment can play a critical role in this regard. If these pragmatic policy initiatives are put in place, it is expected that green banking activities will get an effective force.

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## Appendix A

### PART A:

Name .....

Affiliation:             Central Bank  
                               Private commercial bank  
                               State-owned commercial bank  
                               Non-bank financial institution  
                               Other (please specify).....

Designation.....

Duration in Current

Position (years):     < 5             5 – 10             10 – 15             > 15

Highest Education:    Bachelor     Masters     PhD  
                               Other (please specify).....

### PART B (Please describe in detail):

- 1) Do you think that day-to-day activities of banking sector in Oman address climate change and environment in any extent?
- 2) How do you assess the institutional capacities of the banking sector to address climate change and environment?
- 3) While sanctioning loan, are there any criteria that directly or indirectly ensure pro-environmental performance of the loan seeker/receiver?
- 4) What is the level and frequency of firms in dissemination of environmental activities initiated and implemented by them?
- 5) How do you compare environmental performance of banking sector with other industries?
- 6) How do the firms may become motivated or self-driven to act environmentally friendly for banking operation?
- 7) What is the role of the Central Bank and government in making an effort for banking sector to ensure pro-environmental activities?

**FRAMEWORK FOR SHARIAH ASSURANCE BEYOND COMPLIANCE AND  
VALUE-BASED INTERMEDIATION DISCLOSURES IN ISLAMIC BANKS: AN  
EXPLORATORY STUDY**

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**ABSTRACT**

*This study explores the measures currently adopted within Islamic financial institutions to promote the realization of maqasid Shariah of Islamic financial transactions within the newly introduced concept of Value-based Intermediation (VBI) for Islamic financial institutions. This exploratory study adopts qualitative approach. On the exploration on the existence of internal policies adoption within the institutions offering Islamic financial products to promote the realization of maqasid Shariah of Islamic financial transaction, a semi-structured interview was performed with a Head of Shariah Department in an Islamic financial product providers. In addition, content analysis on VBI proxies disclosed in the annual reports of two fully fledged Islamic banks was performed. The study found that the Islamic financial product providers considers maqasid of Shariah in its policy making in most cases, rather than not. For content analysis, the study found that both Islamic banks have involved in community development. They also have been carrying out waqf program as part of their efforts to sustain the economy. However, they need to contribute more towards community empowerment and environmental aspects. The proposed Shariah assurance framework considers the current Shariah audit scope for Shariah compliance as above as well as maqasid Shariah dimensions. It should be taking into account both mafsadah consideration and promotion of maslahah aspects. The results from this study are useful for Islamic banking industry to strategize the future direction of its banking business. The industry should apprehend that it should move to the next level by focusing on delivering and realizing the objectives of Shariah through its practices.*

**Keywords:** *Shariah governance, Shariah assurance, maqasid Shariah, Value Based Intermediation*

## INTRODUCTION

The demand for shariah-compliant products and services mainly driven by the size of world Muslim population as 1 billion of world's 6 billion population are Muslims, with significant percentage of the population has the ability to consume more than decades ago due to growing size of middle income (Vali Nasr, 2014). Exceptional growth of halal industry is seen in Islamic finance. Islamic finance. In 2016, it is a 1.66 USD trillion market (KFH Research, 2016). The market will further develop into 2.7 USD trillion in 2017 according to PriceWaterHouseCoopers' prediction. Meanwhile, Ernst & Young and MIFC predicts that the size of the market to reach 3.4 USD trillion in 2018.

Warde (2000) envisions that Islamic banks play the role of state bank and development bank that promotes social welfare. According to him, Islamic banks also should be engaging in activities that contribute to economic development by channelling finance to real sectors such as agriculture, trading, manufacturing and technology. Islamic banks are not to investment in ventures that are considered to be excessive as super-luxury development. However, in practice, Islamic finance was leveraged to construct facilities that promote hedonism and materialism such as luxury hotels, shopping complexes and entertainment centres. These transactions, pose little problem if we are looking from the fiqhi perspective, but it does raise the issue of the promotion of excessive spending or *israf* which distorts equality among the members of the society.

Chapra's thought on this is parallel. In his recent book entitled 'Morality and Justice in Islamic Economics and Finance' published in 2014, he has the same arguments on the handicap of the current Islamic banking and finance to address the needs for fulfilment of higher objectives of Shariah, i.e. maqasid of Shariah. Both morality and justice are not automatic quality resulted from the adoption of Shariah-compliant operations. During the modern Islamic finance application, extra efforts are needed to ensure that Shariah-compliant transactions possessed equality and justice quality. Although the notion of distributive justice has been promoted as one of the objective of Islamic economics, its application in Islamic finance industry is not necessarily exist and if it does the magnitude of it is not always satisfactory.

The ultimate objective of Islamic financial transactions is to achieve the maqasid of Shariah. Thus, we could argue that the scope of Shariah audit shall cover the appraisal of whether players in Islamic finance industry had managed to achieve the maqasid of Shariah. For instance, does investment in Islamic finance practice results to allocative efficiency in the market. Allocative efficiency reduces the cost of doing business as well as reducing the wealth distribution gap among the members of the society. Assessment should be performed to know whether Islamic finance has managed to deliver allocative efficiency via its fleet of products consist that are sale-based, asset-based and profit sharing-based.

Malaysia's regulator, Bank Negara Malaysia, in July 2017, taking the lead by issuing a Strategic Paper that tangiblises morality and justice within the Islamic financial industry. The Paper discusses the implementable strategies strengthen the roles and impact of Islamic banks to its stakeholders. The Strategic Paper was issued to gauge the industry players' response on the idea of Islamic banks providing Value-based Intermediation (VBI) services to its customers. VBI is an intermediation function that aims to deliver the intended outcomes of Shariah through practices, conduct and offerings that generate positive and sustainable impact to the economy, community and environment, without compromising the financial returns to shareholders (BNM, 2017). The propositions of VBI as above tells us that it promotes adoption of good values, beyond Shariah compliance.

From the above definition, five elements are highlighted; a) Intended outcomes of Shariah focus on enhancement of well-being of the people through preservation of wealth, faith, lives, posterity and intellect, b) Sustainable impact to the economy, c) Sustainable impact to community, d) Sustainable impact to environment, e) Financial returns to shareholders (BNM, 2017).

Despite the current BNM's initiatives, discussion on the adoption of morality and justice in Islamic finance and subsequent lack of measures on Shariah assurance and Shariah audit guidelines that reflect the impact of Islamic finance to the stakeholders is scant. Thus, this paper aims to explore the measures currently adopted within Islamic financial

institutions to promote the realization of maqasid Shariah of Islamic financial transactions within the newly introduced concept of VBI. The explored measures, at a later stage could be further developed via the engagement and communication to the stakeholders in the Islamic financial industry.

This paper is structured as follows. The next section discusses compliance-based Shariah Assurance, especially Shariah audit on compliance and financial reports as well as the adequacy of Shariah governance. Methodology that covers research method and the two cases discussed next followed by the analysis and results. The paper concludes with discussion on the results and suggestions for future research.

### **COMPLIANCE-BASED SHARIAH ASSURANCE**

The objective of the shariah audit process to audit the shariah compliance of products or services, satisfying the stakeholders' needs as a whole and ultimately complying with the Maqasid Al-shariah, which aims to realise the public benefit and removes hardship and harm (Lahsasna, 2013). In contrast to Lahsasna's definition, Shariah audit performance in IFIs is conducted from the operational *fiqhi* perspective that Islamic financial institutions (IFIs) are required to operate under the strict requirements of Shariah. The section of Shariah law that governs economic dealings are referred to as fiqh muamalat or the understanding of law of economics transactions. Fiqh muamalat's guidance forms the bases for Shariah requirements that IFIs have to adhere to. The same principles could be used as the parameters for Shariah Compliance Audit. This assurance is vital to ensure that Shariah principles are observed. Shariah governance mechanisms were introduced in the early establishments of Islamic banking and finance revolves around the role of Shariah advisory when the IFIs management are introducing new products and services. Progressively over the years, Shariah governance includes assurance measures, in addition to the fundamental Shariah advisory and Shariah review process.

Three lines of defense model is a tool adopted to monitor and control the activities of an organisation that focuses on Shariah compliance and not on other holistic values Islamic finance promotes.

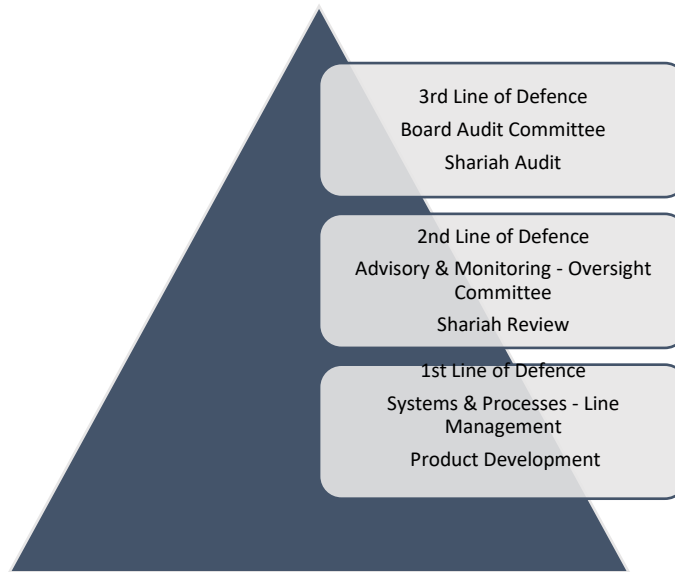


Figure 1: Three Lines of Defense Model

Shariah audit gives an indication to the market that the IFIs are complying with the Shariah guidelines. This is especially important as the market is keener on knowing and seeing that IFIs perform its bidding. The resurgence of Islamic finance over the past 30 years plus the sub-prime crisis has caused greater emphasis for the IFIs to be ever more Shariah-compliant.

The current framework of Shariah assurance deals with the fiqhi approach to Shariah audit as practiced at the operational level in the IFIs. Shariah audit is yet to be adopted to evaluate the impact of Islamic finance to the social welfare of the society, i.e. from the maqasid point of view.

SGF refers Shariah audit as ‘the periodical assessment conducted from time to time, to provide an independent assessment and objective assurance designed to add value and improve the degree of compliance in relation to the IFI’s business operations, with the main objective of ensuring a sound and effective internal control system for Shariah compliance.’ Shariah audit may be conducted as part of the IFI’s thematic audit on specialised areas such as management audit and Anti-Money Laundering (AML) audit. Shariah audit on critical areas shall be conducted at least once a year depending on the risk profile of the IFI.

In the past, Shariah compliance checking on the operations in IFIs is carried out through Shariah review function only. The new requirements strengthen the Shariah governance

by requiring Shariah audit to be performed by internal auditors, i.e. objective assurance of Shariah compliance by personnel not related to policy making and day to day operations of Shariah matters. Internal auditors must have adequate Shariah-related knowledge and training. In addition, the internal auditors may engage the expertise of the IFI's Shariah officers in performing the audit, as long as the objectivity of the audit is not compromised.

According to SGF, the Board Audit Committee, upon consultation with the Shariah Committee will determine the deliverables of the Shariah audit function. The deliverables shall be consistent with accepted auditing standards. The scopes of Shariah audit stated in the BNM's SGF are as follows:

- (i) Audit of financial statements of the IFI;
- (ii) Compliance audit on organisational structure, people, process and information technology application systems; and
- (iii) Review of adequacy of the Shariah governance process.

Shariah audit in IFIs could be regarded as a form of operational risk management in IFIs. Islamic Financial Services Board (IFSB) its "Guiding Principles of Risk Management for Institutions (other than Insurance institutions) offering only Islamic Financial Services", in its principle 14 states that 'IFI should have in place adequate systems and controls, including Shariah Board or Advisor, to ensure compliance with Shariah rules and principles'.

Shariah audit function is the last line of defense to ensure Shariah compliance in IFIs. The three lines of defense principle is a long and well established concept that has been deployed in a variety of industries and situations. Typical examples of the activities of the three lines of defense are as follows:

- i. The business: the day-day running of the operation and the front-office
- ii. Risk and compliance: the continual monitoring of the business
- iii. Audit: the periodic checking of risk and compliance.



Based on SGF (2010), the process of Shariah audit is designed to enable the IFI to assess whether a sound and effective internal control system for Shariah compliance have been implemented, which should cover, but is not limited to the following:

- i. Understanding the business activities of the IFI to allow for better scoping of an audit exercise, i.e. auditability and relevance of activities;
- ii. Developing a comprehensive internal audit program or plan. The program include objectives, scope, personnel assignment, sampling, control and duration as well as establish proper audit processes, policies and procedures of IFI's operations;
- iii. Obtaining and making reference to relevant sources, including the SAC's published rulings, the Shariah Committee's decisions, fatwas, guidelines, the Shariah audit results and the internal Shariah checklist;
- iv. Conducting Shariah audit on a periodical basis; communicating results of any assessment or findings arising from the Shariah audit to the Board of Directors, Audit Committee and the Shariah Committee;
- v. Providing recommendations on rectification measures taken as well as following-up on the implementation by the IFI.

#### **a. Shariah Audit on Compliance to Shariah and Laws and regulations**

In relation to this scope of Shariah audit, the objectives of Shariah audit is set to cover two basic areas; attestation to compliance to Shariah principles and compliance to laws and regulations. In order to comply with the Shariah principles, it must satisfy the following objectives:

- a) Observations of prohibitions in Shariah law, that:
  - i. the activities and operations of IFIs do not involve Riba'
  - ii. the activities and operations of IFIs do not involve Gharar
  - iii. the activities and operations of IFIs do not involve Maysir
  - iv. the activities and operations of IFIs do not involve in activities that are prohibited by the Shariah.
- b) Fulfilment of the contract requirements according to Shariah, in term of the fulfillment of the commandments or *arkan* of contracts and conditions to each of

the *arkan* of the contracts. Major non-compliant occur if the contract does not satisfy its *arkan*, while minor non-compliant occurs if certain conditions are not observed.

- c) Proper use of Muamalat concepts in contracts or products. For example, in ju'alah contract, the manfa'ah must be Shariah compliant and the rate must be measured in order for the management cost of the manfa'ah to be justified.

For the compliance to laws and regulations, Shariah auditors must observe the IFIs' observations of the following sets of laws and regulations:

- i. Acts legislated by the Government; Islamic Financial Services Act (2013), Takaful Act, Company Act (1965).
- ii. Guidelines and circulars issued by authority and regulators
- iii. The resolutions guidelines by the Shariah Advisory Council of Bank Negara and Shariah Advisory Council of Securities Commission.
- iv. The resolutions of Shariah committee and the IFI's Shariah manual.

In addition to compliance to Shariah as well as to relevant Act, regulation and guidelines, Shariah compliance audit should cover the audit for processes and procedures of information technology (IT), organization structure and human resources (HR). The Shariah auditors of the IFI shall evaluate the reliability of computer-generated data supporting financial statements and overall operations. The outcomes derived from the system must reflect that the overall operations including the product, people and organizational structure of the IFI are Shariah compliant. In addition, the auditors shall examine the adequacy of controls in information systems and related operations to ensure system effectiveness. Shariah audit of IT is the process of collecting and evaluating evidence to determine whether a computer system has been designed to maintain data integrity, safeguard assets, allows organisational goals to be achieved effectively, and uses resources efficiently. Shariah audit on organization structure is performed in order to ensure that the structure allows for effective Shariah governance in the IFI.

Each IFI must have its own Human Resource policy. From Shariah point of view, human resource policy must address the issues such as the dress code of the employees, male staff working hours during Friday prayers, employees' trainings on products offered by

IFIs and any other human resources issues identified by the Shariah Committee. Shariah Committee of an IFI must ensure that the policy is being followed through Shariah audit and regular check must be properly addressed. In the event of Shariah non-compliant, it must be rectified immediately.

### **b. Shariah Audit of Financial Statements**

For Shariah audit on financial statements, internal auditors could audit the accounting transactions that relates to Shari'ah matters. These include profit distribution policy, penalty charges, basis of income recognition, zakat policies and computations and so on (Mustafa et al, 2012). In addition, compliance audit should be performed which includes audit on organisational structure, people, process and information technology application systems.

The auditors must audit the Shariah issues in the financial statements to ensure compliance with the Shariah principles. The Shariah auditor should be able to perform the audit on the central issues in financial statements shown in Figure 2.

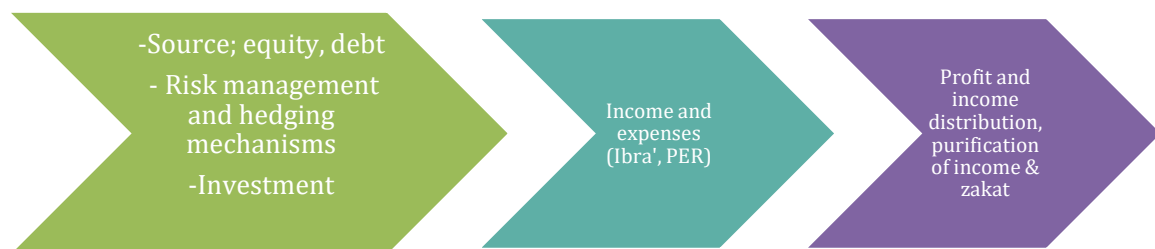


Figure 2: Central Shariah Issues in financial statements

The Shariah auditors must attest the financing, risk management and hedging mechanism, investment, recognition of income and expenses and income/profit distribution including zakat computation and payment. The activities and operations of IFIs should be audited so that the activities provide benefit to the public and to the investors, depositors and shareholders of the IFIs as well as they do not bring harms to the public. This will also promote transparency to the stakeholders of the IFIs.

Internal shariah auditors shall perform audit of financial statements in order to verify that the management of IFIs perform its fiduciary duties to the stakeholders. The scope of Shariah audit in financial statements can be shown in Figure 3 below:

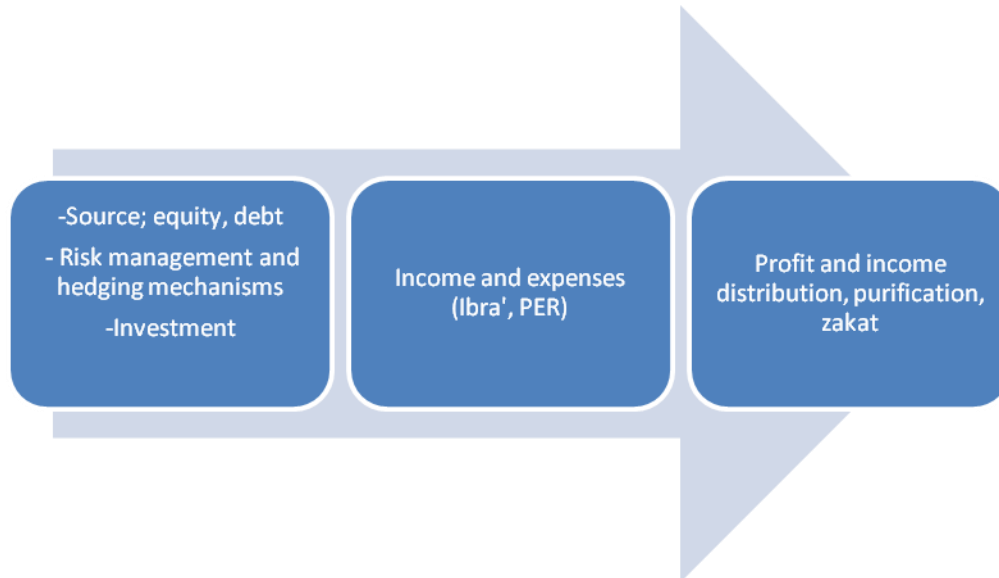


Figure 3: Central Shariah Issues in financial statements

The audit of financial statement to verify that they are following the Shari'ah involved many Shari'ah issues. It is essential to have the audit performed on financial statements in order for to ensure the transactions in IFIs carried out, recorded and reported in the manner compliant to Shari'ah. In the nutshell, Shariah auditors must attest the financing, risk management and hedging mechanism, investment, recognition of income and expenses and income/profit distribution including zakat computation and payment. The activities and operations of IFIs should be audited so that the activities provide benefit to the public and to the investors, depositors and shareholders of the IFIs as well as they do not bring harms to the public. This will also promote transparency to the stakeholders of the IFIs.

Shariah audit in financial statements represents an important facet of compliance audit in IFIs as financial statements are seen as the window to the IFIs overall operation, whether it reflects the application of Shariah rulings or not. Currently, each IFI has their own interpretation of what constitutes the audit scope for Shariah audit in financial statements. Furthermore, little research has been conducted and published to identify the ideal scope

of audit for financial statements of IFIs. Firstly, there should be concerted effort by IFIs and stakeholders in identifying auditable areas relevant to the financial statements of IFIs.

### **c. Review of Adequacy of Shariah Governance**

The auditors must ensure that the findings from Shariah audit shall be communicated to the Audit Committee and Shariah Committee of the IFIs. The roles and functions of the Board of Directors, the Shariah Committee, the Audit Committee and the management must be in place in the IFI. The auditors shall make an observation on this matter during the audit. In addition, they shall also provide recommendations to enhance the Shariah governance process in the IFIs.

According to the SGF, the IFI shall establish formal reporting channels to ensure that the reporting on Shariah matters is carried out effectively and on timely manner. In performing Shariah audit on reviewing the adequacy of the Shariah governance process, the auditor shall collect evidence on the reporting process in an IFI. This is to ensure adherence to the SGF issued by BNM. In this regard, the Shariah Committee shall functionally report to the board of directors. The Shariah review function shall report concurrently to the Shariah Committee and management, and the Shariah audit findings shall be reported to the Audit Committee and Shariah Committee. All Shariah non-compliance events are to be reported to the board of the IFI and the Bank. The findings on Shariah non-compliance events shall be documented by the IFI for the auditors to review during the audit period.

## **ISLAMIC MORAL ECONOMY AND SHARIAH ASSURANCE REGIME BASED ON MAQASID SHARIAH**

Making religious-based consumption available is a noble effort. The prophet mentioned that *al-kasib habibullah* (Entrepreneurs are the love of God). However, commodification of the halal economy give rise to a new form of consumerism; Shariah-compliant consumerism. The consumption and product offering for food, travel, lifestyle and finance is focused on the compliance to legal semantics, rather than focusing on the wholesome value of *Halaalan Toyyiban*. For this to happen, the halal environment has to be good in the context both human-to-human and human-to-environment relationship. Lack of the *Halaalan Toyyiban* mindset in Shariah-compliant environment we are now

results to waste, lavishness and promotion of pure consumerism that lacks inclusiveness and balance in the economy. In Islamic finance, the lack of the spirit of maqasid Shariah creates gaps of its ideal objectives to the realities of outcomes from thirty years of its adoption.

- Focus on debt financing rather than equity
- Focus on corporate financing rather than Small Medium Enterprise (SME), Micro Small Medium Enterprise (MSME)
- Lack of Corporate Social Responsibility (CSR)/Social Responsibility Investment (SRI) agenda
- Little differences between conventional and Islamic financing on the impact to social fairness
- Shariah resolutions focused on contracts, little attention to impact of contracts

Islamic financial contracts facilitate economic development leveraging on its diversity of concepts. For instance:

- *Salam, istisna'*: matching of capital and producers. Provides finance for provision of goods and services in the economy
- *Musharakah, mudharabah*: equity finance keeping inflation at check. Financing to MSME through micro-finance schemes could contribute to poverty alleviation.
- Takaful as risk management instrument. E.g. Micro takaful for micro finance participants
- Third sector economy instruments; gift economy for economic development

Islamic Moral Economy (IME) has the element of soul inherent to it, unlike capitalism economic system that did not require conviction for the players of the economy to practice value. Acts of positive values such as ethics, CSR etc, are voluntary in the capitalist economy. Islamic economy, on the other hand is imbued with the theological mandates that requires the actors in the economy to observe their moral behaviours. Regulations are internalised by the way of religious observation.

Another important distinction of IME to the capitalist economy is that capitalist free market system allows the economic units to pursue their own self-interest, while the

interest of other fellow man and the society is considered as the ‘externalities’. With the main objective of business ventures is to maximise profit for the stakeholders (more so to the owners of the business/shareholders), many of the business costs are passed to the outside parties now to be treated as social costs.

Karim (2010) defines Islamic moral economy as an economic, social, and political model predicated upon the theological doctrines and values promoted by the Quran and Sunnah. In term of practice, the IME is a utopian model characterised by equitable distribution of wealth and systemic social structures that provide universal care for all individuals in need. Asutay (2007) argues that IME is the utopian (ideal) state of Islamic economics that fulfils the Shariah objectives; human well-being, economic development and social justice in society. IME also exhibits qualities of pure free-market capitalism which leaves the market players to determine the supply and demand in the market. Due to that, Islam prohibits monopoly or *ihthikar* as it distorts the achievement of market equilibrium (Karim 2010).

The goal of Islamic economics is to achieve brotherhood and justice in the society. In order to guide the market players to maximise the social interest, Nuesser (2013)<sup>115</sup> highlights that the morality aspect of Islamic economics serves as mechanisms to check and balance the economic players. He also points out that the role of Islamic economics that facilitate generosity, promote social welfare and to hinder economic egoism, greed and economic fraud. The check and balance mechanisms are vital as economic players are not able to regulate themselves, especially in the financial market. The tumble of mega financial institutions that had stood for decades had provided insights to the regulators around the world that adequate market controls are needed to ensure that rights of parties in the market are fulfilled. Islamic economics, being normative, value-based economic principles, provides the rules of the game. The writer argues, as more others such as Kuran (2004)<sup>116</sup> that the Muslims are not necessary the best adopter of their own religion, and they are struggling to prevent the degradation of morality in their society.

Islamic tradition introduced *hisbah* which is lies with “الامر بالمعروف و النهي عن المنكر” the concept of (enjoining the good and forbidding the evil). *Hisbah* was institutionalized in

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<sup>115</sup> Omar K Nuesser (2013), A New Factor in the Global Economy: Islamic Economics, [http://www.livingislam.org/m/iecon\\_e2.html](http://www.livingislam.org/m/iecon_e2.html)

<sup>116</sup> Timur Kuran (2004), Islam and Mammon, Princeton University Press, Chapter 1, page 30

the early days of Islam, but not focusing on economic and commercial activities only. Chik (2011) views that in the past, *hisbah* was an integral part of a just economy in a just society. One of the objective of *hisbah* is to assist human-being in worshipping Allah (ibadat), those relates to the right of Allah and those relates to the right of other human beings which includes Islamic financial transactions.

Asutay (2007), on the other hand discusses that *hisbah* is a part of mechanisms and instruments of Islamic economic system. He wrote:

“*Hisbah* is another important positive institution in the Islamic economic system that regulates the market mechanism by responding to its failures and shortcomings and overcoming its excesses”

The work of previous research on maqasid Shariah in Islamic finance, among others:

- i. Chapra and Ahmed (2007). The role of morality to the successfulness of the adoption of Islamic economics
- ii. Muhammad Umer Chapra (The Islamic Vision of Development in the Light of Maqasid al-Shariah)
- iii. Auda (2008) on maqasid shariah as a philosophy of law (Maqasid al-Shariah: A Beginner's Guide)
- iv. Housem (2014). Quantitative measure of ethical performance. The approach involves a Pentagon-shaped performance scheme structure via five pillars, namely wealth, posterity, intellect, faith, and human self.
- v. Nooraslinda Abdul Aris et al (2013) on the general discussion on maqasid framework/ ideas from four major scholars; Al-Ghazali, Ibn Qayyim al Jawziyya, Shatini, Ibn Ashur. The paper too discusses Maqasid Shariah in Islamic finance with relation to its impact towards social welfare.
- vi. Shafiel Karim (2010) on the state of hierarchy of compliance (Shariah tolerance, compliance and dependence) and the corresponding effect to the realisation of IME.
- vii. Dusuki (2008) on Survey of stakeholders on the understanding the objectives of Islamic banking.
- viii. Dusuki (2015) on Maslahah and equity based sukuk



- ix. Dusuki (2009) on Maslahah in Islamic capital market
- x. Dusuki (2008) on the application of Maqasid to parallel areas and proposal of pyramid of CSR
- xi. Tawfique Al-Mubarak and Noor Mohammada Osmani (2010) on applications of maqasid shariah and maslahah in Islamic banking practices
- xii. Zulkifli Hasan and Mehmet Asutay (2011) on *maslahah* in stakeholder management for Islamic financial institutions. They suggest maqasid dimensions to be adopted as a tool for decision-making in IFIs
- xiii. Mustafa Omar Mohamad and Syahidawati Hj Shahwan (2013) on objectives of Islamic economics and Islamic banking in light of Maqasid shariah at product development stages
- xiv. Abu Hurayra (2015), evaluation of maqasid in Islamic banking practice in Pakistan focusing on the analysis of a bank's products' consideration for maqasid of shariah

Despite amount of works done on maqasid shariah in Islamic finance, governance measures from the issuance of framework and policies by the regulators that guides the industry on how to achieve maqasid Shariah is non-existence, until the current conceptual directives by BNM.

In order to argue for the case of assessment of IFIs' achievement of maqasid, the work of Shafiel Karim (2010) on the spectrum of Shariah adoption in Islamic finance could be referred to. He examines the levels of Islamic permissibility of various legal structures within the framework of IME. The Islamic permissibility is expressed in terms of Shariah tolerance, Shariah compliance and Shariah dependence. He writes on the three levels of Shariah adoption in the modern Islamic financial transactions as:

*“According to most Islamic banking and insurance practitioners, there are three levels of Islamic permissibility with regard to financial instruments and contracts today: tolerance, compliance and dependence. These three terms span a spectrum of low to high compliance with Islamic law. The term ‘tolerance’ refers to the lowest level of solubility with Islamic law and ‘dependence’ is considered the highest level of solubility with Islamic law”*

The current Shariah audit practice examines the Shariah compliance, which refers to the technical or mechanical application of Shariah requirements to Islamic financial transaction. Shariah dependence examination could be argued to consist the examination of Islamic finance actors' action towards the achievement of IME. The restriction of the current scope of Shariah audit to limit to the audit of mechanical application of Shariah in Islamic financial transactions due to the term adopted in the Islamic finance circle as these while, i.e. that Islamic financial transactions are to be Shariah-compliant.

Islam is the way of life. It provides guidance to the affairs of human and provides solutions to their problems. It is thus does not contain measures for individuals, but also prescribes mechanisms that ensures the wellbeing of the society, i.e. *maslahah*. The morality and ethics in Islamic finance stresses on the provision of systemic social structure via the call for zakat, sadaqah, taking care of the orphans, widows, the indebted, etc. The morality and ethics put forward by the Islamic moral economy could be achieved from the observance of the divine requirements of Shariah that specify the mandates and prohibitions of actions during muamalat activities. The measures include the abstention of *riba*, *gharar*, *maysir* and *jahalah* in the contracts, dealing the environment of information asymmetry and the practice of coercive monopoly, among others (Karim, 2010). The prohibitions of these practice is to ensure that the society is protected via the morality specifications that results to just, equitable and sustainable economy. Along with the broad specifications, IME actors are prohibited to a number of activities that pose harm to individuals and society, namely activities related to alcoholic beverages, porcine products, gambling and pornography related activities. These are often referred to in the industry as the qualitative screening or sector prohibitions.

### **SHARIAH ASSURANCE BEYOND COMPLIANCE**

At current, our Shariah assurance focus is on compliance. The current framework does little to facilitate the realization of economic development of the society. No specific measures are being done to ensure positive impact/managing negative impact of Islamic finance transactions to the society, environment, individuals. The current framework lacks reference on the role of governance organs on impact of Islamic finance to the economic development. In other words, what are the roles of SAC, Board, management and regulators to realise the maqasid Shariah of Islamic finance.

Moving forward, the regulator is keen to focus on the value-based consideration of the provision of Islamic banking and takaful services. BNM issued a strategic paper on Value based intermediation that includes on maqasid application in Islamic banking. The Bank is getting the feedback from practitioners, ended end of August 2017. The edited version is due to be published by the Bank. The strategic paper attempts to strategize the steps that should be taken by Islamic banks to strengthen the roles and impact of Islamic banks to its stakeholders. Value-based Intermediation (VBI) is an intermediation function that aims to deliver the intended outcomes of Shariah through practices, conduct and offerings that generate positive and sustainable impact to the economy, community and environment, without compromising the financial returns to shareholders (Bank Negara Malaysia, 2017).

Referring to its definition, VBI emphasizes on delivering value to all stakeholders beyond Shariah compliance. VBI highlights five elements including a) Intended outcomes of Shariah focus on enhancement of well-being of the people through preservation of wealth, faith, lives, posterity and intellect, b) Sustainable impact to the economy, c) Sustainable impact to community, d) Sustainable impact to environment, e) Financial returns to shareholders (Bank Negara Malaysia, 2017). Scrutinizing the emphasis of VBI, it can be said that elements are actually the manifestation of *maqasid shariah*.

Bank Negara Malaysia (BNM) argues that current Islamic banking products and services have been designed to comply with shariah requirements as demanded by the customers. Islamic banking industry should put greater importance on the wider impact of its business activities. The industry should be able to create more business opportunities through entrepreneurship and community empowerment (Bank Negara Malaysia, 2017). According to the shariah principles, Islamic banks should perform financial intermediary function to preserve the *maqasid*. The function should stimulate the entrepreneurship and technological innovation by providing funds to entrepreneurs to initiate new products and business (Ismail & Che Pa, 2015).

In addition, a Discussion Paper was put up to the industry on the New Shariah Governance Framework which will focus on Islami finance innovation to reflect its true value rather than focusing on compliance . The New SGF is expected to be implemented sometime in 2018. Another positive development is the guideline on Shariah committee

report. A Discussion Paper too was issued for industry deliberations. The plan is for the report to reflect on the role of SAC beyond shariah compliance. Report of SAC should be too communicative, beyond Shariah compliance. The future SGF emphasises on:

- i. Effective board oversight on shariah governance implementation
- ii. Sound decision by the shariah committee
- iii. Shariah compliance culture and robust risk management practices
- iv. Strengthening internal shariah function and operational excellence

### **METHODOLOGY**

The paper surveys on the measures currently adopted to promote the realization of maqasid Shariah of Islamic financial transaction. We are interested to learn on the internal measures adopted within the institutions offering Islamic financial products to ensure positive impact of Islamic financial transactions to environment, social and governance (ESG) and how these measures are evaluated/audited within the IFIs? The study adopts the aspects of Maqasid Shariah developed by Houssein (2014) who developed a quantitative measure of ethical performance. The approach involves a Pentagon-shaped performance scheme structure via five pillars, namely wealth, posterity, intellect, faith, and human self. He links Islamic banks' performance to the ethical vision of Islam based on maqasid al-shari'ah (i.e., the objectives of Islamic law).

A semi-structured questions was answered the Head of Shariah of a financial institution offering Islamic windows operation. The institution is currently undergoing full conversion to Islamic banking operation. BNM accepted the proposal for conversion to be fully implemented in three years starting at the date of conversion.

The second analysis is the performance of content analysis on the annual reports of two full-fledged Islamic banks; Bank Islam Malaysia Berhad and Bank Muamalat Malaysia Berhad. The study examines the two banks' disclosure measures of five elements of VBI. We proposed proxies that we thought would reflect the definition of VBI promulgated by BNM. BNM (2017) defined VBI as "an intermediation function that aims to deliver the intended outcomes of Shariah through practices, conduct and offerings that generate positive and sustainable impact to the economy, community and environment, without compromising the financial returns to shareholders (BNM, 2017)."

From the above definition, VBI's elements includes:

- a) Intended outcomes of Shariah focus on enhancement of well-being of the people through preservation of wealth, faith, lives, posterity and intellect
- b) Sustainable impact to the economy
- c) Sustainable impact to community
- d) Sustainable impact to environment
- e) Financial returns to shareholders

We performed content analysis on the reporting and disclosures, relates to the "Intended outcomes of Shariah". We looked for proxies that reflects the elements of intended outcomes of Shariah:

a) *Justice*

Minimise unjust elements i.e. uncertainty, exploitation

b) *Wealth preservation*

Recognise private ownership

Prohibit transgression of rights of others

Ensure valid transfer of ownership

c) *Wealth circulation*

Equitable wealth distribution

Prohibit wealth hoarding

Encourage income generation

Channeling wealth to productive sector

## **RESULTS AND FINDINGS**

This section contains the results and findings of this study. It contains two exploratory analysis; i) Engagement with the financial provider on the measures currently adopted to promote the realization of maqasid Shariah of Islamic financial transaction, ii) content analysis on the reporting and disclosures in the annual reports that relates to the "Intended

outcomes of Shariah” for two full fledged Islamic banks in Malaysia.

### **Exploratory Engagement with Head of Shariah from a financial institution offering Islamic windows operation**

The engagement was communicated via email that contains three sections; all related to adoptions of maqasid Shariah within the institution. The series of questions solicit response on the institution’s consideration the maqasid Shariah aspects in its policies.

**Table 4.1 : Consideration of maqasid Shariah and existence of policies**

<b>1</b>	<b>Dimensions</b>	<b>Consider when making decision</b>	<b>Specific Policies</b>
	<b>First dimension: Enrichment of the human self</b>		
1.1	Dignity, self-respect and social equality	√	
1.2	Justice	√	
1.3	Spiritual and moral uplift	√	
1.4	Security of life and property	√	
1.5	Freedom	√	
1.6	Education	√	
1.7	Good governance	√	Credit Policies SGF Responsible Financing Policy
1.8	Need fulfilment	√	
1.9	Employment and self- employment	√	
1.10	Equitable distribution of income and wealth		
1.11	Marriage and proper upbringing of children	√	
1.12	Family and social solidarity	√	
1.13	Mental peace and happiness		
1.14	Minimization of crime		
	<b>The second dimension: Enrichment of faith</b>		
2.1	Religious worldview	√	
2.2	Values	√	
2.3	Proper motivation		
2.4	Education	√	
2.5	Justice, freedom, security of life, property and honor, honesty, fulfillment of all socio-economic and political obligations, patience, thriftiness, prudence, tolerance, mutual care and trust	√	Credit Policies SGF Responsible Financing Policy

2.6	Removal of poverty, need fulfilment of all, employment and self-employment opportunities	√	Credit Policies SGF Responsible Financing Policy
2.7	Equitable distribution (Human brotherhood)	√	
2.8	Family integrity, social solidarity and political stability	√	
2.9	Good governance	√	Credit Policies SGF Responsible Financing Policy
	<b>The third dimension: Enrichment of intellect</b>		
3.1	Proper upbringing	√	Human Resources Policy
3.2	High quality of education at affordable prices		
3.3	Library and research facilities	√	Human Resources Policy
3.4	Freedom of thought and expression	√	Human Resources Policy
3.5	Reward for creative work	√	Human Resources Policy
3.6	Finance	√	Human Resources Policy
3.7	Expansion of knowledge and technological base	√	Human Resources Policy
	<b>The fourth dimension: Enrichment of posterity</b>		
3.1	Marriage and family integrity		
3.2	Social solidarity		
3.3	Intellectual and moral development	√	Human Resources Policy
3.4	Need fulfilment	√	Human Resources Policy
3.5	Moral and worldly education	√	Human Resources Policy
3.6	Healthy environment		

3.7	Freedom from conflict and insecurity		
	<b>The fourth dimension: Enrichment of posterity</b>		
3.1	Marriage and family integrity		
3.2	Social solidarity		
3.3	Intellectual and moral development	√	Human Resources Policy
3.4	Need fulfilment	√	Human Resources Policy
3.5	Moral and worldly education	√	Human Resources Policy
3.6	Healthy environment		
3.7	Freedom from conflict and insecurity		
	<b>The fifth dimension: Development of Wealth</b>		
5.1	Education, research, and improvement in technology and management	√	Human Resources Policy
5.2	Security of life, property and honor	√	Credit Policies SGF Responsible Financing Policy DSR policy
5.3	Good governance	√	Credit Policies SGF Responsible Financing Policy
5.4	Freedom of enterprise	√	Credit Policies SGF Responsible Financing Policy
5.5	Employment and self-employment opportunities	√	Credit Policies SGF Responsible Financing Policy
5.6	Removal of poverty, need fulfillment and equitable distribution	√	Credit Policies SGF Responsible Financing Policy
5.7	Social solidarity and mutual trust		



5.8	Saving and Investment	√	Credit Policies
5.9	Optimum rate of development		

Table 4.2 reports the response of the Head of Shariah when asked about the existence of policies for the Shariah governance organs on maqasid Shariah.

**Table 4.2: Existence of Policies for Shariah Governance Organs**

	<b>Organs of Shariah Governance</b>	<b>Scope of Policies</b>	<b>State the policy if any</b>
1	Board of Directors (BOD)	Strategic policy to cater for maslahah vs mafsadah (for eg., the equivalenet of ESG, SRI consideration)	No specific policy
2	Shariah Committee (SC)	Fiqhi vs maslahah vs mafsadah considerations	No specific policy
3	Management	Operationalization of maqasid Shariah (investment, financing, HR, marketing policies)	As reported in Table 4.1

	<b>Organs of Shariah Governance</b>	<b>Scope of Policies</b>	<b>State the policy if any</b>
1	Board of Directors (BOD)	Strategic policy to cater for maslahah vs mafsadah (for eg., the equivalenet of ESG, SRI consideration)	No specific policy
2	Shariah Committee (SC)	Fiqhi vs maslahah vs mafsadah considerations	No specific policy
3	Management	Operationalization of maqasid Shariah (investment, financing, HR, marketing policies)	Internal SGF, Human Resource policies, credit policies, Responsible Financing Policy

The Head of Shariah too, agrees that maqasid shariah consideration is to be included as part of the evaluation criteria for BOD's and SAC's performance and part of Shariah audit scope, in addition to the current Shariah audit on Shariah compliance. The current Shariah audit exercise, however is very much compliance-based. This is reflected by the Shariah audit objectives of the institution:

“Internal Audit Department (IAD) has two primary objectives, the first objective is to assist **Institution A** management at all levels in the effective discharge of their responsibilities. The second objective is to provide assurance to the members of Board of Directors (BOD) and Audit Committee (AC) concerning the adequacy, economy, efficiency and effectiveness of the Shariah operations that are subject to review by IAD. Secondary objectives encompass the following:

- a) To provide an independent assessment & objective assurance designed to add value and improves **Institution A** compliance with Shariah requirements.
- b) To ensure that **Institution A** management is discharging its responsibilities in compliance with Shariah rules and principles as prescribed by the Shariah Advisory Council of the BNM and the **Institution A** Shariah Council (SC).
- c) To ensure that the system of internal control for Shariah Compliance is conceptually sound and effective in implementation, so as to ensure that the goals and objectives for Shariah compliance are achieved.
- d) To ascertain the validity, completeness and timeliness of the documentary evidence and record in relation to Shariah compliance requirements.
- e) To assess the activities and operations of **Institution A** products and services are Shariah compliant as approved by the relevant **Institution A** SC members.
- f) To assess the identified auditee's compliance with all other applicable laws, regulations, internal/external guidelines, policies and procedures (including assessment of the adequacy and effectiveness of policies, internal guidelines and procedures).
- g) To meet any other objectives as may be required under BNM/RH/GL (013-4) Guidelines on Internal Audit Function of Licensed Institutions.

In addition to exploration on the decision-making and operational policies related to maqasid shariah, as discussed in the methodology section, we performed content analysis

to explore the disclosure of two full-fledged Islamic bank with regards to VBI. We match VBI disclosure and that of the proxies reported in the two banks. Section 4.2 elucidates further the result.

