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<Special Feature "Malaysian Practice of the Islamic Economy at a Crossroads: Issues and Challenges">Islamic Social Enterprise Framework: The Case of Malaysia

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## Islamic Social Enterprise Framework: The Case of Malaysia<sup>1</sup>

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### I. Introduction

The roles of the third economic sector are important to reduce the gap between the poor and the rich, and to support government initiatives to provide extensive facilities to the community. It is reported that 40 percent of Organisation of Islamic Cooperation (OIC) countries' population earn under the poverty line (SESRIC 2012). The third economic sector can increase the opportunity for the poor to access education and skills, consumption, property ownership, and self-mobilization (Obaidullah and Muhamed, 2016). The roles of this sector should be expanded given that Islam promotes charitable activities as well as economic development. There are several charitable-based contracts in Islamic teachings, i.e. *zakah* (Islamic tithe), *waqf*, *sadaqah* (donations), *hibah* (gift), which should be explored and tailored to more efficient and approachable ways due to extensive needs of the beneficiaries. Islamic Social Enterprise (ISE), as one type of institution under the third economic sector, is currently gaining attention especially within the local communities where they are operating.

Compared to other institutions under the umbrella of the third Islamic economic sector such as *zakah*-based institutions, ISE's existence does not receive similar limelight. As such, only limited studies can be found in the literature. The distinctiveness of the ISE lies in its sources of funds and activities to create revenues. This institution can contribute to the society mainly in two ways; i.e. by providing basic consumptions to the needy and other customers via trading activities as well as by giving opportunities for donors to give donations. ISE is a new dimension of the Islamic third economic sector in a way that it serves the community by offering the basic and medium types of consumptions and services. Since ISE uses charitable funds (in the form of monetary and goods) for the purpose to generate and expand their revenues, certain Islamic charitable contracts such as *zakah* (that has its strict rules on recipients and time frame) is irrelevant to ISE. By looking at this perspective, the sustainability of this institution is essential for the purpose of ensuring continuous contribution to stakeholders in the long term.

With a limited number of ISEs in comparison with other Islamic charitable institutions and social enterprise (SE), not much is known about the governance, financial, and income

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distribution of ISE. There are few ISEs that can be found in Malaysia, which can also be categorized based on types of institutions (under company limited by guarantee or established as sole proprietorship), and owners (by individuals or under Parent institution). In general legal perspective, ISE cannot be generalized to ‘company’ due to its variant form of establishment. Charity Shoppe, Amal Palestine, Imanina Shoppe and Waqf Annur Clinic are among the examples of ISEs in Malaysia (Mishbahrudin and Mohd Noor, 2016; Muhamed *et al.*, 2016b).

Due to ISEs different features and the reasons for the establishment, not much is known on the existing models of ISE’s operations worldwide that can sustain their existence. This paper aims to explore the operation of ISE in Malaysia in three aspects; governance, financial management, and distribution of income. The arrangement of the paper is as follows; the next section outlines the literature review followed by the theoretical framework, research methodology, analysis on cases and discussions. The last section concludes the paper.

## **II. Literature Review**

### **2.1. Concept of ISE**

The objective of ISE should be directed to achieve the Objectives of Islamic Law (*Maqasid Shariah*), and thus to preserve the public well-being (*maslahah*). ISE shares the concept of SE in terms of getting funds in the form of money and goods, and trade them to the community or providing services for the purpose of getting revenues and giving back to the society as well as sustaining the institutions. ISE’s contribution is not limited to goods as it also can offer services for community such as in education and health (Abdul Kadir *et al.*, 2015). As highlighted by Dees (1998), non-profit organisations including the SE tend to be involved in commercial activities in order to sustain themselves financially in order to cover for their activities, rather than depending on government’s grants.

