



# A framework to analyse the efficiency and governance of *zakat* institutions

*Zakat*  
institutions

43

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## Abstract

**Purpose** – This paper aims to present a conceptual model on the efficiency and governance of *zakat* institutions that are responsible in collecting, managing and distributing *zakat* in Malaysia. *Zakat* is an Islamic religious “tax” charged on the rich and well-to-do members of the community for distribution to the poor and the needy as well as other beneficiaries based on certain established criteria according to the *Qur’an*. The main aim of *zakat* is to protect the socio-economic welfare of the poor and the needy.

**Design/methodology/approach** – The paper reviews and synthesises the relevant literature on efficiency, governance and *zakat*. The paper then developed and proposed a conceptual model to study the efficiency and governance of *zakat* institutions.

**Findings** – The paper identifies the appropriate methods to evaluate efficiency and governance of *zakat* institutions. Such evaluations are crucial for the Islamic financial system to function effectively in order to achieve the noble objectives of socio-economic justice through proper distribution of wealth.

**Originality/value** – This paper presents a conceptual model of efficiency and governance of *zakat* institutions which would be useful for further empirical research in this area. The findings are not only relevant and applicable to Malaysia but also to other Muslim countries.

**Keywords** Process efficiency, Governance, Malaysia, Taxes, Religion, Islam

**Paper type** Conceptual paper

## 1. Introduction

*Zakat* literally means to grow and to increase (Qardhawi, 2000). The term *zakat* has three different connotations; linguistically, theologically and legally. Linguistically, *zakat* means cleansing or purification of something from dirt or filth. Theologically, it means spiritual purification resulting from giving of *zakat*. According to Maududi (1988), a person’s wealth is impure if he does not pay the right of *Allah’s* servant from the wealth bestowed by him. It also means growth or increase which has two dimensions; first, spiritual development by pleasing *Allah*, and second, redistribution of income (as Islam forbids accumulation and hoarding) which will lead to greater enjoyment and in turn, will stimulate production and growth. Legally, *zakat* means transfer of ownership of specific property to specific individuals under specific conditions. Muslims have the obligation to give a specific amount of their wealth (with certain conditions and requirements) to the specified beneficiaries and in fact, the payment of *zakah* is one of the five pillars of Islam. The eight beneficiaries are clearly specified in the *Qur’an* (Surah At-Taubah: 60); namely the poor, the needy, the administrator of *zakat*, those whose heart are to be inclined (including new Muslim converts who lack economic support), the slaves,



debtors (debts due to real needs), in the cause of *Allah (Fi sabilillah)*, and the wayfarers (*Ibnu sabil*) (Muhammad, 1980).

The main objective of *zakat* is to achieve socio-economic justice. With respect to the economic dimensions of *zakat*, it is aimed to achieve the favorable effects on several dimensions such as aggregate consumption, savings and investment, aggregate supply of labor and capital, poverty eradication and economic growth. Hence, the objective of this paper is to highlight the importance of efficiency and governance of *zakat* institutions, especially in a modern Muslim country such as Malaysia, in fulfilling socio-religious obligations.

Efficiency is a term used to measure how well an organization is using its resources to meet its specific objectives (Farrell, 1957). Governance, on the other hand, is defined as the manner in which the power is exercised in the management of an organization (United Nations Development Programme, UNDP, 1997). In the context of *zakat* institutions, efficiency refers to how well the institutions are using its resources (e.g. the staff, expenditure, etc.) to meet its objectives of socio-economic justice (e.g. reducing poverty) while governance refers to the process and structure in directing and managing the affairs of the *zakat* institution towards enhancing social welfare of the rightful *zakat* recipients as well as demonstrating accountability to the *zakat* payers. The ultimate objective is to seek the pleasure of *Allah*, whilst taking into consideration the requirements of the *shari'ah*. Hence, the need for such a study is crucial in ensuring the achievement of socio-economic justice. An aspect of novelty of this paper is its attempt to contribute towards the economic and administrative theory of *zakat* as there has been limited in-depth review on the efficiency and governance of *zakat* institutions. This study will contribute to the dearth of empirical studies on *zakat* especially on the efficiency of the institutions in managing the *zakat* funds. In addition, the results will be useful to policy makers in improving the institutions' governance system and efficiency.

The remaining of the paper is structured as follows. The next section will discuss the economics of *zakat*, followed by past studies undertaken on *zakat* institutions. Section 4 of this paper discusses the background of *zakat* institutions in Malaysia and prior studies undertaken on the topic. Section 5 looks into the efficiency and the use of data envelopment analysis (DEA) to measure efficiency of *zakat* institutions while Section 6 explores the governance and *zakat* institutions. Section 7 concludes the paper.

## 2. The economics of *zakat*

The theoretical underpinnings of Islamic economics are founded on the *Shariah* precepts, which are developed based on the main sources of Islamic knowledge and practice, i.e. the *Qur'an* and the *Sunnah* (the practices and sayings of Prophet Muhammad), and *Fiqh* (jurisprudence). According to *Shariah*, an Islamic economic system should be based strictly, among others, on the following principles:

- (1) business and financial transactions are free from interest (*Riba'*);
- (2) goods traded and services provided are legal (*Halal*) from the Islamic point of view;
- (3) transactions involving high uncertainty (*Gharar*) that may lead to financial loss must be avoided; and
- (4) the payment of *zakat*.

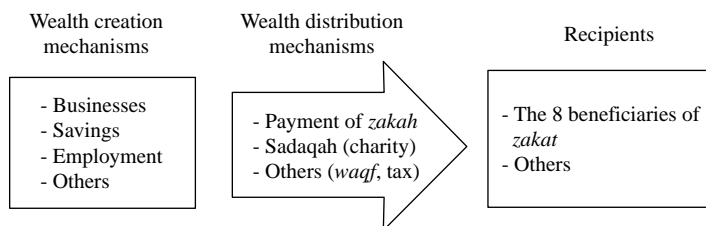
The underlying reasons behind those principles are grounded on the salient Islamic socio-economic objectives and equitable distribution of wealth (Samad *et al.*, 2005).