### Content Analysis on the Reporting and Disclosures on Intended Outcome of Shariah in Two Full-fledged Islamic Banks in Malaysia

**Table 4.3: Reporting and Disclosures of Proxies for Value Based Intermediation Elements**

Elements	VBI measurements (BNM, 2017) and Proposed proxies	BIMB (2016)	BMMB (2016)
1. Intended outcomes of Shariah focus on enhancement of well-being of the people through preservation of wealth, faith, lives, posterity and intellect			
<i>a. Justice</i>	<b>P/S Financing</b> (total <i>mudharabah</i> and <i>musharakah</i> financing). Profit sharing financing activities describe the practices of just and fair business by avoiding uncertainty business activities.	√ It only categorizes <i>mudharaba</i> and non <i>mudharaba</i>	√ It is displayed in financial reports and notes to financial reports
<i>b. Wealth preservation</i>	<b>Insurance deposit</b> The amount of insurance spent by the Islamic banking institution to assure the third party deposits.	√ It is stated in notes to financial statement	√ It is stated in notes to financial statement
<i>c. Wealth circulation</i>	<b>Profit sharing growth</b> It shows that the Islamic banking institutions are encouraging income generation by providing financing. The profit sharing growth indicates the incremental profit gained by the third party.	√ Income attributable to depositors is increasing	√ The comparative profit sharing shows the increasing trends.
	<b>The amount of non-<i>murabahah</i> financing</b> It describes the amount of wealth distributed to productive sectors.	√ It is displayed in financial reports and	√ It is displayed in financial reports and

		notes to financial reports	notes to financial reports
2. Sustainable impact to the economy	<b>The growth of financing</b> It reveals the efforts of the Islamic financial institution to ensure the sustainable economy	√  It is displayed in financial reports and notes to financial reports	√  It is displayed in financial reports and notes to financial reports
	<b>Waqf management by the IBIs</b> Activities relating to <i>waqf</i>	√  <i>Waqf</i> land development project	√  <i>Waqf</i> Muamalat and <i>Waqf</i> Selangor Mumalat, Commercial & <i>Waqf</i> Land Development
3. Sustainable impact to community	<i>Qard</i> activities and the amount of <i>qard</i> provided	-	√
	Number of initiative to support business sector/SMEs	√  Investment Account Platform (IAP) for SMEs	√  Introduction of the Investment Account Platform (IAP), a new fundraising avenue for commercial and corporate customers including SMEs
	Percentage of financing disbursed to identified sector/new growth areas	√  It is displayed in notes to financial reports	√  It is displayed in notes to financial reports
	Number of first time banking customers (financial inclusion)	-	-
	IBIs' contribution to an improved efficiency and productivity level of business entity (customers)	√  Simplifying products for	√  The centralisation

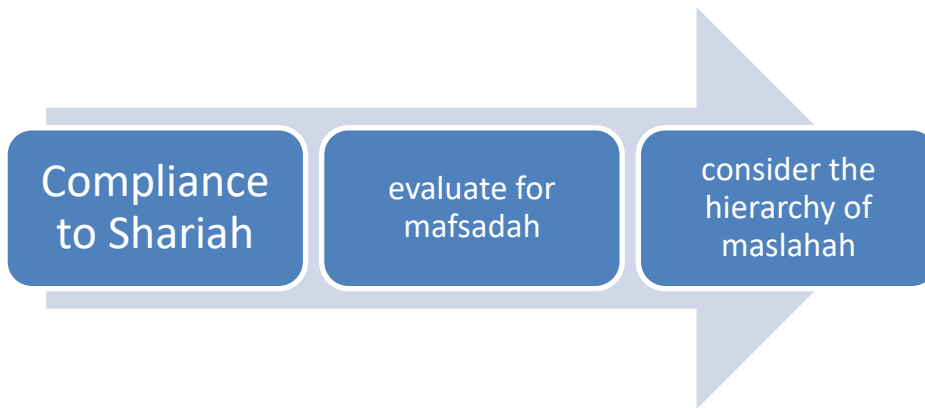
		efficiency purposes	process at branches had successfully improved the overall efficiency and productivity.
	Number of innovative products and services introduced for the community	√ Incorporating innovation in corporate responsibility activities	√ Investment account product and Dual Currency Investment (DCI-i) product
	Number of community-based projects driven by IBIs	√ AMAL corporate responsibility manages CR activities in a few of community programs	√ Providing monthly allocation for a few of community programs.
	Number of individuals benefitted from community-based projects	-	-
	Social impact indicators e.g. enhanced standard of living	Only mentioning the commitment to expand social impact through CSR programs	-
4. Sustainable impact to environment	The amount of any donations or activities carried out to protect the environment	-	-
	The bank's role in environmental development	√ Making proportion of environmental activities as part of CR	-
	Green environment	√ Preserving the environment. Conducting	-

		green day	
	Printing reduction and paperless	-	-
5. Financial returns to shareholders	Information on banking soundness	√ Providing banking soundness indicators in financial highlights	√ Providing some soundness indicators in financial highlights
	Comparative financial performances (current year and previous year)	√	√
	Policy on dividend	√	-
	Dividend payment	√ It is stated in notes to financial statements	√ Dividends are paid for subordinated <i>sukuk</i>

### Proposed Framework: Shariah Assurance Framework based on Maqasid Shariah

This paper explores the roles and responsibilities of Shariah governance organs, namely BOD, Shariah Committee and the Management of Islamic financial institutions towards the realization of maqasid shariah. From the conceptual analysis of relevant academic papers as indicated in Section 2 and relevant results in Section 4.1, we found that Shariah assurance framework should be consisting of both the compliance function as well considerations on the impact of IFIs decision and operation to the stakeholders. This could be done by first evaluate the resultant negative impact of the decisions by performing mafsadah vs maslahah analysis.

Hasan and Asutay (2011), for instance stated that maqasid shariah could be used as a decision-making tool within IFIs. If *maslahah* is greater than the *mafsadah* identified, IFIs may proceed with the decision making for the issue on hand. The authors provides analysis of some scenarios where for decision making using *maslahah-mafsadah* approach; in cases of ijarah sukuk, tawarruq financing and tawarruq deposit.



**Diagram 4.1:** Shariah Assurance Framework based on Maqasid Shariah

Shariah assurance framework deals with Shariah compliance as follows:

- a) Observations of prohibitions in Shariah law, that:
  - v. the activities and operations of IFIs do not involve Riba'
  - vi. the activities and operations of IFIs do not involve Gharar
  - vii. the activities and operations of IFIs do not involve Maysir
  - viii. the activities and operations of IFIs do not involve in activities that are prohibited by the Shariah.
- b) Fulfilment of the contract requirements according to Shariah, in term of the fulfillment of the commandments or *arkan* of contracts and conditions to each of the *arkan* of the contracts. Major non-compliant occur if the contract does not satisfy its *arkan*, while minor non-compliant occurs if certain conditions are not observed.
- c) Proper use of Muamalat concepts in contracts or products. For example, in ju'alah contract, the manfa'ah must be Shariah compliant and the rate must be measured in order for the management cost of the manfa'ah to be justified.

In addition, the Shariah governance organs should be taking into account *mafsadah* consideration as well as the promotion of *maslahah* aspects.

Mafsadah: Monopoly/*ihhtikar* of resources and market, Zulm, inequality, waste, greed, excessive consumerism, disregard of resources and profit sharing, risk transfer, pollution as externalities, corruption, etc

Maslahah: Environment, society, governance, risk management, profit sharing, risk sharing, qard hasan, waqf, sadaqah, promotion of sustainability, etc.

- Hierarchy of maslahah

Hasan and Asutay (2011) highlights the role of SAC on making decisions beyond the compliance mindset:

*“It is imperative for the Shari’ah board to take into account the maslahah based approach on top of illah (legal cause) in deliberating the Shari’ah rulings with the objective of establishing the requirements of maqasid Shari’ah in an aspirational sense. The understanding and knowledge on maslahah upon certain issues that need deliberation may contribute towards solid and sound fiqhi verdicts especially in resolving the unresolved fiqhi issues. At this point, the authors strongly advocate the application of maslahah based ta’lil by going beyond the mechanistic interpretation of fiqh as a consideration for any fiqhi verdicts by any fatwa institution”*

Our Shariah Assurance Framework proposes for maqasid shariah consideration to be taken into account in all the Shariah governance organs decision making, and not limited to SAC. The dynamics of discussion among the Shariah governance organs could promote both financial performance versus social performance that maqasid shariah aims for. Shariah governance organs constitutes as *shura* as correctly spelled out by Hasan and Asutay (2011):

*“The decision making process refers to the process of shura in the Islamic corporate organisations. In the context of financial institutions in general, the decision making process is made by the BOD or the management and in the case of IFIs, it involves another layer of governance, namely the Shari’ah board.”*

Hasan and Asutay (2011) highlighted too that shareholders also play a big role as active participants and conscious stakeholders in the process of decision and policy making framework by considering the interest of all direct and indirect stakeholders rather than maximizing their interest or profit alone. This is in order to fulfill the both the private and



social goals. In our case, we include the roles of Shariah governance organs as shareholders' interest is represented by the BOD.

Shariah auditing maqasid shariah scope was previously suggested by Hasan and Asutay (2011).

*“While this paper argues for the firm or BOD to adopt the maslahah based model as a prescriptive model, another important issue that needs to be addressed is how to ensure that it is adopted. It has been suggested that reinstitutionalization of hisbah (a traditional regulative institute) in an effective manner would help to ensure the efficiency of maslahah based approach in stakeholders model of governance. The governance committee at the BOD level may play its role in ensuring that decision making process takes into account stakeholders' interest through maslahah based approach. In applying this to the case of IFIs, Shari'ah Board is the ideal institution that may specifically advise and supervise the extent of IFIs adherence to maslahah based approach in stakeholder management by adopting a dynamic and non mechanistic fiqh (Islamic jurisprudence) based attitude. It is important to state that currently Shari'ah scholars have adopted a mechanistic and rationalistic interpretative attitude towards IFIs related judgments, which may not necessarily consider or endogenise the larger perspectives on stakeholders interest. Therefore, a consequentialist attitude by Shari'ah scholars by endogenising value oriented understanding beyond mechanistic attitude through maslahah is essential to fulfill the religio-spiritual expectations from IFIs as identified by maqasid al Shariah and maslahah. Hisbah can play a crucial role in ensuring that stakeholders' interests are properly established. Therefore, both Governance Committee at the BOD's level and Shari'ah board in IFIs would be able to play their functions as the internal institution of hisbah within the context of the firm through the internalisation of values and rights.”*

They, however did not specifically highlight the role of all Shariah governance organs to adopt the *maslahah* approach. They highlighted the role of hisbah to ensure the IFIs fulfills maqasid but did not mechanise the implementation of the hisbah practice. This paper proposes the Shariah assurance framework to include mafsadah versus maslahah consideration. In this case, maqasid Shariah dimensions could be designed as Maqasid Shariah Policy for Shariah governance organs, as follows:

For BOD- Strategic policy to cater for *maslahah* vs *mafsadah* (as for ESG, SRI consideration)

SC- *fiqhi*, *mafsadah* evaluations, *maslahah* hierarchy considerations

Management- operationalization of *maqasid* Shariah (investment, financing, HR, marketing policies)

*Maqasid* Shariah policy could serve as a policy document guiding the organs of governance going about making strategic, juristic and operational decisions. *Maqasid* Policy Document spells out the roles of SAC, Board, management to realise the *maqasid* Shariah within IFIs. The policy document will later be audited by the Shariah audit team as part of its thematic audit. Shariah audit team will refer to the policy document as a pre-execution document and examine the impact of decisions as a post event. Shariah audit findings will highlight the digression between pre-documentation and post impact of any particular decision. Negative digression will be highlighted as an audit findings.

### **POLICY IMPLICATIONS AND CONCLUSION**

Developed Shariah assurance framework based on *maqasid* Shariah that caters both Shariah compliance and the impact of Islamic financial transactions to stakeholders will guide practitioners in IFIs and other Islamic based institutions to make finance, investment and other operational decisions. Shariah auditors too could use the tool to examine the state of Shariah compliance and the degree of *maqasid* of Shariah achievement within their institutions. The findings of this paper will offer Shariah audit scopes that takes into account *maqasid* Shariah adoptable in Islamic finance industry which may guide IFIs to play their role as a fair, equitable and inclusive development agent of the *ummah*.

In addition, Bank Negara Malaysia has stepped forward to boost the roles of Islamic financial institutions by introducing Value-based Intermediation initiative. It states that an intermediation function should aim to deliver the intended outcomes of Shariah through practices which are the realization of *Maqasid* Shariah concepts. VBI believes that the current paradigm focusing on Shariah compliance should be shifted beyond the compliance. IFIs should be able to create and deliver value to all stakeholders. IFIs should generate sustainable impact to the economy, shareholders, community and environment.

Having VBI as the new strategic concept will ease the IFIs to have Shariah Assurance Framework based on Maqasid Shariah as proposed in this study. The Shariah governance organs should be taking into account *mafsadah* consideration as well as promoting *maslahah* aspects.

Assessing two fully fledged Islamic banks give a small picture of the readiness towards VBI execution. Emphasizing on Maqasid Shariah-based outcomes will encourage the IFIs to provide the reports containing the required information. Both pioneers in Malaysian Islamic banking industry have involved in community development proven by the information stated in the annual reports. They also have been carrying out Waqf program as part of their efforts to sustain the economy of the ummah. However, they need to contribute more towards community empowerment and environmental aspects.

The Shariah assurance framework we are proposing considers the current Shariah audit scope for Shariah compliance as above as well as maqasid Shariah dimensions. Both bank provide slightly similar report contents. The reports should inform more on the environment and community aspects, especially how the IFIs give impact on the environment and community empowerment. VBI is still general, it requires more research to come up with the proposed detailed measures for each intended outcomes of Shariah.

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## **ANTECEDENTS OF EFFECTIVE INTERNAL SHARIAH AUDIT IN ISLAMIC FINANCIAL INSTITUTIONS**

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### **INTRODUCTION**

In a competitive business environment, Shariah compliance perceived to be one of the crucial issues to provide a distinctive features for Islamic financial institutions (IFIs) compared to its conventional counterparts. IFIs are mandated to operate based on the Shariah principles in all processes, system and activities. Shariah compliance is important to enhance the viability of IFIs and to meet the growing demand of Shariah compliance products among the consumers (Abu Kasim, 2012). The extent of Shariah compliance reflects the accountability and integrity of IFIs. Stakeholders are expecting IFIs to the socio-economic substances outline by the objectives of Shariah (Dusuki, 2008). In the current global financial crisis, IFIs are also expected to ensure that they could operate a responsible, inclusive and sustainable Islamic financial activities (Bank Negara Malaysia, 2016).

Intense regulations and guidelines are imposed to the IFIs which operate Islamic financial activities and operations in order to gain significant trust from the stakeholders (Alhabshi, 2016; Bank Negara Malaysia, 2016). It is challenging for IFIs to have full Shariah compliance but the efforts to prevent or minimise the occurrences of any Shariah non-compliance activities should be welcomed (Ab Ghani & Abdul Rahman, 2015). Majority IFIs may have offered Islamic financial products which comply with the Shariah principles and guidelines established by the regulators, but most IFIs normally may still fail due to bad governance and assurances (Askari, Iqbal, & Mirakhor, 2009). Islamic financial industry are facing with the Shariah governance challenges, hence it is important

for the IFIs to ensure effective Shariah governance including effective Shariah audit to enhance public trust and confidence towards IFIs (Abdul Rahman, 2011; Grassa, 2013).

Assurance of Shariah compliance in Islamic financial activities through the Shariah audit practices is crucial to enhance the integrity of IFIs. The main objective of this paper is to suggest a proper understanding of the antecedents of effective Shariah audit function in IFIs. The understanding of at least four (4) identified antecedents such as internal control system, Shariah risk management function, management support, and function of Shariah Committees may assist the Islamic financial industry and the regulator to enhance the present regulatory requirements such as the Shariah governance framework of the respective jurisdictions.

### **INTERNAL CONTROL SYSTEM**

According to the COSO Internal Control Framework, internal control is “a process, affected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations” (Moeller, 2014: 13). The internal control system includes five (5) components such as control environment, risk assessment, control activities, information and communication and monitoring activities.

Firstly, control environment is a significant factor to determine that effective operations are implemented within the organisation based on the guidelines. The second component of risk assessment is crucial as it identifies the possibility of any events that risks may occur which could prevent the achievement of objectives at all levels organisation (Moeller, 2014). The third components of control activities represents three (3) principles for the organisation to select and develop the control activities to mitigate the risks, establish applicable technology that could lead to the achievement of objectives and to develop proper policies and procedures or the control measures (Moeller, 2014). On the other hand, Moeller (2014: 88) argued that the fourth component of information and communication in the COSO Internal control framework “describes the types of information stored by an enterprise and how it is communicated to various parties”. Finally, the last component of monitoring activities in the COSO Internal Control

framework performs periodic identification of internal control problems, produce reliable information to enable decision making, ensure good preparation of financial statements and to provide assurance on the effectiveness of internal control (Moeller, 2014). Within these five (5) components of internal control, Moeller (2014) outlines another 17 principles to explain each of the internal control components which must be implemented to achieve effective internal control system in the organisation.

In practice, Fadzil, Haron and Jantan (2005) has adopted the COSO Internal Control Framework to examine whether the compliance to the SPPIA in the internal audit practices influence the quality of internal control system. The study found that the performance of internal audit has positive relationship with the control environment and control activities in organisation. In addition, professional proficiency has significantly influence the monitoring and control environment aspect of the internal control system (Fadzil, Haron, & Jantan, 2005). In this respect, it can be seen that compliance to the internal audit framework has led to better quality of the internal control system of the company.

Meanwhile, Badara and Saidin (2014) found a significant positive relationship between effective internal control system and internal audit effectiveness in Nigeria. The study adopted contingency theory to explain the factors influencing the effectiveness of internal audit and used the measurement of effective internal control system such as the reliability of financial and non-financial records, system to safeguard assets and the compliance with relevant policies and procedures in the local government in Nigeria. In addition, a study done in the Greek hotel business found that the internal control system shows positive influence towards the effectiveness of internal audit in terms of the control environment, risk assessment, control activities, information and communication and monitoring (Karagiorgos, Drogalas, & Giovanis, 2011).

In theory, the study argued that contingency theory by Fiedler (1967) can be adopted to explain the situational elements such as effective internal control system in IFIs which could influence the effectiveness of Shariah audit function. In this respect, the Guidelines on Corporate Governance for Islamic Banks (GP1-i) requires IFIs to establish effective internal control systems and the Board should ensure that the operations are

dealt in a proper manner (Bank Negara Malaysia, 2013b). Effective internal control system in IFIs is then assessed by the Shariah audit function as required by the SGF (Bank Negara Malaysia, 2010).

The empirical studies done by Shafii and Salleh (2010) proposed the Shariah internal control checklist to be used by the Shariah auditors in performing Shariah audit. The study used the Shariah internal control checklist to compare the disclosure components of internal control system in the annual report of Bahrain Islamic Bank (BIB) and Bank Islam Malaysia Berhad (BIMB). It is found that BIMB has established full disclosure of internal control system in the annual report (Shafii & Salleh, 2010). Internal Shariah auditors are responsible to ensure the effectiveness of internal control system to prevent any Shariah non-compliance issues (Ab Ghani & Abdul Rahman, 2015). Another conceptual study proposed that there is a positive relationship between effective internal control system and effective internal Shariah compliance function in Takaful institutions (Mohamad Puad, 2014). On the other hand, the Exposure Draft of ISAF outlined that the Shariah audit objective includes assessment on the adequacy of internal control system (International Shariah Research Academy (ISRA), 2011). Effective internal control system is measured in terms of the components of control environment, risk assessment, control activities, information and communication and monitoring activities as outlined in the COSO Internal Control framework (Moeller, 2014).

In view of the above presumption, the study argued that contingent factors such as effective internal control system could have influenced effective Shariah audit function since internal control structure will govern the whole operational activities in IFIs in relation to Shariah matters and provide better information for the Shariah audit function to conduct the Shariah audit process. More empirical evidence could be further examined on the influence of effective internal control system towards the effectiveness of the internal Shariah audit function in IFIs.

### **SHARIAH RISK MANAGEMENT FUNCTION**

Another factor which could closely influence the internal audit practice is risk management function. Previous research performed by Vinnari and Skarbak (2014) has



examined the contingent factors such as risk management as the antecedents for internal audit activities. The research found that internal audit unit has important responsibilities in relation to the development and assessment of risk management. Although internal audit unit is not conducting the risk management process, they perform the risk-based audit approach to highlight on the unexpected events in the organisational operations (Vinnari & Skarbak, 2014).

In addition, risk management is found to provide the contingent effect on the internal audit effectiveness given a proper establishment of risk management process in the organisation (Arena & Azzone, 2009; Badara & Saidin, 2014) especially when using the risk assessment findings in audit planning (Allegrini & D'Onza, 2003) and given a certain criteria such as the stages of Enterprise Risk Management (ERM) development, type of industry and leadership in ERM (Beasley, Clune, & Hermanson, 2006). Moreover, Sarens and De Beelde (2006) argued that the role of internal auditors is important to monitor the company risk profile in the US and Belgian companies. This is because the Chief Executive Officer normally expects the internal auditor to formalise the risk management system in the companies.

In relation to IFIs, the Shariah Governance Framework (SGF) requires that the Shariah risk management function performs the systematic approach to manage Shariah non-compliance risks and ensure that IFIs are not exposed to any unacceptable level of risks (Bank Negara Malaysia, 2010). The Shariah risk management function is performed by the qualified Shariah risk officers as part of the integrated risk management framework in the IFIs.

The process conducted by the Shariah risk management function works to identify, measure, monitor and control the Shariah non-compliance risks in IFI's operations. The identification includes ensuring that IFIs have established the means to control and mitigate the Shariah non-compliance risks. In addition, Shariah risk officers measure the impact of Shariah non-compliance risks in IFIs based on the historical and actual de-recognition of income from the Shariah non-compliant activities. Furthermore, Shariah risk officers perform the monitoring of Shariah non-compliance risks to ensure that efficient management of such risks are in place in the IFIs. The Shariah risk officers

will then provide periodical report on any possibilities of Shariah non-compliance risks to the Board, Shariah Committee members and the management. Shariah risk management function ensures control measures are in place to keep track of any income that are not recognised from the Shariah non-compliant activities. Besides that, Shariah risk management function includes the recommendation of policies for the Shariah non-compliance risk management and awareness in the IFIs (Bank Negara Malaysia, 2010). A study argued that proper Shariah risk management method needs to be stipulated as a vital components in the SGF or other guidelines established by Bank Negara Malaysia (Muneeza & Hassan, 2011).

From the discussion above, the study argued that effective risk management perceived to be the contingent factor towards the effectiveness of internal audit. Thus, effective management of Shariah non-compliance risks using the integrated risk management framework could have influenced the internal Shariah audit function to perform an effective risk-based audit. Based on the Exposure Draft of Internal Shariah Audit Framework (ISAF), the Shariah audit scope needs to ensure the establishment of Shariah risk management function and the process covers the review of risk assessment of Shariah non-compliance risks in IFIs and adequacy of the Shariah risk management process (International Shariah Research Academy (ISRA), 2011). Effective Shariah risk management will be measured using the integrated risk management framework outlined by the SGF in terms of the risk identification, risk measurement, risk monitoring and risk control of Shariah non-compliance in IFIs (Bank Negara Malaysia, 2010).

### **MANAGEMENT SUPPORT**

Besides that, academic interest in the study of management have looked into the relationship between top management support and effectiveness of internal audit (Mihret & Yismaw, 2007; Soh & Martinov-Bennie, 2011). The empirical studies argued that management support is important to implement internal audit recommendations. Internal auditors also need good relationship with the management as long as the communication does not affect their independence and objectivity to conduct the assurance procedures.

In addition, a study argued that effective internal audit function can provide an intuition to the management in terms of other external areas such as risk assessment, ethics and corporate governance (Paape, Scheffe, & Snoep, 2003). Another five (5) case studies conducted in Belgian companies examine the relationship between internal audit and senior management. The study found that internal audit function is able to meet the expectations of senior management by providing the objective assurance on the effectiveness of the governance process and improve the internal control system in the companies (Sarens & Beelde, 2006). In addition, a survey done on the professional internal auditors and non-internal auditors found that the use of Balance Scorecard increased the involvement of internal auditors in strategic management (Melville, 2003).

The relationship between management support and effective Shariah audit function in IFIs can be seen from the responsibilities of management to provide full support in the implementation of the Shariah compliance functions as outlined by the Shariah Governance Framework (SGF). Although management do not have direct reporting relationship with the Shariah audit function, effective Shariah audit function can also influence effective conduct of management in terms of the recommended measures of any Shariah non-compliance matters in Islamic banking activities. In this respect, management needs to be effective to ensure proper conduct of operations according to the Shariah precepts and resolutions (Bank Negara Malaysia, 2010).

In theory, management support could be the contingent factors to influence effective Shariah audit function. This is because IFIs are specifically bound by the strict regulation such as the SGF and IFSA 2013 imposed by Bank Negara Malaysia as the regulator especially in the execution of management responsibilities. To ensure that Islamic banking activities are Shariah compliant, management has specific responsibilities to implement the Shariah rulings and discuss with the Shariah Committee in terms of any Shariah issues. The management is also responsible to ensure that the operations and activities in their respective IFIs are dealt in accordance to the Shariah principles and Shariah resolutions decided by the Shariah Committee members. It is important for the management to be effective as their work covers the whole execution of the Shariah compliance functions such as allocation of adequate resources and manpower, human resource policy for the employees, staff training and development and support to

the Shariah Committee members. (Bank Negara Malaysia, 2010). In addition, management is also responsible to establish good Shariah compliance environment within the IFIs (Bank Negara Malaysia, 2010).

On the other hand, Yahya and Mahzan (2012) argued that lack of support from management contributes to the challenge to implement effective Shariah audit. The study found that some managers in IFIs do not appreciate the importance of Shariah audit due to misunderstanding in the differences between Shariah audit and conventional internal auditing (Yahya & Mahzan, 2012). According to the Exposure Draft of ISAF, effective Shariah audit function can be established if it is independent from the management and free from interference to perform the Shariah audit activity. Shariah audit function needs to assess the human resource policy to comply with the Shariah principles which is developed by the management and reviewed by the Shariah Committee members (International Shariah Research Academy (ISRA), 2011). The assessment of Shariah audit function on the Shariah compliant human resource policy may help the management to execute the policy in the organisation especially in terms of the recruitment procedures and ethical conduct of the staff.

The study adopts few elements from the previous internal audit research to measure management support such as the involvement in internal audit plan, response to the internal audit findings, commitment to strengthen internal audit function and the access of resources available to the internal audit department (Alzeban & Gwilliam, 2014; Mihret & Yismaw, 2007). In addition, the research also combines the criteria outlines by the SGF to determine the management criteria such as implementation of Shariah rulings and decisions, provide continuous training to the key internal stakeholders in IFIs, establish holistic culture of Shariah compliance and to ensure Shariah policies are accessible at all times (Bank Negara Malaysia, 2010). Therefore, the study argued that good support from management could influence effective Shariah audit function in terms of providing holistic culture of Shariah compliance in IFIs and ensure Islamic financial operations are dealt in accordance with Shariah precept. Hence, the probability of Shariah non-compliance matters to occur may be reduced.

## FUNCTION OF SHARIAH COMMITTEE

On the other hand, academic interest in the study of Board of Directors has developed few model and measures to assess the effectiveness of Board of Directors. It is argued that effective Board of Directors can be achieved when the committee consists of more independent outside directors who can perform the oversight role on the operations of organisation (Bank Negara Malaysia, 2013a). In addition, each committee members in the Board can be effective if they have relevant expertise to perform their role and meet more than twice a month to discuss on matters related to the organisational activities (Alkhafaji, 1990).

In terms of measurement, previous study developed a model of effective banking boards which can be categorised into the board-level drivers such as number of directors, proportion of independent directors, separation between the role of Board Chairman and Chief Executive Officer, frequency of meetings and adequacy of reporting system and individual drivers such as competencies and contribution of the board members to the board activity (Carretta, Farina, & Schwizer, 2010). Another study argued that effective Audit Committee can be measured through its composition (i.e. expertise, independence, integrity and objectivity), authority (i.e. responsibility and influence level), resources (number of members and access to management) and diligence (i.e. motivation and incentive) (DeZoort, Hermanson, Archambeault, & Reed, 2002).

In practice, scholars examined the effect of Board of Directors' attributes such as board composition in terms of number of inside or outside directors, duality, occupation, incentives and key relationships are seen as the contingent variables to influence corporate governance (Cravens & Wallace, 2001). A good composition of board members allows the board to effectively fulfil their responsibilities in monitoring organisational operations. In terms of judgement and decision making, Mala and Chand (2015) stressed that knowledge is an important factor to improve audit effectiveness.

In relation to IFIs, SGF requires Board of Directors to appoint at least one (1) Shariah Committee members with adequate knowledge in Shariah to sit in the board to bridge the gap on the understanding of board members in relation to the Shariah matters

(Bank Negara Malaysia, 2010). Shariah Committee members perform the oversight role on the Shariah matters in Islamic banking activities and operations. With respect to the Shariah audit function, internal Shariah auditors need to consult the Shariah Committee members in planning the scope of audit. The Shariah audit function needs to utilise the rulings and decision made by the Shariah Committee members in implementing the Shariah audit process. The Shariah audit findings shall then be reported to the Shariah Committee members (Bank Negara Malaysia, 2010).

Academic interest in the study of the Shariah Committee members highlighted the issue of its relationship with the internal Shariah auditors. A study found that internal Shariah auditors are too dependent on the Shariah Committee members to perform Shariah audit especially in relation to the Shariah matters (Kasim, Mohamad Ibrahim, & Sulaiman, 2009). However, Yahya and Mahzan (2012) found a mix relationship between Shariah audit function and Shariah Committee members. A few internal Shariah auditors' in the Islamic banks are found to have close working relationship with the Shariah Committee members whereas a few Shariah Committee members in another Islamic banks did not even perform their responsibilities to oversee the Shariah audit function. Moreover, Shafii and Salleh et al. (2013) argued that some Islamic banks let the management to decide on the reporting line of the Shariah audit findings to the Shariah Committee members. If the Board Audit Committee has Shariah background, management may decide that it is sufficient for the Shariah audit function to report to the Board Audit Committee, thus no relationship could be developed between Shariah audit function and the Shariah Committee members (Shafii, Salleh, Mohd Hanefah, & Jusoff, 2013).

On the other hand, the establishment of the Shariah audit function through the SGF provides a positive impact to the role of Shariah Committee members (Shafii, Abidin, Salleh, Jusoff, & Kasim, 2013). Previously, the Shariah Committee members only perform the advisory role in Islamic banking activities. After the implementation of the SGF, Shariah Committee members need to extend their role to monitor the Shariah audit function and approve all procedures related to Shariah matters in Islamic banking operations (Shafii, Abidin, et al., 2013).

Besides that, SGF requires IFIs to appoint at least five (5) Shariah Committee members who have sufficient knowledge and qualification in Shariah and Islamic finance (Bank Negara Malaysia, 2010). Good function of Shariah Committee members in IFIs is important to help all members understand the Shariah issues raised in the Shariah audit findings. In addition, Shariah Committee members are the one who make the decision regarding any Shariah issues in Islamic financial operations. Apart from the knowledge in Shariah, it is good if Shariah Committee members to have adequate knowledge in auditing to understand the work of Shariah audit which could help in the advisory process. Although limited research performs in relation to Shariah Committee members in IFIs, the function of Shariah Committee could be the factors to influence effective Shariah audit function.

Based on the above discussion, the study argued that function of Shariah Committee can be the contingent factors to influence the effectiveness of Shariah audit function in IFIs. The function of Shariah Committee can be measured in terms the minimum number of Shariah Committee members, qualifications and proficiencies, number of Shariah Committee members who can sit in the Board of Directors, effective performance of oversight role on Shariah matters and disclosing the report on Shariah compliance in the annual report (Bank Negara Malaysia, 2010).

## **CONCLUSIONS**

This paper has identified and argued for the four (4) antecedents and factors i.e. internal control system; Shariah risk management function; management support; and the function of Shariah Committee are argued as influencing the effectiveness of internal Shariah audit function in IFIs. The relationships between and among these factors should be empirically examined in future studies in order to obtain a clear understanding of these antecedents and the effective function of Shariah audit. For the IFIs, future empirical studies on the impacts of these four antecedents on the effectiveness of Shariah audit may give a clear direction for the IFIs to re-orientate the present function of Shariah audit in their respective institutions. The need for effective of Shariah audit also provides the urgency for the relevant regulators to establish strong and sound guidelines and framework for the IFIs to properly implement Shariah audit. Effective function of Shariah audit is

imperative in assisting the Islamic financial industry and the regulators to effectively monitor and enhance the integrity and accountability of Islamic financial industry.

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**ESTABLISHING RELIABILITY AND VALIDITY: PILOT TESTING OF A SURVEY INSTRUMENT FOR A QUANTITATIVE RESEARCH ON RISK MANAGEMENT PRACTICES OF ISLAMIC BANKS IN MALAYSIA**

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**ABSTRACT**

*This paper discusses the processes involved in a pilot study carried out to determine the reliability and validity of the survey instrument to be used in the main study. The aim of the main study is to examine the determinants and consequences of risk management practices in local and foreign Islamic banks operating in Malaysia. With the aid of SPSS software and panel of experts, the instrument's reliability, validity and subsequently data normality were examined. The pilot test showed that the instrument was reliable and valid based on data that exhibited reasonable normality. The pilot tested instrument shall now be employed in the main study.*

**Keywords:** *Reliability, validity, Islamic banking, risk management practices*

**INTRODUCTION**

Survey research is often used today as the mode of observation in social sciences (Babbie, 2007) Survey includes the use of questionnaire, an instrument used to obtain information particularly from a large population for analysis. Survey is an excellent way to measure attitude and orientation of the population and may be used for descriptive, explanatory, and exploratory purposes (Babbie, 2007).

However, a questionnaire whenever used as the measuring instrument in research, has to be tested for reliability and validity first before it is used for a substantive study (Peterson, 2000; Baines & Chansarkar, 2002; Malhotra & Birks, 2007). Reliability and validity are two major criteria for evaluating measurements (Zikmund et al, 2013).

This paper is divided into five sections. After this introduction, the next section presents the background followed by research methodology in Section Three. Then results will be discussed in Section Four and the last section concludes this paper.

## **BACKGROUND**

### ***Islamic Banking***

Islamic banking is a banking system based on Islamic principles or the Shariah laws (Sulaiman Abdullah & Jorihah, 2013). The first principle of Islamic banking is the absence of interest-based transactions (riba) which is the hallmark of Islamic banking (Asyraf Wajdi & Nudianawati, 2007). In fact, Islamic banks are prohibited from collecting interest from customers or paying interest to them (Sulaiman Abdullah & Jorihah, 2013). Complying with the Shariah laws is the significant factor that differentiates Islamic banking system from the conventional one.

Complying to the Shariah principles refers to the act of observing the permissible (halal) and refraining from the prohibited (haram) as commanded by Allah (Saiful Azhar, 2010). For instance, a Muslim is prohibited from indulging in riba-based activities such as borrowing with interest but at the same time, is permitted to perform trading. The prohibition of riba and the permissibility of trading are explicitly stated in the Quran: "Trade is like usury. Whereas Allah has permitted trading and forbidden usury..." (Al-Quran. Al-Baqarah 2:275) and Allah labels those who return to (dealing in interest or usury) are the companions of the Fire and they will abide eternally therein.

As a Muslim, complying with the Shariah is mandatory. Prophet Muhammad SAW (Al-Quran 3:132) reminded all Muslims in his final sermon on the 9th day of Dhul-Hijjah, 10 A.H. in the 'Uranah Valley of Mount Arafat, "Oh people, reflect on my words, I leave behind me two things, the Quran and my example and if you follow these, you will never go astray" (Abdullah, 2010). The Prophet's reminder is very significant and it is strongly supported by Allah who says, "And obey Allah and His Messenger that you may find mercy." (Al-Quran. Al-Imran 3:132).

Although Shariah is the main attraction to the Muslims in patronizing Islamic banks, it does not deter the non-Muslims from accessing the Islamic banking services. In fact, the banking system has been expanding at a rate faster than the conventional banking. Islamic

banking assets with commercial banks globally reached US\$1.54 trillion in 2012 (Ernst & Young, 2015). This includes both pure-play Islamic banks and windows. Islamic banking growth outlook continues to be positive and it is projected that by 2020, the Muslim world will be doing 50 percent of its banking with Islamic institutions (Ernst & Young, 2015).

### ***Risk Management in Islamic Banking***

As a financial intermediary, both Islamic banks (IBs) and conventional banks (CBs) have to face various risks in their businesses. Risk in banking is one of the most important elements that need to be managed, however small the risk may be (Nor Fahimah & Shamsiah, 2011). Managing risk is not only critical to the banks but also to the economy as a whole in the country where the bank operates. The failure of risk management in banks will lead to financial losses, and continued losses will eventually cause the bank's failure (Khadijah, 2014). Hence, it is crucial for the industry players, including Islamic banks to understand the role of risk management practices in maintaining the stability of the overall banking system (Akikizidis & Khandelwal, 2008).

Banking is a business that is exposed to various kinds of risks (Arora & Sharma, 2014). Both CBs and IBs face common risks which comprise credit, market, liquidity, and operational risks. However, IBs face additional risks comprising equity investment risk, displaced commercial risk and rate of return risk (Lahsasna, 2014). Another unique and important risk faced by IBs is Shariah risk, which is classified under operational risk (Khadijah, 2014). Failure to ensure compliance to the Shariah principles or Shariah laws will expose IBs to Shariah non-compliance risk (Zurina et al. 2013), which is a Shariah risk. Shariah risk poses serious financial and non-financial implications to IBs even if other type of risks are well-managed.

Hence, it is very important for the local and foreign IBs particularly in Malaysia understand the various risks inherent in the Islamic banking business. A deep understanding of risks and risk management would likely enhance risk management practices by the banks. Several authors relate risk management practices to understanding risk and risk management, risk identification, risk assessment and analysis, and risk monitoring (Ali & Naysary, 2014; Arora & Sharma, 2014; Mahmoud & Ahmed, 2014; Soyemi et al., 2014).

In managing risks, it is crucial for IBs to be aware of the factors that determine or influence risk management practices (RMPs) so that the risks can be better managed. Good RMPs have been associated with increased financial performance (Mahmoud & Ahmed, 2014; Soyemi et al., 2014), which is in turn crucial to the continued survival of IBs.

***Determinants of Risk Management Practices of Local and Foreign Islamic banks in Malaysia***

The present study aims to examine the determinants and consequences of risk management practices (RMPs) in local and foreign Islamic banks operating in Malaysia. Previous studies have identified at least five determinants or constructs or variables which influence RMPs in Islamic banks (Al-Tamimi & Al-Mazrooei, 2007; Abul Hassan, 2009; Khalid Amjad, 2012; Khattak et al, 2013; Arora & Sharma, 2014; Mahmoud & Ahmed, 2014; Rashidah et al 2014). The determinants or constructs comprise; (i) understanding risk and risk management (URRM), (ii) risk identification (RI), (iii) risk assessment and analysis (RAA), (iv) risk monitoring (RM), and (v) credit risk analysis (CRA). In the study by Mahmoud & Ahmed (2014), perception of bank performance (PBP) is determined to be the consequence of RMPs.

All the constructs enumerated in the preceding paragraph have been tested to be valid and reliable. However, the items or questions of URRM, RI, RAA, RM, and CRA constructs employed in six of the studies are adopted from the earlier study by Al-Tamimi & Al-Mazrooei (2007). It has been more than 10 years since the items/questions were first developed by Al-Tamimi and Al-Mazrooei in 2007.

To-date, no extensive review or revalidation of the items/questions of URRM, RI, RAA, RM, CRA, and RMPs constructs have been reported to be carried out. This is the first gap that the present study attempts to address. In addressing the gap, an extensive review or revalidation exercise will be carried out in order to produce an up-to-date questions/items for the constructs that suits the Malaysian environment.

In the present study, the researcher has also identified three additional determinants of RMPs. These determinants or constructs are hypothesized to have an influence on RMPs in local and foreign Islamic banks operating in Malaysia. The new constructs comprise; (i) corporate governance (CG), (ii) Shariah review (SR), and (iii) Shariah audit (SA).

There has been minimal study on the influence of CG on RMPs and there is almost no known study carried out to determine the effects of SR and SA on RMPs particularly in the context of Malaysia. This is a second gap that the researcher plans to address in the present study. In addressing the second gap, it entails the development of entirely new items/questions for the three new constructs/variables.

### ***Reliability***

Reliability is an indicator of a measure's or scale's internal consistency (Pallant, 2005; Zikmund et al, 2013). Internal consistency refers to the degree to which the items that make up the scale 'hang together'. Are the items measuring the same underlying construct? (Pallant, 2005). For instance, in the present study, are the eleven items really measuring the construct of risk management practices?.

Reliability is also defined by Bryman & Bell (2007) as consistency of a measure of a concept, i.e consistency to obtain the same results again in different and separate study (Peterson, 2000). Reliability also indicates the extent to which an instrument is consistent and stable across the various items or questions in the scale (Sekaran and Bougie, 2010) or consistent across time (Maiyaki & Mokhtar, 2011). Thus, the concept of reliability focuses on consistency.

However, De Vaus (2014) cautions that a consistent but false response is still reliable. Still, reliability is an important issue that researchers should take into account when conducting pilot study even if they are using questionnaires which have been established before (Maiyaki & Mokhtar, 2011).

There are several methods available for checking reliability such as (i) Test-Retest Reliability, (ii) Parallel-Form Reliability, (iii) Inter-Item Consistency and (iv) Split-Half Reliability (Hazzi & Maldaon, 2015). The first two methods ensure consistent measurement across time, whereas the last two methods can be used to examine the homogeneity of items in the scale that measure the same construct. Cronbach's alpha coefficient and Kuder-Richardson Formula 20 (KR-20) are ways of Inter-Item Consistency (Hazzi & Maldaon, 2015).

Cronbach's alpha coefficient is the most commonly used measure for checking reliability (Field 2005) in many disciplines, especially, when studies address multiple Likert-type



scales in business, industrial and social psychological research (Hazzi & Maldaon, 2015). Cronbach's alpha specifically measures the internal consistency of a scale, the degree to which all the items of scale measure the same construct. The coefficient shows whether the different items converge or not.

There are differences in opinion among various authors on what is an acceptable Cronbach's alpha value. For instance, Griffiee (cited in Hazzi & Maldaon, 2015, p. 58) suggests that 0.3 at the threshold, 0.5 or higher is adequate, and 0.7 or higher is high. On the other hand, George and Mallery (cited in Hazzi & Maldaon, 2015, p. 58) opined that coefficient values of > 0.9 is excellent, > 0.8 is good, > 0.7 is acceptable, > 0.6 is questionable, > 0.5 is poor, and < 0.5 is unacceptable").

Ideally the Cronbach's alpha value should be above 0.7 (Pallant, 2005). However, Pallant (2005) highlights that it is not uncommon to find quite low Cronbach values (e.g. 0.5) especially for shorter scales (e.g. scales with fewer than ten items). Other authors opined that a Cronbach's alpha value of 0.6 is considered to have average reliability whilst instrument with a value of 0.7 and above is regarded as having high reliability (Nunnally, 1978; Hair et al., 2006; Sekaran & Bougie, 2010).

### ***Validity***

Validity refers to the degree to which a measure accurately presents what it is supposed to measure and not something else (Hair et al., 2010). Simply said, validity refers to "whether an indicator measures the concept that we say it does" (DeVaus, 2014).

Cronbach (1950) emphasizes the importance carrying out a validity test. The author points out that there is no merit in enhancing reliability unless validity is enhanced at least proportionately. Validity seems to be a better criterion than reliability (Chang, 1994).

According to Zikmund et al (2013), Sekaran (2003) and Nunnally (1978), there are several ways in which validity can be assessed; (i) face validity, (ii) content validity, (iii) criterion validity, and (iv) construct validity. Face validity refers to subjective agreement that a scale logically reflects the concept being measured (Zikmund et al, 2013). When an item measuring a construct matches the definition of the construct, the scale is said to have face validity (Zikmund et al, 2013).

Content validity ensures that the measurement scale includes a sufficient and representative set of items that tap the concept, in a simple connotation like, “Are we measuring the right things?” (Sekaran, 2003). Face and content validities are the two methods commonly employed in a pilot study.

Criterion-related validity or sometimes called predictive validity (Babbie, 2007) is established when the measurement that differentiates individuals on a criterion is expected to predict (Tabachnick & Fidell, 2013). However, this validity test is not usually employed in a pilot study especially when the research scenario relates to past events.

Construct validity is to testify how well the result obtained from the use of the measurement fits the theories around which the test is designed (Sekaran, 2003). This assessment method involves exploratory factor analysis (EFA) and confirmatory factor analysis (EFA). Since a pilot test usually employs a small sample size, construct validity test is not normally undertaken as the test requires a rather large sample size.

The way to ensure reliability and validity is achieved for any research instrument before using in in a full scale study is to conduct a pilot study of the research instrument. A pilot study is an essential initial step in a research and this applies to all types of research studies (Hazzi & Maldaon, 2015).

### ***Pilot Study***

A pilot study, sometimes referred to as pretest (Zikmund et al, 2013) is a small-scale or a mini version of a research project that collects data from respondents similar to those that will be used in the full scale study (Van Teijlingen & Hundley, 2001; Zikmund et al., 2013). A pilot study is fundamental in any research as it helps to detect possible flaws in the measurement instrument (Van Teijlingen & Hundley, 2001) such as the questionnaire. In fact, a pilot study is critical in refining questionnaire (Zikmund et al, 2013).

No matter how carefully researchers design questionnaires, there is always the possibility of making mistake (Babbie, 2007). Therefore, a pilot study is important in improving the quality and the efficiency of the main study (Hazzi & Maldaon, 2015). Although conducting a pilot study does not guarantee success in the main study, it does increase the likelihood of success (Van Teijlingen & Hundley, 2001). A pilot study can add value and credibility value to a research project (Van Wijk & Harrison, 2013)

In performing a pilot study, a researcher should not only pay attention to the issue of reliability and validity but should also address the issue of missing data and normality of data distribution (Maiyaki & Mokhtar, 2011; Hazzi & Maldaon, 2015). These issues have to be addressed as they will affect the results of the statistical analysis.

In the Statistical Package for Social Science (SPSS) software, missing data can be handled in four different ways, i.e. (i) exclude cases list-wise, (ii) exclude cases pair-wise, (iii) replace with mean, and (iv) delete missing case. However, 'exclude cases pair-wise' is strongly recommended by Pallant (2005). This method will exclude the case (respondent) only if the missing data is required for the specific analysis. The case (respondent) will still be included in any of the analysis for which the case has the necessary information.

In the case of normality of data distribution, Hazzi and Maldoan (2015) highlight three methods in which data normality can be checked; (i) descriptive statistics such as analyzing the values of Skewness and Kurtosis (ii) eyeball tests (e.g., using histogram and normal Q-Q plot), and (iii) conducting certain statistical tests such as Kolmogorov-Smirnov and the Shapiro-Wilk tests.

