

# Enhancing Financial Management Practices for Zakat Micro-entrepreneurs in the New Normal through Impact-Focused Framework: A Conceptual Paper

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## Abstract

The zakat micro-entrepreneurs (ZME) programs aim to improve *mustahiq's* (beneficiaries) standard of living and well-being. Its effectiveness depends on *mustahiq's* wisdom in managing finances. The objective of this study is to conceptually discuss on the development of an impact-focused framework for the *mustahiq* using the financial management practices (FMP) as a quality intervention program. The research framework of this study is built on the Theory of Change and Logic Model that posited quality of intervention contributes to a series of outcomes and intended impact. This study discusses three propositions. First, the best FMP as a quality intervention for the ZME. Second, a social impact measurement framework for ZME programs and third, the description of the data collection application using mixed-methods for the proposed framework. The outcomes of this study will benefit zakat institutions in evaluating the effectiveness of zakat funds in improving the well-being of the *mustahiq*.

**Keywords:** Impact-focused, financial management practices, financial well-being, micro-entrepreneurs, *mustahiq* upliftment, zakat.

## 1. Background of the Study

The concept of socio-economic performance and management is still relatively new in the microfinance sector. However, within the Islamic finance industry, the adoption of socio-economic performance and management provides an important tool in aligning the industry focus beyond syariah compliance towards delivering the intended outcomes of syariah through practices, conduct and offerings that generate positive value and sustainable impact to the economy, community and environment. The shift towards comprehensive value creation and value-based activities are in line with the Central Bank of Malaysia initiative as documented in its Strategy Paper titled, Value-Based Intermediation (VBI): Strengthening the Roles and Impact of Islamic Finance in July 2017.

Apart from providing access to financial resources for micro-entrepreneurs, microfinancing in Malaysia has proven to be significant in helping to improve the living standards of the rural

population (Adejoke, 2010). It provides small funds to poor people who cannot afford to give physical collateral in return for the financing, instead of social collateral is required. The dual role of achieving social and financial objectives requires microfinancing programmes to aim for long-term financial sustainability. The microfinance programmes are broadly classified into two: repayable and non-repayable micro funds. Among major microfinance institutions that offer repayable micro funds are Amanah Ikhtiar Malaysia (AIM), TEKUN Nasional and Yayasan Usaha Maju, Sabah. On the other hand, there are non-repayable micro funds provided to micro-entrepreneurs using zakat funds by zakat institutions (e.g. Selangor, Penang, Negeri Sembilan, and Kuala Lumpur) and non-profit organizations (NGOs), such as Yayasan Basmi Kemiskinan.

Zakat is one of the five fundamental pillars in Islam, which makes this a compulsory act by all Muslims, provided they meet certain conditions. Indeed, zakat can only be distributed to specific beneficiaries and projects. There are eight groups of people on who zakat should be spent.

*“The alms are only for the Fuqara’ (the poor), and Al-Masakin (the needy) and those employed to collect (the funds); and to attract the hearts of those who have been inclined (towards Islam); and to free the captives; and for those in debt; and for Allah’s cause, and for the wayfarer (a traveller who is cut off from everything); a duty imposed by Allah. And Allah is All-Knower, All-Wise.”*

[Al-Quran 9:60]

Eight groups mentioned above are al fuqara (the poor), al masakin (the needy), al amilyn ‘alaiha (the zakat administrators whose duties are to collect), al mu’allafatu qulubuhum (recent converts to Islam), fir riqab (those in bondage or slavery), al gharimin (those burdened by debts), fi sabilillah (in the path of Allah pertains to anyone who struggling for a righteous cause) and ibnu al sabil (travellers whose travelling is lawful according to syariah but who cannot reach their destination without financial assistance).

