

Integrating Religious Based Nonprofit Organizations into the Mainstream Economy: A Case Study of Zakat Institutions in Malaysia

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Abstract. Zakat is one of the five basic pillars in Islam. It is an obligation of all financially able Muslims to give a specific amount of their wealth to predetermined beneficiaries. In ensuring zakat obligations are fulfilled, zakat institutions are set up to manage zakat efficiently. Although, zakat institutions have been operational for almost a hundred years in Malaysia, their performances have yet to reach full potential. It is of prime importance that these institutions are managed effectively and efficiently because of their pivotal role in the society. In a country where zakat is one of the necessary components for development, the way to ensure optimum utilization of zakat is through the integration of zakat institution into the mainstream economy. For zakat institutions to be integrated into the mainstream economy, efficient performance is required. Based on hermeneutic and demarcation approaches, this study proposes the phases of zakat integration in Malaysia, namely; minor, partial and full integration. As such, this study also introduces several indicators to identify the phases of zakat institutions' integration into the mainstream economy.

Keywords: Integration, Zakat Institutions, Mainstream Economy

1. Introduction

Zakat is one of the five basic pillars in Islam. Its relationship with the macroeconomic system can be accessed through poverty eradication instrument, income redistributive device and stabilization mechanism. Zakat also narrows down the economic inequalities in the community whereby the rich may not grow richer and the poor not become poorer. In addition, proceeds of zakat are not only allocated to the destitute and the poor, but also for the provision of social security to unemployed individuals. In other words, zakat is a vital instrument for overcoming unemployment where the money received by all categories of poor can be used to start small scale businesses.

In Malaysia, matters pertaining to zakat are under the respective state rulers and the state government. Hence, there is no standardization in the management of funds among the zakat institutions (ZIs). As a result of this, there is an imbalance in performance among the ZIs primarily because of the different approaches adhered and practiced by the various states both in collecting as well as in distributing the proceeds of zakat. In continuance to this, ZIs must be efficient in performance in order to align and integrate into the mainstream economy. The proponents of this paper believe that in order to integrate into the mainstream economy, ZIs must be efficient from every spectrum of the scope and objectives of the establishment.

The organization of the study is as follows: Section 2 dwells on the background of zakat institutions in Malaysia; section 3 explores the roles of zakat in the mainstream economy while section 4 and 5 explains methodology and integration, respectively. A final section summarizes and concludes the paper.

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2. Background of zakat institution in Malaysia

Malaysia has been a successful developing country which is forging ahead to become a developed nation in its own mould. Government efforts to transform Malaysia into a developed nation and to reach the aspired zero-poverty target by 2020 involve several initiatives streamlined for the poor and needy in the country [1]. Thus, the nation has to be managed effectively and efficiently in order to successfully overcome its weaknesses and shortcomings. One major challenge it has to address in this endeavor is the improvement of the people's well being and the quality of life. In order to triumph over these challenges, zakat, an Islamic institution anchored within the Islamic economic system, fittingly caters to the people's quality of life as well as their well being. However, although Malaysia is a country where Islam is the largest practiced religion (comprising approximately 61.3% Muslims), the development of zakat institutions - a primarily religious based non-profit organization in the mainstream economy, has yet to be significant.

ZIs in Malaysia have been established since the colonial period in 1824 [2]. During this period, zakat was informally collected at village level and paid directly to religious teachers [2]. The collections were then distributed to villagers who were in need of financial assistance. Until 1957, Malaysia had witnessed the establishment of ZIs in 14 states. Among others, the establishment of ZIs was aimed at improving the management of zakat. Specifically, the establishment was to increase the collection and distribution of zakat. For example, in order to increase efficiency in zakat management the state religious authorities took a significant step to improve their performance via corporatizing their zakat collection sections. As a result, zakat collection increased tremendously, thanks partially due to corporatization [3].