Among the three methods of normality checking, Skewness and Kurtosis indices are usually commonly used, as they are easy and effective for checking the normality both for small and large sample (Hazzi & Maldaon, 2015). The skewness value provides an indication of the symmetry of the data distribution whilst Kurtosis provides information about the 'peakedness' of the distribution (Pallant, 2005).

Data is said to be normally distributed if the skewness and kurtosis values are  $< 2$  and  $7$  respectively (West et al in Hazzi & Maldaon, 2015, p. 57). On the other hand, Kline (1998) suggested absolute values of the skewness index greater than 3.0 as 'extremely' skewed whereas absolute values of kurtosis from 8.0 to over 20 indicate 'extreme' kurtosis. Data is also said to be normally distributed if both the absolute values of skewness and kurtosis are within plus and minus 2 (Cameron, 2004).

The aim of this paper is to report the pilot test procedures and the results of the reliability and validity tests of the survey instrument of an ongoing research in preparation for the large scale study. Specifically, the proposed large scale study will examine the relationship between eight independent variables (understand risk and risk management,

risk identification, risk assessment and analysis, risk monitoring, credit risk analysis, corporate governance, Shariah review and Shariah audit) and RMPs, the dependent variable.

## **RESEARCH METHODOLOGY**

The researcher carried out a pilot study using survey method in relation to the main study that examines the determinants and consequence of RMPs in local and foreign Islamic banks (IBs) operating in Malaysia. Survey method has been employed in several previous researches pertaining to RMPs of both types of IBs (Khattak et al, 2013; Kozarevic et al, 2013; Arora & Sharma, 2014; Mahmoud & Ahmed, 2014; Mokhni et al, 2014). The researcher will also employ survey method in the main study in order to answer the research questions within the time, budget and human resources (Ghauri & Gronhaug, 2005).

Before carrying out the pilot study, the researcher designed the questionnaire following the nine steps as suggested by Malhotra and Birks (2007), Churchill and Iacobucci (2002) and Baines and Chansarkar (2002). The steps comprise; (i) specify the required information, (ii) determine type of questionnaire and method of administration, (iii) consider type of analysis, (iv) determine content of questionnaire, (v) determine form of response to each question, (vi) determine wording of each question, (vii) determine sequence of questions, (viii) determine layout and physical appearance of questionnaire, and finally (ix) pre-test questionnaire and revise accordingly. The researcher followed these steps in developing the items/questions for the new variables (CG, SR, and SA).

In carrying out the pilot study, the researcher is guided by the procedures proposed by Peat et al (cited in Van Teijlingen & Hundley, 2001, p. 35) as shown below:

- Administer the questionnaire to pilot subjects in exactly the same way as it will be administered in the main study;
- Ask the respondents for feedback to identify ambiguities and difficult questions;
- Record the time taken to complete the questionnaire and decide whether it is reasonable;
- Discard all unnecessary, difficult or ambiguous questions;
- Re-word or re-scale any questions that are unanswered as expected; and,
- Shorten, revise and, if possible pilot again.

The following sections discuss and deep-dive into the pilot study procedures undertaken by the researcher.

### ***Sampling***

In the present pilot study, 50 questionnaires were distributed to five selected Islamic banks (IBs) through purposive (judgmental) sampling, which is a non-probability sampling technique (Babbie, 2007). The population for the pilot study comprise all local IBs and all foreign IBs operating in Malaysia.

Using purposive sampling, the researcher, through his judgment located a few subjects or respondents in each selected bank through his personal contact to complete the questionnaire. These specific respondents were the most useful and relevant to the study and met the requisite criteria set by the researcher (Sekaran & Bougie, 2010). They became the initial samples or units of analysis and later appointed as the representatives of the researcher.

The representatives were then politely requested to identify others who qualified for inclusion in the sample. After identifying further respondents, the representatives distributed the questionnaires to them to be filled up. The identified respondents led more respondents who can be asked to complete the questionnaire and so on.

The qualified respondents were those; (i) who have been working in the present employment for at least a year in the head office or branches of the bank, or (ii) who have worked for less than a year but have been confirmed in their employment and familiar with the subject matter, or (iii) who have worked for less than a year in the bank but has sufficient experience in risk related matters in their previous employments. The samples came from various departments and units such as Risk, Shariah, Audit, Legal, Compliance, Credit Administration, Credit Origination, Product & Development, Debt Collection & Recovery and other related departments or units.

### ***Data Processing***

Upon receiving 40 questionnaires from the respondents, the questionnaires were subjected to data processing whereby data was evaluated and checked for errors and missing values. One questionnaire was rejected due to ineligibility of the respondent. The researcher also rejected four other questionnaires due to incompleteness and significant

missing data. After processing, 35 usable samples remained for further analysis. The data was also checked for normality. After the data was in order, the researcher proceeded to perform reliability and validity tests as discussed in the results section (Section Four).

### ***The Research Instrument***

The researcher identified ten constructs or variables to be included in the proposed main study. The constructs comprised; (i) understand risk and risk management (URRM), (ii) risk identification (RI), (iii) risk assessment and analysis (RAA), (iv) risk monitoring (RM), (v) credit risk analysis (CRA), (vi) corporate governance (CG), (vii) Shariah review (SR), (viii) Shariah audit (SA), risk management practices (RMPs), and perception of bank performance (PBPs). The aim of the main study is to examine the influence of URRM, RI, RAA, RM, CRA, CG, SR, and SA on RMPs of local and foreign Islamic banks operating in Malaysia. The main study is also aimed at determining the relationship between RMPs and PBP.

The variables comprising SR, SA, and CG are newly introduced and developed whilst the others were adopted from past studies and adapted for the proposed main study. The researcher developed the items for CG variable or construct based on Bank Negara Malaysia guidelines on corporate governance for Islamic banks. On the other hand, Shariah Governance guideline issued by Bank Negara Malaysia is used to develop the items for SR and SA variables/constructs.

Earlier, the researcher planned to adopt the items/questions for URRM, RI, RAA, RM, CRA, RMPs, and PBP used in the previous studies. However, it was strongly recommended that these items be reviewed or revalidated since they have been in existence for more than 10 years. In this respect, the researcher carried out an extensive exercise to review or revalidate the items/questions which lasted for about three months.

In order to carry out the exercise, the researcher sent out letters of appointment signed by the researcher's supervisor to eight academicians from local institutions of higher learning and five practitioners from the Islamic banking industry. Following the appointment, the selected academicians and the industry practitioners were requested to undertake two main tasks. Firstly, they have to revalidate the items for URRM, RI, RAA, RM, CRA, RMPs, and PBP constructs, and secondly, they have to validate the items of

the CG, SR, and SA constructs. The comment and feedback received from them are presented in the results section of this paper.

A structured questionnaire consisting of closed ended multiple choice-questions were employed for the pilot study. The questionnaire comprises four sections. Section I: consist of eight questions about the background of the respondents. Section II: comprise 67 questions/items measuring the eight determinants of RMPs construct. Section III: contain 11 questions measuring RMPs construct, and finally Section IV: comprise eleven (11) questions measuring perception of bank performance construct. The questionnaire used in the pilot study contains items/questions which have been validated/revalidated by the academicians and industry experts mentioned in the preceding paragraph.

Following the procedures suggested by Peat et al (cited in Van Teijlingen & Hundley, 2001, p. 35), additional questions were included in the questionnaire of the pilot study as listed below:

- “Are you comfortable with 10 point Calibri for the text of the questionnaire?”
- “Do you prefer a one-page or a two-page questionnaire?”
- “Are the questions clear?”
- “Are there any ambiguous or difficult questions?”
- “How long do you take to answer all the questions?”
- “Is there any other comment or suggestion?”

As the questions/items in the questionnaire are targeted at measuring the respondents’ perceptions and attitudes, a 7-point Likert rating scale is employed ranging from (1) strongly disagree, (2) disagree, (3) somewhat disagree, (4) neither agree nor disagree, (5) somewhat agree, (6) agree, to (7) strongly agree. The 7-point rating scale is preferred as the vast majority of rating scales employed five or seven response categories for decades (Preston & Colman, 2000). In a more recent article, Joshi et al (2015) argue that the 7-point rating scale may perform better compared to 5 point scale as the former scale meets the objective reality of people and appeals practically to the “faculty of reason” of the participants.

## RESULTS

After data processing, 35 usable questionnaires were retained for reliability and validity tests as well as for normality check. The data was analyzed using SPSS version 20 and the results are presented and discussed in the followings sections.

### *Response Rate*

Using purposive sampling technique, the researcher dropped off a total of 50 blank questionnaires to the representatives of the selected banks and later collected back the completed questionnaires personally from the representatives. The researcher took about two months to distribute and collected back all the completed questionnaires.

The researcher obtained back a total of 40 questionnaires giving a response rate of 80 per cent. After data processing, a total of 35 usable samples were retained for further analysis giving an effective response rate of 70% which was reasonably high. According to Sekaran (2003), a minimum of 30 respondents were enough for a pilot study. Likewise, Malhotra and Birks (2007) also recommend a sample size ranging from 15-30 samples for pilot study or pre-testing.

The high response rate obtained in the pilot study was probably due to the prepaid incentives offered to the respondents. The prepaid incentive in the form of pens and note books was included with the questionnaire (Malhotra & Birks, 2007). In addition to the prepaid incentives, constant communication between the researcher and the representatives of the sampled banks might have helped to increase the response rate.

### *Descriptive Analysis*

#### *Who are the respondents?*

The demographic profile of the respondents in this study consists of: gender, age, education level, the type of bank in which the respondent works, number of years in the bank, designation of respondent, and the department or unit where the respondents work.

Table 1 summarizes the demographic profile of the respondents. In terms of respondents, slightly more than half (57%) were female and a large majority (88%) was from local Islamic banks. The respondents came from various departments although a bigger majority was from the Audit department (37%), followed by the Risk department (29%).



Thus, we can conclude that the respondents were sufficiently well-versed with the bank and subject matter, and they were able to comprehend the needs of the questionnaire.

Although more than 60% of the respondents were holding lower (officer) and middle level management (manager), a large majority (80%) had more than five years of experience and 60% were above 40 years old. Also, more than 90% had a Bachelor's degree or higher. Thus, we can conclude that the respondents were sufficiently well-versed with their company operations and able to comprehend the needs of the questionnaire

From the demographic analysis, it can be concluded that the data obtained from the sample is credible and therefore provide useful basis for subsequent analysis and inference.

**Table 1: Profile of Respondents**

<b>Variable</b>	<b>Frequency</b>	<b>Percentage</b>
Gender		
Male	15	42.9
Female	20	57.1
Total	35	100
Type of bank		
Local Islamic bank	31	88.6
Foreign Islamic bank	4	11.4
Total	35	100
Department/unit		
Audit	13	37.1
Compliance	2	5.7
Commercial	3	8.6
Consumer	2	5.7
Credit Administration	3	8.6
Risk	10	28.6
Support	2	5.7
Total	35	100
Designation		
Officer	10	28.6
Assistant Manager	12	34.3
Manager	5	14.3
Senior Manager	4	11.4
Assistant General Manager	2	5.7
Assistant Vice President	2	5.7
Total	35	100
Years in the bank		
Less than 2 years	3	8.6

Between 2 and 5 years	4	11.4
More than 5 years	28	80
Total	35	100
<b>Age Group</b>		
Between 21 and 30 years	5	14.3
Between 31 and 40 years	9	25.7
More than 40 years	21	60
Total	35	100
<b>Education Level</b>		
Diploma	1	2.9
Bachelor's Degree	28	80
Master's Degree	4	11.4
Others	2	5.7
Total	35	100

### ***Results of Reliability Test***

In checking the reliability of the instrument, the researcher selected Cronbach's alpha coefficient as it is the most commonly used measure (Field 2005) in many disciplines. Cronbach's alpha specifically measures the internal consistency of a scale, which is the degree to which all the items of scale measure the same construct. The coefficient shows whether the different items converge or not.

After running the data using SPSS version 20 for windows, the researcher found that eight out of ten constructs possess Cronbach's coefficients above 0.7 (Table 2). This is in line with the benchmark that an instrument with coefficient of 0.70 and above shows high reliability standard (Nunnally, 1978; Hair et al, 2006; Sekaran & Bougie, 2010). On the other hand, the Cronbach's coefficients of CRA and RI are 0.5 and 0.418 respectively (below the 0.6 benchmark) and reliability standard are, therefore, considered below average.

However, according to Pallant (2005), the coefficient value of less than 0.6 for CRA, a construct with short scales (fewer than 10 items) is quite normal. Furthermore, the inter-item correlation for CRA construct is between 0.2 to 0.4 as recommended by Briggs and Check (cited in Pallant 2005, p.90). As such it is acceptable to retain this construct (CRA) for further analysis. In the case of RI construct, the coefficient value has increased from 0.418 to 0.683 after the researcher deleted item number two of the construct. Based on the foregoing, all the constructs are retained for further analysis.

**Table 2: Cronbach's Alpha Values of All Constructs**

<i>Construct</i>	<i>Abbreviation</i>	<i>No. of Items</i>	<i>Cronbach's Alpha</i>
1. Understand risk and risk management	URRM	9	.779
2. Risk identification*	RI	5 (6)	.683 (.418)
3. Risk assessment and analysis	RAA	8	.858
4. Risk monitoring	RM	6	.852
5. Credit risk analysis	CRA	7	.503
6. Corporate governance	CG	11	.933
7. Shariah review	SR	8	.859
8. Shariah audit	SA	12	.913
9. Risk management practices	RMPs	11	.886
10. Perception of bank performance	PBP	11	.796
Total		88 (89)	

\* Item number two (Initial number of item was six)

The figure in bracket is before deletion of an item or question of a construct

### ***Results of Validity Test***

In the pilot study, the researcher tested the instrument for face validity and content validity. Criterion-related or predictive validity was not carried out as the present study concerns with past events. Likewise, the researcher did not perform construct validity test as it involves exploratory factor analysis (EFA) and confirmatory factor analysis (EFA) which require larger sample size.

In testing for validity of the instrument, the researcher sent OUT a letter of appointment signed by the researcher's supervisor to each of the eight academicians of local institutions of higher learning and five experts from the Islamic banking industry requesting them to perform two main tasks. The first task is to check whether the items logically reflects the concept being measured which refers to face validity (Zikmund et al, 2013). Secondly, they were also required to check for content validity, i.e whether the measurement scale includes a sufficient and representative set of items that measure the right things (Sekaran, 2003).

The researcher took two months to receive the inputs and comments from the eight academicians and the five industry experts. Upon receipt of the responses from them, the

researcher presented and discussed their inputs and comments with the researcher's supervisor. The results of the discussion between the researcher and the supervisor and the decision reached are presented in the following sections.

***Face and content validity***

After the validation and revalidation exercises, the academicians agreed that the items logically reflect the concept being measured and that the measurement scale includes a sufficient and representative set of items. They accepted all of the items without amendments. However, industry experts comprising the practitioners of Islamic banking suggested that some of the items be reworded. The practitioners also suggested that few items be deleted and few new ones are introduced.

The industry experts believed that amending, deleting, and adding items are necessary to make the measuring scale logically reflects the concept being measured (face validity) and to ensure that the measurement scale, in which it includes a sufficient and representative set of items that tap the concept (content validity). The final version of the amended and new items is presented in Table 3. The items and variables that are not mentioned in the table indicate that no changes have been made to the items and variables.

**Table 3: Amended and New Items**

<i>Item No.</i>	<i>Before amendment</i>	<i>After amendment (final version)</i>
<b>URRM variable (9 items)</b>		
2 of 9	Responsibility for risk management is clearly set out and understood throughout the bank	Responsibility for risk management is clearly set out and understood throughout the Islamic bank
3 of 9	Accountability for risk management is clearly set out and understood throughout the bank	Accountability for risk management is clearly set out and understood throughout the Islamic bank
4 of 9	Managing risk is important to the performance and success of the bank	Managing risk is important to the performance and success of the Islamic bank
5 of 9	It is crucial to apply the most sophisticated techniques in risk management	It is crucial to apply sophisticated techniques in risk management
6 of 9	The objective of Islamic banks is to expand the applications of the advanced risk management technique	The objective of Islamic banks is to expand the applications of the advanced risk management

		technique/methodology
7 of 9	It is important for your Islamic bank to emphasize the continuous review and evaluation of the techniques used in risk management	It is important for your Islamic bank to emphasize the continuous review and evaluation of the techniques/methodology used in risk management
8 of 9	Application of risk management techniques reduce costs or expected losses	Application of risk management techniques/methodology reduce costs or expected losses
<b>RI variable (6 items)</b>		
5 of 6	The Islamic Bank has developed and applied procedures for the systematic identification of investment opportunities	The Islamic Bank has developed and applied procedures for the systematic risk identification of investment opportunities
<b>RAA variable (8 items)</b>		
1 of 8	Islamic Bank assesses the likelihood of occurring risk.	Islamic Bank assesses the likelihood of occurring risk and its impact on the performance of Islamic bank
4 of 8	Your Islamic Bank analyses and evaluates the opportunities that it has to achieve objectives.	Your Islamic Bank analyses and evaluates the opportunities that it has to achieve according to its objectives.
<b>CRA variable (7 items)</b>		
1 of 7	Islamic bank undertakes a credit worthiness analysis before transaction	Islamic bank undertakes a credit worthiness analysis before granting any credit/financing facility
2 of 7	Before granting capital your Islamic bank undertakes specific analysis including the mudarib's (entrepreneur) character, capacity, collateral, capital and conditions	Before granting credit/financing facility, your Islamic bank undertakes specific analysis including the potential customer's character, capacity, collateral, capital and conditions
3 of 7	Islamic bank's borrowers are classified according to risk factors (risk rating)	Islamic bank's customers are classified according to risk factors (risk rating)
4 of 7	It is essential to require sufficient collateral from small borrowers	It is essential to require sufficient collateral from small customers
5 of 7	Islamic bank's policy requires collateral for granting capital or making transactions	Islamic bank's policy requires collateral for granting credit/financing facility
6 of 7	It is preferable to require collateral against some capital and not all of it	It is preferable to require collateral against some credit/financing facility and not all of it
7 of 7	The level of capital (credit) granted to defaulted clients must be reduced	The level of credit/financing facility amount granted to defaulted customers must be reduced
<b>SR variable (8 items)</b>		
5 of 8	The Islamic bank documents the	The Islamic bank records the process

	process involve in the regular assessment	involved in the regular assessment of its activities and operations
<b>RMPs variable (11 items)</b>		
5 of 11	Your Islamic Bank emphasizes the recruitment of highly qualified people having Islamic knowledge in risk management	Your Islamic Bank emphasizes the recruitment of qualified people having Islamic knowledge in risk management
9 of 11	The application of the Basel II Accord will improve the efficiency and risk management practices in Islamic banking in general	The application of the Basel III Accord will improve the efficiency and risk management practices in Islamic banking in general
11 of 11	Not available	Your Islamic bank always manage risks within the tolerance limits as per the bank's risk appetite guideline
<b>PBP variable (11 items)</b>		
1 of 11	The bank used ROE and ROI ratio to see the performance of bank	The Islamic bank uses return on asset (ROA) and return on equity (ROE) ratios to measure its performance
2 of 11	Bank is keen on increase its sales, reputation and increase profits through monitoring performance and use modern methods to measure performance of the bank	The Islamic bank is keen on increasing its sales, reputation and profits through monitoring performance and use of modern methods to measure performance of the bank.
3 of 11	That the size of profits or returns is an indicator to measure the efficiency of the bank's financial.	The size of profits or returns is an indicator to measure the efficiency of the Islamic bank's financial performance
4 of 11	The efficiency of investment decisions aimed at reducing the cost to a minimum, and to maximize the bank returns	The efficiency of investment decisions is aimed at minimizing cost and maximizing returns of the Islamic bank
5 of 11	The bank gives importance of analysis tools as working to discover the opportunities and threats	Islamic bank emphasizes on the use of analysis tools to discover opportunities and threats
6 of 11	That the economic value of the bank significantly associated rate of return earned on the funds invested	The economic value of the Islamic bank is significantly associated with positive returns
7 of 11	There is a full run of the human and material resources available. It led to an increase in the bank's reputation in the market and increase competition.	Efficient use of human and material resources will lead to an increase in the Islamic bank's reputation in the market and increase competition.
8 of 11	Creating new products and services that lead to increased competition, market value of the bank, as well as the bank's reputation and attract customers.	Creation of new products and services by the bank lead to increased competition, market value of the bank, bank's reputation and attract customers
9 of 11	The relative balance between	It is essential for Islamic bank to have a

11	profitability, liquidity and expand the bank's market. It is essential to restore the balance between the expected returns and potential risks.	proper balance between expected returns and potential risks
10 of 11	Not available	It is critical for Islamic bank to deliver excellent customer service.
11 of 11	Not available	The Islamic bank gives emphasis on Shariah compliance disclosure in the Annual Shariah Committee's report

In validating and revalidating the items/questions of all the ten constructs/variables, the practitioners suggested the following two items be deleted:

“Your Islamic Bank finds that it is too risky to invest funds in one specific sector of the economy” (Original item no.7 of RMPs variable); and,

“That the value of the bank in accordance with the personal perspective is used to ascertain the extent of the safety of the bank. As a result, the market perspective and then correct the deviations” (Original item no. 7 of PBP variable).

At the same time, the practitioners also proposed that three new items be included in the measuring scale as listed below:

“Your Islamic bank always manage risks within the tolerance limits as per the bank's risk appetite guideline” (No. 11 of RMPs variable);

“It is critical for Islamic bank to deliver excellent customer service” (No. 10 of PBP variable); and,

“The Islamic bank gives emphasis on Shariah compliance disclosure in the Annual Shariah Committee's report” (No. 11 of PBP variable).

In response to the additional questions included in the pilot study, the respondents provided various input and suggestion as below:

Ten respondents stated that there were no ambiguities or difficult questions;

Ten respondents stated that they took between 10 to 20 minutes to complete the questionnaires;

Ten respondents prefer a two-page to a one-page questionnaire; and,

One respondent suggested a maximum of ten items/questions per construct/variable.

### ***Results of Normality Test***

Hazzi & Maldaon (2015) highlighted that checking for normality of data distribution is one the most important quantitative methodological issues the researchers should take into account when conducting the pilot test and the main study. As such, normality of data distribution was checked in this pilot study by analyzing Skewness and Kurtosis indices as they were easy and effective way for checking the normality of small and large sample (Hazzi & Maldaon, 2015). These values were obtained from the data of the 35 usable questionnaires received from the respondents.

Table 4 summarizes the kurtosis and skewness for all the constructs/variables. The skewness and kurtosis values shown in the table are both between +2 and -2 for all the ten dimensional constructs of the study. Skewness or kurtosis values within this range are considered excellent by George and Mallery (cited in Hazzi & Maldaon, 2015, p.58) and hence, the distribution of data in this pilot study is considered normally distributed (Cameron, 2004).

**Table 4: Skewness and Kurtosis Values**

	Abbreviation	Skewness		Kortosis	
		<i>Statistic</i>	<i>SE</i>	<i>Statistic</i>	<i>SE</i>
Understand risk and risk management	URRM	-.421	.141	.480	.281
Risk identification	RI	-.204	.141	.347	.281
Risk assessment and analysis	RAA	.231	.141	.127	.281
Risk monitoring	RM	.077	.141	-.263	.281
Credit risk analysis	CRA	.177	.141	.011	.281
Corporate governance	CG	-.056	.141	-.307	.281
Shariah review	SR	-.004	.141	-.410	.281
Shariah audit	SA	-.162	.141	.085	.281
Risk management practices	RMPs	-.242	.141	1.158	.281
Perception of bank performance	PBP	-.363	.141	1.420	.281



## CONCLUSION

As indicated in Section 2.6, the aim of this pilot test is to determine the reliability and validity of the instrument of an ongoing project in preparation for the large scale study. The pilot study analyzed the data of a small sample collected from several Islamic banks in Malaysia. Reliability test that was carried out revealed that all the constructs except for credit risk analysis items were reliable with Cronbach's alpha coefficients exceeding the benchmark of 0.70 including risk identification variable after deleting one of its items.

The measuring scale was also subjected to validity test where all the items of the questionnaire were validated and revalidated by the academicians and the industry experts. Following the validation/revalidation exercises, some items were reworded and deleted whilst few new ones were introduced as recommended by the industry experts. The measuring scale was found to have face validity and content validity after the validity test was carried out.

The questionnaires with substantial missing data were not included in the reliability and validity tests. Finally, normality test using skewness and kurtosis indices showed that the data distribution was reasonably normal. From the pilot study, the results have revealed that the instrument was reliable and valid and it can be employed in the final large scale study.

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## **ZAKAH INSTITUTION IN YEMEN: CURRENT PRACTICE AND EXPECTED TRANSFORMATION**

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### **ABSTRACT**

*Yemen is among the poorest countries in the region and it has become apparent during the current political crisis, where the majority of population is classified as poor and the poverty line's group has been widened. As far as Zakah is concerned, it is a duty on wealthy people to pay their alms to the poor and hence a redistribution of the wealth among the society would be achieved. Zakah rests under the responsibility of the government to supervise, govern, and apply the rules prescribed in the legislation (Shari'ah rules) to ensure that its role in the society is attained. For the last three decades since the formation of the new country "republic of Yemen" that emerged from two previously separated countries, Zakah institution has been governed and managed by the government, and their administration is formed under the responsibility of the Zakah agency, and later on under the local counsel of each locality. Such management and administration has been criticized of being less transparent on Zakah resources on both collections or distributions sides. Therefore, Zakah efficient collections have suffered due to the low level of confidence in the governmental agencies assigned to collect Zakah funds and this encourages Zakah payers to always seek an alternative way to channel Zakah funds, which has being found in many voluntary organizations to carry same role of the government in collections of Zakah funds. This paper is a theoretical in nature and it aims and focuses on the discussion of administration and legislation of Zakah and its importance to the society in Yemen. It also highlights the current status of Zakah in Yemen. More than that, the discussion elaborates that Zakah in Yemen lacks its role in the society in reducing poverty, which has become more apparent recently. Analyzing the way Zakah is carried out revealed that Zakah administration needs a rethink on how to organize and restructure it in a way to serve its underlying purposes. Government may not be the proper Zakah administrator at this point of time due to the rise of corruption in the government agencies, and since the Zakah funds is commingled with the other public budget resources, it is more likely to be misused as other resources and no possible differentiation to be expected. Expected transformation of Zakah is needed and the role can be carried out by the non-government bodies supervised by scholars and experts who*

*can be held accountable under certain governance system. This paper originally is of importance to all stakeholders as it serves as the building block for initiating a proper system or framework of Zakah administration, a system that provides its contemporary guidelines on Zakah, taken into the consideration the original wisdom and objective of Shari'ah on Zakah enforcement by the Almighty.*

## INTRODUCTION

*Zakah* is the third pillar of faith and type of *Ibadah* (worship) in Islam. Literally, *Zakah* means a purification, thus *Zakah is the purification of the wealth*. It is part of 'Islamic economic system which aims to achieve the socio-economic development of the society. *Zakat* is one of the most significant institutions of wealth-sharing that promotes the Muslims' economic activities and assures a minimum standard of living for the Muslims (Haji Abu Baker & Haji Abd. Ghani, 2011).. According to Chapra (1992) *Zakah* is an integral part of Muslim's belief and it is social self-help instruments ordained to support and alleviate the poverty in Muslim's society (Chapra, 1992). It is one of Islamic indicators of economic justice that aims to provide an equal and trustworthy redistribution of wealth with the premise of eradicating the poverty (Haji Abu Baker & Haji Abd. Ghani, 2011; Ansari, 2011). Scholars in many countries have put a mounting emphasis on the importance of proper management of *Zakah* to achieve divinely prescribed socio-economic objectives. This is because management of *Zakah* funds and resources is very critical as it involves a matter of religion that concerns all Muslim and therefore, it should be managed efficiently with proper and right institutions leading such management. Various bodies are assumed to handle in an efficient manner the management of *Zakah* in its two functions, the collection and disbursement. However, researchers across the Muslim countries argue that *Zakah* management is still unsatisfactory at different levels (Buang, 2000; Juwaini, 2008; Farhan, 2008) which has led to a lack of the confidence on the institution in performing its role in the society as a mechanism of redistribution of wealth. Oran (2009) in one side argued that *Zakah* is long away from the realization of its role in solving socio-economic problems and as wealth creation on the other. In most Muslim countries, the major shortcoming facing *Zakah* institution rests on the administration of collections and allocation (distribution) of *Zakah* funds. The argument of Oran (2009) applies to Yemen as well and researchers substantiate this fact in Yemen (Farhan, 2008; Al-Matari, 2008). In particular, in Yemen, the distribution of *Zakah* funds

still an ambiguous process to various stakeholders. The very clear reason is that the government of Yemen collects *Zakah* funds from various payers and comingles them with other government revenues and resources in order to finance the various development projects and budget needs of each district, which are approved by the planning committee. This has motivated and challenged the *Zakah* payers to find their own ways to reduce the amount of *Zakah* payable to the government and then pay their due by their own channels. Responding to these issues, Yemen has restructured the *Zakah* management and it has been placed under the authority of local council of every governorate as they believe it would improve the efficiency of *Zakah* due to the close connections between the institution' branches and the related stakeholders of *Zakah*. In connections with such initiative by the government of Yemen, this new way of handling *Zakah* management has shown its reasonable success, however, it was not at the expectation. Similar initiatives have been placed in practice within Malaysia to improve the management of *Zakah*, and these includes initiative such as corporatization and localization of *Zakah* which have produced significant improvement in *Zakah* management in its both sides , the collection and the distribution. In all, the general theme of the policy initiatives is to enhance the efficiency of *Zakah* management either collections or distributions with the aim of boosting confidence on the institution of *zakah* in the society. In this line, this paper aims to theoretically and critically examine, discuss and evaluate the *Zakah* model in Yemen as well as the ethical considerations of management of *Zakah* in Yemen in respect to the current and expected future move as a response to the recent crisis and war that has waged the country since 2014. The remainder of the paper is organised as follows: Section two briefly presents the legislation of *Zakah* institution in Yemen. Section three provides a historical review of *Zakah* administration practice in Yemen. Section four discusses the realization of *Zakah* ethical consideration pre-and-post current crisis in Yemen. Section five discuss the proposed transformation in *Zakah* management in Yeme. The final section provides a conclusion discus and corresponding limitations, as well as some recommendations for future studies.

## **THE LEGISLATION OF ZAKAH INSTITUTION IN YEMEN**

As mentioned above, *Zakah* as a pillar of Islam is aimed to purify the wealth of Muslim and as an act of worship whereby the ultimate aim is to seek the pleasant of Allah. Its



implementation helps to enhance the socio-economic situation of Muslim Ummah (Wahid and Abdul Qader, 2010). However, to achieve such objective, proper management of *Zakah* is vital to achieve its objectives. *Zakah* is compulsory levy on wealth of the rich as stated in the Holy Qura'n.<sup>117</sup> Different countries have adopted different systems of *Zakah* administration. In practice, there are two main methods of managing *Zakah* functions. First way is where the *Zakah* is levied by the state and the second method where there are private entities collect *Zakah* on voluntary basis without government interference. In the first category, the collections and the destitutions of *Zakah* both perform by government on mandatory basis and enforced by the law or the government set up the department attached to one of ministries. Countries which have adopted this system include Pakistan, Saudi Arabia, Yemen and Malaysia. The second approach of handling *Zakah* is adopted by countries such as Kuwait in which the *Zakah* is conducting through voluntary *Zakah* administration (Kahf, 2000). As Yemen belongs to the first approach of *Zakah* administration, the *Zakah* is embedded in the constitution of the country as absolute requirement to be obeyed by the people of country. In the constitution of Yemen, it is clearly mentioned that "the state shall collect the Zakat (*Shari'ah* tax) and shall spend it through its legal channels in accordance with law". According to the Yemeni law of *Zakah* no. (2) 1999 article (25) (a), the General Administration for Zakat Duties is responsible for collections of *Zakah* in special account and distribute them to the specified recipients mentioned in the Qur'an and reemphasized in article (25) part (b) of the same law. Article (27) urges the General Administration for Zakat Duties to collect *Zakah* in due time and taking into consideration the principle of easiness and encouragement in the collection process and giving the right to the *Zakah* payers to keep 25% of *Zakah* amount and to be distributed by their own ways to the poor and needy. However, with the embarking in implementation of the local government and the issuance of enactment (4) in 2000, the new law becomes the main law of reference in matter of *Zakah* collections and distribution. Mainly, as the country changes to what so called cosmetic decentralization of its bodies in 2002, the local council enactment points out that *Zakah* is considered as a source of income for the local council that is necessary for the process of development at the lower level of districts in each governorate. With the emergence of elected local council in 2002, the government has made amendment on the law of *Zakah* in which the collection and distribution of *Zakah* is placed under the

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<sup>117</sup> *Zakah* has been stated in the Holy Quran 82 times (Reference)



authority of local council. In each district, the local council has its own administrative unit or *diwan* that apparently includes information, *Zakah*, and other revenues collection staff. The local council enactment No (4) places the collections and distribution of *Zakah* under the responsibility of the local government. Chapter (5) of the enactment is related to the sources of revenues for the local governments or councils. The first part of article No. 123, clause (1) states that the sources of incomes for local council of each districts includes among other the collections of *Zakah* from its sources. Particularly, 50% of *Zakah* collections are considered as source of income for the specified district or local council. The other 50% of collections at the level of districts is considered as a source of income for the governorate according to the article No. 123, the second part clause No (1). Article No (124) (b) specifies that 50% collected at the level of districts and handed to the governorate as joint source of income is distributed by local council of governorate as following:

1. 25% for the district that collects the amount of joint *Zakah* resources;
2. 25% for governorate activities;
3. 50% is distributed equally to all districts in the same governorate or locality.

The distribution process of *Zakah* according to the local council enactment is different from the previous law in the sense that distribution is conducted through the government budget using government ministries and includes mainly the ministries of social welfare and security, education and health. Article No. (125) indicates that all sources of income that levied and collected by local councils which specified in article (123) including *Zakah* collections, should be spent to finance the social and economic development projects of the same localities. Clearly by the current enactment, the government is the only authority (i.e. institution) which has the rights to collect and distribute *Zakah* in Yemen not the Non-government organization (NGO). However, *Zakah* payers do not obey the law strictly and pay *Zakah* by them-self to beneficiaries although the law allows that 25% of amount of *Zakah* could be distributed by the *Zakah* payers themselves, many *Zakah* payers prefer to approach charitable organizations (NGO) as they believe it is more trustworthy than government bodies. In other words, there are charitable organizations that collect *Zakah* beside the government and distribute them according to their agenda.

It is noteworthy that Yemen is one of the highest corrupted countries in the world (Transparency International Corruption Perceptions Index, 2015) and this is a threat to the *Zakah* administration. Transparency International Corruption Perceptions Index indicates that the average corruption index in Yemeni public sector is 22.54 Points from 2003 to 2015. This reveals extreme corruption practice by the government. The rank of Yemen in terms of corruption worldwide is 154 from 157 countries. Undeniably, *Zakah* administration in Yemen is not isolated from the issue of rampant corruption in Yemen, where the *Zakah* administration is part of Yemeni government to handle. Therefore, the Yemeni *Zakah* payers intend to pay off their *Zakah* to non-government organization (i.e. private charity organizations), but not to the government. The *Zakah* payer in Yemen confidently and have trust on the NGO to manage their *Zakah* in more efficient way, regardless of the enforcement by Yemeni law to pay the *Zakah* to the government only. This is might be due to the level of good practices, accountability and transparency practices by the NGO.

Empirical evidence shows that when the government collect the *Zakah*, the amount of *Zakah* collected will be low. Studies like Furhan (2008) revealed that collections by government are very low compared to expected collections projected. Reasons such as bribery and high corruption, inefficiency of employees charged with *Zakah* collections, lack of awareness among people about *Zakah*, the lack of transparency from the government, lack of trust are the main drivers of inefficient collections of *Zakah* (Alqurshi, 2010). This has led to status of mistrust between government and *Zakah* payers as the government agency is proved to be inefficient in dealing with the *Zakah* management and hence lack the confidence. Many Muslim have doubt about accountability and methods of *Zakah* institutions (Lessy, 2009). Therefore, the *Zakah* payers move to another direction to pay *Zakah* to charitable organizations. Even though in the law, there is a penalty on those who late or do not pay *Zakah*, this law is either characterized by lack of enforcement or can be applied only to the registered companies and even though registered companies can find a way to reduce the *Zakah* amount and then pay it by themselves to charitable organizations or directly to recipients. This dual role of *Zakah* collections as opined by Jubran (2010) has led in some cases that some beneficiaries receive *Zakah* share more than one time.

Studies conducted on the *Zakah* management in different countries revealed that in most cases *Zakah* is not managed efficiently and there are different issues of mismanagement and mishandling of *Zakah* fund. The approach of managing *Zakah* in different countries could have an effect on the collections and distribution of *Zakah*.. In Yemen, the way of *Zakah* handling could be an influential factor on the efficiency of *Zakah* particularly in term of collections and to some extent on *Zakah* distributions. The need for *Zakah* efficies vital and essential as studies and reports indicates that *Zakah* is inefficiently collected (Farhan, 2008; Almatari, 2008; Alqurshi, 2010) and it is not clear whether the distribution is conducted in accordance with the prescribed recipients.

### **HISTORICAL REVIEW OF ZAKAH ADMINISTRATION PRACTICE IN YEMEN**

Abd.Wahab & Abdul Rahman (2011) opine that there is a need for evaluation of *Zakah* institutions' efficiency and management in order to enhance the operations and consequently contributing to the achieving the main objective |(Maqsid AlShari'ah) of *Zakah* ordinance. As the studies in this area are limited, it is hoped that it could serve as guidance for future studies and it may be a reference for policy makers on *Zakah* management.

In the light of the fact that Yemen is classified amongst the poorest countries in GDP per capita in the Arab world and amongst the lowest income country in Middle East and it is facing huge economic difficulty since last two decades, the current war has waged the situation and moved the country into the line of poverty for almost 80% of the population according to the reports. World bank reports that as of March 2017, an estimated 17 million Yemenis (about 60 percent of the total population) are estimated food insecure and a further 7 million severely food insecure. It is reported further that Over 21.1 million Yemenis (80 percent of the population) are in need of humanitarian assistance and 2.8 million Yemenis have been forcibly internally displaced (April 1, 2017, World Bank Country Overview)<sup>118</sup>. Even though before the crisis, the poverty line is undeniable. The country has one of the highest malnutrition rates in the world, and an estimated 43 percent of its 23 million citizens live below the poverty line (IMF, August

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<sup>118</sup> <http://www.worldbank.org/en/country/yemen/overview>

10, 2017).<sup>119</sup> In the same time the country is characterized by a rapidly growing population, poor infrastructure, and weak institutional capacity. United Nations statistics revealed that poverty is in rise in Yemen, compared to 2007 in which percentage of population below National Poverty Line is 42% and in 2008 45 percent of the people in Yemen live on less than USD 2 a day.<sup>120</sup> As one of poorest least developing country in the world, Yemen further experiences weak state institution with under skilled and under-paid state employees.<sup>121</sup>

The above situation is further exaggerated as the result of the ridiculous fighting of the predatory elites of Yemen who are in the state of competition with each other in order to get the personal gain from the resources at different levels leaving large portion of society under the poverty line. As aforementioned that Yemen ranked as one of highest corrupted countries (Transparency International Corruption Perceptions Index, 2015). Ethically, this environment of corruption has been reflected into the individual employee's attitude. Thus, the corruption has become so ingrained in popular culture that it is no longer shameful for individuals to prosper as a result of corrupt practices. The most common form of administrative corruption in Yemen is the taking of a bribe by government employees as a way of facilitating the procedures which lead in some cases to the enrichment of a group of people at the expense of other and at some cases to get your due rights (Yemen Polling Center, 2006)<sup>122</sup>. Beside the issue of prominent level of corruption, poor administration, low level of education, and predatory elites' competition for resources, the deterioration in economic situation due to a huge drop in oil production since early 2007 has another striking impact on the country's economy. With the collapse of international oil prices in late 2008, the country's oil revenues—which account for about 60 percent of government revenues and over 90 percent of export revenues—have declined. Although Yemen began producing liquefied natural gas in late 2009, this positive development only partially offset the impact of the drop-in oil revenues. Therefore, there was need for urgent respond to substitute such reduction in the country revenues by looking to other resources that could help in boosting economic condition of

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<sup>119</sup> <https://www.imf.org/en/News/Articles/2015/09/28/04/53/socar080310b>

<sup>120</sup> United Nations report on the world social situation (2010) show that 17% of Yemen population lives with less than 1.25 USD a day. United Nations Development program (2007) assessment of poverty in Yemen.

<sup>121</sup> ARD (2006) UNSAID report, Yemen Corruption Assessment.

<sup>122</sup> There are several motives for such kind of illegal action including the low salaries that are not sufficient to cover the living expenses.

the country. One of these sources is the *Zakah* fund which initially is included in the public budget and it is responsibility of government to levy *Zakah* and distribute it according to law of *Zakah*. Meanwhile, it is the duty of people to pay *Zakah* compulsory to the government according to the constitution and law of the country. However, the current status of *Zakah* collections and disbursements is still debatable among the scholars, academics and public at large as they believe that the role of *Zakah* is still weak and absent in the economy.

Al-Matari (2008) argue that the absence of sole agency to collect *Zakah* has an effect on the *Zakah* collections and this would increase the chance of mismanagement particularly due to the lack of coordination with the other institutions (i.e. charitable organizations) that collect *Zakah* hand by hand with the government. The issue of mismanagement of *Zakah* funds has consequently led various scholars, some politicians and civil society agencies to urge for not paying *Zakah* to the government as the disbursements did not channel to the specified recipients as indicated by Qur'an. On the other hand, Alqurshi (2010) is of view that the lack of the role of *Zakah* in the society is due to different factors including declining in the religiosity level of Yemenis, lack of the awareness on the important of *Zakah* payment, the lack of government role in the administration of *Zakah* generally and disbursements in particular, the lack of guidance from the scholars and the heavy burden of the taxes. He further argued that the *Zakah* Amils (*Zakah* employees) are not trusted people any more to handle this work. Mohammed Kawkaban (2009), the general manager of the General Administration for Zakat Duties in capital of Yemen, Sana'a, admitted that many challenges deter the improvement of collection performance. According to Kawkaban 's opinion, each organization can perform well depending on the level of awareness and efficiency of members particularly, its employees and he clearly declared that the employees of the General Administration for Zakat Duties in Sana'a and its branches are still not qualified (Yemen times, 16/09/2009). His view could have held true for the capital city, however, other cities could be worse than that and hence the collections of *Zakah* could be affected more than the capital of Yemen. Similarly, Alhariri (2010) acknowledged that there are certain differences in conducting the *Zakah* collections from one governorate to another, however, *Zakah* payers are complaining with the ways the *Zakah* employees dealing with them. According to Alhariri, some *Zakah* Amils handle the collections process illegally

and unethically. Such behavior ranges from the process of estimating of *Zakah* amount whereby *Zakah* employees deny the acknowledgment of *Zakah* payers on the amount of wealth and the related amount of *Zakah* and to certain level of getting bribery in order to certify the amount of *Zakah* as the payers want and in certain cases to pay less than the due amount to the government (Algomhoriah, newspaper, 9 September 2010).

Jubran, a professor of economics at Sana's university opines that *Zakah* collection is very low which constitute not more than 10% of budgeted collections.<sup>123</sup> His opinion is supported by Farhan (2008) in his study that revealed that the *Zakah* collections are very low compared to the budgeted collections. The evidence of study shows that actual collections of *Zakah* are 2.6 % compared to the estimated *Zakah* collections. The percentage revealed by furhan (2008) is the lowest compared to countries like Sudan (20%), Saudi Arabia (28%) and Jordan (6.7 %). There is a view among the academics and officials that the funds of *Zakah* are often mishandled despite a 1999 law intended to regulate and streamline the practice (Saeed Ali, Yemen times, 16/09/2009). Unfortunately, local councils, which now are authorized to collect zakat duties do not distribute revenues to the poor and the needy," said Dr. Mohammed Jubran, professor of economics at Sana'a University. He further argued that most of zakat revenues that local councils collect are spent as rewards and travel expenses for councils' members. He went more to claim that *Zakah* has substantial impact on any economy, however, in Yemen *Zakah* still lack its the role with an ambiguous influence. This opinion is supported by the study conducted by Studies and Economic Media Center in 2009, which revealed that *Zakah* only makes up 0.18 % of Yemen GDP.<sup>124</sup> Thus, *Zakah* is not promising as percentage of GDP, and hence it can be argued that their impact on economy cannot be seen. The lower percentage might be due to the inefficient collections and therefore, if the *Zakah* is collected efficiently as planned and estimated it could constitute huge contribution to the government budget and to GDP of country. Some argued that the *Zakah* collection could reach Yemeni Riyals 100 billion which is equivalent to USD 500 million. Consistently, the findings of the study conducted in 2008 by Farhan which revealed that the actual collection of *Zakah* is very low.