While zakat is fundamentally Islamic in origin, the Sustainable Development Goals (SDGs) have no link with religion. Zakat has the potential to become an alternative power source in supporting the SDGs (Mohar, 2017). There are some striking commonalities between the SDGs and zakat. SDGs that act as the universal agenda to end poverty, protect the planet and ensure that all people enjoy peace and prosperity, provide clear guidelines and targets to be achieved over the next 15 years. SDGs comes with 17 sustainable goals to be implemented by countries signed up on 25 September 2015 (UNDP). The goals are interconnected while incorporating environmental and economic sustainability, along with the aspiration of peaceful and inclusive societies. Zakat thus aligns strongly with numerous SDGs, including no poverty (SDG 1), zero hunger (SDG 2), reduced inequalities (SDG 10) and others (Rehman & Pickup, 2018). Although direct payment of zakat is still acceptable, especially for the non-productive *asnafs* (e.g. the disabled and elderly), zakat is recommended to be distributed in the form of capital finance to the poor and the needy to encourage business activities among the *asnafs*. In the long run, the productive *asnafs* are expected to gain future independence, with the ability to support themselves and their families and consequently escape poverty (Ibrahim, 2008).

However, there are zakat institutions such as the National Zakat Foundation in the United Kingdom that has taken the initiative to distribute zakat through ‘The *Wakalah* Model’ method by taking into account the potential socio-economic impact resulting in the short and long term (NZF, 2018). However, the method of measuring socio-economic impact performance strategically can calibrate information on the value of socio-economic effectiveness to ‘multi benefiting stakeholders’ is still not done. This direction is in line with Bank Negara Malaysia’s (BNM) initiative through the strategic paper BNM, Value-based Intermediation financing and investment impact assessment framework: Guidance Document (BNM, 2019), which emphasizes value-based activities to social well-being and sustainability of the social system.

The remaining paper is organised as follows. Section 2 presents the research questions of the study. The discussion of literature and theoretical consideration is deliberated in section 3. Section 4 discusses the propositions of the study. Section 5 concludes the study.

## **2. Research Questions**

While analysing the effectiveness of four microfinance programs; Lembaga Zakat Selangor (LZS), Yayasan Basmi Kemiskinan (YBK), AIM and TEKUN, Hamdan, Othman, and Wan Hussin (2012) indicated that financial performance of participants in repayable schemes is significantly higher than those in non-repayable programs. In addition, Che Yaacob, Mohamed, Daut, Ismail, and Mohd Don (2013) revealed that the performance of *asnaf* in Johor showed that only 13% out of 173 capital aid recipients managed to earn over RM1,000 per month, while another 33.5% had income between RM300 and RM900 only. Meanwhile, in assessing the performance of micro-entrepreneur programmes, that is non-financial performance, Nazri, Omar, and Rahman (2018) suggested that although participants of non-payable micro funds financially perform lower than the repayable micro fund’s participants (AIM sahabat), *asnafs* are generally more satisfied with their overall conditions which include business ownership, happiness, gratification, level of independence and life improvement. Thus, they proposed that non-repayable programmes should provide micro-financing to hardcore poor entrepreneurs, whereas repayable programs are for the poor category.

In the literature on measuring social performance, Cordery (2013) noted that while social performance measurement in the not-for-profit sector focuses on outputs, outcomes and impact, the focus differs from one institution to another. Ebrahim and Rangan (2014) argued that organisations operating in the not-for-profit sector are also under growing pressure to demonstrate the impact of their social initiatives. To differentiate between outcomes and impact, they specified that outcomes refer to lasting changes in the lives of individuals while impact refers to lasting results achieved at a community or societal level. Driven by the pressure to demonstrate accountability, researchers in the area of social performance measures, offer various reasons for institutions to provide information on their social performance, such as justifying their social initiatives to relevant stakeholders, providing evidence on management effectiveness in managing the funds for social purposes and reporting the ethical and responsible management of funds in the interest of the public. The common contention in literature is that social performance measurement facilitates decision-making made by relevant stakeholders (LeRoux & Wright, 2010).