SE is widely evolved in Western countries since 1980s and is viewed in a very broad and different perspectives. SE is defined either based on their objectives, activities, or their forms of establishment (Spear *et al.*, 2009; Kerlin, 2006; Di Domenico, Haugh, and Tracey, 2010; Defourny and Nyssens, 2008). It can be defined as an institution with primarily social objectives where its surpluses are reinvested in the businesses or community, rather than be used to maximize shareholders’ wealth (Spear *et al.*, 2009; Kerlin, 2006). SE can contribute to the community by providing jobs to the unemployed community, as well as providing education and health services (Darby and Jenkins 2006).

Even with some similarities of both institutions, ISE is different as it accepts funds from Islamic based charitable contracts and distributes the contribution to permissible places as guided by Shariah. Similarly, the Islamic principles guide where money will be distributed. Hati and Idris (2014) defined ISE as non-profit organisations that collect Islamic alms such

as *zakah*, *infaq*, *sadaqah*, and *waqf* as well as fulfil social enterprise criteria. However, the definition is limited since some of the Islamic based charity has some restriction in terms of dealing with those funds. *Zakah* funds, for example, is not tradable and should be distributed within a specific term to selected recipients. Within this framework, Muhamed *et al.* (2016) proposed the definition of ISE as an Islamic-based institution that gained funding (in the forms of monetary, goods and assets) from Islamic charitable sources (*waqf*, *sadaqah*, *hibah*, and *qard*) and channelled them into businesses for the purpose to sustain the contribution to the needy in a long term while at the same time contribute to customers (Muhamed *et al.*, 2016: 10). This definition thus excludes other Islamic-based entities that accept charities and directly distribute them to the needy, without accumulating those funds. There are four main elements that form the ISE; its form as Islamic-based institutions, Islamic charitable sources, activities and contributions of ISE.

As these institutions need to strengthen their financial position for long term sustainability and should be less reliance on charitable source of income, monitoring and managerial aspects should become the focus of the institutions. As highlighted by Sulaiman *et al.* (2008), lack of regulation, code of conduct, and efficient internal control can contribute to inefficient religious-based organisations. While ISE's objectives may not be targeted to maximise shareholder values like private companies, functions of governance, financial management and distribution of income are among the main aspects that can lead to effective ISE. This will ensure elements of accountability, transparency, fairness and responsibility as well as efficiency to be present in the organisation and safeguard stakeholder's values. All these aspects should be viewed as a continuous process in ISE that can contribute to the achievement of its objectives.

## **2.2. Governance**

Governance is an important mechanism to ensure that the organisations under monitoring do not divert from their objectives. Cornforth (2002) defined governance as "systems and processes that ensure the overall direction, effectiveness, supervision and accountability of an organisation." The mechanism of governance may comprise governing boards, monitoring systems and signalling mechanisms like organisational or corporate reporting.

Governance plays important roles in Islam, and was practiced widely in the past. The concept of *amanah* (trust), *hisbah* (supervision and follow up) and *syura* (consultation) are the governance-related concepts that are being highlighted in Islam. As highlighted in Hamed (1993), there are three layers of controlling and supervision in Islam; the first is controlled by God (this aspect is also related to the concept of *ihsan*), the second is self-controlling and the third is external controlling. Governance is an important element that should appear in all organisations. It works as a defence to prevent any deviation in the organisations. From the

perspective of corporate governance, it was defined by the Cadbury Code (1992) as a system by which corporation are directed and controlled. Furthermore, the OECD Principles of Corporate Governance described it as a set of relationship between a company's management, its board, shareholders, and other stakeholders (OECD, 2004).

Charity organisation's existence is to provide public benefit. *UK Charity Governance Review* (Grant Thornton, 2013) had highlighted the importance of good governance in charities, where it becomes the basis for underpinning effectiveness and efficiency in their performance. In addition, good governance could also ensure the legitimate objectives of key stakeholders are met. Hyndman and McDonnell (2009) had highlighted that governance in charities relates to reduce potential hazards in the organisations. This may include governance regulation, production of annual reports and monitoring by the board. Governance of charity can be divided into internal and external form of governance. Internal mechanism includes boards of directors/trustees, internal committees, compensation plans for managers and internal audit facilities.