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<sup>124</sup> Yemen Times; Farhan M. A. (2008)

## REALIZATION OF ZAKAH ETHICAL CONSIDERATION PRE-AND-POST CURRENT CRISIS

During the past two decades Yemenis are liable to pay *Zakah* to the government as one of the religious duties. As part of the Islamic teachings and beliefs, the adherence to state is among the highly Islamic values. Therefore, businessmen and individuals were channeled their *Zakah* amount to the state with hope that the state use this money to alleviate poverty and carry out other duties in line with the prescription of *Zakah* payment. However, as it was described above in previous section as the corruption and the elite people were controlling all resources of the public budget including zakak resources which comingles with the other resources of budget. The main argument is that the government spends on various ministries including social security of the poor, which is one of the eight categories (sanf) of *Zakah* recipients prescribed in the holy Qur'an. This also includes spending on the army of the country. Relevant to this point, which is the main ethical issue of *Zakah* management and distribution in Yemen is that the fact that while Yemen poverty line has recorded a high levels before 2011 and even getting worse after 2011 running to 2015, it has been realized that the army of Yemen as one of the *Zakah* beneficiaries that is funded by the comingled funds of *Zakah* and other resources was established and developed to protect the top generals of the army and their elite. When it comes to call the army to be in the side of the people, most of the army generals have not taken any stand in favor of people, but they went to support the outset president. On the top of that, once the coup government controlled the capital city, they have controlled the Army and its all resources including weapons that were used to destroyed several cities and villages across Yemen. Worse than that we have recognized that outset president was keeping his own army which has been used during the few years of war and this army was developed as protection for himself and not for the country. Therefore, the question is that whether the *Zakah* being paid for the government and used partly to develop such army that has been involved in killing so many citizens is a rationalized under any circumstance? The very clear answer for this is that developing of such an army is not much important than feeding the poor. As such *Zakah* amount that has been channeled to the government was not wisely used to the right recipients. Billions of Riyals that have been paid as *Zakah* was utilized to ruin the country for the sake of the power and this situation will continue as evident recently. Now, as being practiced for



the last 25 year, we expect that this trend would continue to persist in the country. A future leaders and elite of the country also are expected to behave in similar way to build their own defense and protection mechanisms including army. This needs a lot of resources to be generated from the citizens of the country, and *Zakah* can be imposed to be paid to the government under the umbrella of following the leader of Muslim in the country. Therefore, our argument is built upon the ethical consideration for the right of the *Zakah* recipients. Although army is one of these recipients, but we believe in its current form is still far to qualify for such share. When this army is built upon the loyalty to the country and to the extent that it would be protecting the country, then it can be given a consideration in this respect. However, an army of which power is built to protect the elite and serve them, even though it is against the public, raise more quarries. Consequently, the scholars should involve in this matters and they should not recommend the payment of *Zakah* to the government in current circumstances as the government is not using the resources of *Zakah* wisely and beyond that there is no transparency where the collected *Zakah* resources are spent. Moreover, the poor in the country are on rise which necessitate action plan apart from the government of the country. The administration of *Zakah* in Yemen, which we believe would be valuable resources for the poor for the coming years, lacks expertise, system of governance, transparency and even infrastructure, which all are issues that need to be tackled to ensure proper management of *Zakah* for the sake of poverty eradication and lifting the people standard of living as poverty index focuses on three areas which are long health life, knowledge and standards of living which all are lacking in Yemen, and the government continue to mishandle the economic resources including *Zakah* funds.

### **THE FUTURE OF ZAKAH MANAGEMENT IN YEMEN: A SUGGESTION AHEAD FOR A TRANSFORMATION**

With no transparency in the *Zakah* distribution amount as well its collections accompanied by high corruption authorities with no accountability, where the corruption index before the current crisis indicates that Yemen government is among the high corrupted state, and ranks in the place 154, 5 places ahead from the end list of most corrupted countries (Transparency International, 2015). Given this in mind and with proliferation of the poverty line we can claim that *Zakah* amount at the hand of corrupted



people, who focus on their wealth generation leaving majority of poor with less than 2 Dollars a day would be misused at the expense of the poor. Scholars are of agreement that proper management of *Zakah* as prescribed by *Shari'ah* can lead to a poverty reduction if not elimination (Abdelbaki, 2014). If the proper management of *Zakah* and other resources is not being practiced during the normal time, the proper management of *Zakah* would be at doubt during the crisis time and tough economic conditions of the State. The government cannot play any role to alleviate the hardship of their people during the current circumstances. Therefore, it is proposed that the *Zakah* management responsibility should be under the independent administration of trusted and institutionalized body. The scholars of the country should play a crucial role in this matter by calling for a transformation of *Zakah* collections and disbursement. This transformation should be led by them, considering various expertise in various field who are transparent, accountable and religiously pious. We are of the view that the *Zakah* in Yemen should be transformed to the non-governmental institution (i.e. charity organizations) that will be able to take necessary steps in the way of poverty reduction and should be focusing on prioritization of the needs of the people. With this calamity situation in Yemen, it is necessary to have urgent fatwa from the scholars in applying this proposal and avoid using the *Zakah* collection into the war matters. Therefore, scholars have to lead this transformation and handle the *Zakah* funds properly and according to the needs of current situations. We are of the view that poverty should be the major target of the *Zakah*, leaving the Army to the state. This is not a call to abandon the recipients but to prioritize the Asnaf according to the major *Shari'ah* objectives (Maqasid Al*Shari'ah*). There would be an argument that may claim that Army is defending the highest objective of *Shari'ah*, which is the religion, but practically this is not the case and there is no evidence of that during the 37 years that lapsed since the formation of the country in its current status.

### **CONCLUSION, IMPLICATIONS, LIMITATIONS**

This paper presents and highlights an assessment of *Zakah* institution in Yemen, its legislation, current status and expected transformation. *Zakah* as one of the pillar of Islam carries huge importance in the *Shari'ah* as it has a significant implication for a poverty alleviation. Moreover, its implications on the various dimensions of society economically, spiritually and socially are undeniable. Without doubt, an agreement

among the scholars, academia and practitioners that *Zakah* proper administration would be reflected in the poverty reduction (Abdelbaki, 2014). Proper management or administration of *Zakah* would take various forms, one of these way to manage *Zakah* properly is to institutionalize the *Zakah* under well-structured institution. With the worsening economic conditions in Yemen and the rise of poverty line, its noteworthy to realize and suggest that the state has failed in reducing the poverty and in all aspects of economy and hence *Zakah* institution should play a better role in poverty alleviation, which cannot be done under the government supervision. This is because many factors, one of the them the lack of vision toward the importance of *Zakah* in poverty alleviation, and also the rise of corruption within the government agencies and servants. Less transparency in *Zakah* collection and the ambiguity in the distribution of *Zakah* in Yemen is considered among the critical issues of *Zakah* management in the country. Such issue is reflected in the lack of clear policy on *Zakah* and its purpose. Thus, creating a viable body to manage *Zakah* should be one of the priority and one remedies to rectify the role of *Zakah* in social welfare of the society. However, government would not suggest such a policy or a move as it will lose one of the sources to finance their public budgets. As such, *Shari'ah* scholars, academia, economists and public at large should call and put pressure on the government to reform and delegate *Zakah* institution to a new body as early as possible to carry its expected and prescribed role in the society.

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## **THE IMPLICATION OF CORPORATE SOCIAL RESPONSIBILITY AND MARKET ORIENTATION ON ORGANIZATIONAL PERFORMANCE: A CONCEPTUAL PAPER**

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### **INTRODUCTION**

Majlis Fatwa Kebangsaan issued a *fatwa* (decree) in 1972 mentioning that conventional life insurance is prohibited (Bank Negara Malaysia, 2005). As a result, the development of the Takaful industry in Malaysia had started in the 1980s. Syarikat Takaful Malaysia Sdn. Bhd. became the first Takaful operator established in 1985 and Bank Negara Malaysia (BNM) assumed the regulation and the supervision of conventional insurance and Islamic insurance (Takaful) industries in 1988. In order to create competition and exchange of business through retakaful, Takaful Nasional Sdn. Bhd. became the second company issued a Takaful license in 1993 (Abdul Hamid and Othman, 2009). Subsequently, Maybank got the takaful license in 2002, and Takaful Ikhlas Sdn Bhd in 2003. Currently, there are more than ten takaful operators in Malaysia, where most of them offer Family and General Takaful (Bank Negara, 2010). Generally, takaful companies' business model in Malaysia adopt either Wakalah (Agency-based model) or Mudarabah (profit-sharing model), but Wakalah model is identified as a more efficient and sustainable distribution channel and has shown a rapid growth (Halim, 2012). It is evidenced by the number of Takaful agents which has increased from 11,000 only in 2006 to 74,089 in 2010 and the figure keeps on growing (Bank Negara Malaysia, 2010). Basically, takaful agency plays an important role in marketing takaful products and reaching a wider customer base including penetrating non-Muslim market (Sharif, 2012). With the help of Takaful agents, the awareness and ownership of family Takaful scheme

among Muslim in Malaysia is increasing based on the early empirical study that showed nearly 50 percent of the respondents are aware of Family Takaful Scheme (Norlida et al., 2004). This awareness level has increased to 86 percent based on the extension study conducted later (Abdul Hamid and Othman, 2009).

Although the Takaful industry has seen double-digit growth since 2010, but it is reported that the industry still suffers from a lack of market penetration, and still underperforms (Halim, 2012) Even, Bank Negara Malaysia reported that large potential Takaful market still remain untapped to its fullest (Bank Negara Malaysia, 2001). In addition, recent Ernst & Young Takaful Report 2012 showed that current Takaful market share in Malaysia and GCC countries stands only at 10% and 15% respectively which is lesser than the industry's potential as a whole. Thus, there have been calls for Takaful industry to apply societal, entrepreneurial, and marketing concept to make the industry more competitive (Halim, 2012; Sharif, 2012).

This research will study the concept of corporate social responsibility (CSR) which is also known as social responsibility (Arnaudov and Koseska, 2012) in the context of Takaful industry in Malaysia as Chapple and Moon (2005) argued that relatively little research on the concept has focused on companies in Asia. From the Islamic point of view, there is a similarity between Takaful concept and social responsibility (Yaacob and Abdul Ghani Azmi, 2012). The foundation of Takaful concept is relationship or brotherhood where it strongly encourage community's benefit (religion, intelligence, life, honor, dignity and property) in fulfilling the Maqasid al Shariah (Yaacob and Abdul Ghani Azmi, 2012; Muji Tahir, 2009). This topic has attracted many researchers to study corporate social responsibility (CSR) either from Islamic point of view (Siwar and Hossain, 2009; Yaacob and Abdul Ghani Azmi, 2012) or other perspectives (Carroll and Buchholtz, 2000; Moir, 2001, Greenfield, 2004, Suchman, 1995; Maignan and Ferrell, 2004). Another growing issue in CSR topic is the study of the construct and business performance relationship which produces disparity findings (Wickham, 2006). According to Goll and Rasheed (2004) CSR and performance research is context dependent study and proposing environment as contextual variables that moderate the relationship between the constructs may contribute to a better understanding of the constructs. Therefore, it will be another research gap to be fulfilled in the study, where the relationship between CSR and business performance in the context of Takaful agency in Malaysia will be investigated by

proposing the role of environment in moderating the relationship between the constructs. Briefly, the objectives of the research are:

- i. To investigate the influence of corporate social responsibility on business performance of Takaful agency.
- ii. To investigate the moderating effect of environment in the relationship between corporate social responsibility and Takaful agency's business performance.
- i. To investigate the influence of market orientation on business performance of Takaful agency.
- ii. To investigate the moderating effect of environment in the relationship between market orientation and Takaful agency's business performance.

## **LITERATURE REVIEW**

### ***Takaful concept***

Technically, Takaful comes from an Arabic word of "kafala" which means to guarantee, to look after or trust (Abdul Hamid and Othman, 2009). Literally, "Takaful" is derived from adverbs "takafala" which means "looking after one another" (Abdul Hamid and Othman, 2009). Bakar (2000) asserts that, Takaful is different from conventional insurance because from Takaful concept point of view a company is not the 'insurer' insuring the participants but the participants are actually mutually insuring one another and this is the very essence of the word Takaful in Arabic.

Conceptually, Takaful is an arrangement by a group of people with common interests to guarantee or protect each other from certain defined misfortunes such as premature death, disability and property damages (Obaidullah, 2005). Basically, insurance does not contradict with the Islamic principles since it is essentially a system of mutual help (Redzuan et al., 2009). However, uncertainty (*gharar*) and gambling (*maysir*) in the contract of insurance as well as usury (*riba*) in its investment activities become the elements that cause the operation of conventional insurance contradicts to the principle of Shariah (Redzuan et al., 2009).

## **CORPORATE SOCIAL RESPONSIBILITY (CSR)**

The concept of corporate social responsibility has been widely discussed in the literature but it's generally accepted definition is still debatable (e.g. Green and Peloza, 2011; Jamali, 2008). This is because the concept has been conceptualized from various angle McDonald and Lai (2009), such as economic perspective (Friedman, 1962), good corporate citizenship (Hemphill, 2004), and also from a broader perspective which covers economic, legal, ethical and philanthropy (Carroll, 1979). Among earlier definition comes from Bowen (1953 p.6) who defined CSR as:

*“the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of actions which are desirable in terms of the objectives and values of our society”.*

Other researchers such as Brown and Dacin, (1997, p. 68) define CSR as:

*“the company's status and activities with respect to its perceived societal or, at least, stakeholder obligations”*

The concept has also been discussed in the literature from other perspectives such as consumer, economics and theoretical perspective (McDonald and Lai, 2009). Zenisek (1979) defined the concept from economics point of view as return maximizing activities to shareholders. However, some researchers argue that businesses have only one responsibility which is to maximize investor return and it can be achieved by fully utilizing resources through profit maximization as people have freedom to choose what they want (e.g. Friedman, 1996; Sternberg, 2000; Henderson, 2001). This view is consistent with classical economics view of profit maximization that believed only a financially stable organization can support the cost of performing CSR (Handy, 2002).

Even though many scholars view promoting social good as beyond company's economic interest (McWilliams and Siegel, 2001; Turban and Greening, 1997), other scholar has viewed the concept in a broader scope that encompasses economic, legal, ethical, and philanthropy dimensions (Carroll, 1979). Economic responsibility of an organization embraces activities such as operation efficiency activities, creating job and fair pay for employees and providing return of investment (ROI) to shareholders Jamali (2008), as well as other economic activities to its stakeholders (Carroll, 1991). Legal dimension



entails organizational responsibility to adhere to rules and regulation (Carroll, 1979). Ethical responsibility embraces activities that are not necessarily legalized (Jamali, 2008), but the activities are based on religion and commitment towards humane principles and human right (Novak, 1996). Finally, philanthropy responsibility encompasses activities that promote human welfare (Carroll, 1991), and this dimension has the widest scope in CSR concept cause it to become the most controversial aspect of the concept (Jamali, 2008).

CSR concept has also been widely discussed from the perspective of stakeholder theory (Reverte, 2009). This theory concerns with any individual or group that can affect or affected by organizational achievement (Freeman, 1984). This is because the responsibility towards shareholder who is one of the stakeholders cannot be performed without considering to some degree the need of other stakeholders (Jamali, 2008). Different stakeholders' views on how an organization should carry out its activities may cause them to negotiate various social contracts with various stakeholders (Reverte, 2009). Although the concept is widely discussed from different theoretical point of view, the concept of stakeholder still becomes central to CSR practice (Maon et al., 2009), and its main challenge is to improve the relationship between an organization with its stakeholders by delivering benefits to them through its policies and activities (Post et al., 2002).

### **ISLAMIC PERSPECTIVE OF CORPORATE SOCIAL RESPONSIBILITY**

Corporate social responsibility concept has been discussed and established in the literature more than 50 years (Carroll and Buchholtz, 2006), but interestingly, the concept has been chosen as the solution for recovery of moral deficiency in the neoclassical economy (Mohd Nor, 2012). Recently, scholars have started to show their interest to rationalise CSR where Islamic moral economy (IME) becomes the underlying foundation by articulating the values of justice, fairness and equity (Mohd Nor, 2012). Islamic moral economy (IME) promotes justice in social and economic aspect as accentuated in Islamic economic system which is based on Shariah principles, where having a consciousness of God's presence (*taqwa*) in daily activities including economic activities becomes the fundamental bedrock of IME (Iqbal and Mirakhor, 2007). IME becomes the alternative to the neoclassical economy which promotes capitalism and profit maximisation (Ahmad, 1980; Chapra, 1979; Siddiqi, 1980; Naqvi, 1994; Tripp, 2006). IME is viewed to have the

capabilities to deliver material benefits to the economic development more effectively and transparently because IME stresses on ethics and morality (Siddiqi, 1980; Tripp, 2006). IME is inspired from the Western concept of 'moral economy' that comprises elements of faith or cultural norms, moral and ethical values as well as economic activities. Therefore, Islamic CSR is built upon faith (aqidah), personal moral behavioural disposition (akhlaq) and Shariah-compliance economic activities (Mohd Nor, 2012).

### **MARKET ORIENTATION**

Marketing research in small and medium sized enterprises (SMEs) has become an important research topic among academics and practitioners (Cromie, 1990) and still become a debatable topic among scholars (Brodie, Coviello, Brookes & Little, 1997; Gilmore, Carson & Grant, 2001). Generally, there is no mutually agreed definition of market orientation in the literature (Rapp, Schillewaert & Wei Hao, 2008). However, there are two prominent approaches in conceptualizing the construct. The first approach is from cultural perspective by Narver & Slater (1990:21) who defined it as the organizational culture that most effectively and efficiently creates the necessary behaviors for the creation of superior value for buyers and continuous superior performance for the business. From behavioral perspective; Kohli & Jaworski (1990:6) defined the concept as an organization-wide generation of market intelligence pertaining to current and future customer needs, dissemination of the intelligence across departments, and organization-wide responsiveness to this intelligence.

Other than its conceptualization being discussed, many studies on market orientation-performance are in the literature where the relationship between market orientation and performance depends on cultural factor (Agarwal, Erramilli & Dev, 2003; Mahmoud & Hinson, 2012). The variability of MO-performance result also depends on sectorial factor as evidenced by several studies in various organizational sectors for instance service organization (Gray & Hooley, 2002), industrial manufacturing organization (Bigne´ Blesa, Kuster & Andreu, 2004), non-for-profit organization (Macedo & Pinho, 2006), political context (O'Cass, 2001), charity organization (Balabanis, Stables & Phillips, 1997) as well as in developing economies (Ellis, 2005). Moreover, the study by Greenwald (1991) has supported the importance of market orientation concept and the need for the companies to stay closer to their market as global competition is increasing and consumer need is changing. It is also believed that the concept becomes an effective

competitive weapon for firms including insurance companies to survive in the competitive environment as insurance companies deal with intangible products that require service quality and customer orientation (Lado & Maydeu-Olivares, 2001). Although many researchers postulated the importance of market orientation-performance study, only little MO-performance research has been performed in the context of small organization (Raju, Lonial & Crum, 2011), specifically insurance sector (Lado & Maydeu-Olivares, 2001).

### **ORGANIZATIONAL PERFORMANCE**

The mutually agreed definition of performance is yet to be found (Andersen, 2010), because it is a multidimensional concept (Lumpkin and Dess, 1996), and has been conceptualized from divergent perspectives (T. Ramayah et al. 2011). Andersen (2010) categorizes performance in terms of what is being measured and how it is being measured. Other researchers categorize performance into financial measure such as sales growth and non-financial measures such as satisfaction (Venkataraman and Ramanujam, 1986).

Several researchers consider organizational performance entails performance in finance, business and organizational effectiveness (Chu-Hua et al., 2001; Terziovski and Samson, 1999; Venkataraman and Ramanujan; 1986), and its degree to satisfy organization's survival need and stakeholders' needs because performance is influenced by various factors (Griffin, 2003). The results of operational performance by organizational members are also considered as organizational performance (Ruey-Gwo and Chieh Ling, 2007), and the crucial driver behind an organizational exertion is its incremental strategies where performance becomes the backbone (Terziovski, 2000).

Generally, there are two approaches in measuring performance: objective and perceptual (subjective) approach (Andersen, 2010; Greenley and Foxall, 1998). Many studies have found the perceptual performance of a company is positively related to actual performance (Dess and Robinson, 1984; Golden 1992; Venkataraman and Ramanujam, 1986; Wall et al., 2004). In the absence of suitable objective measures, perceptual measure is suggested (Day and Westley, 1988).

### **CORPORATE SOCIAL RESPONSIBILITY AND ORGANIZATIONAL PERFORMANCE**

Several empirical studies found a positive relationship exists between the construct and organizational business and financial performance (e.g. Bird et al., 2007; Kang et al., 2010; Luo and Bhattacharya, 2006; Waddock and Graves, 1997; Wang, 2010). However, in other studies, it was found no existence of relationship between corporate social responsibility and organizational business performance (e.g. Aupperle et al., 1985; Margolis et al., 2007), and even negative effect of the concept on organizational performance (e.g. McGuire et al., 1988 and Qu, 2009). Several researchers argued that failure in considering the market segment or industry effect when investigating the relationship become the reason of mixed finding in CSR and performance study (Chand, 2006). Another reason is organizational financial performance relies on industry characteristics that define the accepted degree of ethics and morality in evaluating whether the activities are socially responsible or not (Lee et al., 2012).

Research works that study corporate social responsibility and business performance relationship are rapidly growing (Wickham, 2006). McWilliam and Siegel (2000) suggested two types of business performance in corporate social responsibility study; short run and long run profitability. Generally, there is a mixed finding of corporate social responsibility and performance research for example several studies have shown a positive correlation between corporate social responsibility and business performance (Luo and Bhattacharya, 2006; Waddock and Graves, 1997). However, other researchers found that the adoption of corporate social responsibility is important but it leads to negative business performance (Qu, 2009), and even no relationship exists between the constructs (Aupperle et al., 1985).

### **THE MODERATING ROLE OF EXTERNAL ENVIRONMENT**

The study on external environmental concept on an organization's strategic choices is widely researched in the literature Boyd et al., (1993), and it is considered as one of the important contingencies in organization theory and strategic management (Child, 1972). Environmental complexity and volatility influence organizational decision making May et al., (2000), and different organizations are affected by different numbers of environmental factors that are uncertain, complex, and dynamic (Wang et al., 2012). Any organization that does not take environmental factors seriously will be facing troubles Wang et al., (2012), because an organization's strategy and structure should favorably align its business with the environment (Dess and Keats, 1987). This view is consistent

with Aldrich and Pfeffer (1976) that believe managerial choice may be severely constrained by environmental factors and managers must understand the nature and factors of environment

Although the concept is widely discussed and regarded as a fundamental concept in management theory, there is little consensus regarding the conceptualization and measurement of the construct (Boyd et al., 1993; Fuentes-Fuentes et al., 2004). According to Dess and Beard (1984), environmental condition also known as objective environment comprises of three dimensions; munificence, complexity, and dynamism. Whereas, Jaworski and Kohli (1993) have conceptualized market turbulence, technological turbulence, and competitive intensity are its dimensions. Lumpkin and Dess (2001) exerted that many conceptualizations are consistent with the conceptualization developed by Dess and Beard (1984), and it becomes commonly-researched dimensions in environmental study (Fuentes-Fuentes et al., 2004). Even, Gotteland and Boule (2006) argued that only objective environmental factor can affect performance.

Munificence is described as the extent of the competition that can exist based on price or non-price factors (Grant, 1995), and the boundary of environment in providing sufficient resources for firms (Sharfman and Dean, 1991). A slow growth market might be extremely munificence if it contains few competitors (Fuentes-Fuentes et al., 2004). Environmental hostility becomes the opposite concept to environmental munificence (Covin and Slevin, 1989; Fuentes-Fuentes et al., 2004; Zahra and Covin, 1995) which emerges as a result of too many competitors, unfavorable supply condition and strict regulation (Zahra and Bogner, 1999). Environmental munificence often reduces the profit and research and development (R&D) activities of an organization (Zahra, 1996).

Complexity is believed a similar concept with heterogeneity (Fuentes-Fuentes et al. 2004). This view is consistent with the exertion by several researchers (e.g. Silverblatt and Korgaonkar, 1987; Thompson, 1967; Tan and Litschert, 1994) who defined the complexity of the environment as “the heterogeneity degree of its constitutive elements”. Heterogeneity indicates the distinct of market segments in which the company operates (Dess and Beard, 1984; Zahra, 1991). Companies operate in heterogeneous market usually face greater complexity than those companies in homogenous market (Slater and Narver, 1994).

Dynamism is similar to turbulence or volatility that are connected to the degree of newness in the changes or to their speed (Ansoff, 1979), and it indicates the industrial rate of variation, the volatility of customers' behavior and competitors' way of actions, as well as the shifts in the technological conditions of an industry (Zahra, 1996). Several scholars define the dimension as "the variation degree over time of its constitutive elements" (Aldrich, 1979; Dess and Beard, 1984; Tan and Litschert, 1994). Dynamism also relates to the rate of unpredictable change in a firm's environment (e.g. Duncan, 1972; Tosi et al., 1973) which indicates the uncertainty that minimize managers' ability to anticipate future and its impact on an organization (Khandwalla, 1977). According to Goll and Rasheed (2004) argued CSR is a context dependent study where the performance consequences of socially responsible corporate behavior are likely to vary significantly across environments. Briefly, this study proposes the following hypothesis:

H1: Corporate social responsibility exerts positive influence on organizational performance of Takaful agency.

H2: Market orientation exerts positive influence on organizational performance of Takaful agency.

H3: External environment moderates the relationship between corporate social responsibility and organizational performance of Takaful agency.

H4: External environment moderates the relationship between market orientation and organizational performance of Takaful agency.

## **METHODOLOGY**

This research will adopt purposive sampling where Takaful agency (the owner/manager) will become the respondents whose criterion meets the purpose of the study. Their homogenous characteristics are crucial to ensure accuracy of the theory testing, consequently increase the internal validity of the study (Calder et al., 1982). Purposive sampling is a nonprobability sampling technique; where the researchers will obtain the information from specific target samples that have required characteristics to become samples, to satisfy researchers' specific purposes, even though they are not fully representative (Zikmund et al., 2010). This sampling technique is inhibited to specific category of people who can provide the required information and may be the only useful

way to answer certain types of research question (Sekaran and Bougie, 2009). In this study, the registered Takaful agencies in Malaysia will be chosen as the target respondent. They are selected for several reasons;

The agency-based distribution is identified as a relatively more efficient form of distribution and fast gaining ground in the Takaful industry (Halim, 2012). The author even argued that according to industry players, agency-based distribution allows Takaful operator to reach a wider market at lower management expenses with Wakalah fee payable to Takaful agents is factored in the pricing structure of Takaful products. Secondly, the majority of Takaful operators in Malaysia is adopting Wakalah-based model, and it becomes another important reason to study the agency's business performance since this Shariah-compliant Takaful model is less controversial and gaining more popularity (Muhamat @ Kawangit et al., 2012). Thirdly, Takaful agents play important roles in the industry and Malaysia economy, as evidenced by the tremendous growth of Takaful agent as discussed above.

The unit of analysis of the study is organizations as it is investigating performance of *Takaful* agency (SME organization). Specifically, the target population of the study are *Takaful* agencies managers' agencies which are registered with *Takaful* operators in Malaysia. *Takaful* agencies managers are chosen as the respondents in the study as managers in SMEs are more likely to carry multiple roles and responsibilities, work with fewer organizational level or people and have a broader job scope (Hooi & Ngui, 2014). Specifically, *Takaful* agencies managers whose offices are located within Kuala Lumpur, Wilayah Persekutuan Putrajaya and Selangor state will be selected. Kuala Lumpur and Selangor state will be selected because most *Takaful* operators' head offices and *Takaful* agencies' offices are located within these areas. Additionally, Selangor state will be selected because it is the most populous state with a population of 5.46 million of people (Department of Statistics, 2010). Wilayah Persekutuan Putrajaya will be chosen because it has the highest population growth rate for the period of 2000-2010 (Department of Statistics, 2010). Hence, most *Takaful* agencies are likely to operate their businesses in these states since because of high density of customers within these areas. Malaysia is chosen because the country is aiming to be a global Takaful leader where it has a relatively high ratio of average gross written contributions per Takaful operator, averagely US\$20 million of contribution in 2010, which is approximately 27 percent of



the global market (Annuar, 2005). And Malaysia's total Takaful contribution will be US\$1.2 billion by the year 2015, if the estimated annual rate of growth is 60 percent (Annuar, 2005). Moreover, Malaysia is also acknowledged as having the most developed Islamic financial market with its liberalization policy, and with its strong government and regulatory support (PricewaterhouseCoopers, 2010).

According to Dillon (1994) a regular range of sample for market study is between 1,000 and 1,500, and the minimum sample size is 500. However, Roscoe (1975) proposed that sample sizes larger than 30 and less than 500 are appropriate for most research. . A sample size of 200 respondents is recommended for a study that employs Structural Equation Modelling (Hair et al., 1995). In other *Takaful* research the sample used by the studies is 500 (Abdul Hamid & Othman, 2009; Alajmi et al., 2011). However, the size of only 300 samples is still acceptable if limitations present in getting samples (Sekaran, 2003). Based on the discussion above, 500 questionnaires will be distributed to *Takaful* agencies managers around Kuala Lumpur, Selangor and Putrajaya.

### **DATA COLLECTION METHOD**

A cross-sectional research will be conducted for this research where self-administered questionnaire will be distributed to Takaful agency's manager of Takaful agencies located within Kuala Lumpur, Wilayah Persekutuan Putrajaya and Selangor state.

#### ***Measurement Items***

Generally, all construct measures in the literature will be directly employed but necessary modification and adaptation will be made for any unsuitable items to suit the local context and purpose of study (Gu et al., 2008). Only scales that have reliability coefficient of Cronbach Alpha above the acceptable level of 0.7 or item factor loading above 0.5 will be employed as suggested by Nunally (1978). In addition, this study will adopt 5-point Likert scale because it is more reliable, and can produce interval data that provides a greater volume of data than other scales (Cooper and Schindler, 2006). The data will be analyzed by adopting SEM PLS 3.0 where the findings, recommendations and limitations of the study will be discussed.



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## **SUSTAINABLE GROWTH RATE OF FIRM: DOES CAPITAL STRUCTURE OF SHARIAH COMPLIANT COMPANY MATTER?**

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## **ABSTRACT**

*Capital structure is very important for a company's investment choice because it will affect the company's value and financial risk. There is a reducing number of Shariah compliant firms because the companies have higher level of conventional debt. Increase in debt will lead to increasing or decreasing sustainable growth rate when a company's growth is higher than their maximum growth. Therefore, each company should focus on its capital structure planning in order to have a better company's growth. The purposes of this research is to (i) examine whether financial ratio benchmarks of firms which is less than or more than 33 percent debt ratio would give different effects to the sustainable growth rate, and, (ii) investigate the determinants of the sustainable growth rate of Shariah compliant firms in Malaysia. Panel data analysis was used to examine a relationship between capital structure, dividend policy, profitability, asset efficiency, and size towards the sustainable growth rate of Shariah compliant companies in Malaysia from 2006 to 2015. This research employed pooled OLS and dynamic model estimated using Generalised Method of Moment (GMM). Our overall results suggest that debt ratio, profit margin, and assets to sales are factors or determinants variables affecting the sustainable growth rate of Shariah compliant firms in Malaysia. The results under GMM estimations showed that debt ratio under group of less than 33 percent debt ratio is*

*negative significant due to control from size. This research also found that less than 33 percent companies is less risky compared to more than 33 percent that is risky. Our results comply with the pecking order theory and fulfil the theory of sustainable growth rate that the management needs to plan and monitor its operating and financial activities, especially, the capital structure in order for the firms to meet their maximum growth rate without change financial leverage. The results support the assessment that capital structure planning makes a company attracted to have a capital structure planning for a company to survive. Unlike previous studies, this paper investigates the company's capital structure decisions either financial ratio benchmarks of firms which is more or less than 33 percent affecting the firm's sustainable growth rate. This paper provides the understanding of capital structure planning and sustainable growth rate in Malaysia.*

**Keywords** – Sustainable growth rate, Capital structure, Shariah compliant company

## INTRODUCTION

In 2013, the screening methodology was revised by the Securities Commission Malaysia (SCM) not only on operating activities but also on financing and investing aspects of listed firm's business operations. Due to the revised screening methodology in Nov 2013, the number of Shariah compliant stocks reduced to 71.4 percent from the total listed securities on Bursa Malaysia. In the previous screening, there was no screening based on the financial ratio benchmarks. For the financial ratio benchmarks, the screening was based on two ratios namely, cash over total assets and debt over total assets. These financial ratios must not be more than 33 percent to be listed under the Shariah compliant firm list. Therefore, the reduction number of Shariah compliant firms is because of the companies having a higher level of conventional debt which is more than the benchmarks given by the Securities Commission Malaysia. Junaina Muhammad (2015) stated that after the revised screening methodology, the status of firm was affected due to (i) companies' mixed activities which were previously assessed under the 5, 10, 20, and 25 percent benchmarks but currently firm activities are assessed under the 5 and 20 percent benchmarks, and (ii) companies with high level of conventional debt affected, as previously there was no screening based on the total conventional debt of the companies. Thus, the firm should sustain its conventional debt ratio of not more than 33 percent in order to remain listed as a Shariah compliant firm. This research focuses on the effect of financial leverage of firms whether debt ratio of less or more than 33 percent can affect the sustainable growth rate of the firm.

By considering the firm's leverage to the sustainable growth, the prosperity of companies is much related to how the manager manages the company's capital structure (Fonseka, Ramos, & Tian, 2012; Johnson & Soenen, 2003; Srinivasa, 2011). This is also related to whether the manager borrows money under long-term debt, short-term debt, or equity in addition to improving the companies' growth. Sometimes, too much growth rate causes financial stress to the company and therefore, the firm will face higher costs, higher debt, bankruptcy, financial losses, and declining market share (Fonseka et al., 2012). A company can maintain its growth by determining the factors that affect sustainable growth. Sustainable growth affects the company's structure changes, for example, financial leverage increased, sustainable growth tend to increase while financial leverage decreased, and sustainable growth also decreased (Srinivasa, 2011). Moreover, the use of debt can give impact to the company's earnings. Handling company's financial leverage might be one of the important factors in sustaining the growth of the company. This is supported by Johnson & Soenen (2003), who stated that the company's strategic planning by handling essential limitations and constraints of policy with respect to leverage and dividend pay-out can sustain the company's growth. The decision in managing the financial and operating activities towards the growth of a company is related to the pecking order theory. Therefore, the objective of this research is to investigate the determinants of the sustainable growth rate of Shariah compliant firms in Malaysia.

This research is organised as follows; the next session covers the literature review of the sustainable growth rate based on previous research and then followed by data and methodology under Section 3. Model of analysis for this research is discussed in Section 4. Research findings and analysis are laid out in Section 5 and Section 6 discusses the overall conclusion of the research.

## **REVIEW OF THE LITERATURE**

Based on a previous study by Amouzesh, Zahra, & Zahra (2011), a firm's sustainable growth rate depends only on the earnings' retention rate ( $r$ ) and the return on equity. The calculation of sustainable growth rate refers to the retention ratio multiple return on equity. Mostly, capital structure, profitability (profit margin), asset efficiency and

retention ratio are associated with sustainable growth rate. Capital structure, profitability, asset efficiency and retention ratio are a combination of operating and financial elements. Moreover, Kanani, Moradi, & Valipour (2013) state that the important factors in financial information are firm's growth and also the risk of the company. In this case, the decision-making process and investment guidance are influenced by financial information. Sometimes, too much growth rate causes financial stress to the company and therefore, firm will face higher costs, higher debt, bankruptcy, financial losses, and declining market share (Fonseka et al., 2012).

Furthermore, the calculation of leverage ratio should use the figures of the same date which is opening the total assets divided by opening equity. Specifically, the modification of the calculation of asset turnover rate based on those changes can be calculated by sales divided opening the total assets rather than dividing closing total assets as used by Higgins (1977). The modification using the same date is more intuitive because sales are created based on the assets rather than other things, which was more indirect and remote (Ashta, 2008). Moreover, the concept of sustainable growth rate by Ashta (2008) is a useful concept for firms that are growing very fast and also for firms that are facing financial distress by modifying the calculation that can improve financial analysis and clarity by calculating a firm's sustainable growth rate. The author's findings prove that the modification of sustainable growth rate formula is consistent when the calculation is used in the opening assets in the asset turnover ratio. Therefore, both the assets and equity should have a specific term in the calculation of leverage ratio. Also, the assets should have a beginning of period value under the asset turnover ratio.

Korteweg (2010) mentioned that the market expects that it will lever up later on to catch the advantages of leverage. As stated by Park & Jang (2010) debt leverage is one of the effective ways for the firm to improve its performance and enhance free cash flows. Their results found that debt leverage has a positive influence on firm performance. Their results supported the signalling effect theory by Ross (1977). Anderson & Nyborg (2011) stated that they have found a negative correlation between growth and firm performance which have an inverse argument from previous researchers. In relation to this, Shaikh & Salman (2010) expressed that leveraged firms can expand their profits in booms. However, in declines, they lose the control and can even go bankrupt and their creditors

and shareholders can suffer. Leveraged firms are more stable and gaining compared to the non-leveraged firms during the economic booms. However, during recessions, leveraged firms are more risk prone and less profitable than non-leverage firms. In this case, leveraged firms are relying upon the economic condition that assumes constant economic boom.

Chung, Na, & Smith (2013) found that there is no significant evidence on capital structure policy that influences acquisition or probability of failure. They used the data from the oil industry and stated that firms seem to increase their leverage when they face attractive growth opportunities. Another reason to increase firm leverage is because they face poor operating performance that reduces equity value or requires borrowing. In addition to that, firms are acquired when they face a rapid growth and this can reduce financial slack. They claim that firms can survive and operate with persistently low leverage without being focused for acquisition including getting potential financing sources which supports the pecking order theory by using internal financing (retained earnings).

Gómez-Bezares, Przychodzen, & Przychodzen (2017) stated that firms that incorporate sustainability issues into their business operations are able to leverage their resources better towards stronger financial performance and shareholder value creation than other companies. Meanwhile, the relation between financing and growth behaviour is explicitly integrated (Molly, Laveren, & Jorissen, 2012). The authors also found that the capital structure is not directly influenced by the managing generation, but indirectly through the realised growth rate. Moreover, the results indicate that next-generation companies grow slower because they have the tendency to forego part of their growth rather than risk the loss of family control due to the increased use of debt.

In addition, leverage amplifies to the losses or gains in business activities (Ilie & Olaru, 2013). The leverage busts the gains and supports economic growth when it is good during the good times. As such, government and firms are using leverage at large scale. However, government and firms will deleverage during the bad times because leverage busts losses and does not support the economic growth. Therefore, financial crises happen because of the high degree of leverage and usually, deleveraging will follow a financial

crisis. This can be noted that firms deleverage because they face risks; not only risks but also the situations where they also want to strengthen their financial stability.

The study by Sánchez-Vidal (2014) in Spain, a country that has a critical debt, extends that problem to the public and private firms. One of the factors that influences firms leverage for that country is when the firms disclose the important information, particularly, for the high indebted firms. This study used the OLS method on the quantile regression to analyse the leverage determinants for a large sample size of companies for the period from 2001 until 2011 depending on the level of firm indebtedness. The results of the study show that many factors are no longer significant for the highly leveraged firms and also, the cash flow of the companies is critical when the firms like to decrease their level of debts. In addition to that, the problem of having higher leverage is not only important for the youngest companies but also for the larger companies because they can observe that both size and age of companies can give a positive or negative effect for the highest quantiles. Also, companies that have tangible assets still cannot solve the high debt problem because tangible asset is not seen as a determinant.

Moreover, Conning (1999) examined that microfinance lending organisations (MFO) are facing the contract design problem when they want to maximise the outreach and effect of their lending activities to a target population of poor borrowers and at the same time will maintain financial sustainable. Balance achieved between outreach, sustainability and financial leverage is done by the allocation costs and basic observations. This situation generates the relationships within a chain of agency that is subject to moral hazard between loan staff, borrowers, and MFO equity owners and investors from outside. Taken to all, the sustainability of MFOs that have targeted poorer borrowers must charge the higher interest rate, and at the same time, they will have a higher staff costs per dollar loaned and also, the MFOs have are less financial leveraged. To support the findings of this study, 72 MFOs are used for the sample data. Else, the institution specifies that microfinance will not aggregate to more than a drop in the bucket of poverty alleviation efforts unless very large sums of money can be obtained from the private sources. Thus, the achievement of leverage is not necessarily conditioned by sustainability.

In addition to the financial leverage, Wu & Au Yeung (2012) found that growth type such as firm's initial market to book ratio and asset tangibility can significantly predict the dispersed and determined the different future leverage ratio. Growth type is persistent and main growth type is sorted by cross sections of corporate fundamental variables, such as tangible versus intangible investment style, that are meaningfully determined. Also, low growth type firms are basically more likely to issue new debt than equity when the economic and market conditions improve, while, high growth type firms are least likely to issue debt and equity. Therefore, the findings demonstrate that firms are rationally seeking and investing the financial sources in a manner that is aligned with their types of growth. O'Connor (2013) indicated that for participating firms, the equity market liberalisations did not depend on an increase in external finance growth. In order to obtain the finding, this study used a sample of 686 investable firms from 26 emerging market countries. Firm that issued not more or less equity capital post liberalisation suggested that the gains from equity market liberalisation may not necessarily cause a reduction in financing constraints.

Previous research by Lee, Liang, Lin, & Yang (2016) found that the investment of firm has a positive impact on debt financing and debt financing has a positive impact on the investment. The funds available to outlay the investment can be enhanced by having an increase in debt financing and the increase in investment. This increased the willingness of firms to fund supply by the increase in their investment's future profitability and mortgage of capital investment. The raised investment also can further improve the firm's debt capacity. Meanwhile, there is a significantly negative impact between debt financing and dividend, which means that there is more ability for firms to pay dividend when the firms have lower leverage level. Hence, in order to obtain the finding, they suggest the use of the 2SLS, 3SLS, and GMM methods to analyse the jointly determined three corporate decisions and also the interaction among them which should be taken into account in a simultaneous equations framework. The sample of this study is from the US listed firm's annual data between 1965 and 2012.

The relation between the fundamentals of financial institutions (i.e., cost income ratio, equity to total assets, total asset growth and ratio of loan loss reserve to gross loans) which all these variables with a lag of one year had positively impacted the probability of



financial distress in the next year (Zaki, Bah, & Rao, 2011). The latest findings for emerging economies have cast doubt on the usefulness of macroeconomic information for financial institutions' risk assessment. Similar results are found for the UAE financial institutions in predicting the probability of financial distress.

## DATA AND METHODOLOGY

The data set used in this research was collected from Thomson Reuters Database, in which Shariah compliant firms listed under Bursa Malaysia were used as a sample of firms on an annual basis from 2006 until 2015. For the purpose of this research, we selected all Shariah compliant firms from all sectors except for the finance sector. The finance sector was excluded from the sample because of its exclusive features in financial statements and business activities (Ali, Ibrahim, Mohammad, Zain, & Alwi, 2009). From all the data we only gathered 447 firms used as full data are required for this study.

The previous studies used the Higgins model to calculate sustainable growth rate (Amouzesh et al., 2011; Cahyo Hartono & Rahmi Utami, 2016; Chen, Gupta, Lee, & Lee, 2013; Escalante, Turvey, & Barry, 2009; Fonseka et al., 2012; Hafid, 2016; Molly, Laveren, & Jorissen, 2011). This study used the Higgins model equation to calculate the sustainable growth rate of Shariah compliant firms in Malaysia. The SGR is generally based on information provided in a firm's annual reports, taking the form:

$$\text{SGR} = \text{ROE} \times (1 - \text{DPR})$$

There is a range of alternative SGR measures (Higgins, 1977) with variation found in both the measure of return on equity and the measure of dividend payout ratio selected for calculation. In this paper, we focus on one such definition, the maximum growth rate in sales without having change in the capital structure.

In 2013, the 33 percent of financial ratio benchmarked by the Securities Commission Malaysia consists of debt to total assets which is associated to conventional debt only. The calculation of debt ratio in this research consists of both Islamic debt and conventional debt due to some limitations. Based on the sample, we constructed data by dividing it into three group such as whole sample, less than 33 percent debt ratio, and more than 33 percent debt ratio. We divided the data into three groups because we wanted

to gauge whether there is a different result when the companies have less than or more than 33 percent of debt ratio. We arranged the data of total debt ratio by calculating average over 10 years. Then, the data were categorised by each company and each year into less than and more than 33 percent. After the arrangement, 177 companies were categorised as less than 33 percent debt ratio and 270 companies are under more than 33 percent from total of 447 companies. All data were balanced data.

Table 1 indicates the variables used in this research with the measurements of each variable. In this research, sustainable growth rate was used as a dependent variable and independent variables consisted of financial leverage, dividend policy, profit margin, and assets efficiency, while, size as control variable. The descriptive statistics such as mean, standard deviation, variance, minimum and maximum are summarised in Table 2a, 2b and 2c. Furthermore, the correlation coefficient to examine the relationship between all variables was provided to support and confirm the selected variables' results in this research. It can be seen that most of the variables indicated that within standard deviation variance is higher than between standard deviation which means that the time series variation was more dominated than cross sectional variation. Therefore, panel estimation methods were applicable in this research. The correlation coefficient results for the whole sample found that debt ratio, profit margin, and size were correlated with sustainable growth, which, negative relationship between debt ratio and sustainable growth complied with the pecking order theory. Only asset to sales was not significant with sustainable growth rate for the group of less than 33 percent, while, for the group of more than 33 percent indicated that debt ratio, profit margin and size had a significant correlation with sustainable growth rate at 1 percent level of significant.