Beginning in 1991 with RM 63 million, it increased to RM 320.35 million and RM 1,360.82 million in 2001 and 2010, respectively. From the discussion above, it has been proven that corporatization managed to improve the collections of zakat. Ironically, however, the distribution of zakat was not done at the same pace of collection [4]. As far as corporatization is concerned, the distribution wing of ZI did not reflect the full essence of corporatization [5]. The average percentage of zakat fund distributed was 84.08% among the 14 states. Which means 15.92% of zakat fund was not distributed in 2011. The implication of the undistributed fund was that the eligible beneficiaries had no access to this financial assistance. The growth rate increased to 79.35% in 2011 as compared in 2010, which was only 67.74%. Even though the collection of zakat fund is increasing every year, [6] asserted ZIs would be far from realizing their objective if zakat distribution is not well organized and managed. In this respect, there is room for improvement of zakat distribution and performance via a full integration into the mainstream economy [7], [8].

Currently, ZIs could be considered as partially integrated into the mainstream economy [7]. This is evidenced by the acceptance of zakat by the government through tax rebates on zakat income and zakat business, in 1991 and 2005 respectively [7]. In the event of monthly deduction on zakat income, the deduction is made through monthly salary. The amount of zakat could be deducted from the Scheduled Tax Reduction with several conditions. This could be arranged by informing the Inland Revenue Board at the beginning of the year with the approval from the zakat office. In Peninsular Malaysia, all states have issued a fatwa that imposes zakat on employee income is obligatory [7]. Introducing of tax rebate on zakat businesses by Malaysian Government in 2005 was another important contributor to partial integration [9]. In this measure, a maximum of 2.5% of the aggregate income can be deducted as payment of zakat business [10]. The inclusion of zakat in the national budget or expenditures is relatively a new practice.

3. Methodology

In determining the indicators of the integration phase, the hermeneutics approach has been selected. Hermeneutics is also known as an interpretive analysis which is widely practiced in qualitative research [11]. Furthermore, data of hermeneutics analysis may come from scholarly literature, newspaper articles, textbooks, literary texts, art, poetry and any other medium. In lieu of this, we have made reference to some leading journals, books, articles and also proceedings to be more accurate in determining such indicators. For instance, we have made some groundwork by exploring journals, written by prominent scholars on the interpretation and issues regarding zakat. The preliminary works had begun by identifying keywords of ZIs' development since the pre-colonial period in Malaysia, until the current development of ZIs. Then, each

keyword was interpreted based on the suitability of phases. Table 1 presents the phases and indicators of zakat integration.

Furthermore, the demarcation method has been selected as an appropriate method in demarcating the percentage demarcation threshold. Adapted from [12] the percentage demarcation threshold that is chosen to allocate a percentage to the different phases so as to determine how many percentages will be recognized in each phase. The distribution of the percentage of phases was divided into demarcation ranges of 0% from a lower boundary to an upper boundary of 100%. For instance, in the minor phase, it has been accepted that the percentage is between 0% - 39%. The line of demarcation percentage is shown in Table 1.

Table 1: Phases & Indicators of Zakat Integration

PHASES		INDICATORS	Sources
MINOR	Minor (0% - 39%)	<ul style="list-style-type: none"> Minimal zakat paid No formal institutions / direct institutions Zakat is paid-on agricultural product only Zakat is paid directly to religious teachers/ informal collector 	[2], [4]
PARTIAL	Partial (40%-59%)	<ul style="list-style-type: none"> Establishment of State Islamic Religious Councils (SIRCs) Traditional structure of organization (no corporatization) Tax rebate granted on zakat business and zakat income 	[7], [8], [13]
	Moderate (60%-79%)	<ul style="list-style-type: none"> Partial corporatization Inclusion of zakat in the national budget Effective governance in zakat management 	[7], [8], [3], [14]–[16]
FULL	Major (80%-99%)	<ul style="list-style-type: none"> Full corporatization Full awareness of Muslim Ummah Standardizing accounting standard Utilization of technology in e-zakat Proper performance measurement system 	[7], [17]
	Full (100%)	<ul style="list-style-type: none"> Strong law enforcement Reaching full potential Zakat acknowledgment by public and authority Efficient payment behavior by Muslim Ummah Improving quality of life and well being of Muslim Ummah Applications of Basel 29 core principles 	[8], [13], [17], [18]