Meanwhile, accounting rules, reporting requirements, government regulations and external auditors are part of external governance (Hyndman and McDonnell, 2009). Several frameworks were suggested by Spear, Cornforth, and Aiken (2009) for social enterprises, from a simple form of governance structure based on Anglo-Saxon model and Germany model, to hybrid organisational governance structure. There are limited studies on the governance of ISE. Muhamed *et al.* (2016b) looked at the governance structure of ISE using the secondary data, but from a limited perspective of the governance structure only.

### **2.3. Financial Management**

Financial management is important to ensure that the objectives of organisations can be met. ISE is targeted to fulfil the needs of the poor; however, it is not limited to this group only. With its objective to serve the community using charitable funds that are contributed by donors, ISE objectives should be different from business firms that are targeted to increase shareholders' wealth (Ramli *et al.*, 2015). As mentioned by Adil *et al.* (2013), inaccurate reporting in budgeting, financial statement and internal control are some weaknesses in religious-based organisations. The ISE thus should take into consideration the expectation of the stakeholders such as the donors, as those funds are contributed by these parties.

As suggested by Palmer and Randall (2005), financial priorities of non-profit organisations should be focused on accountability as they are funded by public's money and charitable trust. Palmer and Randall (2005) also highlighted that the organisations need to exhibit value for money and effectiveness.

With sound financial management, organisations could accomplish their objectives. Organisations with strong financial management are also better able to fulfil their missions

and deliver high-quality services. The needs for effective financial management are not restricted only to private entity with profit maximization objective, but it is also important for non-profit entity.

#### **2.4. Distribution of Income**

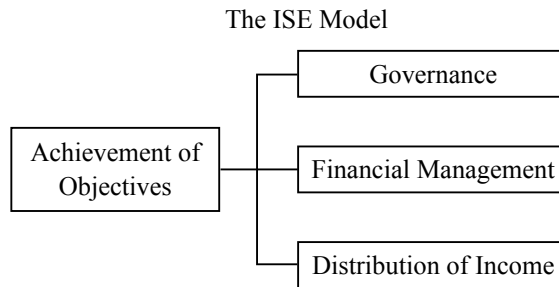
The distribution of revenue is one of the elements of ISE. In theory, there is no limitation for ISE to distribute the revenue except for restricted *waqf*-based ISE that are bound by the types of beneficiaries based on the intention of the donors. Other types of ISE, especially based on *sadaqah*, do not have any limitation on the usage of the income, and whether the distribution is made by cash or goods. Based on the international practices of SE, the distribution approaches adopted by SE are different following its definition, form of establishment, and country of legal practices. SE in the United States are not allowed to distribute their income directly to the recipients (Kerlin, 2006; Defourney and Nyssens, 2008). The contributions of SEs in the US from their income are channelled to support the NGOs' activities such as conducting workshops and programmes.

### **III. Theoretical Framework**

Preserving the *maslahah* (public good) is important for all Muslims and policy makers. *Maslahah* preservation is part of the Maqasid Shariah (objectives of Islamic Law). *Maslahah* based on al-Shatibi is defined as 'a principle that concerns the subsistence of human life, the completion of one's livelihood, and the acquisition of what his/her emotional and intellectual qualities require of him/her in an absolute sense' (Dusuki and Abdullah, 2007). The concept of *maslahah* is further constructed into three elements of *dharuriyyah* (essentials), *hajiyyah* (complementary), and *tahsiniyyah* (embellishments). Based on this route, Muslim economists such as Umer Chapra assert the need for Muslims to sacrifice and share their surplus with the poor, to ensure all members of the society are able to own and benefit the same goods and facilities, as a minimum at the *dharuriyyah* level. The roles of channeling the surplus, in the context of this study, are placed with the ISE's activities.