### **MODEL OF ANALYSIS**

This research used panel data method to examine whether the capital structure gives impact to the sustainable growth rate, and to investigate the determinants of sustainable growth rate of Shariah compliant firms in Malaysia. This method allows the elimination of the unobservable heterogeneity for each observation in the sample of study. Panel data analysis was tested by using Ordinary Least Square (OLS) either fixed or random effect, and Generalised Method of Moment (GMM).

The regression models for panel data must comply with some assumptions either it is linear, unbiased, lag structure or important results prior to testing the model. To test the determinants of sustainable growth rate, this research used the following model:

$$SGR_{i,t} = \alpha + \beta_1 DPR_{i,t} + \beta_2 PM_{i,t} + \beta_3 ATS_{i,t} + \beta_4 TDR_{i,t} + \varepsilon_{it} \quad (1)$$

where  $SGR_{i,t}$  is sustainable growth rate based on Higgin model calculation (return on equity multiply retention ratio) of firm  $i$  at time  $t$ ;  $TDR_{i,t}$  is a total debt ratio of firm  $i$  at time  $t$  and proxy of capital structure;  $DPR_{i,t}$  is a dividend payout ratio of firm  $i$  at time  $t$  and proxy of dividend policy;  $PM_{i,t}$  is a profit margin of firm  $i$  at time  $t$  and represents profitability; and  $ATS_{i,t}$  is an assets to sales ratio of firm  $i$  at time  $t$  and represents assets efficiency.

One fact about Equation 2 was that it was affected by the size of firm. The importance of size (Amouzesh, Zahra and Zahra, 2011; Sánchez-Vidal, 2014; Brick, Chen, Hsieh and Lee, 2016; Park and Jang, 2010) can be observed that size of firm can give a positive or negative effect for the highest quantiles. Thus, to study the effect of size of firm on the sustainable growth of firms we expanded the version of Equation 2, to be incorporated as control variables on the right-hand side:

$$SGR_{i,t} = \alpha + \beta_1 DPR_{i,t} + \beta_2 PM_{i,t} + \beta_3 ATS_{i,t} + \beta_4 TDR_{i,t} + \beta_5 SIZE_{i,t} + \varepsilon_{it} \quad (2)$$

where  $SIZE_{i,t}$  is a vector of control variable and measured by natural logarithmic of total assets of firm. In addition to using a static model, as mentioned above, this research applied the dynamic model to test the effect of capital structure, dividend policy, profitability, assets efficiency on sustainable growth rate. An advantage of this model is that it allowed for the relationship between capital structure, dividend policy, profitability, assets efficiency and sustainable growth rate to be dynamic in nature. This research used the GMM estimator by Arellano & Bond (1991) for investigating the effect of capital structure, dividend policy, profitability, and assets efficiency on sustainable growth rate.

The dynamic growth model takes into account the fact that the actual and target sustainable growth rates may differ by testing one-step difference and two-step difference. Thus, the dynamic regression model, using panels containing many firms and a small number of time periods, is presented as:

$$SGR_{i,t} - SGR_{i,t-1} = \delta (SGR^*_{i,t} - SGR_{i,t-1})$$

Therefore, the dynamic regression model becomes:

$$SGR^*_{i,t} = \delta\alpha + (1 - \delta) SGR_{i,t-1} + \delta\beta_1 DPR_{i,t} + \delta\beta_2 PM_{i,t} + \delta\beta_3 ATS_{i,t} + \delta\beta_4 TDR_{i,t-1} + \delta\beta_5 SIZE_{i,t} + \delta\beta_6 TDR_{i,t-1} + \lambda_i + \eta_t + \varepsilon_{it}$$

(3)

where  $\delta$  is the adjustment speed, representing the magnitude of adjustment from actual to target sustainable growth rate. The  $\delta$  is between 0 and 1, where, when  $\delta_{i,t} = 0$  there is no adjustment to the target capital structure. But, when  $\delta_{i,t} < 1$ , adjustment is required to attain the target, and when  $\delta_{i,t} > 1$ , it means the firms over-adjust, therefore more adjustments than necessary are needed, which is still not at the optimal. In order to gauge financial behaviour of firms, we also included debt ratio from previous ( $TDR_{i,t-1}$ ) to investigate whether previous financial leverage would give effect to the current sustainable growth. To solve such heterogeneity bias, error term can be formed as  $\lambda_i$  and  $\eta_t$  which is an unobserved individual specific effect (two ways such as firm and time).

## EMPIRICAL RESULTS

This section reports and presents the results of estimations for dynamic regression model using GMM estimations and other estimations by using pooled OLS on the data sets described above over the period of 2005 until 2016. The results also interpret the results of various methods to check the robustness of the results, where we produced results for a two-step with a one-step difference and two-step difference, with standard errors that are asymptotically robust to general heteroscedasticity.

### ***Pooled OLS estimation result***

We begin our empirical investigation by discussing pooled OLS results in Table 3. The results presented are for the whole sample, less than 33 percent and more than 33 percent debt ratios. The results for the whole sample show that total debt ratio (capital structure), profit margin (profitability), assets to sales (assets efficiency), and size are statistically significant to the sustainable growth rate. Total debt ratio and assets to sales are negatively significant. The firm experienced that the increase in debt ratio results to the decreased in sustainable growth rate where the total asset is higher than total debt. While the decreasing in debt ratio tends to increase in sustainable growth rate. Firms with more growth will carry less leverage (Haron & Ibrahim, 2012) and comply with pecking order theory (Myers & Majluf, 1984). For the group of less than 33 percent debt ratio, the results is the same with whole sample in which the total debt ratio, profit margin, assets to sales, and size were statistically significant with the sustainable growth rate at 1 percent and 5 percent, respectively. This also indicates that financial leverage for group is less than 33 percent, showing that the management was at the right path to monitor all financial and operating activities for the company to sustain their growth. This seems that all variables had a significant effect on the sustainable growth, where the increasing or decreasing of financial and operating activities will give an impact to the firm to sustain its growth. This is also important for Shariah compliant firms to manage their financial leverage to maintain their debt ratio. Furthermore, the group of more than 33 percent debt ratio found that debt ratio, profit margin, and size give impact to the sustainable growth rate at 1 percent and 5 percent level of significant, respectively. However, pooled OLS model may result in heterogeneity bias because pooled OLS cannot control the probability bias of unobserved heterogeneity, and also the lagged of the endogenous or dependent variable. Thus, pooled OLS results in an unbiased estimation of the of the autoregressive coefficients when firm-specific effect is important. These results motivated us to continue our discussion on the GMM estimations results.

### ***GMM estimation results***

This section discusses the results of dynamic panel GMM estimations (Table 4). The results presented in this section are divided into two columns. Column 1 represents and discusses the results obtained from one-step difference and column 2 is two-step

difference. Both of the results have three groups consisting of the whole sample, less than 33 percent debt ratio and lastly, more than 33 percent debt ratio.

Table 1

Variables used in the measure of Sustainable growth rate and its determinants		
	Variables	Measurement
Sustainable Growth Rate (SGR)	SGR	Return on equity × Retention ratio
Capital Structure (CS)	TDR	Total debt / Total assets
Dividend Policy (DP)	DPR	Dividend per share/Earnings per share
Profitability (P)	PM	Net income / Sales
Assets Efficiency (AE)	ATS	Total assets / Sales
SIZE (Z)	Log TA	Logarithm of total assets

Table 2a

Descriptive Statistics and correlation: whole sample, annual data (2006-2015  
Observations = 4470)

	Mean	Overall Standard deviation	Between Standard deviation	Within Standard deviation	Minimu m	Maximu m
SGR	0.01	0.51	0.16	0.48	-20.76	12.52
TDR	0.39	0.34	0.24	0.24	0	10.32
DPR	0.32	3.19	1.08	3.00	-75	150
PM	8.16	190.08	67.22	177.83	-4659.66	9064.13
ATS	276.68	730.80	411.36	604.31	-	21892.15
					20823.58	
SIZE	2.53	0.60	0.55	0.24	0	4.68

Correlation Matrix						
	SGR	TDR	DPR	PM	ATS	SIZE
SGR	1.0000					

TDR	-0.0685***	1.0000				
DPR	-0.0101	-0.0309**	1.0000			
PM	0.1231***	-0.0407***	0.0033	1.0000		
ATS	-0.0022	-0.0264*	-0.0068	0.2628***	1.0000	
SIZE	0.0674***	0.0621***	0.0136	0.0197	0.0693***	1.0000

Notes: \*\*\*, \*\*, and \* denote significant at 1%, 5% and 10% levels, respectively.

Table 2b

Descriptive Statistics and correlation: less than 33 percent, annual data (2006-2015  
Observations = 1770)

	Mean	Overall Standard deviation	Between Standard deviation	Within Standard deviation	Minimum	Maximum
SGR	0.04	0.20	0.08	.18	-1.89	6.75
TDR	0.23	0.11	0.07	.09	0	1.53
DPR	0.51	4.591	1.54	4.32	-21.1	150
PM	12.45	246.37	90.51	229.24	-4659.66	9064.13
ATS	306.50	689.88	464.72	510.95	-18640.61	6997.12
SIZE	2.438	.53	.48	.23	0	4.34

**Correlation Matrix**

	SGR	TDR	DPR	PM	ATS	SIZE
SGR	1.0000					
TDR	-0.0536**	1.0000				

DPR	-0.0101	-0.0318	1.0000			
PM	0.7251***	-0.0404*	0.0023	1.0000		
ATS	-0.0525**	-0.0749***	0.0041	0.3516***	1.0000	
SIZE	0.0951***	0.0808***	0.0152	0.0393*	0.1451***	1.0000

Notes: \*\*\*, \*\*, and \* denote significant at 1%, 5% and 10% levels, respectively.

Table 2c

Descriptive Statistics and correlation: More than 33 percent debt ratio, annual data  
(2006-2015 Observations = 2700)

	Mean	Overall Standard deviation	Between Standard deviation	Within Standard deviation	Minimum	Maximum
SGR	-0.0003	0.63	0.20	0.60	-20.76	12.52
TDR	0.51	0.393	0.24	0.31	0	10.32
DPR	0.20	1.75	0.58	1.65	-75	33.33
PM	5.34	141.50	45.95	133.86	-1213.37	6109.44
ATS	257.13	755.91	371.88	658.46	-20823.58	21892.15
SIZE	2.60	0.63	0.58	0.24	0	4.68

<b>Correlation Matrix</b>						
	SGR	TDR	DPR	PM	ATS	SIZE
SGR	1.0000					



TDR	-0.0598***	1.0000				
DPR	-0.0232	-0.0150	1.0000			
PM	-0.0418**	-0.0512***	0.0028	1.0000		
ATS	0.0056	-0.0053	-0.0311	0.1976***	1.0000	
SIZE	0.0745***	-0.0020	0.0356*	0.0089	0.0388**	1.0000

Notes: \*\*\*, \*\*, and \* denote significant at 1%, 5% and 10% levels, respectively.

Table 3

Pool OLS results

Dependent Variable: Sustainable Growth Rate

	(1)	(2)	(3)
TDR	-0.103***	-0.101***	-0.101***
	(0.0221)	(0.0248)	(0.0310)
DPR	-0.00222	-0.000614	-0.00951
	(0.00235)	(0.000611)	(0.00694)
PM	0.000348***	0.000685***	-0.000213**
	(0.00004)	(0.000012)	(0.000087)
ATS	-0.00003***	-0.000107***	0.000092
	(0.00001)	(0.000044)	(0.000016)
SIZE	0.0612***	0.0450***	0.0754***

	(0.0125)	(0.00533)	(0.0192)
Observations	4,470	1,770	2,700
R-squared	0.026	0.650	0.012
Number of company	447	177	270

Notes: Column 1 represents for whole sample; Column 2 represents for less than 33 percent debt ratio; and Column 3 represents for more than more than 33 percent debt ratio. \*\*\*, \*\*, and \* indicate significance at the 1%, 5%, and 10% levels, respectively.

Going straight to the results of the dynamic regression model, the error terms are assumed to be independent and homoscedastic across companies and over time. While, for the two-step estimation, the residuals obtained from the step one were used to construct a consistent estimate of the variance covariance matrix. Therefore, the second step was relaxing the assumptions of independence and homoscedasticity. Other than that, the two-step estimator is more robust and efficient rather than a one-step estimation in a larger sample (Arellano & Bond, 1991). The results also provided Sargan test, first and second order detail correlation test. Specifically, the estimated coefficient of lagged sustainable growth is significant at 1 and 5 percent of levels of significance for the whole sample, less than 33 percent debt ratio, and more than 33 percent debt ratio especially for two-step difference. These results justify that the model is a dynamic model. Moreover, the lagged dependent variable (lagged SGR) presents positive significant and most of the speed was adjusted at approximately one year and this concludes that Shariah compliant firms were close approximately by 90% on the gap between the current and target sustainable growths within one year (under Table 5). Therefore, this is beneficial for firms to get close to the target sustainable growth which means that firms were growing faster to obtain the maximum rate without changing the financial leverage.

Since p-value of Sargan results under one-step estimator is less than 0.05, thus, the instruments used are invalid. We continued to use the dynamic GMM estimator of the second step. Based on the results, the Sargan test for two-step estimator is more than 5 percent and failed to reject the H null means that the over identifying restrictions are valid. Additionally, Arellano-Bond tested on the null hypothesis of no first order serial

correlation is rejected but the null hypotheses of second order serial correlation is not rejected. It means that no second order serial correlation for the disturbances of the first differenced equation. Theoretically, these results are correct and in line with the GMM theory.

Using the two-step estimator GMM results, for whole sample, only debt ratio, profit margin and assets to sales are significant 1 percent and 10 percent level of significant, respectively. Debt ratio is positive significant at 1 percent, indicating that the company need to increase more debt if the company wanted to sustain its sustainable growth rate. Profit margin is positively associated with sustainable growth rate and assets to sales is negatively associated with sustainable growth rate, in line with the discussions by Higgins (1977). The companies need to increase their profitability but at the same time they need to reduce assets efficiency. Higgins (1997) mention that companies should increase profit margin and decreasing assets to sales for the effective corporate pruning in terms of sustainable growth equation. For less than 33 percent results, the coefficient of debt ratio is negative significant at 5 percent level of significant. These results contradict with the whole sample, which debt ratio was negatively affected to sustainable growth rate. Profit margin, assets to sales and size are significant at 1 percent level of significant. An increase in debt ratio indicates the reduction of sustainable growth of firm, while, decreasing in debt ratio will increase the sustainable growth rate. When controlling the size of the companies, an increase in debt ratio is negatively related to sustainable growth rate, though not statistically significant in all specifications. Our results also provide evidence that dividend payout ratio is not statically significant for all, where these results comply with Higgins (1977), it indicated only minor effects on sustainable growth rate on large percentage changes in payout rate.

Table 4

Results of dynamic panel GMM estimations  
With Dependent variable is Sustainable Growth Rate (SGR)

	One-step estimator GMM			Two-step estimator GMM		
	(1)	(2)	(3)	(1)	(2)	(3)
SGR (-1)	0.0391** (0.0187)	0.126*** (0.0328)	0.0363 (0.0238)	0.0377*** (0.00152)	0.181*** (0.0147)	0.0351*** (0.00122)
TDR	0.230*** (0.0346)	-0.226*** (0.0479)	0.181*** (0.0443)	0.216*** (0.00464)	-0.110** (0.0482)	0.168*** (0.00333)
DPR	-0.00274 (0.00269)	-0.000255 (0.000594)	-0.0123 (0.00775)	-0.000583 (0.00220)	-0.000126 (0.000142)	-0.00966 (0.0120)
PM	0.000422*** (0.000045)	0.000768*** (0.000017)	-0.000056 (0.000091)	0.000555** (0.000035)	0.000782*** (0.000012)	0.000107* (0.000032)
				*		**
ATS	-0.000034** (0.000016)	- (0.000063)	0.00012 (0.000024)	-0.000031* (0.000017)	- (0.000026)	0.000046 (0.000062)
		0.000175***			0.000173***	
SIZE	-0.00799 (0.0406)	0.100*** (0.0143)	-0.00421 (0.0636)	0.00528 (0.00955)	0.0670*** (0.0166)	0.00409 (0.0111)

Sargan	1046.012	127.707	726.4487	40.26081	41.76166	29.55608
Test						
	(0.0000)	(0.0000)	(0.0000)	(0.2487)	(0.2005)	(0.7281)
AR (1)				-2.1404	-3.8932	-2.0749
				(0.0323)	(0.0001)	(0.0380)
AR (2)				-0.70838	1.3563	-0.61659
				(0.4787)	(0.1750)	(0.5375)
Observatio ns	3,576	1,416	2,160	3,576	1,416	2,160
Number of company	447	177	270	447	177	270

Notes: All models are estimated using the Arellano and Bond dynamic panel GMM estimations (Stata `xtabond` command). The variables are defined as follows: SGR = Sustainable growth rate defined as Return on equity multiply Retention rate; TDR = Total debt ratio defined as Total debt/Total assets; DPR = Dividend payout ratio defined as Dividend per share/Earning per share; PM = Profit margin measure as Net income/Sales; ATS = Assets to total sales; Control variable is SIZE = size of firm (Log of total assets). Column 1 represents Whole sample; Column 2 represents Less than 33 percent debt ratio, and Column 3 represents More than 33 percent debt ratio. Figures in the parentheses are t-statistics. \*\*\*, \*\*, and \* indicate significance at the 1%, 5%, and 10% levels, respectively.

Table 5  
Impact of sustainable growth maturity in speed adjustment

		Whole sample	Less than 33 percent debt ratio	More than 33 percent debt ratio
		(1)	(1)	(1)
GMM (1-step)	SGR (-1)	0.0391	0.126	-
	Speed of Adjustment	0.9609	0.874	
	Year	1.04	1.14	
GMM (2-step)	SGR (-1)	0.0377	0.181	0.0351

Speed of Adjustment	0.9623	0.819	0.9649
Year	1.04	1.22	1.04

Notes: \*\*\*, \*\*, and \* denote significant at 1%, 5% and 10% levels, respectively. The computation of speed of adjustment is derived from one minus the coefficients on SGR (-1).

Under more than 33 percent debt ratio indicate that the coefficient for the debt ratio is positive and significant, thereby confirming that an increase in debt ratio positively affects sustainable growth rate. The sustainable growth rate sensitivity with respect to financial leverage suggests that the companies need to re-strategies their financial activities by borrowing more Islamic debt in order to increase sustainable growth rate. Furthermore, the whole sample and less than 33 percent debt ratio that profit margin is positively related to sustainable growth rate of firm. We, therefore, conclude that our findings comply to Srinivasa hypothesis that sustainable growth is affected the company's structure changes, for example, financial leverage increased, the sustainable growth tends to increase while financial leverage decreased, and the sustainable growth also decreased. However, Debt ratio results are not the same for less than 33 percent debt ratio since the results have negative significant. These results support Razali Haron & Khairunisah Ibrahim, and Myers & Majluf hypothesis. For some reasons, the growth of firms will use less debt ratio in order for the company to reserve firm's debt capacity in the future and in other words, the firms use lower debt that is able to raise additional funds in the future. Hence, our findings comply with pecking order theory (Myers & Majluf, 1984).

## CONCLUSION

The results revealed in this research used a robust alternative estimation method, using balanced data for the period of 2006 until 2015, pooled OLS and GMM estimation to estimate a dynamic regression model that includes correlation coefficient. The purpose of this research was to investigate the determinants of the sustainable growth rate of Shariah compliant firms in Malaysia and to analyse whether the financial benchmarks of 33 percent debt ratio can affect the sustainable growth rate of the firms. Besides, at the same time these firms comply with the sustainable growth rate theory to maximise firm's growth without changing firm's financial leverage. Our overall results suggest that debt ratio, profit margin, and assets to sales are factors or determinants of the variables that affect the sustainable growth rate of the firm.

But, when we categorised three groups (whole, less and more than 33 percent debt ratio), the results under GMM estimations showed that debt ratio for less than 33 percent debt ratio is negative significant. The negative significance is due to control from size, which increases sustainable growth rate would require companies to decrease their debt ratio, increase profit margin, and decrease assets to sales. Our results comply with the pecking order theory and fulfil theory of sustainable growth rate as the management needs to plan and monitor their operating and financial activities, especially, the capital structure in order for the firms to meet their maximum growth rate without changing financial leverage.

The empirical analysis and results reported in this research confirm the determinants affected the sustainable growth rate of Shariah compliant firms in Malaysia. This research also found that less than 33 percent companies is less risky compared to more than 33 percent that is more risky. Moreover, financial and operating activities are very important for the management to be issued and delivered which have been emphasised by the current literature. However, this research has some limitations especially on the ways investigated by literature and suggested that there is a need for more empirical research on other factors such as industry, and other mechanisms that help to expand our understanding on sustainable growth rate.

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## **IMPACT OF ISLAMIC HUMAN RESOURCE PRACTICES ON ORGANISATIONAL PERFORMANCE IN BANGLADESH BANKING SECTOR**

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### **ABSTRACT**

*This paper aims at exploring the impact of Islamic human resource (HR) practices on organizational performance through organizational commitment. Data were collected from randomly selected 170 branch managers of six Islamic Banks listed on Dhaka Stock Exchange of Bangladesh. Based on the collected data, SPSS 25 was used to obtain descriptive analysis. Structure Equation Model (SEM) method was used to examine the reliability and validity measure for the model constructs while SmartPLS 3.2 was used to assess both measurement and structural model. Using Structural Equation Model (SEM), the study found that Islamic HR practices have a significant impact on organizational performance through organisational commitment. The findings of the study advocate that Islamic banks should emphasize more on the Islamic HR practices to uphold their performance. This study contributes to the existing literature on Islamic HR practices, where there has been a lack of studies in the context of Bangladesh.*

**Keywords:** *Islamic Banks, Islam, Human resource practices, Organizational commitment, Bangladesh*

## INTRODUCTION

As stated in the Holy Quran “Indeed Allah has created the human in the best of forms” (Surah At-Tin - 95:4). This verse indicates to human being as the best and the noblest creation of the Almighty. Through human being’s physical construction or human potentiality or human soul and mind, we discover a profound glimpse of HIS wisdom. When a human uses his or her knowledge, potentiality and skill to make up the workforce of an organization, firm, business or economy is known as human resource. But each human is not resource. Human needs to convert into resource. Without this human resource, it is quite difficult to handle other physical resource. Sustainability and development of any organization depend on the efficacy of its human as human control all other resources (Dhar and Hoque, 2014; Dhar et al, 2017).

In this competitive world, every organization seeks performance because it relates with its existence. For sustaining long run, different strategies are taken by the organization. Sometimes strategies support organization commitment towards the society but most of the times it is being violated. Being connected to affect and emotion, religion and spirituality develop across our lifecycle which are integrally social-psychological phenomena, so it can be widely used in case of enhancing organizational performance (Rouhoma et al, 2017).

According to Azmi (2015), Islamic ethics and values are mostly being practiced in Islamic organizations. Being Islamic organizations, Islamic banks listed of Bangladesh is much more Islamic concept oriented. Therefore, this research focus on the impact of Islamic human resource practices on organizational performance through organizational commitment in the Banking Sector of Bangladesh, the gap of the previous studies.

The aim of this study is to focus on the influence of Islamic HR practices and organizational performance through organizational commitment. The remaining portion of this research is designed as follows: Section 2 defines the relevant literature on Islamic HR practice, organizational commitment and organizational performance and analysis of gap; Section 3 focuses on methodology; Section 4 indicates analysis of data, Section 5 emphasizes on theoretical and managerial implications, and Section 6 presents conclusion which includes future research directions.

## ISLAMIC HR PRACTICES, ORGANIZATIONAL COMMITMENT AND ORGANIZATIONAL PERFORMANCE

Islamic HR practices involve a plenty of dimensions. This study focuses on Azmi (2015), Junaidah Hasim (2007, 2008, 2009, 2010) and Namazie and Tayed (2006) to determine the dimensions of Islamic HR practices. There are four dimensions of Islamic HR practices adopted in this study, these are: Practice of Islamic selection and recruitment, Practice of Islamic training and development, Islamic Career Development, and Practice of Islamic Reward. In conventional HR practices, there are different criteria (like advertising for job, short-listing of candidates, process of interview, selection of perfect candidate as far as possible and offering job) for a candidate to be selected and recruited. Apparently, it seems similar with the Islamic selection and recruitment process. This include selection and recruitment process, which mainly focus on *alwara* (piousness), *akhlak* (ethics), *amal jamah* (teamwork) and *khibra* (experience). In addition to that, through Islamic selection and recruitment process, an Islamic organization fairly tries to find a candidate who has *tafan* (Dedication), *aitizam* (Commitment), *qudrat aleamal aljad* (Hardworking capability), *almasyuwlia* (Responsibility) and *althiqa* (Trustworthy) (Azmi, 2015). After the selection process, shortlisted candidates are provided an offer letter accordingly with a-six month probationary period before being recruited permanently to begin their work and maintain organizational commitment, as a vicegerent of Allah SWT (Hashim, 2007).

According to Aizam (2015), through the practice of Islamic training and development, one's soul can be purified from bad and evil attributes to good and holy attributes. Islamic organizations emphasis on Islamic values during practice of Islamic training and development. For this reason, Islamic organization provides regular training by highlighting Islamic ethics and values to their employees under knowledgeable and religious trainers for making capable about their work, organization's goals and performance. As Islam does not allow discrimination among people in terms of gender, religion, race or color and does not want to confine people to remain satisfy in the same position, Islamic organizations focus on career development for all. According to Hasim (2007), for enhancing career, struggled, consistent and honest, employees need to provide facilities and support. Reward and HRM both are integrated. Islam practices reward policy based on qualification, expertise and experience.

According to Azmi (2015), Islam does not allow any delay or late payment to employees. Moreover, reward amount (in the form of allowances, bonus, overtime payment, increment of salary, leave and medical treatment) supposed to be sufficient to buy cloth, food, accommodation and transportation without discrimination of gender or race. In addition, married employees should be paid more than unmarried to bear family expenses and maintain their standards of living.

The ultimate goal of a business organization is maximization of wealth for stakeholders (Absar et al, 2010; Becker & Huselid, 1998; Horngren, Foster, & Datar, 2000). Azmi (2015) found that organizational performance can be considered into two types in the view of Islam, which are the achievement of the organization's objectives and accomplishment of Allah's satisfaction. Though, the latter could only be measured after death. According to Bontis (2008), Cheng et al. (2010), Karimi, (2014), Khalique et al. (2011), and Sharabati et al. (2010), human productivity, profitability and market valuation are three major indicators of business performance. Karimi (2014) denotes human productivity as the association between input (what is put in to the business) and output (result) where through training and remuneration, input can be measured and through profit per employee, output can be measured. Moreover, output can be measured in two ways; based on actual goods and services produced and by considering people relative to key financial performance. Profitability arises when revenue exceeds over the costs. It is can be measured using sales growth and profit growth. Sales growth is the increase in sales over a specific period and profit growth is a combination of profitability and growth (Karimi, 2014). Market valuation indicates when market value exceeds its book value. It is the ratio of the total market capitalization which is the average share price time's number of outstanding common shares to book value of net assets (Karimi, 2014).

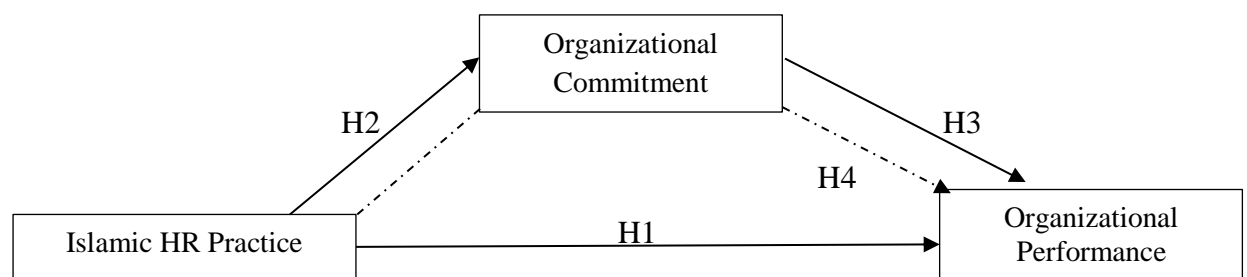
Regarding the organizational commitment, it indicates an affective attachment to an organization characterized by shared values, a desire to remain in the organization and a willingness to exert effort on its behalf (Mowday et al, 1979). Meyer (2015) and Meyer and Allen (1991, 1997) developed three ways to justify organizational commitment: affective (want to), normative (ought to), and continuance (have to) commitment, respectively. Demirtas and Akdogan (2015) and Hartmann (2000) mentioned that this kind of commitment mentions to the feelings of belonging to the organization which is

related to organizational structures, leadership performances, and the individual characteristics. All definitions regarding affective organizational commitment focus on employee's bond with organization which is captured by characteristics such as acceptance of organizational mission, vision and values (Perry 2004). Herscovitch and Meyer (2002), Meyer and Herscovitch (2001) and Meyer & Parfyonova (2010) stated that normative commitment is the mindset that one has responsibility to chase a course of action of relevance to a particular target. Based on Jaros and Culpepper (2014), concepts of organizational commitment are based on Becker's (1960) theory of commitment resulting from 'side bets' that bind the employee to the organization, the continuance commitment construct developed by Meyer, Allen, and colleagues (Allen & Meyer, 1990; Meyer & Allen, 1984, 1991, 1997) has received the most research attention.

Few studies examined Islamic HR practices, organizational commitment, intention on turnover, job satisfaction and employee performance (e.g. Akhtar, 1992; Azmi, 2015; Hashim, 2008, 2009, 2010; Khan *et al.*, 2010; Rahman and Shahidi, 2009; Rana and Malik, 2017). Others focused on conventional HR practices, job satisfaction, organizational performance, employees' turnover, organizational climate, and customer satisfaction (Absar et al, 2014; Amin et al, 2014; Andreassi et al, 2014; Bergiel et al, 2009; Chan and Mak, 2012; Delaney and Huselid, 1996; Karin et al, 2014; Menso, 2012; Moideenkutty et at. 2011; Osman et al., 2011; Rogg et al., 2001). Meanwhile, this study attempts to fill the gap by looking at the Banking Sector in Bangladesh, specifically on the impact of Islamic human resource practices on organizational performance through organizational commitment.

### RESEARCH MODEL AND HYPOTHESES

Based on literature reviewed, there is a scope of research to find out the organizational performance by practicing Islamic HR through organizational commitment. Figure. 1 illustrates the research model used in this study.



**Figure 1: Conceptual model of the study**

On the basis of research model used, following hypotheses are developed:

- H1: Islamic HR practices has influence on organizational performance
- H2: Islamic HR practices has influence on organizational commitment
- H3: Organizational commitment has influence on organizational performance
- H4: Islamic HR practices has influence on organizational performance through organizational commitment

**METHODOLOGY**

As the present study focuses on the practicing Islamic HR and Islamic banking sector, six Islamic Banks (First Security Islami Bank, Islami Bank Bangladesh, Al-Arafah Islami Bank, Social Islami Bank, Shahjalal Islami Bank and ICB Islamic Bank) listed in Dhaka Stock Exchange were selected in this study. A seven-point Likert scale questionnaire was used in this study to assure reliability of the results and convenience to the respondents (Harris and Ogbonna, 2001). The questionnaire was divided into four sections: respondents' information, Islamic HR practices, organizational performance and organizational commitment. The study adopted four dimensions of Islamic human resource practices (Practices of Islamic Training & Development; Practices of Islamic Reward; Practices of Islamic Recruitment & Selection, and Practices of Islamic Career Development) as posits by Azmi (2015); three dimensions of organizational performance (human productivity, profitability and market valuation) used in this study (see Sharaboti, 2010 and Karimi, 2014), whereas as for the organizational commitment, three dimensions were adopted, namely affective, continuance and normative (Meyer & Allen, 1997).

The questionnaire was circulated based on Krejcie and Morgan's (1970) table of determining sample size among 265 branch managers of six Islamic banks listed in Dhaka Stock Exchange by using simple random sampling technique (Cooper and Schindler, 2003). A number of 170 completed questionnaires were returned. Based on the collected data, Statistical Package for the Social Sciences (SPSS) program version 25 was used to carry out descriptive analysis. Structural Equation Model (SEM) method was used to



determine the significant influence between dependent variable, independent variables and mediating variable and to examine the reliability and validity measure for the model constructs. SmartPLS Version 3.2 was used to apply the structure equation model (SEM), analysing the research hypotheses. SmartPLS was also used to assess both measurement and structural model (Alavifar *et al.*, 2012; Hair *et al.*, 2016, Hair et al, 2017).

### DATA ANALYSIS

Approximately, 98.8% were male and 1.2% were female among respondents. Out of respondents, 70.0% were between 40 to 49 years old and about 80.4% of them had master degree. Out of them, 90.6% have working experience between 16 years above.

*Table 1: Describes the demographic profile of the respondents.*

		<i>Frequency</i>	<i>Percent</i>
<i>Experience level (in years)</i>	<i>1-5</i>	2	1.2
	<i>5- 10</i>	3	1.8
	<i>11- 15</i>	11	6.5
	<i>Above 16</i>	154	<b>90.6</b>
	<i>Total</i>	170	100.0
<i>Age</i>	<i>less30</i>	5	2.9
	<i>30 – 39</i>	24	14.1
	<i>40 – 49</i>	119	<b>70.0</b>
	<i>50 above</i>	22	12.9
	<i>Total</i>	170	100.0
<i>Education</i>	<i>Diploma</i>	2	1.2
	<i>Bachelor degree</i>	2	1.2
	<i>Master degree</i>	160	<b>94.1</b>
	<i>Doctorate degree</i>	6	3.5
	<i>Total</i>	170	100.0
<i>Gender</i>	<i>Male</i>	168	<b>98.8</b>
	<i>Female</i>	2	1.2
	<i>Total</i>	170	100.0

#### **Measurement model**

Construct reliability, Individual item-wise reliability, discriminant and convergent validity of all measurement items need to be examined. By using individual item-wise

reliability and internal consistency of scale, reliability measures were examined. Individual item reliability need to be measured in terms of standards loading of individual item into its original variable. Cronbach's alpha loading values of each item should be at least equal to or higher than 0.7. Average variance extracted value of 0.50 or higher indicates that the construct explains more than half of the variance of its indicators. Convergent validity was evaluated by examining the composite reliability and the average variance extracted. Composite reliability values between 0.70 and 0.90 can be regarded as

<i>Measurement item</i>	<i>Islamic HR Practices</i>	<i>Organizational Commitment</i>	<i>Organizational Performance</i>
<i>CAR</i>	0.924		
<i>RCU</i>	0.929		
<i>REW</i>	0.917		
<i>TR</i>	0.961		
<i>AFFE</i>		0.794	
<i>CONT</i>		0.770	
<i>NOR</i>		0.834	
<i>MV</i>			0.891
<i>PEROF</i>			0.930
<i>PROD</i>			0.910

satisfactory (Hair et al, 2014; Hair et al, 2017; Vinzi et al, 2010; Yaseen et al, 2016).

*Table 2: Loadings of Measurement (Outer Model)*

[Here, CAR= Practices of Islamic Career Development; RCU= Practices of Islamic Recruitment & Selection Practices; REW= Practices of Islamic Reward; TR= Practices of Islamic Training & Development; AFFE= Affective Commitment; CONT= Continuance Commitment; NOR= Normative Commitment; MV=Market Value; PEROF=Profitability; PROD=Human Productivity]

*Table 3: Reliability and convergent validity*

<i>Construct</i>	<i>Cronbach's alpha (α)</i>	<i>AVE</i>	<i>CR</i>	<i>R<sup>2</sup></i>
<i>Islamic HR practice</i>	0.950	0.870	0.964	
<i>Org Commitment</i>	0.720	0.640	0.842	
<i>Org Performance</i>	.0897	0.829	0.936	0.432

Table 2 and 3 show that outer model loading, discriminant validity, and composite reliability. As shown in Table 2, most item loading were lager than 0.7 and significant at  $p < 0.01$ . Chu et al, (2004) recommended that items with small loadings and insignificant contributions should be dropped. Therefore, the study dropped the objective data from

their respective constructs for having factor loadings below the 0.5 thresholds (Chin, 2010). The data indicates that the measures are robust in terms of their internal consistency reliability as indexed by the composite reliability. Cronbach's alpha, for all factor loadings, are greater than 0.7 and more significant. Composite reliability of all constructs was above 0.8, the average variance extracted for every measurement exceeded 0.50 and  $R^2$  is 0.432.

*Table 4: Discriminant validity*

<i>Constructs</i>	<i>Islamic HR practice</i>	<i>Org Commitment</i>	<i>Org Performance</i>
<i>Islamic HR practice</i>	<b>0.933</b>		
<i>Org Commitment</i>	0.427	<b>0.800</b>	
<i>Org Performance</i>	0.490	0.605	<b>0.910</b>

Table 4 demonstrates the correlation matrix of model constructs. Moreover, it demonstrates square roots of average variance extracted. For stipulating that, square roots of average variance extracted are more than correlation between construct and other constructs, discriminant validity was measured. (Smith et al, 2012; Yaseen et al, 2016).

### ***The structural model***

Research model of Fig. 2 was analyzed using Partial Least Square structural equation modeling (SmartPLS 3.2) tool which assesses psychometric properties of measurement model. Moreover, it evaluates parameters of structural model. SmartPLS develops component-based approach to structural equation model by using bootstrapping method. Moreover, SmartPLS path model entails of two essentials: Inner model (measurement model) and outer model (structural model) (Yaseen et. al, 2016).

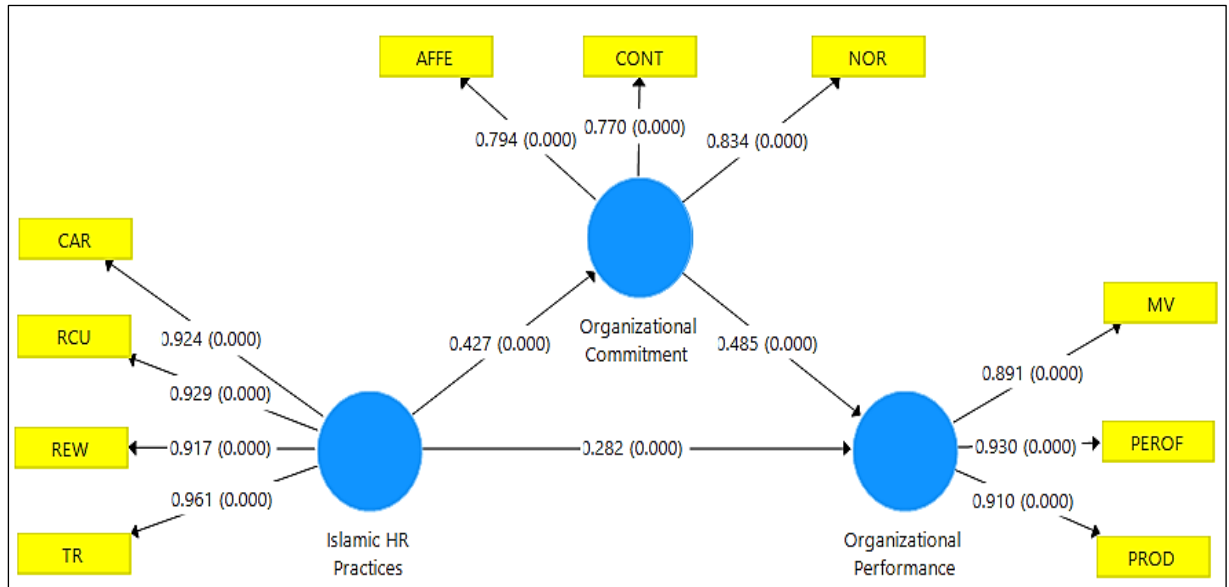


Fig. 2: Results of PLS analysis

[Here, CAR= Practices of Islamic Career Development; RCU= Practices of Islamic Recruitment & Selection Practices; REW= Practices of Islamic Reward; TR= Practices of Islamic Training & Development; AFFE= Affective Commitment; CONT= Continuance Commitment; NOR= Normative Commitment; MV=Market Value; PEROF=Profitability; PROD=Human Productivity]

Table 5: Results of Hypotheses

Path	$\beta$	T-stat.	Level of Sig.	Result
Islamic HR practices -> Org Per	0.490	4.664	***	support
Islamic HR practices ->Org Com	0.490	7.707	***	support
Org Com -> Org Per	0.485	7.850	***	support
Islamic HR practices -> Org Per -> Org Com	0.207	4.664	***	support

Fig. 2 and Table 5 shows Islamic HR practices with organizational commitment, and organizational commitment with organizational performance have found statistical significant effect with path coefficients  $\beta=0.427$  and  $\beta=0.485$  respectively. All path coefficients ( $\beta$ ) are statistically significant and positive ( $p < 0.05$ ). The overall path coefficients ( $\beta$ ), significance level and explanatory power ( $R^2$ ) can be inspected through structural model. Research model accounts for 0.432 in Table 3. Results of the purposed hypotheses has been summarized in Table 4 and it shows that all relationships among variables are significant at 0.05 level. The strongest direct effect on the competitive

advantage were Islamic HR practices and organizational performance, and Islamic HR practices and organizational commitment (0.490 in both case). The path coefficients between organizational commitment and organizational performance is  $\beta = 0.485$ . The indirect effect among Islamic HR practices and organizational performance through organizational commitment is  $\beta = 0.207$ .

## IMPLICATIONS OF THE STUDY

### *Theoretical implications*

Existing research focuses on influence of Islamic human resource practices on organizational performance whereas this research magnifies the relationship. The current research shows that organizational commitment has a positive influence in between Islamic human resource practices and organizational performance.

### *Managerial implications*

By enhancing Islamic human resource practices and organizational commitment, management of Islamic banks and financial organizations can increase the performance of their organizations. As a result, the employees of the Islamic banks will be more enthusiastic to be loyal as well as the proper implementation of Islam can be justified in the society.

## CONCLUSION

Islamic HRM practices and organizational performance through organizational commitment has been examined among six Islamic banks under Dhaka Stock Exchange of Bangladesh in this study. Obtaining higher organizational performance, Islamic banks should more emphasize on the practices of Islamic HR. Though success in the Hereafter is the most blessed and forever. But sustaining and getting competitive advantage in this unstable world, higher organizational performance is mandatory. So, by applying Islamic HR practices, organization can attempt to seek Allha's pleasure. Having the pleasure of Allha, Muslim will not gain accomplishment in this world only but in the Hereafter also. The finding of this study can be generalized in the context of Islamic banks only. Further research can be conducted in other banks and organizations in Bangladesh and other

countries of the World. Moreover, the study can use morality and ethics as moderator to justify the relationship more.

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## **A CRITICAL REVIEW ON FACTORS INFLUENCING THE ADOPTION OF COMMERCIAL BANKS IN ONLINE BANKING**

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### **ABSTRACT**

*Online banking is changing the banking manufacture and has been of great concern to banks sector personnel worldwide. Nevertheless, from a global perspective, there is not or enough evidence of literature review that has been conducted on this important subject. The major goal of this paper is to describe and understanding with regards to online banking. Literature review has been conducted by referred to relevant articles published between 2010 and 2017 on online banking in commercial banks sector. Previous studies showed that sense of security have a negative and positive effect on the adoption of online banking. To relieve these factors, the review has detected various policies that could help accept online banking in commercial banks.*

**Keywords:** *Online banking, customers, commercial banks.*

### **INTRODUCTION**

In the age of openness, several services can be done through the internet, as well depend on the user's target to access to Online Banking (OB) transactions that previously required a visit to the bank, access to knowledge and social communication. The internet has become unavoidable dynamic part of today's by companies that help positively to enhance the comprehensive efficiency of the process, retain clients, low costs, and reduce time (Couto et al., 2013; Dauda and Lee, 2015). According to Martins et al. (2014), "the banking field has been utilizing the internet not only to perform online business activities

and to provide new products but also to introduce key services to their customers". Research evidence proposes that internationally, online banking field in commercial banks under appalling conditions. To increase profits and attain strategic sustainability in a quickly growing competitive circumference, banks assure OB protection for clients by applying encryption technology, for instance, checking OB account activity, secure sockets layer (standard security technology), combining account security advantages, and warning clients permanently regarding of avoiding threats such as identity theft (Chircu et al., 2000; Sarreal, 2016). Although the infrastructure in certain countries are advanced in comparison to some of the other regional examples, intention to use OB has become a major concern for banks (Shannak, 2013). Further, the context and nature of the OB adoption add further challenges engendering intention among customers.

Thus, this article attempts to review scientific research on the factors influencing online banking in commercial banks from a global viewpoint.

### **CONCEPTION OF ONLINE BANKING**

The concept of online banking has been imagined differently by different researchers. (Ragusa, 2013; (Suriyamurthi et al., 2012; Al-Majali, 2011; Alsajjan & Dennis, 2010) describes online banking is implement banking services through technology (online service) without relying on human resources (HR) of banks besides clients, (whether through the personal computer system (PCs) or smart devices connected to the internet). In contrast, the sector of banking and financial services provides different online services such as account opening, requests for checkbooks, recording stop payment instructions, balance inquiry; funds transfer instructions, settlement of online credit card transactions resulting from shopping via the internet and other methods of traditional banking services. It is also defined as "contains any electronic payment system that allows clients of the banks to perform financial transactions by the bank's website. Present day, internet banking contains transportable online banking technology, for instance, person-to-person payment mobile smartphone applications and text banking" (Sarreal, 2016). Because internet banking and online banking are not different as far as their definitions are concerned, the terms are used interchangeably.