Islamic economic system comprises of both profit and non-profit financial institutions. Profit financial institutions are institutions that make profit through its businesses like banks, insurance firms, pawnshops, etc. while non-profit financial institutions are institutions that are not making profit such as *zakat* institutions, *baitulmal*[1], etc. The institution of *zakat*, a non-profit financial institution, has several direct impacts on the economic system (Khan, 1995). It is regarded as a complement to the financial institutions and as part of a comprehensive Islamic economic system. Unfortunately, most secular governments in Muslim countries manage *zakat* only as a peripheral system and not as one of the main parts of the fiscal system[2]. Unlike taxation which forms an integral part of the fiscal system, *zakat* is treated only as a voluntary system (Bakar and Rahman, 2007). Furthermore, modern Islamic economic institutions have been regarded as focusing too much on wealth creation institutions (e.g. Islamic banks, Islamic insurances, etc.) with little emphasis on wealth distribution institution such as the *zakat* institution.

Islam encourages people to work and earn legitimate income to sustain themselves and their families but *Allah* has reminded Muslims to achieve a balance between worldly life and the hereafter. Hence, the mechanisms of wealth creation need to be balanced with wealth distribution in order to achieve the main objective of *zakat*, which is socio-economic justice. Proper distribution of *zakat* may affect aggregate consumption, savings and investment, aggregate supply of labor and capital, eradication of poverty, enhancement of social security system, distributive efficiency and economic growth.

The effect of *zakat* on aggregate consumption especially among the beneficiaries can be considered in a Keynesian framework of declining marginal propensity to consume (Kahf, 1997). If the rich use their income for consumption, buying capital goods (saving), spending for the cause of *Allah* their *zakat* obligation as well as making charitable contributions, and the poor spend their income including those received from *zakat* and charity, this will theoretically increase the overall consumption and reduce savings. Figure 1 shows how socio-economic justice can be attained via the mechanisms of wealth creation and distribution.

*Zakat* is expected to increase savings since it takes away a part of the precautionary savings (Choudhury, 1983). If income is expected to fall short of subsistence, people will tend to save more as a precautionary measure. Metwally (1986), however, added that the impact of *zakat* on savings will depend on the nature of the consumption function that the society follows in its consumption behavior. If the consumption behavior takes the relative income hypothesis[3], *zakat* is likely to increase savings because it will reduce



Source: Authors own

Figure 1. Mechanisms to achieve socio-economic justice

the income of the rich. If it corresponds to the absolute income hypothesis[4], the savings effect of *zakat* is likely to be negative since *zakat* redistributes resources from the rich to the poor and the average propensity to consume by the low-income group is relatively higher than those in the high-income group. On the other hand, if the permanent income hypothesis[5] is relevant, then the saving effect will be neutral (Sadeq, 2002).

In theory, *zakat* should make positive impact on investment since people have the incentive to invest their wealth rather than keep the investable resources idle. Kahf (1997) argued that *zakat* could affect the aggregate supply in three ways: supply of labor, supply of capital and resource allocation. The impact of *zakat* on the supply of labor can be achieved through improvement of the health, nutrition and other living conditions of the poor. Thus, it will increase labour productivity and positively affects the supply of goods produced in the economy. In theory, *zakat* will not only increase the demand for goods and fulfill the basic needs of the poor, but may also reduce demand for luxurious goods by the rich.

The institution of *zakat* can also contribute to eradication of poverty, which is one of the major problems in society today. If *zakat* is effectively implemented, it will encourage the rich to invest their wealth, which would then increase the disbursement of *zakat*, and in turn, increase employment and productivity. *Zakat* also provides a social security system to Muslims. According to Afzal (1980), the mutual responsibility to look after each other in time of need is the essence of the Islamic concept of responsibility. Thus, every Muslim community is responsible in supporting the less fortunate members of the society from the *zakat* proceeds. The *zakat* institution is part of the wider social security system which should be enforced by the state for the upliftment of the disadvantaged groups in society (Sadeq, 2002) rather than being treated as a voluntary institution.

### 3. Prior studies on *zakat*

Several studies on *zakat* institutions have been theoretically and empirically undertaken. Kahf (1989), Buang (2000) and Bakar and Rahman (2007) considered the theoretical aspects of *zakat*. Kahf (1989) discussed on the issues of zakatable items during the life of the Prophet Mohammad Saw and the potential proceeds of *zakat* in eight Muslim countries. The study suggests that *zakat* can eradicate poverty in the Muslim world within a reasonable period of time, only if the new forms of wealth and new sources of income, especially in the sectors of industries, commerce, finance and services, are made zakatable. Buang (2000) discussed on the issue of *zakat* management. The study outlined the basic principles of *zakat* management derived from the main sources and relevant *fatawa* (legal pronouncement in Islam made by scholars) on *zakat* administration. Bakar and Rahman (2007), on the other hand, distinguished between *zakat* and modern taxation and further discussed the implementation of *zakat* and taxation in Malaysia. Rahman (2007) discussed the pre-requisites to effectively integrate *zakat* into mainstream Islamic financial system in Malaysia. The pre-requisites discussed include the objective and fair measurement of business wealth for *zakat* purposes, standardizing *zakat* accounting practices and development of appropriate performance measures[6].

Past studies indicate the importance of efficient collection of *zakat* to ensure socio-economic objectives of *zakat* are attainable. Shehata (1994), for instance, examined the contemporary utilization of *zakat* funds in financing socio-economic infrastructure for Muslim individuals and communities. The study examined the legal rules regulating the expenditure of *zakat* including the entitlement and distribution of *zakat*.