Undeniable, many studies have been done on the financial performance of micro-entrepreneurs, but very little is known about the social performance of micro-entrepreneur programs, particularly for zakat-funded micro-entrepreneurs' programmes by zakat institutions. Therefore, measuring, analysing and tracking the economic and social attributes of the beneficiaries to optimize the socio-economic impact of microfinance on target groups (i.e. *mustahiq*) is vital in optimising the potential socio-economic impact to the beneficiaries, in particular. Given the current challenges resulting from the Covid-19 pandemic, micro funders like zakat institutions face a very competitive funding environment. As such, impact measurement will provide the much-needed foundation for ensuring that stakeholder interest is met and limited resources are optimised in impactful socio-economic initiatives.

Realizing the need to facilitate the efficiency and effectiveness of microfinance program management has motivated the researchers to assess the socio-economic impact of selected zakat micro-entrepreneurs programme for *mustahiq*. This suggests that the development of the best FMP for zakat-funded micro-entrepreneurs in the new normal requires an improved model with some quality intervention activities. The socio-economic impact assessment introduced in the research provides the much-needed mechanism to foster trusts among the partners. Subsequently, most research focuses on the provision of financial literacy training but very few research focuses on providing context-specific financial literacy training in building the capability of the micro-entrepreneurs.

## 2.1 Purpose of Inquiry and Inquiry Questions

This conceptual paper aims to identify the appropriate impact assessment mechanism that will provide useful information to the management of microfinance programmes to facilitate their strategic decision-making process and create values to the stakeholders. The theory of change will be used as a basis to assess the desired impact (Ghate, 2018). The mixed-method will be utilised to enrich the data by focusing on the Asnaf Economics Development Program recipients. To embark, the researchers have constructed the following research questions:

- RQ1. What are the best financial management practices for impactful zakat micro-entrepreneurs program?
- RQ2. Why is there a need for socio-impact measurement for zakat funded micro-entrepreneurs program?
- RQ3. How the measurement of socio-economic impact should be carried out for micro-entrepreneurs program?

## 2.2 Significance of Inquiry

This conceptual paper is very important as it is slightly different from most previous studies. Previous studies focus more on measuring the performance of non-profit-oriented institutions in general. This study on the other hand aims at calibrating information of socio-economic effectiveness value to 'multiple stakeholders'. In addition, aspires to identify deficiencies in the existing impact assessment mechanism to facilitate the strategic decision-making process for LZS. A quantitative approach will focus to obtain data on the most active micro-entrepreneur programme in Selangor. Meanwhile, the qualitative data will add value by exploring the

informant's experience in providing input to relevant institutions to form a strategic plan to ensure the performance of entrepreneurs is evaluated from different angles, thus achieving program-specific goals.

### **3. Discussions on the Literature**

#### **3.1 Financial Management Practices and Zakat Micro-entrepreneurs**

To this day, the practice of individual financial management remains an important essence often proclaimed by governments, financial institutions and NGOs. The Covid-19 pandemic caused drastic changes in individual spending and credit management patterns. Loss of employment, inability to pay off various types of financing and loans, erosion of savings, loss of ownership of houses and properties, as well as anxiety in adjusting daily expenses are worrying situations that haunt most households today. This economic uncertainty has prompted more individuals to come up with new ideas for survival. Many small traders are starting to appear and the most popular is the food business.

Business starts with savings and loans from family and friends. Later, it was expanded with the help of microfinance assistance from government agencies micro creditors such as TEKUN and AIM (Hashim, Mohamad, & Othman, 2020). The zakat institution is also seen as one of the main choices of small Muslim traders. It becomes an additional resource fund for the provision of physical capital and access to wider micro-credit for *asnafs* (Abdul Rahman, Kamarudin, Siwar, Ismail, Bahrom, & Khalid, 2013). Microfinancing can prevent Muslims from getting involved with usury (*riba'*) and its benefits are greater where *mustahiq* is given the opportunity to improve their standard of living by doing business and thus avoid high reliance on a continuous distribution of zakat in the form of consumer goods (Adnan, Hamat, Yahaya, & Zain, 2017).