## **FACTORS INFLUENCING THE ADOPTION OF COMMERCIAL BANKS FOR ONLINE BANKING**

This section shows the review results considering the restraints influencing the adoption of online banking in commercial banks.

### ***Demographic characteristics***

Demographic characteristics have been observed to be linked to the adoption of different banking channels, particularly online banking service (Karjaluo et al., 2002). Such as, the population with high-level educational achievement may have an ability to use computers and possess useful information processing skills. These features are important in the context of online banking service and hence a relationship among official education and adoption are propounded. The results described in (Flavián & Guinalú, 2006) showed that females were also less probable to conduct their banking activities internet. According to Akinci et al. (2004) the results in Turkey have been mentioned that mid-aged users are more probable than younger or older users to adopt online banking service. Other literature such as Mattila et al., (2002) stated that those who belong to the higher and average class and have high-level professions are more likely to adopt online banking service.

### ***Prior internet knowledge***

Prior technologies impact the user's adoption of online banking service, particularly previous PC experience. Therefore, user awareness of technologies simplifies the appreciation of the possibility of adding an inherent advantage in technology (Nasri, 2011). According to "Joseph Schumpeter" stated Maitlo et al. (2015) that Technology motivates banks to examine user behavior. Thus, added (Nasri, 2011) that Prior knowledge of internet has a great effect on behavioral intention to use internet banking service. Furthermore, Maitlo et al. (2015) said that development of modern technology has changed the process transactions are carried, such as selling and buying financial transactions with the guidance of various distribution channels, for instance, smartphones and internet banking services. This all change supports the banks to discover about client

new choices. As the same researcher showed the results prior internet knowledge about the internet banking services have the positive impact as well positive relationship with adoption of internet banking services in Hyderabad.

### ***Sense of security***

The sense of security was determined from prior studies as one of the important factors affecting to the adoption of online banking. The intangible service about Internet deals tends to increase the user's sense of risk (Lee et al., 2005). Also, one main reason why many customers utilize the internet but do not adopt online banking is that of beliefs about the sense of security to performing business over the internet (Gefen & Straub, 2003).

In traditional safety and security scales, a security environment is built up to establish a trust limit within which there is self-control about computing systems and also sensitive data is processed and stored. For instance, the organization firewall usually encounters this boundary. The network affords passage to trusted end users', which works in a similar way (Pearson & Benameur, 2010). This system includes the public Internet but does not for online banking (a mix among private and public deployment). The security environment becomes unclear which means that private information may be addressed outside trusted and known areas, where this computing circumference often has blurred boundaries regarding of information is processed and stored. Furthermore, to obtain the service, clients need to increase their trust in the online banking provider, thus can provide a point of communication between service provider and client (Pearson & Benameur, 2010; Sheikh & Rajmohan, 2015).

### ***Convenience***

Convenience has been determined as critical adoption factor for new technology (while description a group of writers convenience is a group of consumer products that were intensively diffuse and required limited time and physical and mental effort to purchase product (ACNielsen, 2005; Ramsay & Smith, 1999). While stated Brown, (1990) that convenience is attention to resources, for instance, time and effort required of the purchaser in shopping for a product (positive word of mouth). Also, some previous

definitions developed the concept of convenience to mix non-shopping activities. It is linked to the visual perspective of the online compared to phone banking (Black et al., 2002). Moreover, the 24 hour a day, 7 days a week service available anytime in worldwide by easier access to houses, it is also a wide diversity of services accessible as drivers of convenience in online banking (Gerrard & Cunningham, 2003; (Liao & Cheung, 2002).

One of the Prior studies deemed that online banking plays a pivotal role in adopting for the retail channel in the top services (Gerrard & Cunningham, 2003). According to (Ramsay & Smith, 1999; (Yang, Ye, Tang, & Wong, 2003) that convenience is one of the dominating factors in transaction channel preferences and the main determinant of doing satisfaction. Whereas (Eastin, 2002) has been mentioned that perceived convenience was the most critical predictor to the adoption of online banking service. Finally, a study indicated (Chung & Paynter, 2002) that much of the community not interested in the adoption of online banking service as they did not need high convinces. Further, accessibility which related to convenience also has a positive impact on using online banking service.

**Table 1:** Evidence of information extraction

Scholar	Objective	Factors	Major findings
Abu-Assi et al., (2014)	The primary purpose of OB research is to investigate the factors that influence the OB adoption of clients who have internet access.	Perceived Ease of Use Usefulness Compatibility Trainability Security Demographic factors	The results show that compatibility, perceived ease of use, security and perceived usefulness positively affect OB adoption. The effect of all the independent factors together and identifies a positive relationship between them and OB adoption.
Shannak, (2013)	The paper aimed to examine the current status of Jordan's OB industry, identify its strengths and weaknesses.	OB infrastructure regulatory framework	The results showed that the infrastructure is advanced in comparison to some of the other countries; it was still under the Western standards. It also has been confirmed that the Jordanian OB is still not trusted enough by clients. Eventually, the legal or regulatory coverage in Jordan was found to be not fully



satisfactory yet.

Alzoubi et al., (2013)	The study aimed to evaluate the innovation of OB transaction risk communication matters inside banks in Jordan from the socio-organizational.	National Culture Risk Communication in OBT Organizational Culture	The results indicated that the impacts of national and organizational cultures based on the risk communication process. Despite risk communication matter has been approved to be one of the success reasons of OB usage, the risk communication methods that have been developed during earlier years for providing narrow technically oriented solutions, and they have not paid enough attention to the social aspects of risks.
Aslam et al., (2011)	To determine the barriers to the adoption of OB in cities of Pakistan	Psychological barriers Technical barriers	The results indicated that clients perceive more value and satisfaction in the traditional banking system compared to OB. In addition, the customer banker communication gap seems to be the most important the factor.
Mohamed, (2017)	This study aimed to determine factors encourage the clients to adopt the OB in UAE, from the perspective both of bank managers and clients.	Efficiency Security Reliability Assurance Responsibility	The findings showed that reliability and security have positively impact client satisfaction; efficiency and responsibility were while contributing negatively. The results also showed that managers were not fully knowledgeable of the client satisfaction levels and their attitudes about using online banking.
AL-Adwan & AL-Tarawneh, (2017)	This paper aimed to determine the influence of the OB Service Quality in improving Performance.	Website Interface Dependency Security Connection Response Usability	The results show that the OB services quality components (website interface, dependency, security, connection, response, and usability) positively effect on Performance in Jordanian commercial banks.

Maitlo et al. (2015)	The goal of this study is to identify the factors impacting the adoption of OB in Hyderabad.	Channel convenience Perceived Risk Information on OB Security Perception Prior internet knowledge	The findings indicated that use online banking is impacted by channel convenience, perceived Risk, information on OB, security perception, and prior internet knowledge.
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(Shiraj, 2015)	This study investigates the factors impacting the adoption of OB by commercial banks in part of Sri Lanka.	Attitude toward change Users' IT knowledge Perceived benefits Perceived risks Occupation Age Gender Information on OB	The findings indicated use/non-use decision is highly impacted through attitude toward Change, perceived risks, perceived benefits, users' IT knowledge, occupation, age, and gender on OB, while information on OB did not influence intention to use OB.
Gilaninia et al, (2011)	To identify the various factors that affect the customer's behavior toward using OB in the Australian context.	Attention Accessibility Convenience Self-efficacy Usability Risks and costs Relative advantage Knowledge support	The results indicated that there is a high level of OB risk acceptance. In addition, there is a need for wide and deep levels to support customer from banks, particularly in terms of the instantaneous availability of support-oriented knowledge offered by knowledgeable bank employee utilizing interactive channels.
Datta, (2010)	To investigate the factors that affect OB adoption and link among individual features and online banking adoption.	Availability Usage Speed Security Privacy	The results indicated that customer OB adoption is dependent on some individual characteristics followed by business related to the Internet, education level, and then age. In addition, the finding showed that the adult customers with low levels of education were more willing to adopt OB.
Nasri, (2011)	The objective of this study is to identify those factors which affect the OB adoption in Tunisia.	Demographic factors Convenience Previous knowledge of the internet Security perception Perceived risk Information on OB	The finding was that use of OB affect positive on convenience, risk, security and prior internet knowledge. Further, the results also indicate that demographic characteristics play a vital role in influencing the behavior to use OB, particularly,

occupation and instruction.			
Safeena et al., (2011)	The objective of the study is to analyze the factors affecting frequency and duration of OB adoption in India.	Perceived usefulness Perceived ease of use Perceived risk User acceptance Use of OB	The findings indicated that perceived usefulness, perceived ease of use and perceived risk are the significant determinants the adoption of OB.
Hojjati et al., (2015)	The goal of the research was to determine the factors underlying the using OB in Iran.	Perceived security Demographic characteristics Use of other banking products Prior internet knowledge Marketing disposal	The findings indicated that demographic characteristics, prior internet knowledge strongly impacted acceptance of OB. Whereas the level of perceived security don't have influence on acceptance of OB.
Ahmed, (2016)	This paper aims to determine the factors impacting the adoption of OB in Malaysia.	User perceptions Demographic factors User attitudes Social factors	The findings indicated that social factors strongly impacted the adoption of OB in Malaysia.

According to the above Table 1, there were several previous studies about the adoption of OB and the factors which affected OB. In addition, it can be concluded that the literature provides an amount of insights regarding the impact of technology on all transactions in the e-environment. This review has paid special attention to the works related to technology in banking. It was observed from the literature review that there is an important positive relationship between (infrastructure, convenience, risk, security and prior online knowledge and addition demographic characteristics) toward OB adoption. It was found these factors have a strong influence on OB adoption. Based on the literature, there are a set of factors can influence OB, in another meaning, can affect these factors on decreasing or increasing the level of the OB adoption. As well have noted that there is a difference between researchers on how to measure the adoption of OB, while the agreement among researchers that the infrastructure has been effective and useful about influencing OB adoption in banks.

## CONCLUSION

This paper reviewed the studies concerning acceptance of online banking in commercial banks. A prior study indicates that online banking provided by commercial banks is not satisfactory. The review determined factors impacting positively online banking in commercial banks as related to demographic factors, prior internet knowledge, and convenience. The review detected that sense of security have a negative and positive effect on the adoption of online banking. To relieve these factors, the review has detected various policies that could help accept online banking in commercial banks.

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**CHALLENGES OF SHARIAH GOVERNANCE ADOPTION  
IN CREDIT COOPERATIVES IN MALAYSIA:  
VIEWS OF MULTI STAKEHOLDERS**

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**ABSTRACT**

*This paper attempts to evaluate the challenges faced by the cooperatives governance organs in practicing Shariah governance in their organization and discuss the potential strategies to be adopted to resolve those obstacles. This study also reviews the current practices of Shariah governance and the challenges within the cooperative movement. Indirectly, the awareness and willingness of cooperators in practicing governance in their own cooperatives could also be observed. This study applies a qualitative study which involves in-depth interview and a focus group discussion approaches. For the sampling purpose, the researchers conduct in-depth interview with the regulator, the Head of Shariah Department, Suruhanjaya Koperasi Malaysia (SKM), Kuala Lumpur and in-depth interviews with the cooperatives experts comprises SKM staffs and Chief Executive Officer (CEO) of cooperatives. Furthermore, in-depth interview with the governance organs of cooperatives that is the BOD, the management, internal auditor and Shariah Committee (SC) members. In addition, a focus group discussions with cooperatives governance organs comprises the Board of Directors (BOD), the management and the internal auditor. The study found that most credit cooperatives are facing constraints from the aspect of human capital, money capital, and technology or system capital. However, the most important challenge to address is the human capital aspect to provide the governance organs with high credibility in managing and administering cooperatives. This study discovered the current practices and problems in exercising Shariah governance in credit cooperatives. The readiness of the cooperators to fully implement Shariah governance in their own cooperative is also evaluated.*



**Keywords:** *Shariah governance, credit cooperative, Islamic cooperative.*

## INTRODUCTION

In Malaysia, the cooperative society was first established since 1922 to protect the welfare of rural peoples. The establishment is not only to improve the wellbeing of its members but also to eradicate the poverty and act as the distribution tools of national wealth. With the aim to help its members, it is said that cooperative needs to accelerate its performance in order to transform the nation to be the high income nation by the year 2020 ([www.skm.gov.my](http://www.skm.gov.my)).

Cooperatives have always been considered as an economic agency with a strong social responsibility towards the members in particular and the society at large. Cooperatives have contributed significantly to the economic and social development of societies and communities through their operations in a wide range of economic enterprises such as banking, credit/finance, plantations, housing, industry, consumer goods, construction, transport and services. Bello (2005) states that the process of developing and sustaining a cooperative involves promoting the community spirit, identity and social organization as cooperatives play an increasingly important role worldwide in poverty reduction, facilitating job creation, economic growth and social development.

Cooperatives in Malaysia also compete with other organizations that are also growing rapidly with increased opportunities inside and outside Malaysia. Relevant cooperative issues include issues of integrity and growth to continue to contribute to national development. In Malaysia, the need for cooperatives to serve the poor is still important as it is recognized by cooperative movements in Malaysia (Othman & Kari, 2008).

The period 1990 to 2003 show rapid development in terms of numbers and assets of co-operatives in the country, and this represents a huge potential for the sector's contribution to the Malaysian economy. Unfortunately, until 2004 there was no comprehensive policy that could guide and nurture their development. The various shortcomings of cooperatives as mentioned above have had a negative impact on the performance of cooperatives in the country leading to the review of the legislation and

inclusion of several provisions to add strength to supervision, monitoring and enforcement (Bello, 2005).

Their operations need to be streamlined, and overseen by strong and enabling legislation. In Malaysia, the data shows that cooperatives have played a significant positive role in the economic development of the country, and ensuring effective legislation will contribute further to this process while enhancing the standing of the cooperatives themselves. Performance can be enhanced through rigorous checks and balances and effective internal controls. Like other organizations, cooperative sector is also exposed to the governance issues. Generally, the governance issues of an organization include corporate fraud cases, abuse of management power and lack of social responsibility. Basically, the debate is about how to solve the problems encountered in corporate practices through effective mediums or mechanisms, either to satisfy shareholder expectations or to meet current social demands.

A relevant and proper enforcement of legislation is required to be in place for sound cooperative management. The legislation should covers the aspects of environment of workplace as well as the development of the cooperative movement as a hub for knowledge-based, innovative and dynamic. As such, a sound corporate governance system should be in place to create conducive environment in helping the cooperative sector to be more efficient and sustainable.

### **ISSUES IN THE COOPERATIVES GOVERNANCE**

The performance of cooperatives in several portfolios proves that it has some specific capabilities and privileges. However, one of their main weaknesses is in governance. Well-run cooperatives have proven to play an important role in the development of their communities through a democratic process involving beneficiaries. However, the balance of ensuring good governance is a challenge for these organizations. In fact, the issue of governance in the cooperative is critical, especially during the growth period (Branch & Baker, 2000; Cornforth, 2004; Cuevas & Fischer, 2006; Hirschland et.al.2008).

Credit cooperatives also often have problems in their administration. Among the causes identified are due to the lack of clear and precise rules that separate management from the decision making, unqualified personnel in management, inadequate management competitiveness, failure membership and institution to carry out fiduciary responsibilities.

One of the key challenges facing credit cooperatives is establishing the right governance system (Branch & Baker, 1998). Another challenge for cooperative governance remains how to balance the principle of democratic control and retain the imperative of professional management. The continuing and purposeful education of membership is vital to the development of a successful cooperative (Linda Shaw, 2006).

Abdul Manap and Tehrani (2013) stressed that strong advancements and competition from other institutions and economic organizations as well as the challenges in the overall economic environment have placed cooperatives in a tough dilemma that must be addressed by government and cooperative sector. "The National Cooperative Policy (NCP) 2002-2010" acknowledges that majority of cooperatives are small in terms of size and capital backing, their members are indifferent and networking and synergies among them are lacking (Ministry of Land and Cooperative Development, 2010). These problems will hinder their performance and affect their contribution to the economy. Approximately, most of the cooperatives are managed with a voluntary employee instead of full-time professional manager, thereby creating difficulty in maintaining good governance, and experience inefficient administrative and poor financial management (Berita Harian, 2006). It is a major task of SKM to address all these problems through the following means (Bidin, 2007):

- a. strengthening the Government's supervisory framework of the cooperative sector,
- b. mobilizing cooperative funds as a source of micro-credit, and
- c. focusing on the future development and landscaping of this sector.

In addition, corporate governance measures for primary cooperatives need to address the following issues (Taimni, 2001):

- a. An open and easily understandable election procedure; contested elections to the board are desirable and should be encouraged;
- b. Elected office bearers should be made fully aware of their duties and responsibilities through education and training,
- c. involvement in the management of their cooperative;
- d. Clear cut division of legal responsibilities between the board of directors and paid managers should be set in bylaws if not already provided for in the law;
- e. Internal and external audit should be conducted on a regular basis and the audit reports should be thoroughly evaluated by the board;

- f. New ways should be developed and introduced of information, consultation and control so as to increase members' participation;
- g. A 'co-op code of best practice' with the objective of helping a cooperative redefine the duties and responsibilities of the governing bodies and management, to make governing and control issues more transparent and to formulate this should be developed and adopted.

Abdul Hamid (2002) asserts that several factors may attributed towards the bad practice of corporate governance which could result in huge financial loss. Firstly, when the audit committee who plays a very important role in a company is inactive. The second factor is the values and attitudes of CEOs who are in power in the companies. Thirdly, the possibility of the management to trespass their power and failed to comply with the board's decision.

Currently, there is no specific act that governs the Islamic cooperatives. In Islamic banking and finance industry, the Islamic financial institutions are governed by a specific act which is the Islamic Financial Services Act 2013. It provides specific requirements for the Islamic financial institutions. The absence of a specific act or regulation for the Islamic cooperative may trigger issues in cases where the current regulation may not be in compliance with the Shariah principles or may hinder the process of Shariah compliance. Many Islamic operatives focus on retail-based financial products such as *Qard Hassan* and *Bai Al-Inah* to facilitate its members to buy homes, cars and others. However, the question is whether the cooperative mechanism to ensure compliance with the Islamic Shariah in service.

In the current implementation, the Angkatan Koperasi Kebangsaan Malaysia Berhad (ANGKASA) has conducted an audit on the Islamic products offered by the cooperative. The audit is conducted according to a cooperative who wishes to obtain a Shariah-compliant product status. Although the cooperative Shariah governance guidelines - GP28 have been issued by the regulator, Suruhanjaya Koperasi Malaysia (SKM) but the implementation is still at an infant stage and very minimal level. In fact, there are still many superiors and cooperators who are unaware of this guidelines.

When an organization deals with important governance issues or institutions that are working to improve performance, it will involve thorough review. This is because governance organization is the result of interaction between individual skills, experience and motivation; the relationship between the board and the management; and support the effectiveness of governance policies, procedures and process (Kiel & Nicholson, 2003).

Looking at the various issues that arise in the management of the cooperative, it gave the signal to the need of emergence of Islamic cooperative with implementation of Islamic law (Shariah law) in place to be used as guidelines in governance.

The concerns for Shariah compliance have brought a new dimension of governance which falls under the corporate governance framework. This is somewhat unique to the Islamic system of financial management (Hassan, 2012). The fundamental role of Shariah governance is to ensure that the operations of the Islamic finance activities comply with the Shariah and the rights of the involved parties are not violated. As far as the literature on Shariah governance is concerned, it remains limited since the subject is relatively new. Thus, the main difference between conventional and Islamic finance is that Islamic financial institutions and market needs to operate based on the concept and principles of Shariah (Kassim et al., 2013).

### **RESEARCH METHODOLOGY**

Qualitative research is, by its nature, an exploratory work which investigates a new or rare social phenomena about which there is little information beforehand. Thus, this type of study is an inductive approach and it is undertaken to comprehend the relevant phenomenon in depth by applying techniques such as observation and also extensive interviews (Sekaran, 2003). Further, Cresswell (2007) also argued that this approach is appropriate and can be used to get a new perspective on something that is already known and to get a more in-depth information dishonor difficult to be expressed quantitatively. Exploratory research design is, therefore, considered as an appropriate research design for this study in obtaining extensive information of Shariah governance practices in cooperative sector.

The reason for adopting exploratory design for qualitative analysis is to understand the perceptions and practices in a specific bounded system (Vandestoepe & Johnston, 2009). As the study aims to explore the practices of Shariah governance in cooperative setting, the study is constructed as an exploration oriented in which the primary data collected through interview surveys.

Table 3.1: List of Participants

<b>PARTICIPANTS</b>	<b>MEDIUM</b>	<b>TOTAL PARTICIPANTS</b>
Regulator	In-depth Interview	1
Experts	In-depth Interview	4
Governance Organs	In-depth Interview	22
	Focus Group Discussion	9
<b>TOTAL</b>		<b>36</b>

Referring to the above table, several in-depth interview sessions have been conducted as follows:

- i. Interview session with the regulator which has been represented by the Head of Shariah Department of Suruhanjaya Koperasi Malaysia (SKM).
- ii. Individual interview session with the selected experts in the cooperative sector. Interview sessions with experts have also been conducted to obtain their feedback and views on the subjects to be explored in this study as highlighted in the above research objectives. Interviews with regulator's representatives are needed as they are actively involved in the cooperative sector, especially the direct involvement of visiting cooperatives, providing consultancy services and advice in various aspects. This service is served from the beginning of cooperative establishment until the preparation and revision of the cooperative financial statements at the end of the year as a sign of continued support from SKM to cooperatives in Malaysia. While interviews with cooperative management were also conducted to obtain their clarification in detail on governance issues arising in their cooperatives, especially issues relating to Shariah governance.
- iii. There were 22 participants from the governance organs comprises of BODs, management team, internal auditors and the Shariah Committee involved in the interviews in which their cooperatives were listed in 100 best Malaysian cooperatives over the past 5 years. The number of interviewees involved is considered adequate when responses for each question asked during the interview have reached saturation level.

- iv. FGD was conducted with nine credit cooperative participants from various states in Malaysia. The participants included board members, management teams, and internal auditors.

### FINDINGS

Table 4.1 depicts the findings and analysis of this study in relation to research objective.

Table 4.1: Summary of Findings

<b>Regulator</b>	<b>Experts</b>	<b>FGD</b>	<b>Governance Organs</b>
<p><u>Challenges:</u> Capital constraint. BOD attitudes. Absence of Shariah expert. Lack of awareness among cooperatives' leaders.</p> <p><u>Strategies:</u> To establish good governance. Accountability. Transparency. Disclosure.</p>	<p><u>Challenges:</u> Lack of skills and knowledge. Absence of expertise. Financial constraint - Additional (transaction) cost. Lack of readiness / willingness.</p> <p><u>Strategies:</u> To establish good governance. Experience and exposure of leaders. Commitment by governance organs. Identifying incompliance issues. Knowledge upgrading. Youth involvement.</p>	<p><u>Challenges:</u> Perception on current governance practice. Not satisfied. Perception on how SG could be implemented in cooperatives. Difficult. Lack of supports and facilities. Absence of Shariah expert.</p> <p><u>Strategies:</u> To overcome the existing governance problems. To improve the functions of the BOD. Training is required to promote Shariah governance. Guidance and continuous support from SKM. Enforcement and close monitoring by authorize parties.</p>	<p><u>Challenges:</u> Lack of experience dealing with SG. Absence of expertise. Lacks of support system. Lack of skills and knowledge. Existing governance problems. Mismanagement. Misconduct.</p> <p><u>Strategies:</u> To establish good governance and Islamic values in operation. Commitment by governance organs. To equip knowledge in Finance among the governance organs. - To clearly understand the concept of <i>Riba</i>'.</p>

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From table 4.1 above, the findings from interviews with regulators have admitted that the cooperative sector has three key constraints, namely human capital, money capital, and technology or system capital. In fact, these three elements are related to each other. From the perspective of human capital, increased knowledge among cooperative members, especially leaders, should be given priority because failure in most cooperatives is because most BODs and management do not understand the scope of their duties.

The findings from expert interviews revealed that the experience of key organs in the banking sector, whether in Islamic banks or in full-fledged banks, is one of the best strategies that can be used in cooperatives to address the challenges in the implementation of Shariah governance. This shows that it is important to choose the right leader to navigate the organization or cooperative. Among the important features that leaders must possess is the ability to perform the mandated responsibilities.

In fact, corruption issues, abuse of power and others that occur within the organization often involve highly educated leaders. On the contrary, in a cooperative environment, being highly educated is not a compulsory requirement to become a leader. From the FGD's response to Shariah governance practices, some participants are quite skeptical of its implementation in their cooperatives as they claim that most cooperatives are still facing managerial problems with current governance practices. They propose to overcome existing problems before commencing the full implementation of Shariah governance in cooperatives. This fact actually reflects their readiness and willingness to explore and practice Shariah governance in the current cooperatives setting. Therefore, cooperative leaders need to be appointed among those individuals who are willing to commit and uphold Islamic law and good governance towards achieving a more holistic cooperative mission and vision.

Although there are various challenges and weaknesses in the co-operative sector which includes skills and knowledge amongst leaders and members as a whole, the absence of Shariah experts, lack of capital, lack of motivation and support system, but all these obstacles can actually be resolved periodically.



Findings from the study also demonstrate high demand for courses related to governance from all levels of main organs. In fact, various courses were offered by the Maktab Koperasi Malaysia (MKM), the cooperative training centre to cooperators. It offers variety range of training from free courses to courses involving very minimal fees. There are compulsory courses which are offered for free of charge and should be attended by cooperative governance organs within a year after appointment. The courses are:

Mandatory Course 1 - Introduction of Cooperative

Mandatory Course 2 - Financial Statement of Cooperative

Mandatory Course 3 - Strategic Planning of Cooperative

Mandatory course for Cooperative Auditors.

However, none of the courses or modules provided by MKM offer Shariah governance-related courses. As a result of interviews with governance organs, there were cooperative auditors who voiced that they should be exposed to the Islamic accounting system and the Shariah audit procedure in preparation for the full implementation of Shariah governance in their cooperatives. Suitable courses are required to ensure that auditors can improve their knowledge accordingly.

The study also revealed that there are still cases where governance organs fail to attend the mandatory courses within the prescribed period and there was no actions taken by MKM as a course provider as well as lack of enforcement from SKM itself. This could also be a causative factor that allows misleading issues, misunderstandings, mismanagement, and other problems in the cooperatives.

There is also a view of the Shariah committee member on the needs to provide them with knowledge in Finance. On the other hand, some Shariah committee member have commented that it would be a big challenge to provide an understanding to the other cooperators especially on the difference between loans and financing. The “financing” term should be used in the Islamic cooperatives. It is found that the “loan” term which is synonymous with *Riba*’ is still being practiced in some cooperatives. The preparation of Shariah courses is actually not just helping the implementation of Shariah governance in cooperatives but the knowledge is very relevant in the life of each person especially when

the business transaction being a major activity in the individual's daily life. Shariah knowledge is important to ensure that every single transaction is in accordance with Shariah provisions.

Allah SWT says in a Holy Quran:

*“O you who believe! Enter Silm perfectly, and follow not the footsteps of Shaytan (Satan)” (Surah al-Baqarah, 2:208)*

Allah commands His servants who believe in Him and have faith in His Messenger to implement all of Islam's legislation and law, to adhere to all of its commandments, as much as they can, and to refrain from all of its prohibitions. `Al-`Awfi said that Ibn `Abbas said, and also Mujahid, Tawus, Ad-Dahhak, `Ikrimah, Qatadah, As-Suddi and Ibn Zayd said that Allah's statement: (Enter Silm) means Islam. Allah's statement: (...perfectly) means, in its entirety. This is the Tafsir of Ibn `Abbas, Mujahid, Abu Al-`Aliyah, `Ikrimah, Ar-Rabi` bin Anas, As-Suddi, Muqatil bin Hayyan, Qatadah and Ad-Dahhak. Mujahid said that the Ayah means, `Perform all the good works and the various pious deeds, this is especially addressed to those from among the People of the Scripture who embraced the faith.' (Tafsir Ibn Kathir).

Another interesting finding should be disclosed from this study, it was found that the cooperative sector was largely led by middle to old generation people whereby the participation from youth is very limited. Efforts towards promoting youth involvement are very important as they are vulnerable to the current flow of modernization with the latest technology of development. This will help in creating the latest and powerful ideas in the cooperative movement.

Human empowerment can also be implemented by taking steps to introduce suitable modules to SKM's cooperative college i.e. iCoop which offers a Diploma in Cooperative Management program. Modules identified are *Usul-fiqh*, *Fiqh Mu'amalat*, Islamic Theology (*Aqidah*) and *Qawaid Fiqiyyah*. Management of the iCoop College can collaborate with several institutions including institutions of higher learning such as USIM, UIA, UIM, IBFIM and ISRA to obtain instructors for the above modules. With this, iCoop graduates will be able to hold a position as Secretariat or Shariah Committee. This approach is seen as a step that offers great potential where today's challenges are

managed from the grassroots. With this, the country will be able to produce more graduates who are able to handle the cooperative sector better in the future.

## CONCLUSION

This study integrates all the data by contextualizing the finding that is appropriate for cooperative nature and setting of operation. The main basis of this study is comprehensive and holistic in nature, in which it would like to see the integration of the material and spiritual development in the development of Islamic institutions, including the development of the cooperative sector. The development of this sector directly involves empowerment for the development of individuals, families, institutions, communities and the country in general.

From this study, it is found that most credit cooperatives are facing constraints from the aspect of human capital, money capital, and technology or system capital. However, the most important challenge to address is the human capital aspect to provide the governance organs with high credibility in managing and administering cooperatives.

In practice, it requires a lot of patience and determination especially when facing any obstacles or unforeseen challenge. For a Muslim, the implementation of such affairs must be accompanied by strong *Aqidah* and a steady mindset. It also requires the support of a sincere, honest, trustworthy and highly respected leader to translate the planning into realistic practice. Development of the Islamic cooperative sector is a key mechanism in implementing Islamic-based development. Hence, the existence of Shariah-compliant cooperatives is said to support the development of the Islamic banking and finance sector today. Despite its small size and the availability of capital constraints, cooperative contributions have been recognized globally.

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## **IMPORTED INPUTS CONTENT: A PANEL DATA ANALYSIS BY OWNERSHIP OF MALAYSIA MANUFACTURING SUB-INDUSTRIES.**

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### **ABSTRACT**

*This paper investigates the relationship between imported inputs content and ownership of Malaysian manufacturing industries. An industry level analysis was conducted for 53 sub-industries in the manufacturing sector categorised as Malaysian owned and non-Malaysian owned industries for period from 2000 to 2006. The Generalised-Least Square (GLS) estimation result suggests that imported inputs have a positive relationship with the growth of industries owned by non-Malaysian but not for industries owned by the Malaysian. The results for industries owned by the Malaysian is consistent with the government actions that have strongly encouraged the domestic industries to use domestic inputs through implementation of various incentives under the Import-Substitution Industrialization (ISI) strategy. The finding might further suggest that non-Malaysian industries whose import their intermediate inputs have increased their growth performance and productivity during the period studied.*

**Keywords:** *Imported inputs, Ownership, Malaysia, non-Malaysia Industries.*

### **INTRODUCTION**

One of many important aspects in the growth of the Malaysian economy is related to the content of imported intermediate inputs which influences the growth of the manufacturing industries. Sub-industries such as the electrical and electronics industries were classified with a high content of imported inputs as early as the 1970s. A high imported input content can be translated into being highly dependent on the foreign produced inputs. Since the end of 1980s Malaysia had depended mostly on high technology industries and according to various annual report produced by the Malaysia Investment Development Authority (MIDA), a majority of the investment approved projects between the ends of 1980s until present were made in the high technology industries. The reports also stated that since 2012 until present the investment approved projects were concentrated in the

aerospace, semiconductors, solar, machinery and equipment, biotechnology, petroleum and petrochemical products and medical devices industries.

High technology refers to products and services that embody advanced technologies and have a prominent level of research and development intensity. High technology industry generally covers sub-industries such as pharmaceuticals, office, accounting and computing machinery, radio, television and communications equipment, medical precision and optical instruments, aircraft and spacecraft. Based on the experience of developed countries, high technology manufacturing can contribute to higher output growth and capabilities of stimulating structural change in the economy by creating externalities for other sectors in the economy towards higher value-added activities where it establishes strong linkages with the other sectors of the economy.

Malaysian manufacturing exports depend highly on the imports of intermediate inputs, especially in industries such as electronics, textiles and machinery equipment. The Malaysian government has implemented various economic policies with intent to reduce dependency on importation of goods especially for consumption. The first phase of the import substitution policy from 1958 until 1967 was implemented especially for this purpose. In 1967 the Malaysian government established an institution known as the Malaysian Industrial Development Authority (MIDA). MIDA and its industrial strategy served as the conduit to reduce dependency on imported inputs and in turn encourage the utilization of domestic inputs through the enforcement of the Investment Act (1986). The institution also served to invigorate the manufacturing sector especially by segregation of resource and non-resource based industries.

This segregation is important to identify the inputs usage for these industries separately. It also serves as a tool to identify significant industries in each group based. The utilization of domestic inputs is usually associated with resource based industries and the utilization of imported intermediate inputs is usually associated with the non-resource based industries (Sulaiman, 2012). However, the encouragement of the utilization of domestic inputs by the resource and non-resource based industries is due to several reasons. Firstly, to increase the domestic value-added production in both resource and non-resource based industries. Secondly, the resource and non-resources based industries need to create intense linkages between economic sectors especially between manufacturing and agricultural sectors. Besides, the efforts to promote domestic inputs utilization will create

and encourage the linkages between foreign and local industries, particularly in relation to small and medium industries (SMIs), since these foreign industries have been given incentives to encourage the use of domestic inputs in their production activities. Lastly, use of domestic inputs can improve the deficit in current balance of payment by reducing the leakages arising from the dependency of imported inputs.

### **LITERATURE REVIEW**

One of the earliest empirical investigations pertaining to the imported input dependency level in the Malaysian manufacturing sector was conducted by Alavi (1987). The study shows that resource based industries such as agriculture-based food products, wood and wood products, rubber and rubber products, petroleum refining and non-metallic metal products industries had procured most of their inputs from local producers and utilized a small imported input content. However, in the foods processing, beverages and tobacco sector dependency on imported inputs existed and varied widely among the industries. The dairy products sub-industries utilized 42 percent of imported inputs, flour mills 62 percent, sugar refinery 78 percent, animal feed products 37 percent and cigarette manufacture 50 percent. Table 1 (please refer to the appendix) shows the imported input content in the Malaysian manufacturing sector in 1987. The finding also shown that most of the intermediate goods imported were industrial supplies such as textiles and apparel, electrical and electronic products, transport equipment metal and chemical and chemical products. These were amongst the intermediate goods required as parts of the material input to produce non-resource based industries in Malaysia. During this period the intermediate inputs imported mainly comprised of electronic components which recorded the largest expansion and accounted for more than a fifth of the total increase in imports of intermediate goods. Meanwhile a large number of exporting manufacturing firms in Malaysia have more than 80 percent of imported input content.

Another empirical analysis by Sivarajan (2012) shows that from 2000 to 2005, there was a positive relationship between usage of imported input and the share of export in the Malaysian manufacturing sub-industries. The finding shows that from 69 sub-industries analysed, almost 50 percent of the sub-industries could be categorized as high import intensity industries and the highest ranking sub-industries were semi-conductor devices and tubes and circuit boards followed by the office accounting and computing machinery industries in second place and petroleum refinery industries in third.



In another study by Malaysian Institute of Economic Research (MIER) researchers in 2012 found that more than 50 percent of the Malaysian manufactured exports' value comes from the high-technology products which are highly dependent on imported technology, inputs and design. High imported input content contributes to low value added, low research intensity and low level of patenting activities in the offshore subsidiaries because core technology and high value-added production stages are usually controlled by the MNCs in the originating country. Furthermore, Alavi (2013) criticizes that due to high dependence of imported inputs in the major high technology export industries, the Malaysian manufacturing sector after decades of operation has faced several major challenges which have depressed the economy.

A study by Aun (2013) on the value creation in Malaysia shows that the high-technology share of total manufacturing exports declined in the 2000s and that manufacturing productivity growth has shown a dramatically slowing down trend from the 1990s to the present. As such, some of the challenges highlighted by economists include low value added in the high technology dependence industries, which also contributes to the second challenge of losing their competitiveness to the other Asian neighbouring countries such as Thailand and Vietnam, and lastly the challenge faced by Malaysia on how to enhance and create value in the manufactured products trade so that the country can ensure sustainable economic growth and achieve high-income country status by 2020.

Based on the above literature, this paper perceive that it is very important to have a clear picture of the dependent state of the sub-manufacturing industries on foreign intermediate inputs to make suggestions to the policy makers for relevant action plans. Therefore, this paper will explore the relationship between the growth of industries and imported inputs content in selected manufacturing sub-industries.

## **RESEARCH METHODOLOGY**

This paper investigates the relationship between industries growth proxied by real revenue and imported intermediate inputs volume used in production. Variables such as capital expenditure, information and technology expenditure and human resources attainment are included in the analysis as control variables. The industry level analysis was conducted for 53 sub-industries classified as Malaysian owned and non-Malaysian owned. The analysis is available for 7 years which is from 2000 to 2006 due to limited data provided by the Department of Statistics, Malaysia.



### ***Variables Description and sources of data***

The investigation consists of 53 industries (at SITC 3-digit level) classified as Malaysian owned and non-Malaysian owned industries. The base year is 2000 and these data are classified according to Malaysian and non-Malaysian ownership. The summary of the variables description, sources and the expected relationship of the explanatory variables is shown in Table 2, meanwhile the list of 53 sub-industries for the analysis is shown in Table 3 (please refer to the appendix for both tables).

### ***Model Specification***

The model was formulated based on the neoclassical model of two factor productions; capital and labour, however this paper used the augmented Cobb-Douglas production function. As such, the augmented model investigating the relationship between industry growth and imported intermediate inputs are defined as:

$$tr = f(im, ce, rd, hc) \quad (1)$$

where  $tr$  denote the real revenue of the industry in (RM'000 million),  $im$  denotes the real imported inputs volume (in RM'000 million),  $ce$  denotes the real capital expenditure (in RM'000 million),  $rd$  denotes the real research and development expenditure (in RM'000 million), and finally  $hc$  denotes the human resources education attainment proxy by the secondary school enrolment (in million). All variables at constant (year 2000) price are expressed in logarithmic form. Capital expenditure, research and development expenditure, and human resources education attainment are control variables. In a dynamic presentation the equation will be written as:

$$tr_{it} = \alpha + \beta_1 tr_{it-1} + \beta_2 im_{it} + \beta_3 ce_{it} + \beta_4 rd_{it} + \beta_5 hc_{it} + \varepsilon_{it} \quad (2)$$

where the subscript  $i$  denotes the  $i$ -th industries ( $i=1...53$ ) in the manufacturing sector, the subscript  $t$  denotes the  $t$ -th year ( $t=1...7$ ) from 2000 to 2006. The equation is expressed in logarithmic form. In the model  $tr_{it}$  is a function of the error term  $\varepsilon_{it}$ , hence the lagged dependent  $tr_{it-1}$  is also a function of  $\varepsilon_{it}$  which means that  $tr_{it-1}$  is correlated with the error term. Therefore, the OLS estimator of this model is assume to be biased and inconsistent.

The above equation is estimated twice for Malaysian owned industry and then for non-Malaysian owned industry. In both cases, the disturbance term is specified as a two-way error component model:

$$\varepsilon_{it} = \mu_i + \lambda_t + v_{it} \quad i = 1, \dots, 53 \quad t = 1, \dots, 7$$

where  $\mu_i$  denotes an industry-specific effect,  $\mu_i \sim \text{IID}(0, \sigma^2_u)$ ;  $\lambda_t$  denotes a year-specific effect,  $\lambda_t \sim \text{IID}(0, \sigma^2_\lambda)$  and  $v_{it}$  denotes the remainder of the disturbance terms,  $v_{it} \sim \text{IID}(0, \sigma^2_v)$  and all these are independent of each other and among themselves.

## RESULTS

This paper is interested in estimating the firm-specific effects and time-specific effects of the model in the static model for the industry level analysis. As such, the firm-specific effect ( $u_i$ ) can represent any firm-specific characteristics such as firms' strategies, economies of scale and technological changes of the firms, changes in the size of the firm and educational and training attainment of the employees. Meanwhile the time-specific effects ( $\lambda_t$ ) are to be estimated as coefficients which can be justified given events such as the shock in production related to the 1997-98 Asian Financial Crisis, which had a long-term effect on sub-industries in the Malaysian manufacturing sectors, the economic downturn period during 2001 until 2002 and the impact of 11<sup>th</sup> September tragedy whether during the short term or for a longer period. The results of the static estimated model pertaining to OLS, fixed effect, random effect and GLS models for the industry analysis are shown in Table 4 (please refer to the appendix).

The  $R^2$  value for both Malaysians and non-Malaysian industries are 0.846 and 0.951 respectively, which indicates a high measurement of goodness-of-fit in both models. The result of OLS regression shows that imported inputs content for industries owned by Malaysians have insignificant association in determining growth of the industries' output while holding all the other variables as the control variables in the estimation. However, the fixed effect model suggests that imported inputs have a statistically significant association at 90 percent confidence level or higher in determining growth of the industries' output, yet, the correlation is inversed. Likewise, the random effect model also shows that imported input has a statistically significant association at 90 percent confidence levels or higher for Malaysian owned industries. However, the sign is also contradicting the hypothesis which assume that imported input content is good for the growth of the industry.

On the other hand, the result of OLS and random effect regression for industries owned by non-Malaysian shows that imported inputs have a positively statistically significant at

the 90 percent confidence levels or higher in both models. Although the OLS estimation has a high correlation coefficient, a potential problem that may arise in both cases is an inefficient result attributable to heteroskedasticity and serial correlation. As such, the analysis has included the White general test for heteroskedasticity and the Wooldridge test for serial correlation to identify these problems.

The white test result produced  $\chi^2$  of 27.60 for Malaysia and 52.71 for non-Malaysia, meanwhile the Wooldridge test produced F value of 6.44 for Malaysia and 37.611 for non-Malaysia industries, respectively. These results rejected the null hypothesis under the OLS model for both Malaysian and non-Malaysian industry since the p-value produced is smaller than 0.05 which means that heteroskedasticity and serial correlation exist in the models. Hence, the standard errors computed in the OLS estimation are biased and leads to bias in the confidence intervals and the test statistics. The overall statistics for Hausman test in both Malaysian and non-Malaysian industry case have produced a p-value smaller than 0.05 which leads to strong rejection of the null hypothesis that random effect provides consistent estimates and hence accepts the fixed effect model. However, with inclusion of time-specific effects and industry-specific effects, the result of fixed-effect (within) regression for non-Malaysian industries still shows that imported input is insignificant.

We have run the GLS regression which is robust to heteroskedasticity across panels and serial correlation within panels for comparison. The result after correcting for the above mention problems shows that imported inputs are insignificant for Malaysian owned industries. Nevertheless, the result indicates that imported inputs in the non-Malaysian owned industries have a positive statistically significant association with the industries' growth at the 99 percent confidence level.

## CONCLUSION

The objective of the study was to analyse the relationship between industries growth and imported inputs content at industry level. The findings in static estimation models show mixed results. The OLS model suggest that imported inputs content does not play a significant role in determining the growth of the industries owned by Malaysians since no association effect was produced by the estimations. However, in both fixed and random effect models, the results are significance, yet the relationship is the inverse which is against the hypothesis proposed. This finding might indicate the nature of current

industries owned by Malaysia where most of the industries were strongly encouraged by the government to use domestic inputs through various incentives. The findings might support the argument proposed by Zeile (1998) that manufacturers who relied on foreign sources for their intermediate inputs had impeded the development of indigenous suppliers through backward linkages. Besides, the industries owned by Malaysian might also face problems due to penetration of the domestic market with products from China, Thailand and Indonesia which participate in the ASEAN Free Trade Area (AFTA) agreement. On the contrary, the findings suggest that imported inputs content played a significant role in the growth of the industries owned by non-Malaysian where the Generalised-Least Square (GLS) results for the static models support the hypothesis. As such, the paper assume that industries owned by non-Malaysian which import their intermediate inputs would have increased their growth performance which is according to the empirical finding in other studies by Lopez (2006) and Kasahara and Rodrigue (2008).