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It further deliberated on the policy of *zakat* distribution among the eight types of beneficiaries. Shehata (1994) developed a framework for the contemporary use of *zakat* fund in financing Islamic socio-economic infrastructure as well as policy to manage *zakat* fund. There are many types of programs that could be funded by *zakat* such as providing education for the poor, the establishment of schools, vocational training and rehabilitation for *zakat* recipients to make them more productive, establishment of agriculture and cottage industries, provision of fixed assets and equipments to small business projects, provision of working capital, building of low-cost housing, providing medical treatment and health care, etc.

In summary, *zakat* is vital as it has several positive impacts on the macroeconomic variables in the society. The importance of *zakat*, especially to Muslim community, can be considered as comparable and complementary to the social security system that exists in many developed countries. Although it has so far been managed as a peripheral system, the positive effects of *zakat* to the overall economy should be subjected to further empirical studies.

#### 4. Background of *zakat* institutions in Malaysia

In Malaysia, *zakat* is administered under the respective states jurisdiction as part of the administration of the State Islamic Religious Council (SIRC)[7]. The law on *zakat* is governed by each state's enactment or its own *zakat* law (Bakar, 1998). SIRCs are fully responsible in managing *zakat* affairs including its collection and distribution. Each state has its own SIRC but they are all referred to as *zakat* institutions in the Malaysian context. Although the approach in managing *zakat* varies from one state to another, the main aim remains the same.

The federal government has established the Department of *Zakat, Waqf and Hajj* with the aims of mainly coordinating and promoting these institutions in Malaysia. Hence, as stated by Rahman (2007), the development of a proper performance measurement system is important to effectively integrate *zakat* into mainstream Islamic financial system in Malaysia. Rahman (2007) urged for the Malaysian Constitution to take pro-active steps in developing an objective and fair measurement of *zakat* on business wealth in Malaysia because current business activities are very complex and the traditional methods of measurement may not reflect the true and fair amount of *zakat* due. For Islamic business entities, such as Bank Islam Malaysia Berhad, which is burdened with two charges, i.e. corporate tax and *zakat* on business wealth, the introduction of tax liability rebate may help ensure that such corporations are fairly treated. Also, standardized *zakat* accounting practices and proper performance management system are needed to satisfy the needs of stakeholders for *zakat* financial information, including the payers, the recipients and the *zakat* administrators.

The Government of Malaysia is expected to play an important role in promoting good governance within such institution. The governance of *zakat* institutions here refers to the governance structure and mechanism to ensure financial and managerial accountability of *zakat* collection and distribution. In addition, Rahman (2003) proposed that as part of good governance, the Malaysian Government should institute good financial management practices such as the promulgation of accounting and auditing standards on *zakat*, and undertake reform of *zakat* distribution practices through instituting performance management system. The Malaysian Government can also emulate and adapt the model of voluntary and charity sector governance as

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recommended by Deakin Report published in the UK in 1996. The report made a number of policy recommendations on effectiveness, accountability, standards, user involvement, governance, equality and fairness and staff management (Rahman, 2003).

Furthermore, being a public organization, *zakat* institutions are subjected to intense public scrutiny on their efficiency and effectiveness in managing *zakat* affairs. There are a limited number of empirical studies undertaken on the efficiency and governance of *zakat* institutions. Past empirical studies focused mainly on the management of *zakat* collection and distribution. Hence, due to the lack of studies on the economic efficiency and governance of public service organizations, these concerns need to be empirically studied especially in the context of a modern Muslim state. In brief, the economic efficiency mathematically measures how well an organization generates outputs based on the available inputs or resources. Public service governance refers to the specific mechanisms and arrangements to ensure public service organizations manage their resources well and with proper accountability to stakeholders.

In the case of Malaysia, Idris and Ayob (2002), Idris *et al.* (2003), Nor *et al.* (2004) and Wahid *et al.* (2005) studied the determinants of *zakat* compliance. Idris and Ayob (2002) looked at various components of attitude towards *zakat* on employment income including the level of compliance for *zakat* payment among Muslim employees, and their implication on compliance behavior. Based on the items in each component, the results indicate that attitude towards *zakat* on employment income can be divided into five categories, namely general attitude (e.g. have to pay, happy to pay, purify the income, etc.), positive attitude (e.g. suitable to be implemented, calculation is easy, still pay although its unclear), uncertain attitude (e.g. waiting for a good system, confusing, asking for scholars opinion first, etc.), conditional attitude (e.g. penalty, standardized law in every states, etc.) and technical attitude (e.g. *zakat* calculation same as tax, confuse with its calculation). Each type of attitude have different effects on compliance behavior. Using logistic regression analysis, the results revealed that positive, uncertain and technical attitudes were positively and significantly related to the compliance behavior while the other two attitudes were insignificant.

Wahid *et al.* (2005) studied factors influencing payment of *zakat* among 2,500 individuals in Malaysia. The results showed that gender, age of the respondents, marital status, income and expenses of the respondents were significant factors influencing *zakat* payment. On the other hand, Nor *et al.* (2004) examined the compliance of professionals towards *zakat* on income. Using a logit binomial model, the results showed that the level of religious belief (*Iman*) and religious education are two of the most significant factors that influence the payment of *zakat* on income.

Idris *et al.* (2003) examined the intrinsic motivational factors such as perceived service quality, degree of knowledge, degree of exposure on promotional campaign and level of religiosity, in influencing employees working for the federal government to pay *zakat* on employment income. They found three intrinsic motivational variables, namely perceived service quality, level of *zakat* knowledge and level of exposure, to be significantly related to payment of *zakat*.

Wahid *et al.* (2004) further examined the effect of *zakat* distribution on the quality of life of the beneficiaries especially among the poor and the needy. An "effective" *zakat* distribution should result in better quality of life including food, education, health and shelter for the beneficiaries. Using logit model, the study examined the level of satisfaction of recipients in three states in Malaysia on the different categories of quality

of life, i.e. transportation, health, education, shelter and involvement in social activities. Results indicate general dissatisfaction among respondents with the *zakat* distribution. Education and involvement in social activities were the only factors that the respondents were satisfied with compared to other quality of life (transportation and communication, health and housing). The level of education was found to be the most significant factor in affecting the quality of life of the respondents. However, the effect of *zakat* aid was insignificant. The level of income received was also found to be insignificant in affecting the quality of life of the poor.