Although this micro-entrepreneurship's program is expected to help *mustahiq* become independent, the challenge is, to what extent are they able to compete with established businesses, in terms of quality and capital in gaining customer trust (Manggala Putri, Firmansyah, & Hamid, 2019). Business sustainability not only in terms of achieving high sales and gaining many customers, but it is also closely related to the way *mustahiq* manages finances. Therefore, evaluating both financial management in terms of self (*mustahiq*) and the business conducted is important to ensure that micro-funds obtained from zakat institutions successfully achieve long-term objectives.

#### **3.2 Accountability and Impact Measurement**

Zakat plays an important role in socio-economic development for strengthening the social and economic well-being of the less fortunate. Many scholars (Ismail & Possumah, 2013; Rahman & Dean, 2013, Hassan & Noor, 2015) shared their findings showing the importance of zakat for Islamic microfinancing programs. The key concept of microfinance is to enable underprivileged households to have permanent access to a network of high-quality financial services such as credit facilities, savings, insurance and funds transfers (Christen, 2004). Thus, the foremost expectation from the provision of micro zakat funds is to see the production of income-generating activities.

The dual role of achieving social and financial objectives require the microfinancing programmes demand micro funders (i.e. zakat institutions) to demonstrate greater accountability to the zakat payers and the constituencies which are served (*mustahiq*). In line with this, there has been greater research interest in performance measurement and management by zakat institutions which are key mechanisms in discharging accountability. Despite such interests, there is little consensus among the researchers and zakat institutions as to what are the best measures of social performance. The common contention in literature is that performance measurement facilitates decision-making made by relevant stakeholders (LeRoux & Wright, 2010). However, the performance measurement system in Malaysian zakat institutions is still lagging (Mohd Noor, Abdul Rasool, Md. Yusof, Ali, & Abdul Rahman, 2015). Criticism has also been heard regarding the efficiency of zakat management in distributing zakat funds (Nor Paizin, 2014). It is quite difficult to manage something that cannot be measured (Zizlavsky, 2015) while performance measurement is a prerequisite in the analysis towards improvement (Leyer, Heckl, & Moormann, 2015).

Given the current challenges resulting from the Covid-19 pandemic, micro funders like zakat institutions face a very competitive funding environment. As such, impact measurement will provide the much-needed foundation for ensuring that stakeholder interest is met and limited resources are optimised in impactful socio-economic initiatives.

### 3.3 Theoretical considerations

This study will use the principles discussed in the theory of change; how activities can contribute to a series of outcomes that provide the desired impact (intended impacts) (Ghate, 2018). This approach will be able to be used to develop a framework for evaluating the socio-economic impact of the zakat-microentrepreneurs initiative. This study will employ the logic model which is widely used in assessing social impact. The key components of the basic logic model are illustrated in Figure 1 below.

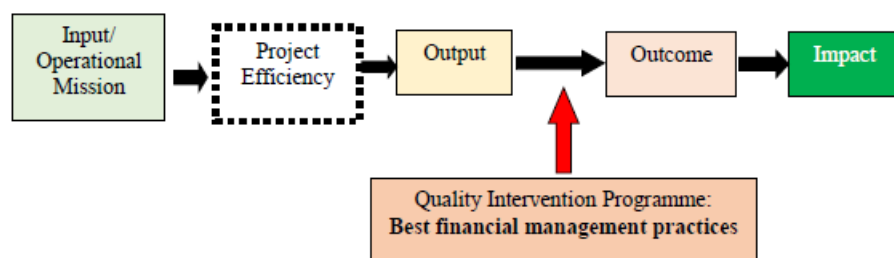


Figure 1: Integration of the ‘Theory of change’ and ‘Logic Model Chain’.

Based on the logic model chain in Figure 1, this approach is very relevant and important in the application of measuring the social impact performance on the zakat-microentrepreneurs program that has been carried out by microfinance funders (i.e. zakat institutions). Socio-economic performance management method through impact assessment measurement is still a new method among zakat institutions in Malaysia.