While ISE is an institution that is focusing on the social and sustainability objectives rather than profits, its obligations are important to ensure the objectives of the stakeholders are materialized. In the context of ISE, the stakeholders of these institutions are diverse and ranges from donors to recipients. This study uses the Adapted Stakeholder Theory as proposed by Iqbal and Mirakhor (2004). Based on the proposed theory, stakeholders of the ISE are important parties that should be taken care by this institution as it is bound by explicit and implicit contracts. Rather than viewing shareholders as part of ISE's stakeholders, this study view shareholders at par with donors. The perspective of this theory lays at all three spectrums of the model; governance, financial management, and distribution of income.

Figure 3.1:



Source: Developed for the Study

Currently, the term Shariah Governance (SG) is established in the Islamic banking and financial institutions as to preserve the elements of Shariah in Islamic banks and to monitor the companies' behaviours. SG is defined by Islamic Financial Services Board (IFSB) as: "the set of institutional and organisational arrangements through which an IIFS (Institutions Offering Islamic Financial Services) ensures that there is effective independent oversight of Shariah compliance" (IFSB, 2009: 2). SG literature is mostly linked to the modified Stakeholder Theory based on Islamic principles, whereby the functions of the organisations are to preserve obligation to God, humans' and the environment's rights. To be in line with Shariah, the IIFS need to ensure that there is a specific body and organs that can monitor, control and ensure the compliance to Shariah rules. Based on the *Shariah Governance Framework* (Central Bank of Malaysia, 2011), the institutions should have proper monitoring structure with additional organs such as Shariah Committee, Shariah Audit and Review as well as Shariah Risk. This study assumes that the elements of SG should be embedded in the ISE.

Financial management is an important process in an organisation. As mentioned in Kluvers (2013), there are few activities in financial management that can be linked to the organisations' capacity as non-profit organisations. These include strategic planning, budgeting, costing, recording and reporting financial transactions, monitoring cash flow, as well as measuring financial and non-financial performance. Even though the measurements related to the financial management can be found in the profit-based firms, this study emphasizes on the importance of the ISE to adopt proper financial management for their operation.

While there are different perspectives and approaches on income distribution of SE (following the government regulations), there is no limitation from the Islamic perspective on how ISE should contribute their income to the recipients, except for restricted *waqf*-based ISE. In this context, any ISE that accepts funds from *sadaqah* is able to distribute their income to the recipients without restriction. However, the ratio of contribution depends on the vision and mission of the institutions as well as the government's regulations.

#### **IV. Methodology**

This study aims to explore three aspects of ISEs management practices; governance, financial management, and distribution of income. Specifically, this study tapped six research questions as follows:

1. What are the objectives of the establishment of ISE?
2. How is the ISE being monitored?
3. How does the decision making process take place?
4. How is the budget prepared?
5. How is the ISE sustained?
6. How is the income distributed?

This paper is qualitative in nature and adopts the case study approach as suggested by Yin (2009), which is considered as favourable for exploratory study. The area of ISE's monitoring and management that is relatively new suits with this method. Structured interview was used as the data collection method. Two ISEs under this study consist of (i) the ISE owned by international-based non-profit organisation [named as Institution 1] and (ii) the ISE owned by local-based non-profit organisation [named as Institution 2]. Given that there is a limited number of ISE population in Malaysia, the two selected institutions under the study are considered sufficient.

This study adopted the purposive sampling as an approach to gain accurate data on the subject of the study. The respondents of the interview were Manager and Head Director of the ISEs. The interview sessions took place in 2016. The interview protocols were prepared prior to the data collection process to ensure the interview processes are conducted properly. Important topics were outlined in interview protocol to grasp the information on the study. Some important aspects included in the interview protocol are background of institutions, governance, financial management, and income distribution aspects. In order to increase the validity, a pilot interview was conducted with the key person in one NGO. This pilot helps the researchers to understand the concepts of the study prior to the actual data collection process. This case was used to increase the validity of the study, thus it was not included as part of the findings.