Recent studies also revealed that there were many shortcomings in the distribution of *zakat* funds (Ahmad *et al.*, 2006; Muhammad, 2008; Wahid *et al.*, 2008, 2009). Ahmad *et al.* (2006) examined factors contributing to dissatisfaction towards formal *zakat* institutions based on a sample of 753 respondents who paid *zakat* to six privatized institutions. Logistic regression was used to analyze the probability of paying to such *zakat* institutions. Results indicate that satisfaction on the distribution and efficient management of *zakat* are main factors influencing *zakat* payment. About 57 percent of the respondents were dissatisfied with the distribution of *zakat* funds which significantly affects payments to the *zakat* institutions.

The results were also confirmed by Muhammad (2008) who examined the perceptions of academics on the efficiency of *zakat* administration especially in terms of distributing and collecting funds, having accessibility to the funds, and providing sufficient information to the public. The study found a positive significant relationship between perception on the distribution of *zakat* funds and payment of *zakat* formally to the *zakat* institutions. Other studies such as Wahid *et al.* (2008, 2009) revealed two main factors contributing to dissatisfaction are the ineffectiveness of *zakat* distribution and the lack of transparency on information about the distribution of *zakat*. The lack of confidence on the governance of *zakat* institutions due to the perceived lack of efficiency and effectiveness may directly undermine the *zakat* institutions in attaining their desired socio-economic objectives. Table I summarizes studies on *zakat* institutions in Malaysia

Table I summarizes the approaches and the findings of past studies on the practices of *zakat* and *zakat* institutions. Most of the studies above are descriptive and theoretical in nature. Some of the studies empirically examined various concerns on *zakat* collection, distribution and management. However, most studies are lacking in terms of rigorous theoretical model development, and robust empirical testing of more pertinent and emerging issues such as efficiency and governance. Table I clearly indicates the dearth of empirical studies especially on efficiency and governance, and the interactions of these two important areas of concern in the context of *zakat* institutions.

## 5. Efficiency and *zakat* institutions

Economic efficiency, based on conventional economic context, is a term describing how well a system is performing in terms of generating the maximum desired output from given inputs and available technology. In other words, efficiency is improved when more output is generated with the same or less amount of inputs. An economic system is more efficient if it can provide more goods and services for society without using more resources. The concept of economic efficiency measurement proposed by Farrell (1957) consists of two components, namely technical efficiency (TE) and allocative efficiency. TE reflects the firm's ability to obtain maximum output from a given set of inputs, and allocative efficiency reflects the firm's ability to use the inputs in optimal

**Table I.**  
Summary of studies  
on *zakat* institutions  
in Malaysia

Author(s)	Focus/issue(s)	Method(s) of analysis	Main finding(s)
1. Idris and Ayob (2002)	Analyse attitudes towards <i>zakat</i> on employment income and their implications on compliance behaviour	Factor analysis and logistic regression analysis	Identified five categories of attitude, namely general attitude, positive attitude, uncertain attitude, conditional attitude and technical attitude towards <i>zakat</i> on employment income. Positive attitude, uncertain attitude and technical attitude were positively and significantly related to compliance behavior while the other two attitudes were insignificant
2. Idris <i>et al.</i> (2003)	Analyse the intrinsic motivational factors, namely perceived service quality, degree of knowledge, degree of exposure on promotional campaign and level of religiosity, in influencing governmental employees to pay <i>zakat</i> on employment income	Multivariate logistic regression analysis	Three intrinsic motivational variables, namely perceived service quality, level of <i>zakat</i> knowledge and level of exposure, were found to be significantly related to payment of <i>zakat</i> . Surprisingly, the level of religiosity was found to be negatively related to compliance behavior and this may be attributed to disagreement on the zakatability of income from employment. Compliance in the study is strictly limited to official payment to the authority
3. Rahman (2003)	Analyse contemporary issues of <i>zakat</i> on business wealth as practiced in Malaysia	Conceptual analysis	Proposed for the federal government to institute good financial management practices and reform <i>zakat</i> distribution practices. Also proposed the introduction of two <i>zakat</i> governance measures, i.e. the promulgation of Islamic accounting standard, and structural and policy reform towards more effective <i>zakat</i> distribution
4. Wahid <i>et al.</i> (2004)	Examine the impacts of <i>zakat</i> distribution on the quality of life (i.e. transportation and communication, education, health shelter and social involvement) of the <i>zakat</i> beneficiaries especially among the poor and the needy	Logit model	The respondents were generally not satisfied with the <i>zakat</i> distribution. Education and social involvement (involving in social activities) were the only factors that the respondents were satisfied with relative to other quality of life variables (i.e. transportation and communication, health and housing). The level of education was found to be the most significant factor in affecting the quality of life of the respondents. The effect of <i>zakat</i> aid and level of income was found to be insignificant in affecting the quality of life of the poor
5. Nor <i>et al.</i> (2004)	Examine the compliance behaviour of professionals towards <i>zakat</i> on income	Logit binomial model	Level of religious belief ( <i>Iman</i> ) and religious education are found to be the two most significant factors influencing the payment of <i>zakat</i> on income. Other factors (i.e. gender, number of dependants, level of education and knowledge on <i>zakat</i> on income) are less significant in influencing the payment of <i>zakat</i> on income. The role and function of the <i>zakat</i> collection centre is found to be not significant in influencing payment of <i>zakat</i> on income

(continued)