Financial incompetence has led many small businesses, especially micro-entrepreneurs, to seek financial support from zakat institutions. For years, zakat institutions have been working towards financial sustainability and ethical practices, and the Covid-19 pandemic that has hit the country today is making this an urgent matter. As a front line, zakat institutions have a huge responsibility in supporting microfinance through non-payable micro funds to small entrepreneurs. Despite various studies on the financial performance of micro entrepreneurs, little is known on the social performance of micro-entrepreneurs' programmes particularly for non-repayable programmes by zakat institutions. In optimising the potential socio-economic impact of the microfinance on the targeted group (i.e. *mustahiq*), it is crucial that the microfinance providers, such as zakat institutions are able to measure, analyse and track the economic and social attributes of the beneficiaries.

The efficient and effective delivery of microfinance initiatives necessitates the measurement of the socio-economic impact that forms an integral part of the aforementioned initiatives. Without the measurement of socio-economic impact, microfinance providers cannot truly determine the success of their initiatives in ensuring the targeted socio-economic well-being of communities. This, in turn, can have positive social effects at different levels of society, from the personal to the community, to the regional level. In achieving this, it is very important to establish sustainable, long-term relationships with participants. Concurrently, it is equally important for microfinance services to be inclusive (in terms of reach) and have a positive impact on as many vulnerable people as possible (scale) on a sustainable basis. Hence, to facilitate efficient and effective management of microfinance programmes, it is crucial to identify appropriate impact assessment mechanism that will provide useful information to the management of microfinance programmes to facilitate their strategic decision-making process and create values to the stakeholders. The proposed study is anchored to the premise that non-repayable micro funders (i.e. zakat institutions) need to work in unison within an ecosystem that centre-stage the need for measurable impact in zakat micro-entrepreneurs programme that targets beneficiaries (*mustahiq*) in the society.

#### **4. Propositions and Discussion**

***Proposition 1: The best financial management practices for impactful zakat micro-entrepreneurs program.***

In evaluating *mustahiq*'s FMP through micro-entrepreneurs' programs, this study suggests a framework based on the theory of change. The theory guides this study to see how guided actions provide specific changes in improving the well-being of *mustahiq*'s life. More specifically in terms of FMP, to assess self-efficacy. This approach can examine *mustahiq*'s ability to use the microfinance funds received for the economic development of the household and business. Spending management, credit, and property accumulation to accelerate the improvement of well-being are assessed through daily practice. Managing finances varies between households. Hence, this study will be able to unearth the themes of *mustahiq*'s best FMP. The findings will help zakat institutions to formulate more comprehensive programs. Apart from micro-entrepreneur development programs, awareness of the importance of prudent money management should also be emphasized.



Figure 2: The best FMP framework

**Proposition 2: Social impact assessment framework for zakat funded micro-entrepreneurs.**

This study proposes a framework to assess the social impact on zakat funded micro-entrepreneurs’ programmes with the best FMP as a quality intervention as suggested in the logic model in figure 3 below:

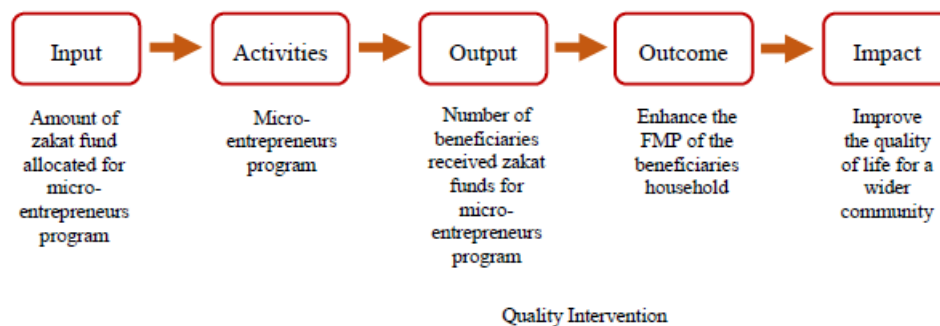


Figure 3: Social impact assessment framework (Source: Authors’ illustration from Ghate, 2018)