#### **V. Analysis on Cases**

##### **5.1. Case Study of Institution 1**

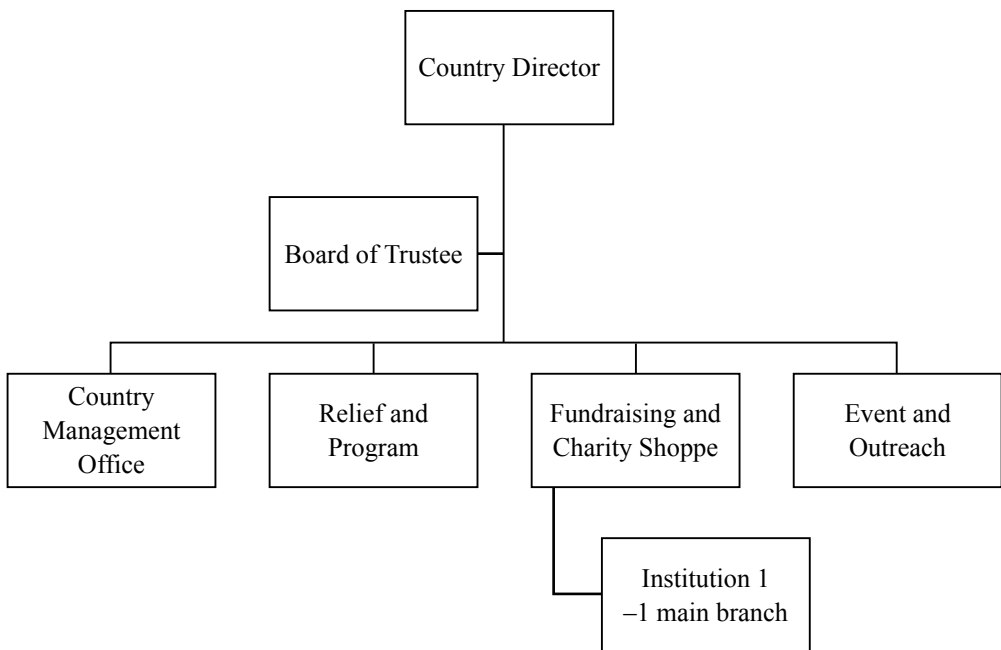
###### *5.1.1. Introduction*

Institution 1 has been established as one section under the Charity Shoppe, Event and Outreach Department of the Malaysian-set up Parent entity, a branch of the international based NGO. The mission of international main Parent and local Parent entity is for humanitarian



purposes, with a broad coverage of countries and beneficiaries. The Malaysian-set up Parent entity was formed as company limited by guarantee (CLBG) under the Company Commission of Malaysia (CCM) and led by a Country Director. Parallel to the objective of international Parent NGO as well as Malaysian-set up Parent entity, the mission of Institution 1 is to support the humanitarian activities. Other departments of Malaysian-based Parent are Service; Relief and Program; Fundraising and Charity Shoppe; and Event and Outreach. As per date of data collection, Institution 1 operates close to the Parent entity and has 3 staff and a manager to manage day-to-day operation.

Figure 5.1. Structure of Malaysian-based Parent Entity and Institution 1



Source: Based on Interviews of the study

### 5.1.2. Objectives of Establishment

Even though Institution 1 follows the objective of the Parent, it has some specific objective of establishment. This is highlighted by the respondent;

*... benefits (objectives) of this CS (Institution 1) are people can do sadaqah. We can sell this sadaqah items to the needy which are from big size family, students, the newlyweds and also fresh graduates, the revenue from that selling we could give to the poor in helping them to repair their house, or not enough of food. And also, we could help the donors.*

As highlighted in the statement, social objectives become the main target of the organisation, where the institution is aware on the fulfilment of the needy. There are three objectives of Institution 1; (i) serving the beneficiaries through fulfilment of consumption of the goods (second) via trading activities, (ii) contributing revenues to beneficiaries, and (iii) performing as the intermediary for the donors. Institution 1 also considers the intention of ‘giving’ by the main stakeholders (donors) to the beneficiaries.