Author(s)	Focus/issue(s)	Method(s) of analysis	Main finding(s)
6. Ahmad <i>et al.</i> (2006)	Analyse factors contributing to the dissatisfaction towards <i>zakat</i> institutions based on a sample of 753 respondents who paid <i>zakat</i> to six privatized <i>zakat</i> institutions	Logistic regression analysis	The main factors influencing <i>zakat</i> payment are found to be satisfaction on the distribution and the efficient management of <i>zakat</i> . About 57 percent of the respondents were dissatisfied with the current distribution of <i>zakat</i> which in turn significantly affect the payment to the <i>zakat</i> institutions Proposed three pre-requisites to make <i>zakat</i> a prominent component in mainstream Islamic financial system: (1) developing objective and fair measurement of <i>zakat</i> on business wealth; (2) standardizing <i>zakat</i> accounting practices; and (iii) developing proper performance measurement system
7. Rahman (2007)	Identify and examine factors that determine the success of <i>zakat</i> institutions towards the effective integration of <i>zakat</i> as part of the mainstream Islamic financial system	Conceptual analysis	A favourable perception on the distribution of <i>zakat</i> funds is significantly and positively associated with payment of <i>zakat</i> formally to the <i>zakat</i> institutions while unfavorable perception on <i>zakat</i> distribution will increase the probability of <i>zakat</i> being paid directly to the recipients Most respondents were dissatisfied with <i>zakat</i> distribution but this did not affect <i>zakat</i> payment significantly. Privatisation was found to have no effect on respondents <i>zakat</i> payment.
8. Muhammad (2008)	Analyse the perceptions of academics on <i>zakat</i> administration especially in terms of distributing and collecting funds, having accessibility to funds and providing sufficient information to the public	Regression analysis	Most of the respondents (57 percent) were dissatisfied with <i>zakat</i> distribution. Unclear method of distribution and lack of transparency on information about the distribution are among the factors identified
9. Wahid <i>et al.</i> (2008)	Analyse factors of dissatisfaction among <i>zakat</i> payers towards <i>zakat</i> distribution, and whether there exist differences in the degree of dissatisfaction towards privatised and non-privatised <i>zakat</i> institutions	Logistic regression analysis	
10. Wahid <i>et al.</i> (2009)	Analyse perceptions of <i>zakat</i> payers towards <i>zakat</i> institutions and the distribution of <i>zakat</i> to the beneficiaries	Descriptive analysis	

Table I.

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proportions, based on given prices and production technology. The two measures are then combined to provide a measure of total economic efficiency. However, for measuring the efficiency of *zakat*, we proposed the use of DEA.

### 5.1 Efficiency of *zakat* and the use of DEA

Based on certain input(s) and output(s), the efficiency of *zakat* institutions can be measured using several methods such as the frontier approach and DEA. Of the available methods, the non-parametric DEA is deemed appropriate for small sample size of firms. DEA is a linear programming technique that forms a piecewise linear convex isoquant over the data points such that no observed point lies to the left or below it (Isik and Hassan, 2002). Thus, DEA frontier represents the set of efficient observations for which no other production unit or linear combination of units employs as little or less of every input without changing the output quantities generated or produces as much or more of every output without altering the input quantities used (Isik and Hassan, 2002).

DEA allows focusing on the TE which measures the proportional reduction in input usage that can be attained if the firm operates on the efficient frontier. The DEA also permits further decomposition of the TE into its two components, i.e. pure TE (PTE) and scale efficiency (SE). PTE measures the relative ability of operators to convert inputs into outputs while SE measures the extent the operators can take advantage of returns to scale by altering its size towards optimal scale. Obviously, the decomposition lets one to better trace the sources of inefficiency in the production units (Isik and Hassan, 2002).

In the case of *zakat* institutions, there are several variables that could be fit into the model. The variables could be the number of staff and its total expenditure as the inputs with the total amount of *zakat* collected, total amount of *zakat* distributed, total number of *zakat* payers and total number of *zakat* recipients as the outputs. Since the DEA allows a few number of institutions in the analysis, the study of *zakat* institutions in 14 states in Malaysia will be useful as an indicator for a better governed institution.

Several studies have been conducted on the efficiency of the public sector as well as the private ones. Among studies on the efficiency of the public sector include Ruggiero and Vitaliano (1999), Husain *et al.* (2000), Sarker and De (2004) and Ibrahim and Salleh (2006). Husain *et al.* (2000) measured public sector's productivity, namely Road Transport Department in Malaysia, by examining how well resources were combined and utilized in order to accomplish optimized set of results. Using the DEA with multiple inputs and multiple outputs, the result showed that out of 46 service units, only 11 service units score above 50 percent on the efficiency scores. Hence, the DEA method is able to objectively identify efficient and inefficient service units. The study also contributed in developing policy measures to improve the efficiency of service units such as reduction in the number of labour and labour cost.

Using a similar method, Sarker and De (2004) examined the efficiency of resource usage of different types of tenure and farm size. Using DEA, the input chosen for the analysis include human labour costs with the outputs being various crops, credit, marketing of products and agricultural extension. The results showed that most of the farms are ideally efficient and valid for both technologically advanced villages, villages that used higher incidence of irrigation and high-yield varieties (HYV) technology, and technologically backward villages, villages that have no irrigational facilities except rainwater and non-HYV technology in agriculture. The result showed that small farms are more efficient than larger size farms. Overall, the study showed that the diffusion

on new agricultural technology is not an important factor in improving level of efficiency of farms. Thus, the adoption of technology may not lead to better efficiency; instead, the management of technology and the governance of the organizations could be critical factors that may influence efficiency.

Using stochastic frontier model, a parametric economic approach, Ibrahim and Salleh (2006) examined the performance of local governments in providing local public goods and services and developed the indices of cost efficiency. The local governments were categorized into three components: city councils for city centres, municipality for large towns and district council for small urban centres. The major function of the local governments is to provide public goods and services that are specific for the localities. The study used labour as the input while number of public toilets, number of parking lots, number of stall spaces, amount of waste disposed, number of trees planted, total population and the length of road were used as proxies for output indicators. A survey instrument was disseminated to 99 local governments in 2000 in order to obtain information on the local public goods and services provided by the local governments and 46 responses were analyzed. The result showed that most of the local governments in Malaysia were cost inefficient. The observed cost of the local governments was 59 percent more inefficient than the best practice cost. Furthermore, the result also showed that municipality councils were more inefficient than the district councils.