The key focus of this study is to propose a social impact assessment framework to measure the socio-economic impact of zakat micro-entrepreneurs programme by zakat institution, namely LZS. This framework is able to assess the impact at the individual level for zakat-funded financing programme. This approach enhances accuracy as write off effect may hide the relationships between the financing programmes and its consequences on the social-economic impact. From the logic chain model, input refers to the financial, human, and material resources used to drive an initiative which is geared to some form of intervention. For instance, this can be the resources used for activities in the allocation of the microfinance. The output is the product which results from the aforementioned intervention. Outputs are relevant to the achievement of outcomes. For example, the number of individuals who successfully received funding from the zakat micro funds. The outcome is the likely or achieved short-term and medium-term effects of an intervention’s outputs. If the output of microfinancing is the number of microentrepreneurs who begin a business initiative, it so follows that there will be *short-term* and *medium-term*



effects or changes on the individuals and other stakeholders. For example, the number of individuals who successfully sustain their businesses and the change in the economic well-being of the immediate family. The impact is the *long-term* effects which may be positive or negative and can be regarded as primary or secondary effects which are the product of the microfinancing programmes. These are direct or indirect effects which may be intended or otherwise. For example, the ability of the individuals to purchase property, to sustain business performance or to fund the academic journey of their relatives/community. The application of the logic model allows evaluation of the impact based on the business models and practices of the organisation and overcomes the impact assessment methodology based on ex post facto resulting in lower quality evidence.

***Proposition 3: Measurement of socio-economic impact for impactful zakat-funded micro-entrepreneurs program.***

This conceptual paper focuses only on surveys and analyses of research and data from the literature. To execute the study, the mixed method will be exploited. A quantitative approach will be used to collect data from selected zakat micro-entrepreneurs programme by LZS through stakeholder engagement approach. The studied population consists of microfinance fund recipients around Selangor conducting business activities. The study sample is limited to only 30 to 50 participants. To get more participants is expected to be difficult as a result of the high transmission of Covid-19 cases in Selangor. In compliance with research ethics, an agreement form will be provided to be signed by each participant who is willing to participate. Participants are also assured of confidentiality where their identities will not be disclosed and all information shared is for research purposes only.

Meanwhile, through in-depth interview instruments, a qualitative approach will be used to strengthen quantitative data. In addition to enriching the data through direct statements of informants (Solheim, Zuiker, & Levchenko, 2011), it reveals individual behaviours in the natural setting (Silverman & Marvasti, 2008). Besides, the phenomenological approach provides an opportunity for researchers to interpret the data from their perspective as the data gathering includes observation and documentation (Creswell, 2003). To validate the qualitative data, the researchers choose to adopt theory triangulation and methodological triangulation where it will verify the fact reported. A pilot study will be conducted before the actual data collection begins. It is to ensure that the questions posed could be understood and the answers obtained achieved the objectives of the study. Participants will be selected through a purposive sampling method that focuses on zakat micro-entrepreneurs' program recipients.

## **5. Conclusions**

The study sought to develop an impact-focused framework for zakat funded micro-entrepreneurs program to enhance trust and good governance practices through impact assurance for the non-payable microfinancing funders. This study has been anchored to the premises that a quality intervention program contributes to attaining significant outcomes and intended impact of zakat funds. Drawing on the best FMP as a quality intervention program, the study suggests three

propositions; first the best FMP as a quality intervention for the ZME, second, a social impact measurement framework for ZME programs; and third the description of the data collection application using mixed-methods for the proposed framework. The application of this framework should serve as a platform for microfinance funders (i.e. zakat institutions) to negotiate on the impactful deliverables of funded social initiatives such as micro-entrepreneurs program. The proposed framework promotes greater stakeholder participation within an ecosystem of all within a much needed financially sustainable ecosystem during and after the Covid-19 pandemic. Another output of this study is a framework to be used by micro funders (such as zakat institutions) as they report outputs, outcomes and the potential long-term impact of their initiatives to complete the loop within an ecosystem that promotes trust and networking values.

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