In order to be integrated into the mainstream economy, an institution must be not only efficient but also be able to fulfill its objectives. Undoubtedly, the issue of ZIs' integration into the mainstream economy is now gaining momentum in recent academic literatures [7], [13], [19]. In continuance to this, it is crucial to define integration for better understanding of the issue. Following [7], [8], [20], this study defines integration as an assimilation of ZIs into the mainstream economy, that has similar provisions like Inland Revenue Board and has become a source of government revenue. Additionally, the zakat system has several similarities with Malaysia tax's system [21]. For example, tax and zakat are collected from eligible payers. The collected amount of tax is then assembled in Federal Consolidated Fund and used for the country's administration, economic development and social economic balancing [21]. Whereas, the zakat fund collection is state-based and it has no federal consolidated fund like the tax system in Malaysia. The accumulated zakat fund in every state will be distributed to the beneficiaries.

4. The Level of Zakat Institutions Integration

This study identifies three phases of ZIs integration namely, minor integration, partial integration and full integration [2], [7], [22], [23]. These phases were identified from several significant indicators that occurred in ZIs. The phases began during the pre-colonial period whereby administration of Islam was disintegrated at state level by colonial policies due to colonialism practices [2]. Then, the second phase was in place when ZIs were keen on improving their establishment through corporatization. The last phase is full integration whereby ZIs are expected to operate as efficiently as the Inland Revenue Board. Fig. 1 presents the phases of zakat integration in Malaysia.

Phase I; minor integration (1824 – 1957). Minor integration is a phase where ZIs are informally administered at micro level. In this phase, villagers paid zakat to religious teachers and imams of villages [2] and peasants in the traditional system paid zakat based on paddy yield. Zakat from the traditional system would then contribute to the maintenance and expansion of religious schools. Furthermore, as has been mentioned earlier, Phase 1 or minor integration was already occurring during the colonial period, which is the collection and control of all revenues and general administration of Islam which were regulated under the advice of British Residents.

The next phase is followed by Phase II i.e. partial integration (1990 – present). Partial integration is a phase where ZIs started to gain recognition at macro level, which is by government and the Muslim community. This is evidenced by the tax rebate on zakat income and zakat business, which has been granted by the government [7]. In addition, the corporatization of some ZIs increased the confidence and further widened their recognition in the society. Apart from that, Muzakarah of National Fatwa has decided that zakat on salary be made compulsory for all eligible Muslims [24]. The decision made by National Fatwa has made ZIs more acceptable by the Muslim to honour their zakat obligations through monthly deduction. In order to be efficient, ZIs must have accounting a valid standard and performance measurement system [7]. As of now, ZIs have not yet implemented these two pre-requisites. Nevertheless, researches are being carried out to make these institutions more aware of these pre-requisites [25]. Then, the moderate integration was represented by partial corporatization, the inclusion of governance in zakat management and also the inclusion of zakat in the national budget.

Meanwhile in Phase III i.e. full integration where major integration was indicated by the full corporatization of ZIs. The full integration is a phase where Muslims become fully aware and perform their zakat obligation. This condition is not impossible as has been shown during Caliphate Umar Abdul Aziz era [2]. During that era, he had ordered his officer to collect the zakat in Africa. Surprisingly, when the time came for the distribution of the zakat, they could not find anyone that was eligible or worthy enough to receive it. Thus, it is clear that zakat that if well-managed, is able to solved the problems of poverty, diseases and ignorance [26]. If zakat institutions are efficient in the collection and distribution of zakat funds, they will gain full recognition from regulatory bodies [23]. As such, the need to improve the performance of ZIs is imminent.

In line with financial institutions, the 29 Basel Core Principles are the *de facto* minimum standard for sound regulation and supervision and are used by financial institutions as a benchmark for assessing the quality of their supervisory. Furthermore, the objective too is to ensure the continued relevance of the Core Principle for promoting effective financial supervision over time and changing environments. In contrast, there is no minimum standard for sound regulation landscape and supervision in the zakat system. Hence, to strengthen supervision in zakat institutions, there is a need to implement Zakat Core Principle in order to achieve minimum standards for regulation and supervision.