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## Appendix

**Table 1: Imported Inputs Content in the Manufacturing Sector (1987)**

Industry	Inputs content (%) From ERP study		Inputs content (%) From Bank Negara Report
	Imported	Domestically Procured	Imported
Food, Beverages & Tobacco	27	73	n. a
Textiles & Apparel	96	4	80-90
Wood & Wood Products	1	99	5-20
Paper & Paper Products	62	38	50-70
Chemical & Chemical Products	82	18	90-95
Petroleum and Products	0	100	n. a
Rubber and Products	23	77	20-30
Non-metallic metal products	26	74	n. a
Metal Products	64	36	80-90
Electrical and Electronics	98	2	80-85
Transport and Equipment	91	9	40-50
Others	53	47	n. a

Source: Alavi (1996)

**Table 2: Variables Description, Sources and Expected Sign for Imported Inputs**

No.	Variables	Description	Sources/Expected sign
1	Revenue	is the dependent variable which is the value of revenue by industries/firms	Data is obtained from Malaysian Department of Statistics.
2	Imported Inputs	is the value of imported inputs by industries/firms	Data is obtained from Malaysian Department of Statistics.  The expected sign is positive.
3	Capital Expenditure:	is the capital expenditure by industries/firms	Data is obtained from Malaysian Department of Statistics.  The expected sign is

4	Research and Development	is the research and development expenditure by industries/firms	positive. Data is obtained from Malaysian Department of Statistics.
5	Human Capital	is the human capital proxy by the total number of employee of the industries by industries/firms	The expected sign is positive. Data is obtained from Malaysian Department of Statistics.  The expected sign is positive.

**Table 3: List of 53 Malaysian Manufacturing Sub-Industries**

<b>No.</b>	<b>Manufacturing Sub-industries</b>	<b>No.</b>	<b>Manufacturing Sub-industries</b>
1	Production, Processing and Preserving of meat, fish, fruit, vegetables, oils and fats	28	Manufacture of structural metal products, tank, reservoirs and steam generators
2	Manufacture of dairy products	29	Manufacture of other fabricated metal products; metal working service activities
3	Manufacture of grain mill products, starches and starch product and prepared animal foods	30	Manufacture of general purpose machinery
4	Manufacture of other food animals	31	Manufacture of special purpose machinery
5	Manufacture of beverages	32	Manufacture of domestic appliances n.e.c
6	Manufacture of tobacco products	33	Manufacture of office, accounting and computing machinery
7	Spinning, weaving and finishing of textiles	34	Manufacture of electrical motors, generators and transformer
8	Manufacture of other textiles	35	Manufacture of electrical distribution and control apparatus
9	Manufacture of knitted and crocheted fabrics and articles	36	Manufacture of insulated wire and cable
10	Manufacture of wearing apparel except fur apparel	37	Manufacture of accumulators, primary cells and primary batteries
11	Tanning and dressing of leather, manufacture of luggage. Handguns, saddler and harness	38	Manufactures of electrical lamps and lighting equipment
12	Sawmilling and planning of wood	39	Manufacture of other electrical equipment n.e.c
13	Manufacture of product of wood, cork, straw and plaiting	40	Manufacture of electronic valves and tubes and other



14	materials Manufacture of paper and paper products	41	electronic components Manufacture of television and radio transmitters and apparatus for line telephony and line telegraphy
15	Publishing	42	Manufacture of television and radio receivers, sound or video recording or reproducing apparatus
16	Printing and services activities related to printing	43	Manufacture of medical appliances and instruments and appliances for measuring, checking, testing, navigating and other purpose except optical instruments
17	Reproduction of recorded media	44	Manufacture of optical instruments and photography equipment
18	Manufacture of refined petroleum products	45	Manufacture of watches and clocks
19	Manufacture of basic chemicals	46	Manufacture of motor vehicles
20	Manufacture of other chemicals products	47	Manufacture of bodies (coachwork) for motor vehicles, trailers and semi-trailers
21	Manufacture of man-made fibre	48	Manufactures of parts and accessories for motor vehicles and their engines
22	Manufacture of rubber products	49	Building and repairing of ship and boats
23	Manufacture of plastic products	50	Manufacture of aircraft and spacecraft
24	Manufacture of non-metallic mineral products	51	Manufacture of transport equipment n.e.c
25	Manufacture of basic iron and steel	52	Manufacture of furniture
26	Manufacture of basic precious and non-ferrous metals	53	Manufacture of miscellaneous (n.e.c)
27	Casting of metals		

Source: Department of Statistics Malaysia

**Table 4: OLS, Fixed, Random Effect and GLS Result**

Variables	Malaysian				Non-Malaysian			
	OLS	Fixed	Rando m	GLS	OLS	Fixed	Rando m	GLS
Imported inputs	-0.019 (-0.48)	-0.209* (-3.53)	-0.081* (-1.81)	-0.013 (-1.31)	0.099* (3.09)	0.053 (1.61)	0.091* (2.97)	0.059* (4.02)
Capital Expenditure	0.907* (19.91)	0.864* (8.61)	0.928* (16.46)	0.917* (66.20)	0.754* (21.23)	0.691* (19.50)	0.718* (21.38)	0.799* (49.39)
Research and Development Expenditure	0.026 (1.14)	0.063* (2.04)	0.042* (1.66)	0.019** (4.67)	0.032** (2.76)	-0.004 (-0.38)	0.008 (0.85)	0.026* (7.99)
Human Capital	0.136* (5.34)	0.133 (0.99)	0.144* (4.10)	0.076* (10.79)	0.099* (4.54)	0.089* (2.210)	0.116* (3.62)	0.058* (5.78)
_cons	1.099* (3.21)	3.867* (3.59)	1.428* (3.14)	1.300* (11.44)	2.040* (10.97)	3.780* (10.51)	2.759* (10.29)	2.100* (22.20)
F	493.08 (0.00)	33.03 (0.00)	-	-	1722.99 (0.00)	222.23 (0.00)	-	-
Chi <sup>2</sup>	-	-	1041.67 (0.00)	16882.8 (0.00)	-	-	2008.67 (0.00)	18979.46 (0.00)
r <sup>2</sup>	0.8460	0.3002	-	-	0.9505	0.74267	-	-
r <sup>2</sup> _a	0.8443	0.1752	-	-	0.9499	0.69672	-	-
Sigma_u	-	0.5111	0.27298	-	-	0.40588	0.30152	-
Sigma_e	-	0.6042	0.60429	-	-	0.19225	0.19225	-
rho <sup>3</sup>	-	0.4170	0.16948	-	-	0.81675	0.71096	-
White test	27.60 (0.00)	-	-	-	52.71 (0.00)	-	-	-
Wooldridge test	6.44 (0.00)	-	-	-	37.611 (0.00)	-	-	-
Hausman test	-	-	18.31 (0.00)	-	-	-	20.14 (0.00)	-

N		364	364	364	364		364	364	364	364
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Notes: \*  $p < 0.10$  indicate the 10 percent or smaller significance levels

Figure in parentheses are t-statistics; <sup>3</sup>fraction of variance due to  $u_i$

**LEARNING ISLAMIC FINANCIAL CONTRACTS THROUGH BOARD GAME  
FOR BANK EMPLOYEES**

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**ABSTRACT**

*The purpose of this study is to test empirically the level of understanding of bank employees on Islamic banking core products when an interactive teaching tool is adopted in learning sessions. The game referred to as Muamalat Interactive Game (MIG), an innovation that incorporates the concepts and operations for retail products offered by Islamic banks adopted for personal financial management. This game involves the participants as the contracting parties in several muamalat contracts commonly practiced in Islamic banks, such as as ijarah, tawarruq, rahnu, musharakah mutanaqisah, murabahah and other supporting contracts. The players of the game interactively transact among them to acquire assets, manages cash flow, pay tithe on income and wealth and contribute to charity, applying the muamalat contracts mentioned. A pre and post-test were distributed to 60 bank employees before and after playing the games. The level of understanding on the subject matter is determined through the correct answer given in the questionnaires. An independent-samples t-test revealed that employees involved in playing the board game reported significantly higher levels of understanding, after playing the game. Findings from this study showed employees experience greater excitement, enjoyment and motivation as compared to the lecture-based training environment.*

**Keywords:** *business game, muamalat, personal financial planning, Islamic finance*

**INTRODUCTION**

One of the significant challenges faced by the Islamic banks is shortage of employees that has knowledge in Islamic banking and finance (Tahir et al, 2004). A research by Zainol et al. (2008) found that the bankers had low understanding on Islamic principles and many of them lack of working experience in the Islamic banks. The customers will be ill advised and to certain extent jeopardizing the image of Shariah, when the employees are equipped with limited knowledge and experience in Islamic financial transactions. In certain circumstances, many of them may not be able to differentiate between the conventional and Islamic banking products, thus inevitably telling their customers these two systems are similar. To resolve this issue, educating and training these employees are

the most essential means to these Islamic banks in order to uphold the true spirit of Shariah. Likewise, training is not only for an individual growth but also for the organization as well.

Nowadays, the contracts used in the Islamic banks, such as *ijarah*, *tawarruq*, *rahnu*, *musharakah mutanaqisah*, *murabahah* and other supporting contracts are quite complicated and complex for those who have little shariah knowledge. Besides, the training usually are being conducted formally either adopting in-house training or sending the staff to the qualified training providers. Some of these employees are still grappling with some jargony Arabic words, in addition to complicated Islamic contracts. The desire of these Islamic banks to keep ahead of other banks in this niche market also compel them to invest heavily in the training of their staff.

One possible approach to making the training session less formal, more interactive and stimulating for these staff is to use games as an educating tool, either to replace or as a supplement to the formal training. Most of the time the objective of a business game is to offer participants the opportunity to learn by doing in as authentic a management situation as possible and to engage them in a simulated experience of the real world. Even though the games may not offer the similar real world experiences, but in some cases games can shed some lights to understanding if not all but part of the scenario. Business games are now rapidly gaining favour as training tools, since they can offer experiential learning and even failure but with no negative implication to the organization (Keys, 1986). Additionally, they are fun and people are usually highly motivated and more likely to participate when they are having a good time.

The objective of this paper is to empirically test whether the employing a board game can be used as an educational tool in staff training for enhancing their understandability in the Islamic financial transactions.

## **LITERATURE REVIEW**

A board game can be defined as a tabletop game that involves counters or pieces moved or placed on a pre-marked surface or "board", according to a set of rules (Wikipedia). The aim of each game can be varies depending whether it is based pure strategy, chance or a mixture of the two. Games are enjoyable and interactive and learners respond natural to

this type of learning dynamic. Playing games can be useful for participants as they acquire skills, which may not otherwise be taught. It has been accepted that in spite of the element of chance, business games polishes the players' entrepreneurial skills as they learn to deal with incomplete information, predict rival's strategies and understand human psychology (Johnson, 2013).

There are many theories that can link games and learning. The first theory is motivation theory, and it is recognized that motivation guides human behavior either internally or externally. (Erwin, 2003). Internal motivation comes from within the student or from for example, students who love to write are intrinsically motivated to write - there is something about writing that they enjoy and that makes them want to do it even if there is no "reward" for it.

External motivation comes from sources external to the student for example through praise, recognition, or rewards. For example, for students who do not enjoy writing, a star sticker or praises may prompt them to write more. Basically teachers would love to spark intrinsic motivation rather than extrinsic is because intrinsic can inculcate continuous learning. The number of strategies for promoting intrinsic motivation include arousing interest in the subject matter, maintaining curiosity, using a variety of interesting presentation modes and even using games. Erwin (2003) suggested games as a means to have fun in learning, thus differ from traditional method.

However, the usage of games as learning tools may not be acceptable to all. Some might considered games as not serious and informal ways in teaching. Nonetheless, previous studies have shown the effectiveness of games as teaching tools for students (Sandford et al., 2006; Hays, 2005; Hergeth & Jones, 2003). O'Leary (2005) found that a group of medical students that used Jeopardy group (games) reported significantly higher levels of faculty/student interaction, enjoyment of the class format and engagement in class content. These students described this method as a "fun and rewarding" way to conduct a review session. Others have used a commercially available board game in a marketing classroom to improve the students' skills (Hays, 2005). In each of these different disciplines, the students enjoyed the change in class format and felt that the games enhanced their learning.

In study conducted by Kennedy et al. (2004), found that more than 70% of the students

who played the interactive board game felt it helped with their learning to counsel geriatric patients. Whereas in Roche et al. (2004) and Patel (2008), the findings revealed that the students enjoyed the subject and more than 60% felt it enhanced their classroom learning. For the purpose of this study, we propose the following research hypothesis: *Participants involved in playing a board game will experience greater levels of understanding in the subject matter.*

## METHODOLOGY

### *Muamalat Interactive Game (MIG)*

The game referred to as Muamalat Interactive Game (MIG), an innovation that incorporates the concepts and operations for retail products offered by Islamic banks adopted for personal financial management. This game involves the participants (contracting parties) in several muamalat contracts commonly practiced in Islamic banks, such as as *ijarah*, *tawarruq*, *rahnu*, *musharakah mutanaqisah*, *murabahah* and other supporting contracts. The players of the game interactively transact among them to acquire assets, manages cash flow, pay tithe on income and wealth and contribute to charity, applying the muamalat contracts mentioned. One player should be appointed as a banker out of the seven players in the game. In the game, basic pillars of ‘aqad (in Muamalat rules) is to be observed such as contracting parties; i) Player: Buyer/customer/Share-holder/Lessee/ ii) Banker: Seller/Agent/Share-holder/Lessor. In addition, the players should observe the process of *sighah* – the *aqad* between banker and player should be loudly spoken in front of other players during in entering a contract.

### *Sample*

This study was conducted in one of the Islamic Financial Institutions in Malaysia. A total number of bank employees of 60, were selected to participate in the study. These are the employees whom have no background in Shariah, however they are dealing with the Islamic products on a daily basis. Through playing the board game it is expected for the employees to gain knowledge on Islamic banking products and the underlying contracts of the products. The employees who participated in the study consist of various departments across the bank.

There are two sessions conducted in playing the board game. The employees were break



into five groups per sessions approximately 5-7 employees in each group consists of one banker and the remaining as players. Participation was mandatory and employees were not informed of this activity prior to class. This game was used throughout the training session and was used as a means to teach the Muamalat products in an interactive way.

### ***The questionnaire***

This present study employed the utilisation of primary data which was collected via survey questionnaire and it is quantitative in nature. The data collection process was conducted over a period of two weeks. For the purpose of this study, survey questionnaires were distributed to employees during the game session. The research examines the impact of experiential learning to the level of knowledge on Shariah contracts embedded in the game by measuring the pre and post score of the employees on the features of the contracts. They answered pre-experiment questionnaire, played the game and eventually answered post-experiment questionnaire. A total of 60 survey questionnaires were received and accepted to be analysed.

Before the games were introduced, the students were asked to complete a pre-test questionnaire. It was explained to them that filling out the questionnaire were mandatory. They were asked to provide their demographic information such as age and gender. The survey questionnaires consisted questions regarding the student's level of understanding about the muamalat sales contracts and Islamic banking operations (see [Appendix 1](#)). All items were measured by asking respondents questions in the form of a five point Likert scale ranging from '1' strongly disagree, '2' disagree, '3' neutral, '4' agree to '5' strongly agree.

At the end of the game session, the employees were required to fill in the post test questionnaire. The filling out the questionnaire was also mandatory for the employees, to test their understanding on muamalat sales contracts and Islamic banking operations before and after playing the game.

### ***Statistical Analysis***

Statistical analysis was performed utilizing the SPSS program. SPSS software version 20 was used to analyse the data. Reliability of the data was measured and the value of Cronbach's Alpha was 0.79 which above the recommended value of 0.7 (Hair et al., 2010). This shows that the data is reliable and ready to be analyzed in the next stage.

Before using inferential tests, several tests were performed to check data normality. The tests reported that our data did fit the normal distribution. For this reason, the tests used were parametric (the paired sample t-test). The paired sample t-test is used in this study since the objective of the research is to compare the significant difference before and after playing the board game to the same group of employees. This test is used to determine whether the mean of the differences between two paired samples differs from 0. The paired t-test calculates the difference within each before-and-after pair of measurements, determines the mean of these changes, and reports whether this mean of the differences is statistically significant.

A paired t-test can be more powerful than a 2-sample t-test because the latter includes additional variation occurring from the independence of the observations. A paired t-test is not subject to this variation because the paired observations are dependent. Also, a paired t-test does not require both samples to have equal variance.

## RESULTS AND DISCUSSION

Below are the summarized findings on the pre and post questionnaire; before and after the employees play the board game. The findings are group according to the muamalat sales contracts and Islamic banking operations such as *tawarruq*, *murabahah*, *istisna*, *rahnu*, *ijarah*, *aimat*, *aitab* ‘*inah*, *ujrah* and zakat operations. In addition to the descriptive analysis, paired sample t-test was used to analyze the significant differences before and after playing the game. The results are shown as follows:

**Table 1: Paired Sample t-Test**

Product	Questions	Pre/Post	Mean	Sig. (2 tailed)
Tawarruq product	<b>Question 1</b> Tawarruq Financing is sale and purchase contract	Pre_1	3.9123	.095
		Post_1	4.0702	
	<b>Question 2</b> Tawarruq Financing requires customer to buy a commodity.	Pre_2	3.8772	.052
		Post_2	4.1053	
	<b>Question 3</b> Tawarruq Financing requires customer to appoint bank to be an agent of his behalf	Pre_3	3.7719	.000*
		Post_3	4.1930	
Murabahah product	<b>Question 4</b> Murabahah Financing requires	Pre_4	3.3333	.000*
		Post_4	3.9649	

	customer to know the cost price of an asset			
	<b>Question 5</b> Murabahah Financing requires bank to buy the asset first.	Pre_5	3.2143	.000*
		Post_5	3.8571	
Istisna'' product	<b>Question 6</b> Istisna'' Muwazi is two Istisna'' contracts which come after another.	Pre_6	3.0536	.000*
		Post_6	3.8929	
	<b>Question 7</b> Istisna'' Muwazi requires bank to act as developer.	Pre_7	3.0357	.000*
		Post_7	3.5893	
	<b>Question 8</b> Istisna'' Muwazi requires bank to assign another actual developer to develop the property.	Pre_8	3.1228	.000*
		Post_8	4.1404	
Aimat'' product	<b>Question 9</b> AIMAT is a hybrid of Ijarah contract and hibah contract.	Pre_9	3.1930	.000*
		Post_9	4.0000	
	<b>Question 10</b> AIMAT requires customer lease an asset from the bank for certain period	Pre_10	3.2143	.000*
		Post_10	3.9821	
Aitab product	<b>Question 11</b> AITAB is a hybrid of Ijarah contract and sale contract	Pre_11	3.3750	.000*
		Post_11	4.0357	
Aimat' & Aitab product	<b>Question 12</b> AIMAT and AITAB differ in the end of the product transfer	Pre_12	3.1786	.000*
		Post_12	4.0179	
Al-Rahnu	<b>Question 13</b> Al-Rahnu is used to obtain fast cash	Pre_13	3.7500	.000*
		Post_13	4.1964	
	<b>Question 14</b> Al-Rahnu allows charging the safekeeping of the gold fee known as Ujrah fee	Pre_14	3.6964	.013
		Post_14	4.0179	
	<b>Question 15</b> Al-Rahnu allows customer to obtain cash via the concept of Al-Qard	Pre_15	3.3929	.000*
		Post_15	4.0893	
Musyarakah	<b>Question 16</b> Musyarakah Mutanaqisah is hybrid of Ijarah and sharing contract.	Pre_16	3.2321	.000*
		Post_16	4.0893	
	<b>Question 17</b> Musyarakah Mutanaqisah requires bank to buy an asset first before leasing it to bank and customer under Musyarakah	Pre_17	3.0526	.013
		Post_17	3.6491	

	agreement			
Zakat	<b>Question 18</b> Zakat is allowed for gold	Pre_18	3.8545	.000*
		Post_18	4.4000	
	<b>Question 19</b> Zakat is allowed for salary	Pre_19	3.8947	.001*
		Post_19	4.3333	
	<b>Question 20</b> Zakat is calculated on 2.5% of the salary and gold	Pre_20	3.5714	.000*
		Post_20	4.3214	

Based on Table 1 above, out of 20 questions, 16 questions are significant in terms of understanding the knowledge of muamalat sales contracts and Islamic banking operations before and after playing the board games. The employees were asked on the concept of tawaruq product before playing the board game Question 3 such as ‘*Tawarruq Financing requires customer to appoint bank to be an agent of his behalf*’. The mean score before playing the game is 3.77. After playing the board game the mean score increase to 4.19 and the result is significant with the p value <0.05. This shows that there is a statistically significant improvement of understanding on tawaruq concept after playing the board game. However, **Question 1 and 2** in the questionnaire there is no significant difference in the mean score since most of the employees are aware on the basic concept of *tawarruq* that requires bank to be the agent of the customer in the contract. The results of no statistically significant differences between pre and post are expected since Question 1 and 2 is a basic knowledge for these employees.

Question 4 and 5 highlight on *murabahah* product. Question 5 ‘*Murabahah Financing requires bank to buy the asset first*’ shows there is significant difference in mean value, which is 3.21 before and 3.86 after playing the game. The employees manage to understand well in the underlying contract that in *murabahah* financing, bank should buy the asset first.

Next, the questions highlights on *Istisna’ Muawazi* product whereby there is a significant differences in all questions related to *Istisna’*. The employees are able to understand the basic pillars in *Istisna Muawazi* that is i) it is two *Istisna’* contracts which come after another, ii) it requires bank to act as developer and iii) it requires bank to assign another actual developer to develop the property. The mean value for *Istisna Muawazi* before and after playing the game are i) 3.06 & 3.89 ii) 3.03 & 3.59 and iii) 3.12 & 4.14. Thus, it shows that the employees manage to develop the understanding of *Istisna’ Muawazi*

instantly through the board game. This finding is rather interesting because based on the trainers' past experience, the concept of *Istisna' Muawazi* is quite difficult to be grasped by the trainees in previous training programs, but using games, they are able to understand the contract.

In terms of AIMAT product, out of 2 questions related, both questions show the significant difference in the mean score with the p-value 0.000. Most of the employees were not sure that AIMAT is a hybrid *ijarah* and *hibah* contract. However, suprisingly after playing the board game the students know that AIMAT product requires customer lease an asset from the bank for certain period.

There are 3 questions related to Ar-Rahnu product. Even though the term of Ar-Rahnu is general in nature, there are 2 questions that show significant differences before and after playing the board game. This can be seen through the mean score for each question '*Al-Rahnu is a mean to obtain cash*' the mean value before is 3.75 and after 4.20. For the next question '*Al-Rahnu allow to charge safekeeping of the gold fee known as Wadiah fee*' the mean value before is 3.69 after 4.01. This shows that the employees are aware on the operation of Ar-Rahnu since there is no significance difference with the mean. Next statement discussed on '*Al-Rahnu allows customer to obtain cash via the concept of Al-Qard*', there is a significant difference on the analysis, the mean score before playing the game is 3.39 and after playing the game is 4.08.

In terms of knowledge on zakat, zakat on gold and agriculture is 2.5% of the current value. Based on this statement, there is significant difference in the mean value before and after playing the board game with the p-value of less than 0.001 in all question of zakat.

## CONCLUSION

The data obtained from our questionnaire indicated that the use of games in the training session setting is an effective way to increase the understanding the complexity of the concepts and it applicability in training the bank employees. The use of games can clearly be used as a strategy in increasing engagement and content retention within the learning environment.

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**INTERNATIONAL FINANCIAL INTEGRATION THROUGH DEPOSITARY  
RECEIPTS (DRS)**

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## ABSTRACT

*The issue of liquidity and under development of the Organisation of Islamic Cooperation (OIC) stock markets has caused problems to companies in those countries that seek higher equity capital. One way out of this problem is to employ international markets more intensively by seeking cheaper cost of capital through Depositary Receipts (DRs). Many studies on DRs focused on emerging and developed countries, leaving many OIC countries behind. Thus, this study investigates the financial implication by examining the integration of returns of local and foreign stock markets via American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs) of OIC countries. Techniques employed in this study are cointegration and the speed of adjustments to examine the existence of integration between the local and foreign stock markets. The study covers a sample of 146 firms from 17 OIC countries that are cross-listed as ADRs or GDRs from 1992 to 2011. The findings show mixed results, when some markets provide evidence of integration while others show evidence of segmentation. The study on the integration between DR and home equity markets has practical implications for both the international as well as domestic investors especially on portfolio selection, risk management, and asset pricing.*

**Keywords:** *Depositary Receipts (DRs), cross-listing, OIC countries, Islamic finance, cointegration*

## INTRODUCTION

The capital markets around the world tend to harmonise their policies and regulations due to the pressure of global competition in the last few decades. This financial globalisation is also affecting stock markets within the Organisation of Islamic Cooperation (OIC)<sup>125</sup> countries. Despite this exposure, a study by the World Bank reveals that many capital markets of the OIC countries remain highly illiquid and segmented, with trading capitalisation concentrating on a few stocks. Out of the total 57 constituent countries, only 21 stock markets fall under the purview of World Development Indicators (World Bank, 2006). The universal reasons that hinder these stock market developments are the weak legal system and regulations, a limited supply of institutional investors, less support from the private sector, and the lack of transparency and accountability. In addition, most companies in the OIC countries with less developed capital markets have not participated in global consolidation waves and are still pursuing a homemade strategy in developing

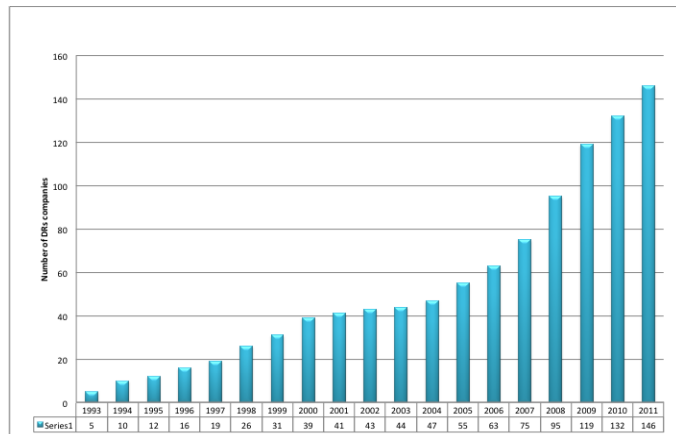
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<sup>125</sup> The Organisation of Islamic Cooperation (OIC) (formerly Organisation of the Islamic Conference) is the second largest intergovernmental organisation after the United Nations which has a membership of 57 states spread<sup>ing</sup> over four continents. The Organisation is the collective voice of the Muslim world in ensuring to safeguard and protect the interests of the Muslim world in the spirit of promoting international peace and harmony among various people of the world.

their own stock market (Hassan & Suk-Yu, 2007). Apart from that, most OIC stock markets are illiquid and relatively small to most emerging markets and tailing even further behind the developed markets.

Some of these companies need liquidity and enhance their value but are being held down by their domestic stock markets. One of the easiest solutions to this problem is to employ international markets more intensively. In some emerging markets, this internationalisation process is the outcome of companies trying to break away from poor domestic environments with poorly functioning markets and weak institutions (Karolyi, 2004; Torre et al., 2005). Claessens et al. (2003) proposed some form of cross-border linkages with other exchanges to achieve cost savings from many different sources, for example economy of scale, sharing system for equity trading, and harmonising rules and requirements between the exchanges with respect to trading and membership. Over the last decades, there has been an increase in the movement of securities market activities to major international financial exchanges, such as London and New York. Many large corporations try to expand their investors' base by listing their stock and raising capital in the market that can offer financing with the lowest costs.

Many approaches have been taken to enhance the capacity and integration of stock markets to promote intra-investment among the OIC countries and the most popular instrument used is Depositary Receipts (DRs). The importance of DR is that it represents ownership of equity shares in a foreign company and it is also one of the popular means to access the international markets. Over the last decade, global trading in DRs has increased dramatically to an all-time high of 150 billion DRs, with a value of \$3.4 trillion, in 2010 (JP Morgan, 2010). Throughout this period, the number of firms listing their securities via DRs has also increased in the OIC countries (refer to Figure 1). In 1993, only five companies from OIC countries subscribed to DRs, but the number has increased to 146 companies in 2011.



**Figure 7: Number of companies that subscribed to DRs (OIC countries)**  
**Source: Bank of New York Mellon, 2011**

The critical question is whether these instruments promote integration between the local and foreign stock market. Financial integration has strong implications on financial stability that it would benefit the region through more efficient allocation of capital, a lower probability of asymmetric shocks, a more robust market framework, and would help to improve the capacity of the economies to absorb shocks and foster development. On the negative side, intensified financial linkages in a world of high capital mobility may also instigate the risk of cross-border financial contagion, in particular when the region's economies are dependent on one another (Yu et al., 2010). According to migration view, internalisation through cross-listing will induce a shift of trade from local market to major international financial market. This condition inevitably hurts the trading and liquidity of the local stock market. As a result, it is vital to have appropriate measures or indicators to monitor the development and assess the progress of financial integration in the region.

Based on the law of one price (LOOP), cross-listed shares represent the same assets and therefore should have identical prices if they are converted into the same currency. Based on this analogy, one frequently used definition of financial integration is that financial markets are said to be integrated when the LOOP holds. As with so many techniques available, several studies uphold the LOOP and conclude no arbitrage opportunities exist (Alaganar & Bhar, 2002; Kato et al., 1991; Rosenthal & Young, 1990; Wahab et al., 1992). Kato et al. (1991) directly compared the market prices of ADRs with their underlying foreign stocks (eight from Australia and Japan and seven from England) for differences and correlations. They found no significant differences between the prices of

the two identical types of claims and concluded that no arbitrage opportunities exist between international capital markets encompassed by their study.

However, Wahab et al. (1992) differed and found clashing evidence of this LOOP. They found that there are possible differences in return volatilities of ADRs and their respective underlying shares due to market imperfections, differential trading frequency, and market micro-structure effects. Although quite a number of empirical studies support the notion of LOOP with or without the aid of arbitrage process; nevertheless, not all studies reach the same conclusion. Some studies discover the LOOP is often violated (Chan et al., 2008; Froot & Dabora, 1999; Gagnon & Karolyi, 2010).

Thus, the objective of this study is to examine from an empirical standpoint the impact of DRs on the integration between the OIC and foreign stock markets. Most of the studies concentrated on emerging and developed countries but did not look into the DR activities of OIC countries. This means that there is still a lack of knowledge towards the impact of DR activities on this particular group of cross-listed shares.

## METHODOLOGY

The financial integration between these markets is determined by two methods. The first method is by examining the cointegration between the price of cross-listed and home-market shares, whilst the second methods measure the speed of convergence of the price deviations from the parity back to the equilibrium of these shares.

### *Price parity for cross-listed pairs across time and cointegration*

As mentioned earlier, one frequently used definition of financial integration is when the LOOP holds. Theoretically, since a DR and its underlying share are identical and comparable assets, logically the price of a DR in foreign market should be similar to the value of its underlying share in home market. Any identical or comparable assets that trade across different markets should produce the similar price, measured by cross-market premium (DR price minus home-market share price). Consequently, in a market that is fully integrated, the value of cross-market premium should be nil or zero.

Since the home-market prices use home markets' currency, thus we need to firstly convert these home-market prices into US dollars at the exchange rate. For the purpose of this study, PH is equivalent to the price of home share value after converting the home market shares in home currency (PHLC) to US dollar using the exchange rate ( $S_t$ ).

$$PH_t = PHLC_t * S_t$$

$PDR_t$  on the other hand is the price of DRs expressed in US dollar (PD) after being adjusted for the DR ratio (R).

$$PDR_t = R * PD_t$$

In this study, the price differences for each pair are being analysed in detail. First, the absolute price discrepancy is simply the measure in dollars of the difference between prices of domestic market and DRs  $(PH - PDR)_t$ . Then, the log-price differences are calculated by taking the natural logarithm of price  $(PH_t)$  expressed in US dollars divided by DRs price  $(PDR_t)$  and can be expressed in this formulae  $(\ln(PH/PDR))_t$ .

$$\text{Price Difference} = \ln(PH_t/PDR_t) = \text{DR Discount(Premium)}$$

If the theory of LOOP holds, the price and return of these cross-listed shares should be similar. However in some cases, this theory is not applicable as a DR may be sold at either a discount or a premium to the value of the underlying asset mostly due to exchange rate expectations and the transaction costs associated with conversion of the DR (Arquette et al., 2008). If the cross market difference is positive, we denote it **DR discount**. It means that the DR shares trade lower than the values attached to the underlying shares in the home market. Otherwise, it is denoted **DR premium**, meaning that the DR shares selling abroad have higher prices than the similar home-market shares.

Following the LOOP, these shares that trade across different economies should not only generate similar price but also the same return. If there is a small deviation or discrepancy across economies as measured by the cross-market return dispersion, it will imply that the equity markets are fully integrated in the sense of return convergence. For this analogy, the daily changes in  $\ln(PH/PDR)_t$ , or the daily return differences in the price deviations are computed as well.

$$\Delta \ln(PH/PDR)_{t-1} = [\ln(PH_t/PDR_t)]_t - [\ln(PH_t/PDR_t)]_{t-1}$$

There is an evidence of integration if the prices of the DR and underlying shares are cointegrated. This means that the difference between these two prices is a mean-reverting, I(0) process. Based on the above, the first hypothesis can be formally stated as follows:

*H1: If the prices of the DR and its underlying shares are cointegrated, there is an indication that the markets are integrated.*

All these data on DRs prices, underlying share prices, and price differences will be tested on several tests such as stationary test and cointegration test. The cointegration test would test whether or not the prices of the DR and home-market shares will go back to the equilibrium. However, the determination of unit root or stationary test is important before the cointegration test is performed.

The unit root test is very important in the context of time series analysis so as to check the level of stationarity of the data as to advance further in testing the cointegration. Furthermore, it is also a well-known fact that almost all financial data are non-stationary in their original form (Doidge et al., 2009). Thus, Augmented Dickey Fuller (ADF) was applied in this study.

### ***The speed of convergence***

In addition of using cointegration technique, we also applied another technique to assess integration. Another approach to measuring this is by capturing the speed of adjustment coefficients. As to measure this speed of adjustment of the deviations from parity, rolling and recursive regressions procedures (Autoregressive Model) were applied. Higher convergence speeds reflect a quicker convergence to LOOP, hence stronger financial integration. The persistence of shocks is estimated using the Augmented Dickey–Fuller model, with one autoregressive component and other lagged differences. That is, we estimate the following model ( $x = \ln(\text{PH/PDR})_t$ ):

$$\Delta x_t = \beta x_{t-1} + \sum_{j=1}^k \phi_j \Delta x_{t-j} + \varepsilon_t$$

The equation measures the change in the premium/discount the differences between the price of the underlying stock and the price of the DR. Put differently,  $\beta$  provides a measure of the speed of convergence of the premium back to its mean. The higher values

of these coefficients, as the sample rolls forward, can be interpreted as higher degree of financial integration (Pascual, 2003; Yeyati et al., 2009).

The value of  $\beta$  is a greater contributor to the degree of financial integration and thus the hypothesis is stated as follows:

*H2: If the value of  $\beta$  is increasing, there is an indication that the markets are integrated.*

### ***Data Descriptions and Model Specification***

For the purpose of this study, we used time series data from 1992-2011. This information is derived from the “DR Directory” of the Bank of New York Mellon<sup>126</sup> as of 31 December 2011 and the numbers are gathered from the active DRs. These data collection start from the Bank of New York<sup>127</sup> since it has a rather complete DR Directory that contains information on current DR activities.

## **ANALYSIS AND FINDINGS**

The summary statistics of DRs in the OIC countries as of 2011 are presented in Table 1. Overall, Turkey led the pack by having 46 DRs, followed by Indonesia (36), Kazakhstan (26), and Egypt (25). The breakdown by DRs comprising of ADRs and GDRs are clearly laid out in Table 1. Generally, the pattern varied by country. Specifically, by looking at the pattern in Table 1, all non-Asian countries were likely to subscribe to GDRs<sup>128</sup>, except for Turkey. On the other hand, Asian countries such as Malaysia and Indonesia dominated the issuance of ADRs, with the exception of Bangladesh and Pakistan.

**Table 7: The Summary of DRs as at December 2011**

No	Country	Companies	ADRs	GDRs	Total DRs	Effective year of DR listing
1	Bahrain	3	0	6	6	2006
2	Bangladesh	1	0	1	1	2005
3	Egypt	13	5	20	25	1996
4	Indonesia	36	36	0	36	1994
5	Jordan	3	2	2	4	1997

<sup>126</sup> Retrieved October 20, 2011 from <http://www.adrbnymellon.com/>.

<sup>127</sup> These data can be retrieved October 20, 2011 from

[http://www.adrbnymellon.com/dr\\_directory.jsp?paramUserType=broker](http://www.adrbnymellon.com/dr_directory.jsp?paramUserType=broker) and according to Kim, BNY database was substantially more reliable and comprehensive than that of Citibank.

<sup>128</sup> The exchanges involved in GDR are London and Luxemburg Stock Exchanges.

6	Kazakhstan	15	2	24	26	1999
7	Kuwait	1	0	2	2	2008
8	Lebanon	4	1	5	6	1997
9	Malaysia	10	10	0	10	1983
10	Morocco	1	0	2	2	1996
11	Nigeria	6	0	10	10	1998
12	Oman	1	0	2	2	2005
13	Pakistan	9	2	14	16	1994
14	Qatar	2	0	4	4	1999
15	Tunisia	1	0	2	2	1998
16	Turkey	37	26	20	46	1993
17	UAE	3	1	3	4	2006
	<b>TOTAL</b>	<b>146</b>	<b>85</b>	<b>117</b>	<b>202</b>	

**Source: Bank of New York Mellon and Datastream**

In Table 1, the number of companies taking up DRs may not be equal to the number of DRs. This is due to the fact that the same companies may have subscribed to both ADR and GDR at the same time. For example, in Egypt there were 13 companies that subscribed to DRs and yet they issued 5 ADRs and 20 GDRs. Meanwhile, the effective start-up year for DR varied across countries, as early as 1983 for Malaysia and as late as 2008 for Kuwait.

Based on the total issues of 202 DRs, more than half of DRs were GDRs. The higher number of GDR issues compared to ADRs indicated that these foreign companies preferred London or Luxembourg to the US. According to Doidge et al. (2009), by 2005 New York's shares exceeded London cross-listings by only 59% compared to 78% in 1998. Many argued that London has become more competitive in attracting foreign listings than New York. A popular justification for this decrease in foreign listings is that the introduction of the Sarbanes-Oxley Act (SOX) in 2002 that imposed severe costs on companies and their managers and thus made the US listings significantly less attractive to these foreign firms. Nonetheless, by referring to Table 1, countries such as Indonesia, Malaysia, and Turkey still preferred ADRs compared to GDRs. This is because the US market is known for their legal structure, stringent nature of SEC of USA requirements, and most importantly higher transparency in financial disclosure (Doidge et al., 2009; Martin, 1995; Sevic et al., 2010).



### *Price Parity for Cross-Listed and Home-Market Shares*

As to arrive at the final sample, the screening of data was implemented<sup>129</sup>. Initially, the number of companies was 146, but after applying these screens, we identified a subset of 34 potential home and cross-listed pairs. Out of these 34 home and cross-listed pairs, almost 85% of these companies subscribed to ADR, whilst the rest were dominated by GDR issuance with a share of 25%. ADR/GDR Level I clearly led with a 71% (24 companies), whilst 11% (4 companies) were GDR Regulation S, 9% of ADR Rule 144A (3 companies) and ADR Level III (3 companies) respectively. Moreover, all the samples used US dollar as the currency although a few of them traded on the Stock Exchange Automated Quotation (SEAQ) International, London.

Tables 2 and 3 present the summary statistics of the daily price discrepancy for each company and country. In Table 2, the absolute price discrepancy was simply the measure in dollars of the difference between prices in host and domestic markets  $(PH-PDR)_t$ . For the final sample, the average price differences was negative USD1.2, which implied that, on average, DRs traded at a small premium relative to their home-market share counterparts. Across countries, we observe interesting patterns in the mean and median price differences. For countries such as Egypt, Indonesia, Lebanon, Nigeria, and Qatar, the mean prices of DR were higher than their underlying share prices in home market. The highest difference came from Egyptian companies, at -USD4.77. Indonesia had the lowest value of almost zero in their price differences. On the other hand, relative to their home shares, DRs from Malaysia and Turkey were selling at a discount averaging of USD 0.26 and 0.8 respectively. Across countries, Egypt had the highest standard deviation of USD6.07, whilst Indonesia had the lowest standard deviation of price differences of USD0.03.

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<sup>129</sup> The same rules by Yeyati et al. (2009) were being applied.

**Table 2: The Exact Value of the Daily Price Discrepancies (PH-PDR)<sub>t</sub>**

	Mean	Median	Maximum	Minimum	Std. Dev.
<b>ALL AVERAGE</b>	<b>-1.21</b>	<b>-0.28</b>	<b>5.14</b>	<b>-7.61</b>	<b>2.60</b>
Egypt	-4.77	-1.56	5.33	-23.91	6.07
Indonesia	-0.01	-0.01	0.15	-0.12	0.03
Malaysia	0.26	0.15	1.41	-1.17	0.47
Turkey	0.80	0.82	2.04	-0.41	0.52
Other - Lebanon	-0.40	-0.38	0.65	-1.40	0.32
Other - Nigeria	-0.02	-0.02	0.02	-0.08	0.02
Other - Qatar	-4.36	-0.93	26.38	-26.19	10.77

Table 3 shows the relative price differences. The average relative price difference was zero, which implied that, on average, DRs trade at a similar value relative to their home-market share counterparts. Across countries, we observe interesting patterns in the mean price differences. For Malaysia and Turkey, their DRs trade at discounts of 43% and 23% respectively. On the other hand, relative to their home shares, DRs from Egypt, Lebanon, Nigeria, and Qatar trade at premiums of 64%, 6%, 22%, and 10% respectively. Indonesia, on the other hand, produced zero relative price differences, implying that all cross-listed share prices were trading at the same price to their underlying shares in home market. Across countries, Malaysia had the highest standard deviation of 67%.

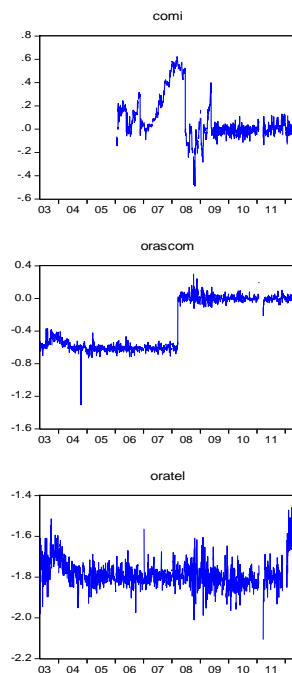
**Table 3: The Relative Value of the Daily Price Discrepancies [Ln(PH/PDR)<sub>t</sub>]**

	Mean	Median	Maximum	Minimum	Std. Dev.
<b>ALL AVERAGE</b>	0.000	0.000	0.000	0.000	0.000
Egypt	-0.644	-0.601	-0.176	-1.105	0.182
Indonesia	-7E-03	-5E-03	2E-01	-2E-01	5E-02
Malaysia	0.438	0.092	2.061	-0.479	0.665
Turkey	0.231	0.233	0.486	-0.030	0.114
Other - Lebanon	-0.057	-0.055	0.146	-0.191	0.045
Other - Nigeria	-0.219	-0.239	0.198	-0.689	0.171
Other - Qatar	-0.098	-0.031	3.137	-1.063	0.520

Based on the summary of the exact and relative value of the daily price discrepancy, the prices of cross-listed and home market shares were trading at more or less similar value. However, there is a need to conduct more tests to confirm this descriptive finding. In the

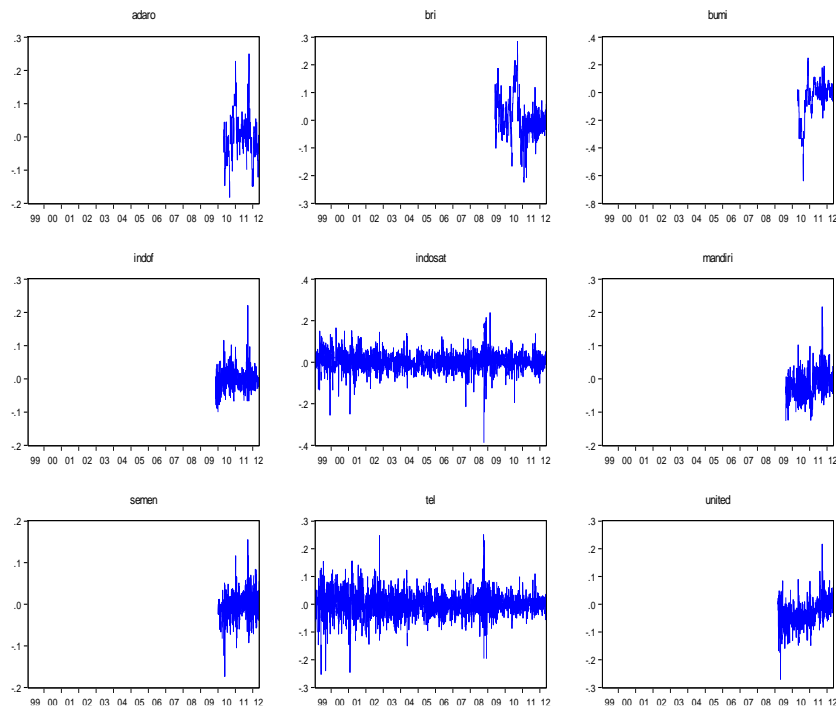
next section, the test of cointegration, the speed of convergence, and concordance index are being explored in great detail as to examine the existence of integration.

However, before delving into the cointegration test, it is best to have a first glance at the price differences for each country shown in Figures 2 to 6.