With regard to *zakat* institutions, there is no published empirical studies that examine the efficiency of the institutions. Hence, a study looking at relevant and robust economic measurements of efficient *zakat* collection and distribution is important. The evaluation of the institutions' efficiency is crucial in improving the overall operations and in turn, in contributing towards achieving Islamic socio-economic objectives.

## 6. Governance and *zakat* institutions

Good governance may contribute to an efficient organization. The United Nations Economic and Social Commission for Asia and the Pacific (2008) defines governance as the process of decision making and the process by which decisions are implemented. According to the UNDP (1998) and Huther and Shah (1998), governance refers to the exercise of economic, political and administrative power in the management of the resource endowment of a state. Its practice requires mechanisms, processes and institutions through which citizens and groups articulate their interests, exercise their legal rights, meet their obligations and mediate their differences.

The 1997 UNDP on good governance covers five principles:

- (1) legitimacy and voice;
- (2) direction;
- (3) performance;
- (4) accountability; and
- (5) fairness (Graham *et al.*, 2003).

Legitimacy and voice calls for all men and women be given democratic voice in decision making. Good governance also mediates differing interests to reach a broad consensus on what is in the best interest of the group and where possible on policies and procedures. The second principle, direction, addresses the strategic vision where leaders and the public have a broad and long-term perspective on good governance along with a sense

of what is needed for development. The third principle, performance, is related to producing results that meet the needs of the stakeholders while making the best use of resources. This encompasses issues such as cost-effectiveness, capacity, responsiveness, dissemination of information regarding performance to the public and monitoring and evaluating management performance. The fourth principle, accountability, requires organizations to be accountable to the public as well as to institutional stakeholders, and also to be fully transparent. Processes, institutions and information should be accessible to those concerned with them and enough information should be provided to stakeholders for monitoring purposes. The fifth principle, fairness, deals with equity and rule of law and call for all men and women be given equal opportunities and for the legal frameworks to be enforced impartially. In the context of *zakat* institutions, legal frameworks must also encompass the *shari'ah* requirements on *zakat*. This is crucial to ensure that the frameworks are relevant to the Islamic institution of *zakat*.

The UNDP (1997) has also enunciated a set of good governance principles specifically for sustainable human development (SHD). SHD is defined by UNDP as the process by which the range of opportunities and choices for people can increase and be expanded, while protecting those same opportunities and choices for future generations as well as the natural systems upon which all life depend (Management Development and Governance Division, 2006, p. 9). This definition was derived from a number of sources, including international declarations emanating from conferences such as the 1992 Earth Summit and from significant work undertaken by others, such as the 1987 Brundtland Commission[8].

SHD according to UNDP's definition is all about the well being of individual human beings. The new paradigm of SHD places people at the center as the principal actor and the ultimate goal of development. By enhancing human capabilities to expand choices and opportunities for all, SHD creates an environment in which human security is guaranteed and individual human beings can develop their full potential and lead a life of dignity and freedom. Human development indicator was developed by UNDP in 1990 as an indicator of the degree of human development enjoyed in respective countries comprising of longevity (life expectancy at birth), knowledge (adult literacy rate, gross enrolment ratio) and decent standard of living (GDP percapita). The UNDP focuses on four critical elements of SHD:

- (1) eliminating poverty;
- (2) creating jobs and sustaining livelihoods;
- (3) protecting and regenerating the environment; and
- (4) promoting the advancement of women.

Meanwhile, the human poverty index was introduced in the 1997 Human Development Report in order to measure the extent of human poverty in a community. It measures the extent of deprivations in developing countries along three dimensions: a long and healthy life, knowledge and a decent standard of living. In the context of *zakat*, the system is a balanced human development programme with the main purpose of ensuring and protecting the social and economic welfare of the poor and the needy. Islam considers mankind as vicegerents (*khalifah*) of *Allah*, and they must ensure that other fellow human beings are well protected socially and economically. The socio-economic cooperation is well ingrained in the Islamic system of *zakat* whereby the rich

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and the well-to-do members of the community take care of the needs and the social welfare of the poor and the needy through an institutionalized system of *zakat*.

A crucial aspect of SHD is governance, which encompasses concepts such as accountability, transparency, corruption, election, participation, democracy, free media, access to information, human rights and rule of law (Hasegawa, 2001). Improvement in the governance system will help improve SHD. With regard to *zakat*, the main objective is the achievement of socio-economic justice (Kahf, 1989). Thus, *zakat* can provide an alternative to the shortcomings of the secular economic system as the main focus of *zakat* is to alleviate poverty through transfer of wealth from the rich to the poor. The Islamic system of *zakat* places human welfare and well being of individuals as an important objective in achieving socio-economic justice. The proper distribution of *zakat* funds will ensure that the poor in a community may enjoy a decent standard of living or at least be able to overcome or reduce poverty.

The study by Shipley and Kovacs (2007) is among studies that used UNDP's principles of good governance. Using the UNDP's (1997) principles of good governance as a reference along with the United Nations Economic, Social and Cultural Organization (UNESCO), International Council on Monuments and Sites charters and conventions and other governance reports, Shipley and Kovacs (2007) measured the oversight and operation of cultural heritage institutions with regard to their relevance to good governance. The study found that there exists a good model in the five principles of good governance (IOG, 2003) that are well conceived and clearly articulated based on the UNDP's characteristics of good governance. These principles, after comparisons with and evaluation against UNESCO and National Trust documents, emerge as robust, useful and transferable with only a small number of additions.