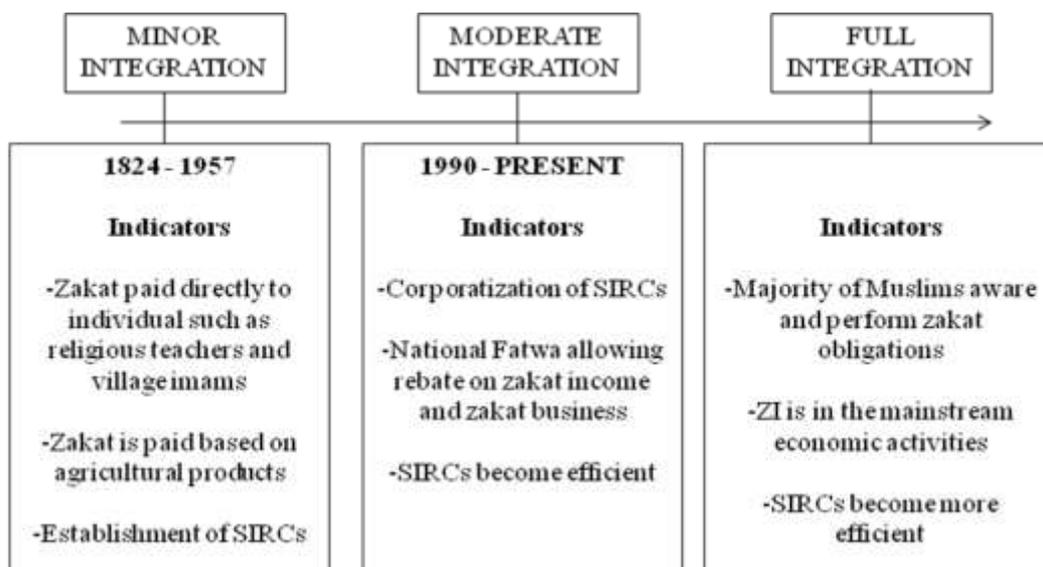


Fig. 1: The level of zakat integration in Malaysia.

Currently, in Malaysia, zakat could be considered as partially integrated into the mainstream economy. This is evidenced by the acceptance of Muslim in paying zakat, which has led to the sharp increase in zakat collection. The collection of zakat has increased tremendously since 1990. Furthermore, tax rebate granted by the government on the related zakat deductions was also a positive measure in indicating the phase of ZIs integration. Despite all these achievements, there is still much to be done to improve the performance of ZIs in Malaysia.

5. Conclusions

Integrating ZI is the next on the agenda of Malaysia in achieving a developed nation status. To achieve a developed nation status, it requires a combined effort from the third sector as well. Since ZIs are one of the compartments in the third sector, they are accountable and responsible for portraying good performance and efficiency in every aspect of the management. Proper management of zakat funds potentially contributes to economic stability and enhances the prosperity of a nation as well as ensures the equality in income distribution. Despite its huge role in the economy, ZIs have not yet attained their full potential. This is due to prolonged unresolved problems such as inefficiency in distributing zakat funds, inexistence of performance measurement system and weakness in corporate governance practices, supervision and regulation landscape. As such, more has to be done to reach the full potential of ZIs; one of them is through integration into the mainstream economy. In order to integrate, ZIs should revitalize their management through enhancing efficiency in performance, developing performance measurement, implementation of Zakat Core Principle as a minimum standard in supervision, accounting standard and regulation and practicing corporate governance efficiently. Indeed, there is a need to revitalize and refresh the management of ZIs in order to overcome the issues that have not yet been resolved. The execution of this study is important because it helps to trigger the possible issues of ZIs integration into the mainstream economy. Furthermore, the three phases of ZIs integration has been discussed at length and further research is encouraged in order to gain a deeper understanding and ultimately make the integration of ZIs into the mainstream economy viable. Hence, an effective strategy is essential in order to resolve the problems and expedite the process of ZIs integration into the mainstream economy.

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7. References

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