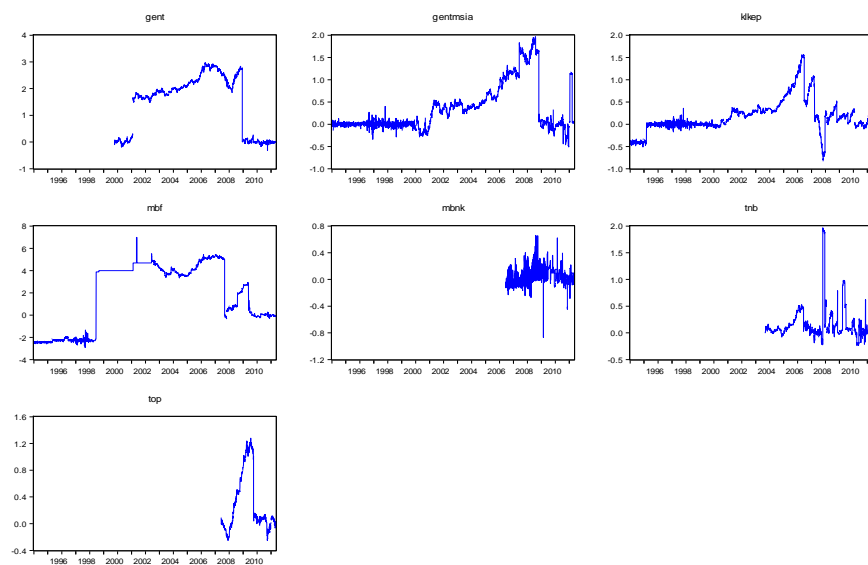
**Figure 2: Price differences for DR companies – Egypt**

Figure 2 presents the graphical illustration of price differences for Egypt. It seems that Oratel company had a rather smaller standard deviation in price deviation compared to Comi and Orascom, but the average price differences oscillated around 1.8, higher than the other two companies. Figure 3 displays the price differences for Indonesian companies and the volatility of the price differences was less compared to the Egyptian companies. Most of the price differences for Indonesian companies moved around zero with a small standard deviation.

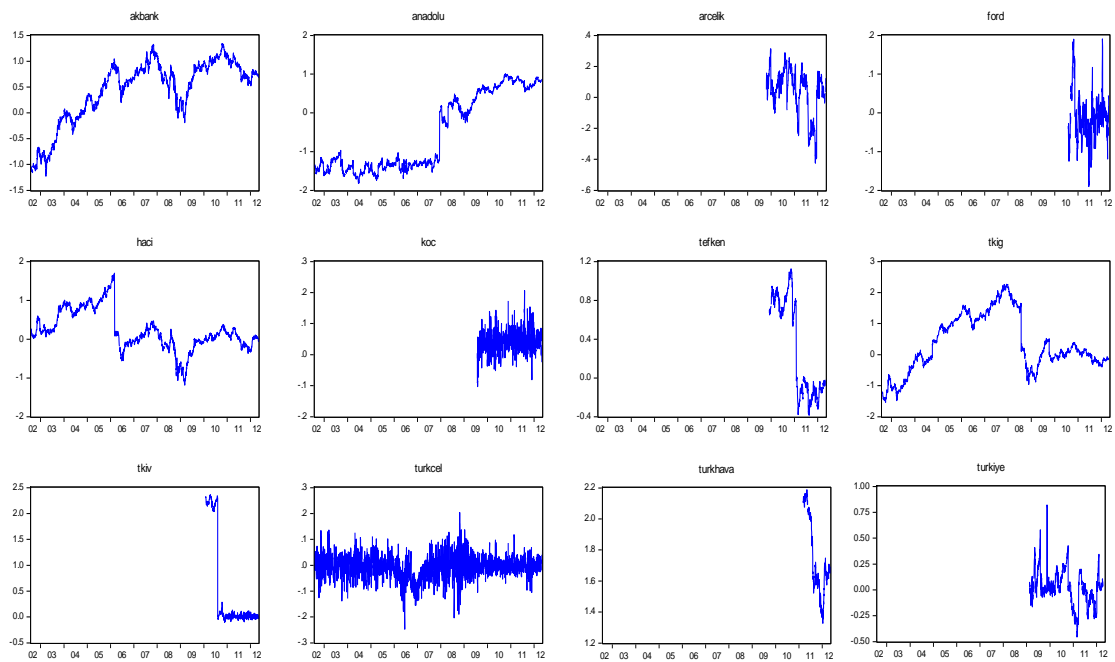


**Figure 3: Price differences for DR companies - Indonesia**

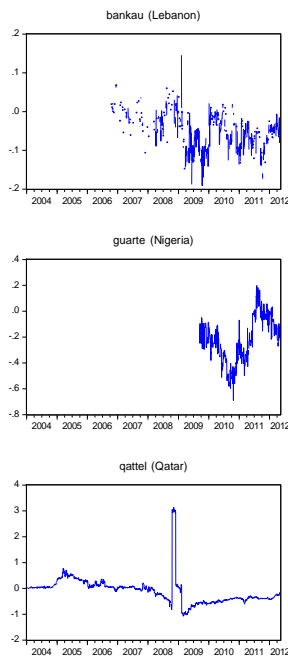
Malaysia, on the other hand, showed a rather different story. Out of all these countries, Malaysia probably had the highest volatility in terms of price differences. All companies showed a wide standard deviation of price differences in Figure 4. The same patterns applied to Turkish companies in Figure 5. Most companies had a wide standard deviation except for two companies, Turkcel and Koc. For these two firms, the price differences oscillated around zero with a small standard deviation.



**Figure 4: Price differences for DR companies - Malaysia**



**Figure 5: Price differences for DR companies - Turkey**



**Figure 6: Price differences for DR companies - Others**

Figure 6 shows the patterns of price discrepancies of three companies from three different countries. Bankau from Lebanon and Guarte from Nigeria displayed rather high volatility compared to Qatari company, Qattel. Qattel's price differences were rather stable throughout 2004 until 2011. However it experienced high volatility in 2008 and 2009, when the price differences jumped to 3.

**Cointegration Test**

Before establishing whether or not the daily stock prices are indeed cointegrated, first there is a need to prove that each of these daily prices is non-stationary with a unit root or I(1) when tested individually. Table 4 presents the necessary evidence to support these claims. Using Augmented Dickey-Fuller (ADF) statistics, we tested all the variables by setting the null hypothesis of the series of having a unit root. We found that they were non-stationary in the level form (both for home and DRs' share prices in Columns 1 and 2) and stationary in the first difference. It can be seen that all variables were stationary in the first difference or simply were I(1) process.

**Table 4: Non-Stationary and Cointegration Tests for the Daily Stock Prices**

	ADF Level (Home)	ADF Level (DR)	ADF First Difference (Home)	ADF First Difference (DR)	Cointegration at 5%
<b>EGYPT (3)</b>	(1)	(2)	(3)	(4)	(5)
Comi	0.952	0.386	0.0001	0.0001	Yes
Orascom	0.824	0.307	0.0000	0.0001	No
Oratel	0.230	0.678	0.0001	0.0001	Yes
<b>INDONESIA (9)</b>	ADF Level (Home)	ADF Level (DR)	ADF First Difference (Home)	ADF First Difference (DR)	Cointegration (5%)
Adaro	0.487	0.993	0.0000	0.0000	No
Bri	0.802	0.490	0.0001	0.0000	Yes
Bumi	0.899	0.989	0.0000	0.0000	No
Indof	0.675	0.651	0.0001	0.0000	Yes
Indosat	0.293	0.264	0.0001	0.0001	Yes
Mandiri	0.793	0.283	0.0001	0.0000	Yes
Semen	0.989	0.216	0.0001	0.0000	Yes
Tel	0.588	0.589	0.0001	0.0000	Yes
United	0.943	0.310	0.0001	0.0000	Yes
<b>MALAYSIA (7)</b>	ADF Level (Home)	ADF Level (DR)	ADF First Difference (Home)	ADF First Difference (DR)	Cointegration (5%)
Gent	0.782	0.479	0.0001	0.0000	No
Gentmsia	0.273	0.015	0.0001	0.0010	Yes

Klkep	0.787	0.959	0.0001	0.0001	Yes
Mbf	0.615	0.070	0.0000	0.0000	Yes
Mbnk	0.196	0.019	0.0001	0.0000	Yes
Tnb	0.131	0.0001	0.0001	0.0000	Yes
Top	0.445	0.578	0.0001	0.0000	No
<b>TURKEY (12)</b>	ADF Level (Home)	ADF Level (DR)	ADF First Difference (Home)	ADF First Difference (DR)	Cointegration (5%)
Akbank	0.194	0.000	0.0001	0.0001	No
Anadolu	0.436	0.349	0.0001	0.0001	No
Arcelik	0.083	0.582	0.0000	0.0000	-
Ford	0.222	0.555	0.0001	0.0000	No
Haci	0.155	0.577	0.0001	0.0001	No
Koc	0.441	0.636	0.0001	0.0000	Yes
Tefken	0.356	0.622	0.0000	0.0000	No
Tkig	0.361	0.083	0.0001	0.0001	No
Tkiv	0.211	0.497	0.0000	0.0000	No
Turkcel	0.138	0.003	0.0001	0.0001	Yes
Turkhava	0.541	-	0.0001	-	-
Turkiye	0.308	0.336	0.0000	0.0000	Yes
<b>LEBANON</b>	ADF Level (Home)	ADF Level (DR)	ADF First Difference (Home)	ADF First Difference (DR)	Cointegration (5%)
Bankau		0.485		0.0000	No
<b>NIGERIA</b>	ADF Level (Home)	ADF Level (DR)	ADF First Difference (Home)	ADF First Difference (DR)	Cointegration (5%)
Guarte	0.027	0.798	0.0000	0.0001	Yes
<b>QATAR</b>	ADF Level (Home)	ADF Level (DR)	ADF First Difference (Home)	ADF First Difference (DR)	Cointegration (5%)
Qattel	0.058	0.255	0.0001	0.0001	No

All the values are *p* value

In the last column 5, the results of the Johansen–Juselius likelihood cointegration test showed the existence of long run co-movement between home and DR market shares at 5% significance level for certain companies. An evidence of cointegration implied that the relationship among the variables was not spurious, evidentially there were in equilibrium in the long run. In other words, even though these variables may have diverged in the short run, in the long run however they would converge. Table 4 shows rather mixed results across countries. It shows that out all of these 34 companies, only 53% (18 companies) show evidence of cointegration. Most of these companies came from Egypt (2), Indonesia (7), Malaysia (5), Turkey (3), and Nigeria (1). The test found that

there is a cointegrating vector at 95% significance level on the basis of Maximal Eigenvalue and Trace Stochastic Test. Indonesia dominated with 78% of the subsample showing evidence of integration. Malaysia came in second with 71%, while Egypt came in third with 67%. However, Turkey had only 25% companies that were cointegrated.

**Table 5: Summary of Companies – Cointegration Test**

Country	Total Number of Companies	Number of Companies Cointegrated	Percentage (%)
Egypt	3	2	67%
Indonesia	9	7	78%
Malaysia	7	5	71%
Turkey	12	3	25%
Others	3	1	33%
<b>TOTAL</b>	<b>34</b>	<b>18</b>	<b>53%</b>

Basically, the results in Table 5 show that 47% of the DRs in the sample violated the LOOP and there was no integration between these markets. Instead of analysing the cointegration, it would be interesting to examine the speed of convergence. The speed of convergence will be discussed in great detail in the next section.

### *The Speed of Convergence*

As mentioned earlier in the research design section, the speed of adjustment of the deviations from parity was measured using rolling and recursive regressions procedures (Autoregressive Model). Higher convergence speeds reflect a quicker convergence to LOOP, hence stronger financial integration. In order to measure this, the ADF model with one autoregressive component and other lagged differences were applied.

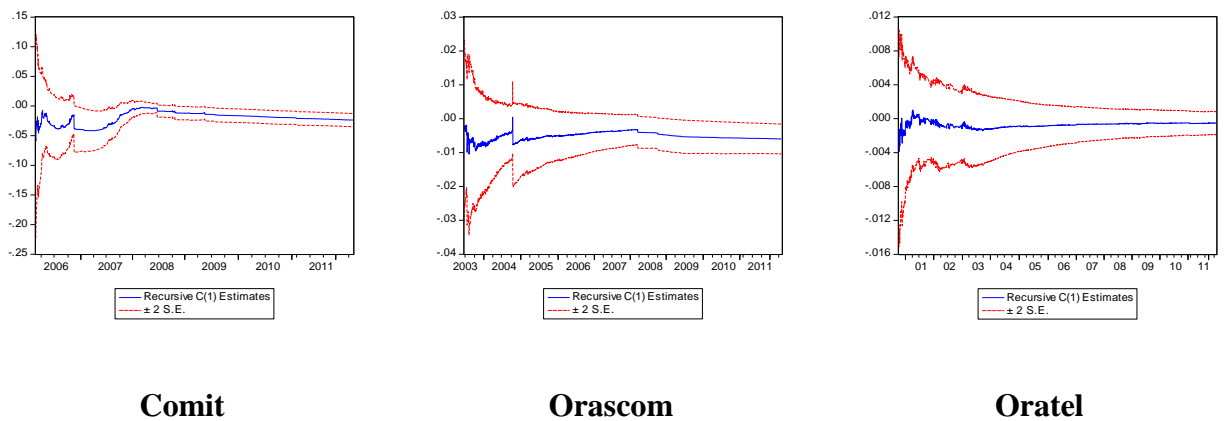
$$\Delta x_t = \beta x_{t-1} + \sum_{j=1}^k \phi_j \Delta x_{t-j} + \varepsilon_t$$

The main interest is to calculate the value of  $\beta$ . This coefficient provides a measure of the speed of convergence of the premium back to its mean.

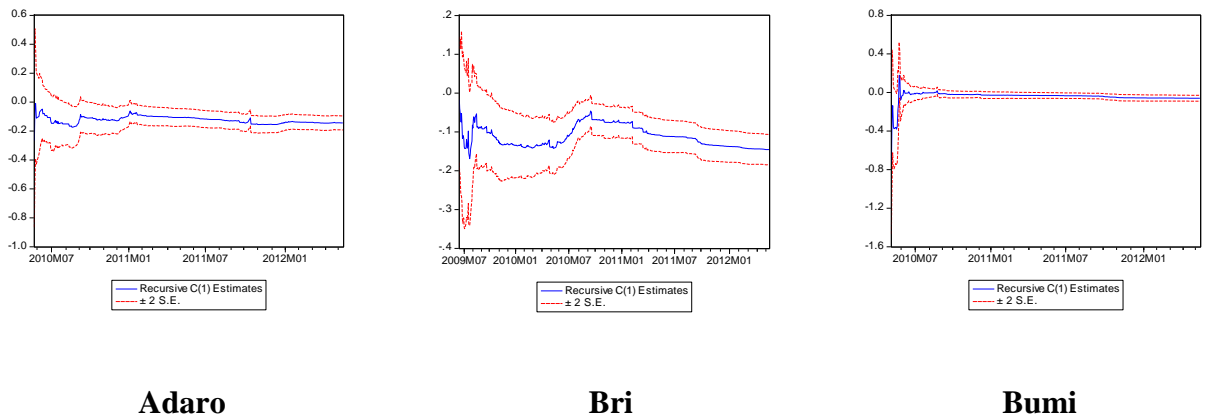
Graphically, a greater speed of adjustment should be reflected if the value of  $\beta$  keeps on increasing (regardless of the positive and negative value). Figures 7 to 11 show the estimates for those coefficients for each company in various countries. Overall, the

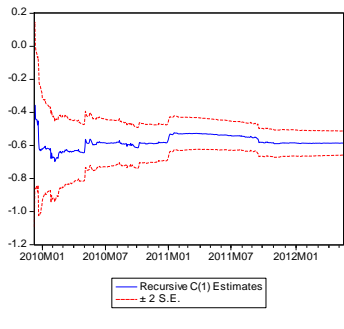


process of integration did not experience any significant changes for all the countries. For example, none of the Malaysian companies showed a greater speed of adjustment except for KLKep but only for a period of six years, from 1995 until 2002. The coefficient estimates started at 0 and then increased to almost 30% in year 2002. But then the coefficient estimates for company KLKep reduced after the turning point in 2002 and remained rather stable around zero after 2007.

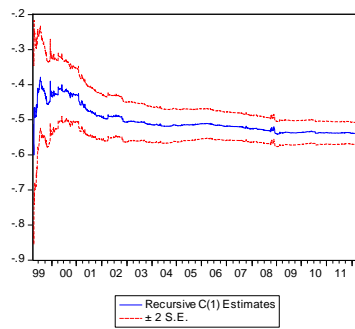


**Figure 7: The speed of adjustment coefficients ( $B$ ) - Egypt**

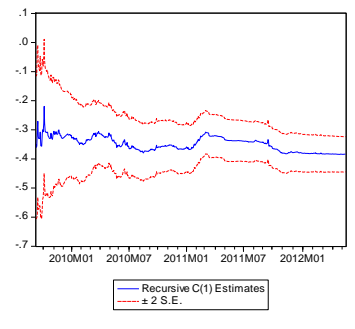




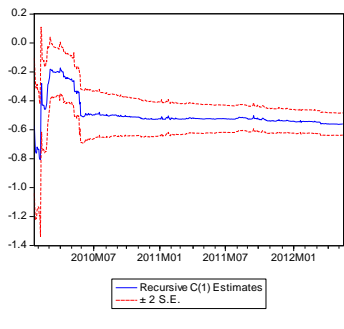
**Indof**



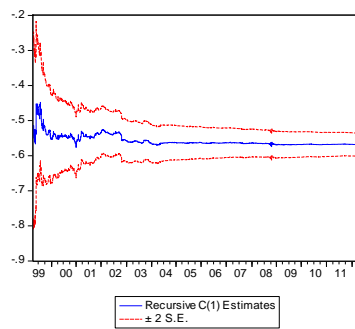
**Indosat**



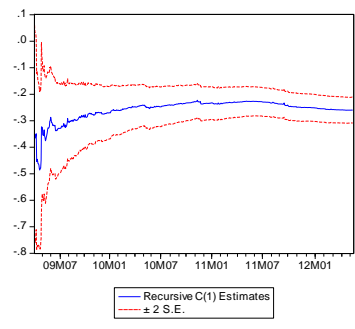
**Mandiri**



**Semen**

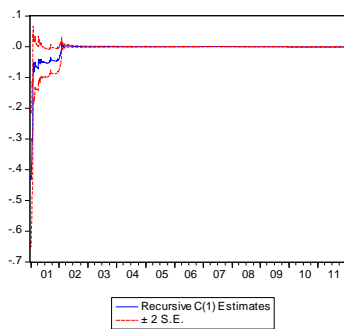


**Tel**

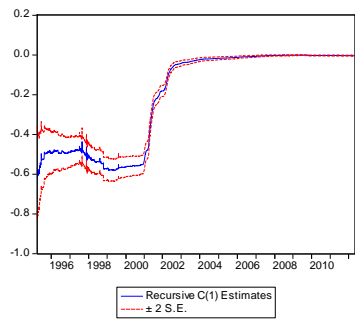


**United**

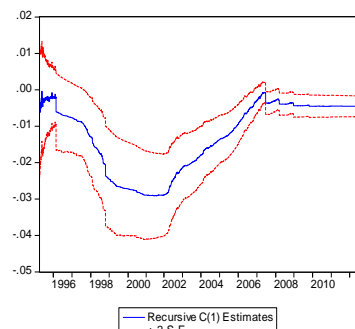
**Figure 8: The speed of adjustment coefficients ( $B$ ) - Indonesia**



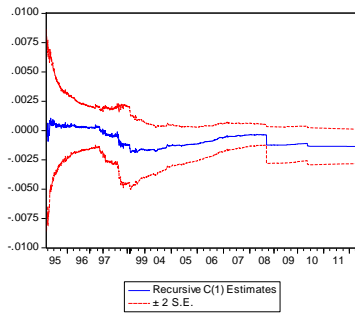
**Gent**



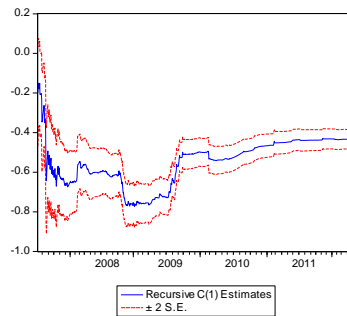
**Gentmsia**



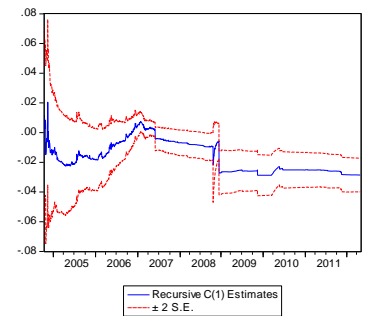
**KLKep**



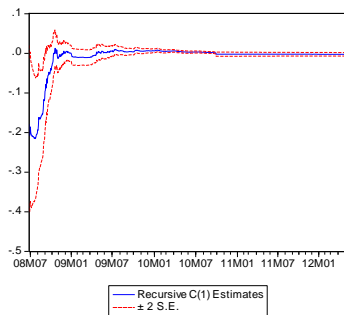
**MBF**



**Mbnk**

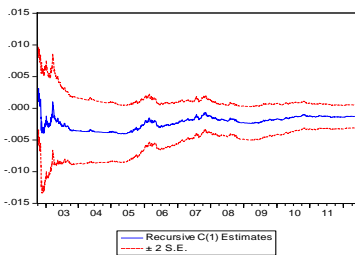


**TNB**

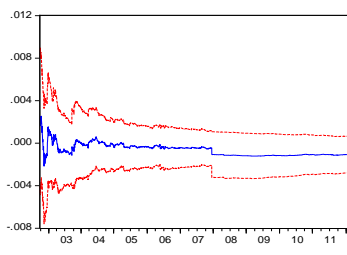


**Top**

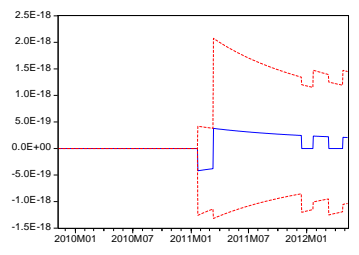
**Figure 9: The speed of adjustment coefficients (B) - Malaysia**



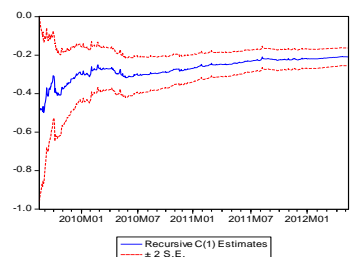
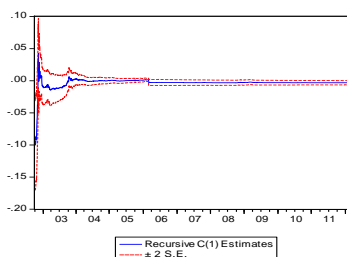
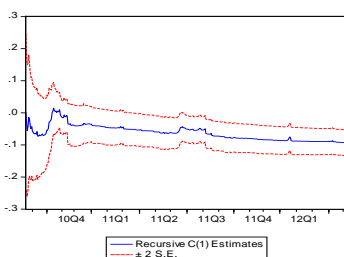
**Akbank**



**Anadolu**



**Arcelik**



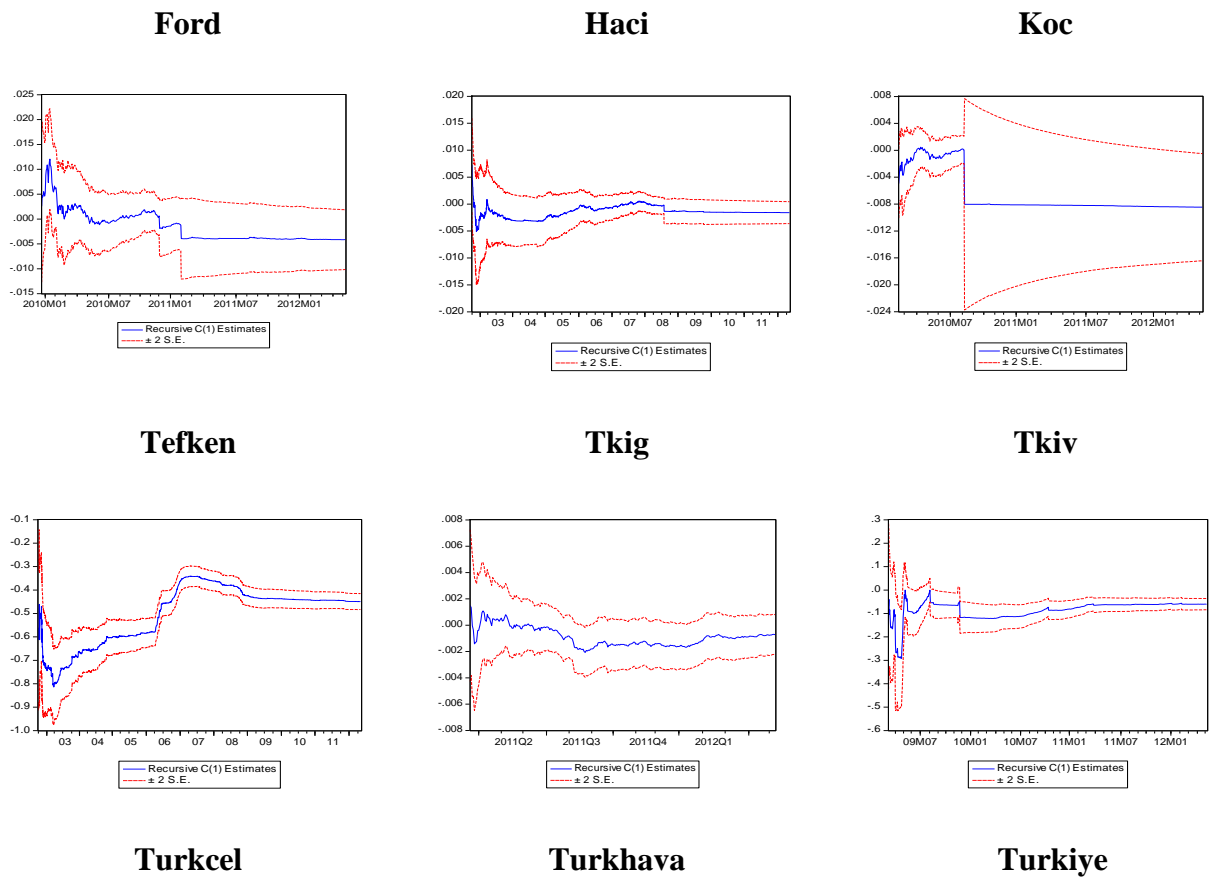


Figure 10: The speed of adjustment coefficients ( $B$ ) - Turkey

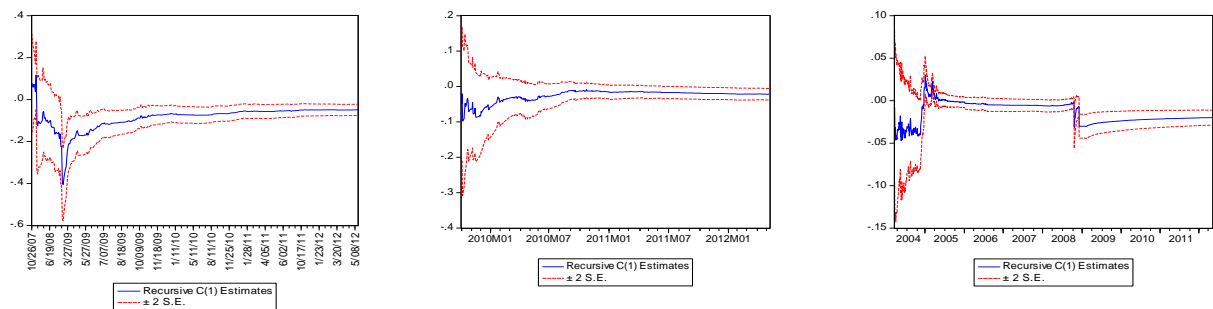


Figure 11: The speed of adjustment coefficients ( $B$ ) - Others

In sum, all these graphical evidences did not indicate a greater speed of financial integration between these home markets and cross-listed markets. This finding is similar to the research done by Gagnon and Karolyi (2010). They found that the convergence process was faster for countries with higher per-capita GDP, stronger investor protection,

higher accounting standards, fewer short sale restrictions, and greater institutional ownership. Since most of the elements stated above were mainly qualities found in developed markets, this could be one of the plausible justifications of why there was no evidence of integration in these OIC markets (usually they fall under emerging markets).

**Table 6: Summary Results on Integration**

<b>Test of Integration</b>	<b>Findings/Results</b>
Cointegration	Only 53% of the companies showed evidence of cointegration. The companies were mainly from Egypt, Indonesia, and Malaysia.
Speed of convergence	None of the companies showed any indications of integration.

In summation, there were rather mixed results of this analysis. One of the reasons for differing findings is due to the fact that our studies had its own limitations in terms of data used in this study. The data were small in scale<sup>130</sup> and the quality of data<sup>131</sup> and this notion is fully supported by Karolyi (2006). Some evidence point to integration, whilst others indicate that the markets are segmented. Both outcomes have their own positive and negative effects. For example, firms in the markets that are not integrated or segmented will certainly have greater investment barriers. This will translate to higher risk, price, and cost of capital. The way to mitigate these negative effects is to adopt policies (in this case, cross-listing) that promote the positive effects of international diversification (Arouri & Foulquier, 2012; Leuz, 2003). If there is integration, the region would benefit through more efficient capital allocation, less probability of asymmetric shocks, a more robust market framework, and help improve the capacity of the economies to absorb shocks and foster development.

Nonetheless, without integration or when the markets are segmented, does have its own benefits. These markets (OIC markets) posit to have better diversification and reduce risk of cross-border financial contagion, especially in the situation when the region's

<sup>130</sup> In this case due to the unavailability of data, we were able to extract a small number of firms and also a number of countries.

<sup>131</sup> There were many missing data and some of these prices were unchanged for some period of time and maybe due to less trading days. The possible explanation could be that these prices were updated and followed the last price of trading day that was available.

economies are dependent on one another (Yu et al., 2010). Basically, the less developed markets such as OIC markets are expected to provide better diversification opportunities compared to other developed markets due to the fact that there is an option to invest in different markets, different securities, and different currencies. Claessens et al. (2002) stated that emerging stock markets have more appealing features in providing investment and diversification opportunities to investors. In another spectrum, the lack of integration could also be a reflection of hindrance to access these markets.

### CONCLUSION

In summary, the cross-listing via DRs produce some evidence of integration. In the case of OIC stock markets, the integration is preferred because if the markets are integrated, the cost of raising capital for the companies is low. Integration can improve local stock market liquidity. If markets are segmented, only local investors can trade in the local markets, whereas all international investors can trade in the local markets if the markets are integrated. Nonetheless, the evidence of integration can be seen either based on the countries or the type of company. In fact, a study by Sabri (2002) discovered that there are still major obstacles concerning the ability and willingness of Arab stock markets to attract international investors. He further suggested that Arab stock markets remove restrictions on foreign investment, improve the regulatory conditions, and reduce fees and bureaucracy in order to attract foreign investors. DRs could be one of the means to increase competition for these firms internationally. Additionally, for international investors, investing shares via DRs could provide a platform for diversifying their portfolio. As mentioned earlier, the OIC countries are in a dire need to come up with mechanism for enhancing cooperation and intra-investment among them. By having the DRs, these companies are able to tap into foreign markets with a lower cost of capital and increase competition.

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## **The Practice of Family Takaful Benefit Distribution in Malaysia in the Context of Islamic Financial Services Act 2013 (IFSA 2013).**

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### **ABSTRACT**

*The standard practice of distributing family takaful benefit in Malaysia is that when a participant of a family takaful dies, the payment of the money by the takaful operator will be to the nominee appointed by the deceased. The nominee will subsequently distribute the money among the participant's legal heirs, in accordance to the fara'id law, even though there is no provision expressly provide in Takaful Act 1984 nor any fatwa issued regarding the position of the money payable by the operator upon the death of the participants. This article analyze the provisions of the IFSA 2013, which detailed several aspects, including the payment of family takaful benefit to the participant's dependents. IFSA 2013 has standardized the practice of takaful benefit distribution among the takaful operators in Malaysia and provide options for participants through conditional hibah by nominating absolute beneficiary.*

**Keywords:** *Takaful, benefit distribution, IFSA 2013,*

### **INTRODUCTION**

Family takaful is an alternative to conventional life insurance scheme in accordance to shariah that provides similar coverage to its conventional counterpart. It is a long term savings and investments contract, with a fixed maturity period that provides assistance to its participants due to untimely death and other mishaps resulting from injury or disablement. The scheme is important in the sense that it provides takaful benefit in the form of compensation to the dependents (heirs) of the participant in the case of untimely death or calamity happening in the future. Therefore, before the scheme be

enforced, the participant is required to nominate a person to receive the takaful benefit. Payment of family takaful benefits by takaful operators in Malaysia is usually in two instances, namely: when the takaful policy has reached its maturity or upon the death or disablement of the participants.

Prior to the implementation of Islamic Financial Services Act 2013 (IFSA), the nominee status in family takaful is still unresolved due to the lack of details on the payment of takaful benefits in the Takaful Act 1984. Takaful Act 1984 does not expressly provide any rules regarding the recipient of the takaful benefits. According to the act, takaful benefits need to be paid to the 'proper claimant'. Proper claimant means 'a person who claims to be entitled to the sum in question as executor of the deceased or who claims to be entitled to that sum under the relevant law'. Upon the death of the takaful participant, the operator will distribute the takaful benefits to the nominee and the takaful operator is free from any liability. However, after the distribution is completely handed over to the nominee, the problem still arises regarding the status of the nominees. This is likely to happen due to the absence of rules regarding the nominated property in Malaysia (Nurdianawati, A and Nazliatul A, 2010).

The standard practice of distributing takaful benefit in Malaysia is that when a participant of a takaful dies, the participant's legal heirs inherit the money paid by the takaful operator. In other words, the payment of the money by the takaful operator to the nominee appointed by the deceased participant is subsequently distributed among the participant's legal heirs in accordance to the fara'id law. This arrangement takes place even though there is no Islamic legal ruling or fatwa issued by any fatwa council in Malaysia, either at national or state level regarding the position of the money payable as compensation by the takaful operator on the occurrences of the death of a participant (Azman, M.N et.al, 2008). However, according to Mohd Kamil and Joni Tamkin, (2017) the division is seen as contrary to the original goals of takaful, which is to create fund for the deceased's dependents. This is because, the takaful benefit received upon the untimely death of the participant sometimes may not reach the most affected dependents due to their status as non-beneficiary or not one of the deceased's legal heir.

One of the methods that can be used to solve the problem is through the use of a conditional *hibah*. Conditional *hibah* allows the total amount of takaful benefits paid to specific beneficiaries as determined by takaful participants without it being subject to

*faraid* law (Mohd Kamil, A. and Joni Tamkin, 2017). This method has also been stipulated in the Islamic Financial Services Act 2013 as well as resolutions issued by the Bank Negara Malaysia Advisory Council.

### **NOMINATION AND HIBAH IN FAMILY TAKAFUL BENEFITS DISTRIBUTION**

Family takaful is a long-term savings scheme that provides investment and protection benefits to takaful participants and their heirs in the event of death or permanent disability. Therefore, benefits provided by family takaful are considered to ease the financial burden faced by beneficiaries of takaful participants who may be affected by the source of income as a result of the death of the participant. Under the family takaful scheme, contributions (premiums) paid by participants will be divided into two accounts, Participant's Account (PA) and Participant's Special Account (PSA). The amounts included in these two accounts are based on the ratio agreed upon by the takaful operator and participants. The AP is dedicated to savings purposes, while PSA is solely for donation purposes based on *tabarru'*. If a participant dies before the policy is mature, his / her beneficiary will receive takaful benefits based on the balance from the PA before the date of death. The beneficiaries also have the right to receive unpaid donations from the date of death to the maturity date of PSA.

The provisions of the Takaful Act 1984 do not specify details of the payment of takaful benefits. Consequently, there is a difference in the aspect of payment of takaful benefits between a takaful operator and another takaful operator. There are two methods commonly practiced by takaful operators in the distribution of family takaful benefits, namely through the appointment of '*wasi*' as a trustee and to provide the takaful benefits to nominee as absolute beneficiary. A study by Nurdianawati Irwani and Nazliatul Aniza (2010) found that in 2010, there were four takaful operators who did not provide a nomination option for takaful benefits as absolute beneficiary (conditional hibah). The four takaful operators are Hong Leong Tokio Marine Takaful, CIMB Aviva Takaful, Etiqa Takaful Berhad and Prudential BSN Takaful Berhad. In such situations, all nominees are considered as executor or trustee. Apart from that, the distribution of family takaful benefits also differs between Muslim participants and non-Muslim participants. A nominee acts only as "executor" or trustee for a Muslim policy, in which the takaful benefits distribution is based on Islamic law of inheritance (*fara'id*). Whereas for non-

Muslim policyholders, nominee is an absolute beneficiary and the benefit distribution is based on the Distribution Act 1959.

Prior to the implementation of the Islamic Financial Services Act 2013 the nominee status remains an issue in the distribution of family takaful benefits due to the absence of regulations on the matter. Because of this, it usually leads to conflict between competing claims parties (Ismail, 2009). Problems may still arise after the distribution is fully submitted to the nominee. The Takaful Act 1984 only states that takaful benefits are payable to "reasonable claimants". The Bank Negara Syariah Advisory Council stipulates that the takaful nomination form provided by takaful operators must be standardized and must clearly identify the nominee's status, either as absolute beneficiary or mere trustee. Unlike takaful, the distribution of the Employees Provident Fund (EPF) is clearly and uniformly stated. For Islamic contributors, the nominee only acts as an administrator (*wasi*), which after the death of the member has an obligation to divide the property of the deceased according to *fara'id* law. For non-Muslim contributors, the nominee will have all the benefits, provided that he or she has reached 18 years of age.

The nominee's status must be settled in a takaful contract as it may avoid an unfair distribution to other heirs. Consider the following scenarios:

**a) Nominee as a Mere Executor**

If the nominee is just the executor, it is his/her responsibility to distribute the takaful benefits according to the Islamic law of inheritance (*fara'id*) to the policyholder's legal heirs. In this context, the nominee may or may not be one of the legal heirs.

**b) Nominee as The Absolute Beneficiary**

If the nominee is the absolute beneficiary, he/she is entitled to the total takaful benefits. Distribution to the other legal heirs is not required. In such case, the takaful benefits are distributed through the concept of *hibah*.

Another issue in the distribution of family takaful benefits is in terms of the heritability of the takaful benefits. Scholars and Islamic practitioners agree on the inherent takaful of the Participant's Account (PA), as it is considered part of the deceased's estate. The money is considered as an estate because it is the right (ownership)

of the participant during his life. However, monies paid by takaful operators taken from the Participant's Special Account (PSA) are still questionable. The portion from the PSA cannot be regarded as part of the estate of the deceased because it is not the rights of takaful participants during his life (Mohd Noor, A & Abdullah, MA, 2015). The money was handed over by the participants for donation purposes to takaful fund funds, which provided compensation money to other participants.

### **IMPLICATION OF ISLAMIC FINANCIAL SERVICES ACT 2013 (IFSA) ON FAMILY TAKAFUL BENEFIT DISTRIBUTION**

As previously mentioned, takaful operators do not necessarily provide options for takaful participants in respect of the takaful benefits payment method before IFSA 2013. In practice, takaful operators will hand over takaful benefits to named nominees. The nominee is deemed to be a trustee and is responsible for distributing the benefit money to eligible heirs based on Islamic inheritance law for Muslim participants. Whereas for non-Muslim participants, the distribution of takaful benefits must be based on the Distribution Act 1959. However, if a takaful participant wishes to give the benefit to a particular party in absolute terms, the participant must fill out the takaful benefits submission form and name the party who receives a conditional *hibah* (Mohd Faiz M. Yusof. et al, 2016).

Implementation of IFSA 2013, not only standardized the practice of payment of takaful benefits among takaful operators in Malaysia, but also provides options in distributing the takaful benefits. However, only the of payments for family takaful and personal accident takaful benefits are detailed in *IFSA* 2013. There was no mention of the payment for general takaful contracts. According to a study by Mohd Faiz M. Yusof. et al (2016), it is because there is no major problem in general takaful benefit claims and usually problems can be solved out of court between participants and takaful operators. In addition to this, factors such as higher compensation amount (as there are elements of protection, savings and investment) and longer maturity periods may contribute to the more attention given to the payment of family takaful benefits.

Paragraph 2 schedule 10 *IFSA* 2013 describes the party authorized to make a nomination. In summary, takaful participants attaining the age of 16 years and above have the power to make nominations either by appointing individuals or certain parties as

trustees or as absolute beneficiary. Participants may make nominations in writing or by filling out the nomination forms to be attached together with the takaful application form. Takaful nomination forms provide three choices to participants to appoint individual either as trustee or as beneficiary or both, depending on the percentage required by the participant (MAA Takaful Berhad, 2013).

A person, who has been appointed to receive takaful benefits, whether as trustee or absolute beneficiary shall receive the payment of such takaful benefits. Absolute beneficiary shall receive the full amount of the takaful benefits. The benefits received are not part of the deceased's estate and cannot be deducted for debt repayment (*IFSA*, 2013). Whereas a person appointed as trustee shall distribute the money under *faraid* law. After *IFSA* 2013 was implemented, all eleven takaful operators in Malaysia have provided options to takaful participants in distributing the benefits. This situation differs from the situation before *IFSA* 2013 is implemented, where there were four takaful operators who do not provide the grant option. Table 1 shows the distribution practices among takaful operators in Malaysia after the implementation of *IFSA* 2013.

**Table1: Review of Takaful Distribution Practices of Nomination and Hibah**

<b>Takaful Operators</b>	<b>Nomination</b>	<b>Absolute Beneficiary (Hibah)</b>
Syarikat Takaful Malaysia Berhad	√	√
Takaful Ikhlas Sdn Bhd	√	√
Hong Leong Tokio Marine Takaful	√	√
CIMB Aviva Takaful	√	√
Etiqua Takaful Berhad	√	√
Prudential BSN Takaful Berhad	√	√
MAA Takaful Berhad	√	√
HSBC Amanah Takaful (M'sia) Berhad	√	√

Source: Mohd Faiz M.Y, et al., 2017

## **THE USE OF *HIBAH* IN DISTRIBUTING FAMILY TAKAFUL BENEFIT**

The Islamic Financial Services Act 2013 (*IFSA*) is a recent act, considered better and provide clearer details than the Takaful Act 1984, especially in terms of the payment

of takaful benefits. It does not only standardize the payment of takaful benefits among all the 11 takaful operators in Malaysia, but also provide options to Muslim takaful participants. It provides options for takaful participants to surrender some or all of the takaful benefits to any party they wish. In fact, according to Mohd Faiz M. Yusof. et al, (2016), the provision of *IFSA* 2013, does not preclude the participants' right to name anyone as their beneficiary, even to those who are not their legal heirs.

The authors argue that the use of conditional hibah can be regarded as an innovation in the payment of takaful benefits which makes it more competitive and able to match the products offered by conventional insurance companies. Among the advantages of using a conditional grant in the payment of takaful benefits are:

1. Payment of the benefits will be easier and faster because the money is not part of the deceased's estate and will not be subjected to the division of the *faraid*.
2. Benefits cannot be demanded by other heirs, thereby avoiding conflict among the potential claimants.
3. Facilitate the distribution of assets during takaful participant's lifetime.

According to Mohamed Hadi (2015), the issue of inheritance rights among the legal heirs in conditional hibah payments does not arise. This is because, in practice, most takaful participants have other assets, with total values exceeding the amount of takaful benefits. This assumption is largely supported by past studies related to insurance or takaful ownership factors, where those with an awareness of having insurance or takaful are those of middle and high income earners who can afford the premiums.

The use of conditional *hibah* can facilitate the management of Islamic property based on current development and in situations where the takaful benefits received may not reach the most affected dependents upon the death of the participants, due to their status as non-beneficiary. Not only applies in the payment of takaful benefits, the use of conditional hibah is also important in the management of other properties. According to many Islamic financial advisers, these are among the groups that should use conditional hibah:

1. Married couple with no children.
2. Married couple with daughters only.
3. Married couple with sons and daughters but want to distribute their wealth equally.
4. Married couple with disabled children (disabled) and need special care.
5. Married couple with adopted children (not legal heir).
6. Unmarried individuals.
7. Men who practice polygamy.
8. Men or women who remarried.
9. Married couple who jointly owned a home.
10. Married couple, who owned a home, but only under one name (either husband or wife).

### CONCLUSION

Family takaful benefits is one of the financial assistance that participants can provide for their dependents, in the event of death or disability. The implementation of *IFSA* 2013 has standardized the practice of paying takaful benefits among takaful operators in Malaysia. It also provides options for takaful participants in the distribution of takaful benefits payment through conditional *hibah* by nominating absolute beneficiary. Through this method beneficiaries have easy access to takaful money because it does not need to go through the tedious process of claiming inheritance. It is also in line with the original goal of takaful, which is to create funds for beneficiaries or dependents who are most affected by the death of takaful participants, even if they are not one of the legal heir. This method can be considered as an innovation in the payment of takaful benefits that make takaful products more competitive and able to match the products offered by conventional insurance companies.

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