Graham *et al.* (2003) used the principles of good governance based on UNDP's list of good governance in the context of protected areas (PA). In applying those principles, three steps were undertaken. First the understanding of the means and ends of the PA governance where the variety of objectives can be summarized under four headings: nature conservation, science, visitor opportunities (recreational, educational, cultural, spiritual, etc.) and local and indigenous needs. This was followed by developing specific criteria for each of the five principles and finally applying the principles and criteria by analyzing specific governance challenges in a PA context in order to pinpoint gaps or weak points in a governance regime. They found that the five principles appeared to be relevant to the full range of models of PA governance. However, the study is rather a conceptual study that discusses the possibility of applying the principles in order to create a meaningful analytical tool.

In the context of *zakat* institutions, the model of governance developed by UNDP can be adapted and modified for the purpose of developing *zakat* governance by taking into considerations relevant *shari'ah* requirements, and the Islamic concepts of accountability and fairness.

A good governance institution is an institution that is accountable, transparent and fair. These principles are important to ensure the achievement of goals and objectives of the institution. For many authors, good governance is the key variable in the firm valuation besides the mitigation of agency conflicts. Hence, study of governance is important towards the achievement of the respective goals and objectives.

In the Malaysian case, Siddiquee and Mohamed (2007) evidenced that the Malaysian Government has introduced a variety of changes in its public management system that are

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geared towards enhancing efficiency and institutional capacity of the governmental machinery, as well as transforming it into a dynamic, accountable and customer-oriented administration. The early reform attempts and those that followed in the 1970s were geared towards institution building and strengthening the administrative capacity to promote state-led socio-economic development while the adoption of the market ideology in the mid-1980s and subsequent policy decisions under the National Development Policy and Vision 2020 (the 30-year perspective plan that seeks to transform Malaysia into a developed country by 2020) marked the new beginning of reforms.

The reforms involved providing customer-oriented services, improving systems and work processes, strengthening public-private cooperation, enhancing accountability and integrity and inculcating values of excellence in the public service and promoting the values of good governance and responsible administrative behavior. The reforms in general, have produced positive impacts in ensuring quick, hassle-free and timely services to customers, and contributed to streamlining the structure and size of public bureaucracy. However, the reforms have fallen short of what was required to promote good governance. For instance, concentration of extensive policy and managerial authority for planning and implementation activities undertaken from the federal to the state and local and district levels limit capacity and resources. The problem of public participation and adequate scrutiny of policy decisions has been compounded by absence of transparency and openness in government operations.

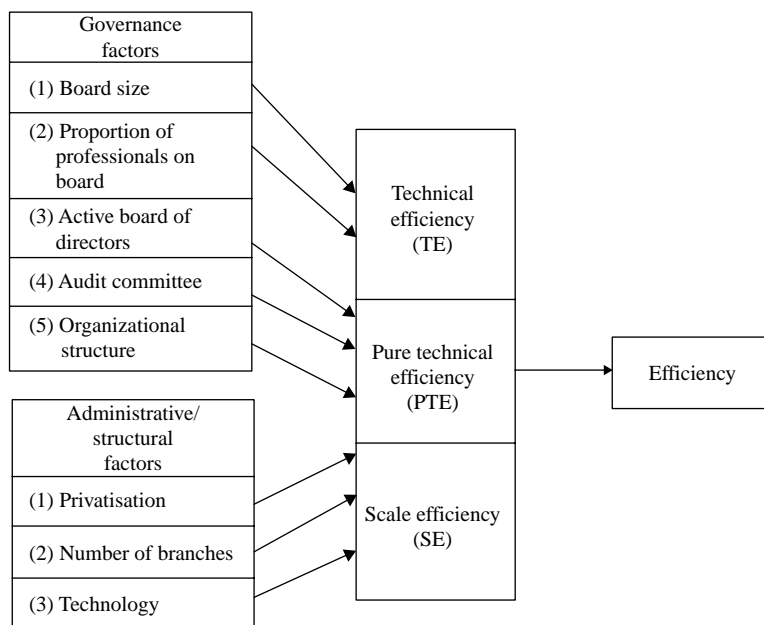
Pellegrina (2007) investigated the different effect of efficiency and governance of European and Islamic banks during the period of 1996-2002. Using productivity (staff expenses/number of employees) as proxy of governance, the results show that insufficient role of staff members in Islamic banks gave a clear signal of inefficiency. Similarly, the estimated parameter is also positive (although largely undersized) in the simulation performed on the European sample banks.

In the case of *zakat* institutions in a Muslim country like Malaysia, good governance is important since it may contribute towards efficiency and effectiveness in *zakat* funds. Closer examination of the various governance mechanisms is important because *zakat* institutions control significant financial resources.

Based on the theory and past studies discussed earlier, we proposed a framework for measuring the efficiency and governance of *zakat* institutions in Malaysia. The theoretical model is shown in Figure 2.

Based on Figure 2, it is assumed that the governance factors (examined by its governance characteristics such as board size, proportion of professionals on board, active board of directors, audit committee and organizational structure) and other administrative/structural factors (including privatisation, number of branches and technology) may lead to better efficiency of the *zakat* organization. The above factors are determined based on the functions and characteristics of *zakat* institutions in Malaysia. The study postulates that the above governance factors such as the composition of the board of directors is a principal mechanism that can enhance and create the coalitions with the stakeholders controlling resources required by an institution. Alshimmiri (2004) argues that larger boards include directors with diverse skills and expertise which would help improve the efficiency of transmitting the information of the organization.

Professionals are people who have great skills and expertise in particular areas. Besides educational background, professionals gain their professionalism and expertise through experience and job training. Educational background for instance,



**Figure 2.**  
Theoretical model

can be an important determinant of efficiency of an organization with better educated directors being more likely to adopt innovative activities. In the context of *zakat* institutions, experts and professionals from various fields such as *syariah*, conventional law, information and communication technology (ICT), etc. are important in improving the efficiency of the institutions. Furthermore, active board of directors measured by number of meetings postulates that more discussion activities (e.g. through meetings frequency) would enhance governance quality (Khanchel, 2007) and also increase the efficiency level (Lin *et al.*, 2009). The existence of an audit committee is expected to improve the accountability of an institution and improve the quality of governance of an institution since its existence may improve internal control and also act as effective monitoring device for improving the efficiency of the institution.

Organisational structure refers to the chairman of the religious councils in Malaysia who is responsible in determining the objectives and the missions of the council. The authority of an institution should have people who are able to respond to local demand as well as having adequate mechanisms for accountability. In the case of *zakat* institutions in Malaysia, decentralisations in the 1980s indicate a transfer of the chairmanship role of some councils from the Sultan (the king of a state) to the state government (Chief Minister) and the Chief Minister while other councils still have the Sultan as the chairman. The new public management system adopted is assumed to significantly contribute to the efficiency of *zakat* institutions in Malaysia as it is seen to be more effective and contributed to the decline in the traditional ethos of the public sector (Brereton and Temple, 1999). Hence, decentralisation measured by type of authorities (Sultan, Chief Minister or others) may lead to better performance of the institution and consequently to the efficiency of *zakat* institutions in Malaysia.

By privatization, an institution will follow the management philosophy of corporate institution such as marketing, research and development as well as utilizing management information system. Through privatisation, *zakat* institutions will adopt the management concept of corporate institution in collecting and distributing the funds and this may contribute to better performance of the institutions in managing the funds and consequently leading to the efficiency of the institutions. Applying the branching concept to *zakat* institutions is expected to increase the efficiency of the institutions. There are different numbers of *zakat* branches in every state in Malaysia. More branches is expected to help in identifying potential *zakat* recipients as well as monitoring the effectiveness of the disbursement in certain area. Hence, it is expected that the higher the number of branches, the more efficient the institutions.

The use of ICT through interconnected computer networks allows individual and institutions to communicate with each other effectively and inexpensively. The widespread availability of ICT (computers, digital telecommunication, etc.) has led to the creation of an unprecedented capacity for dissemination of knowledge and information to the society. In the context of *zakat* institutions, the use of the ICT is expected to improve the efficiency of the institutions as it helps them to improve productivity as well as making it easy for the *zakat* payers to fulfill their obligation and responsibility easily. Thus, measurement based on the number of computers, internet access, web site availability and availability of online payment of *zakat*, the use of ICT is expected to improve efficiency of the institutions.

Good governance is associated with accountability of the leaders. Effective leadership will enhance the performance of the organization while other factors (privatisation, number of branches and technology) may ease the institution in improving its administrative affairs and efficiency. Hence, the governance and other administrative factors mentioned above are assumed to positively influence the efficiency of *zakat* institutions in Malaysia.

## 7. Conclusion

The economic impacts of *zakat*, in theory, can positively affect major economic variables such as consumption, saving, poverty eradication and economic growth. This paper presents a review of the literature on the importance of ensuring the efficiency of *zakat* institutions in managing *zakat* funds through good governance practices. Some recent studies in the context of a modern Muslim country such as Malaysia revealed many shortcomings of the *zakat* institutions, especially in terms of distributing the funds and also a lack of proper governance mechanisms. Owing to the dearth of empirical studies on the efficiency and governance of *zakat* institutions, the paper proposes a comprehensive framework for studying efficiency of *zakat* institutions in Malaysia using DEA. In addition, the undertaking of an empirical study on governance will contribute towards a proper understanding of the governance mechanisms and issues on the complex economics and management of *zakat*. The developed conceptual model in this paper and future empirical findings using this model will hopefully contribute towards sustainability of *zakat* institutions and the enhancement of the noble socio-economic objectives of *zakat*.

## Notes

1. *Baitulmal* is the institution that acts as a trustee for the Muslims that looks after assets from which members of the Muslim public could benefit.



2. One of the ways by which *zakat* has been marginalised is by attaching it to the religious department rather than the Ministry of Finance as in the case of Malaysia. Another method of marginalising *zakat* is by only imposing it on some business activities and exempt others on purely political grounds rather than Islamic socioeconomic justice as proscribed in the *Holy Quran* (9:34; 4:141; 2:188).
3. Relative income hypothesis developed by James Stemple Duesenberry (1949), states that an individual's attitude to consumption and saving is dictated more by his income than by abstract standard of living in relation to others. So, an individual is less concerned with absolute level of consumption than by relative levels. The percentage of income consumed by an individual depends on his percentile position within the income distribution.
4. Absolute income hypothesis proposed by John Maynard Keynes (1883-1946) examines the relationship between income and consumption, and asserts that the consumption level of a household depends not on its relative income but on its absolute level of income. As income rises, the theory asserts, consumption will also rise but not necessarily at the same rate.
5. Permanent income hypothesis developed by Milton Friedman states that the choices made by consumers regarding their consumption patterns are determined not by current income but by longer term income expectations that the individual will consume a constant proportion of his/her permanent income. The key determinant of consumption is an individual's real wealth, not his current real disposable income.
6. Performance measurement in public sector should be measured based on 3Es, i.e. economy, efficiency and effectiveness. Economy represents the relationship between resources expended or budgeted for an activity and what is received from them. Effectiveness focuses mainly on the outputs, i.e. the goods and services produced as a direct result of management activities. Efficiency deals with both inputs and outputs and measures how productive inputs are turned into outputs. The additional measure of performance is outcomes which refer to the consequences of the output produced.
7. There are 14 states in Malaysia and the administration of *zakat* affairs are governed by the states due to the legacy of the British before independence of Malaya, over the administration of (1) matters related to Islam and Malay Customs; and (2) other aspects of state and national administration, where the former was administered by the establishment in each state of a central organization eventually known as the Council of Religion and Malay Customs.
8. UNDP and governance: experiences and lessons learned, available at: <http://mirror.undp.org/magnet/docs/gov/Lessons1.htm#2.5>

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