#### 5.1.3. *Governance*

Institution 1 is an entity that was formed directly under the Malaysian-based Parent. Albeit considered as small size social-based business operating under the control of the Parent, understanding the sources of authority, monitoring, control and compliance are important as the institution deals with funds from the stakeholders. At least three parties have a source of authority to monitor Institution 1, directly or indirectly. These parties are, (i) Board of Trustees, (ii) Advisors, and (iii) Management of the Malaysian-based Parent. This aspect can be seen in the respond, as follows;

*That one from management and be approved by Board of Trustees... We have our Board of Trustees, but there is no condescend yet. Also, we have advisor.*

In another statement, the respondent provided clear response on the flow of the authority of the institution. Institution 1 needs to report to the Country Director. Based on the interview, the roles of the high management is very important in the decision making process. To answer the question on the influence of the Parent entity, the respondent highlights that even though Institution 1 is located under the Parent entity, they are given authority to have their own direction on its operation. This can be understood from the following:

*... we are independent but under one name and collaboration. Once a year, we have family counsellor meeting for sharing session and exchange the ideas. We have our own policies but for the project... they do not dictate. At the same time, we have to divide the percentage of revenue into local and abroad.*

The responds from interview shows that Institution 1 has a governance system in terms of the authority, monitoring and control. However, no specific indication is given on the compliance.

#### 5.1.4. *Financial Management*

Three aspects emerged when questions were asked on the financial management activities, i.e.

budgeting, disclosure and financial sustainability. As Institution 1 is under the umbrella of the Parent, the respondent was asked on the preparation process of the financial budget. Based on the response, the management of Institution 1 will prepare the annual budget and present it to the Board of Trustee of the Parent entity. All the costs incurred are reported to Parent entity. The budget of Institution 1 is provided by the Parent based on justification. Questions were also asked about some other allocation given to Institution 1 by the Parent. The response is as follows:

*... it is more like 'Waqf'. From the beginning, the Parent gives this building and we have to give some revenue to them. We didn't make any loan from bank.*

The financial sustainability of the ISE is important to ensure they can maintain the operational cost (such as salary and overhead cost) and provide some profit for the purpose of the contribution. The respondent highlighted that the Parent does not set specific target on Institution 1's achievement; however, it has its own target.

*...no, they are not. But we always gain profit. So far, Alhamdulillah (Praise to God). Because we are targeting the profit, so we have to work hard for it.*

In terms of disclosure, all information on the activities of Institution 1 is published in the Parent's annual report. This institution does not have its own media to disseminate its reports to the public.

#### 5.1.5. Distribution of Income

As the objective of ISE aims to fulfil society needs, there are several ways how Institution 1 contributes to recipients. From the perspective of Institution 1, it can help the beneficiaries to spend on quality goods at very affordable prices. Based on the interview, there are few types of beneficiaries from the trading services, they range from those who have the ability to pay (but prefer to spend wisely) to the poor. The range of the beneficiaries are highlighted in the statement as follows.

*I can see the buyer is from big-size family, in every occasion like 'Hari Raya', school start season, then they would come for books or toys. Secondly, the maid from neighbouring countries. Thirdly, for example people who have low income level. Especially our product of winter clothing, it gets overwhelming response from many customers. For me, we are not only helping low income people, but also, those who want to spend prudently.*

The main revenue of Institution 1 comes from the trading services of the second hand goods. There are several categories of goods donated by the donors including cloths and wears, kitchen wares and other home appliances, books, toys, and others. The questions asked were on how the distribution of the revenue took place in Institution 1. Based on the interview, Institution 1 has its own Standard of Procedure (SOP) in revenue distribution that should be followed to ensure transparency and compliance in its operation. In this manner, the staff cannot distribute the revenue directly to the needy. All the requirement in income distribution is highlighted in the respondent’s statement;

*... no, we are not giving it that way. All the profit are given to the Account Department. And we are guided by our own SOP. The question in SOP is; why we need to help him? By what time he need that help? How many? Is he/she deserved to get help?*

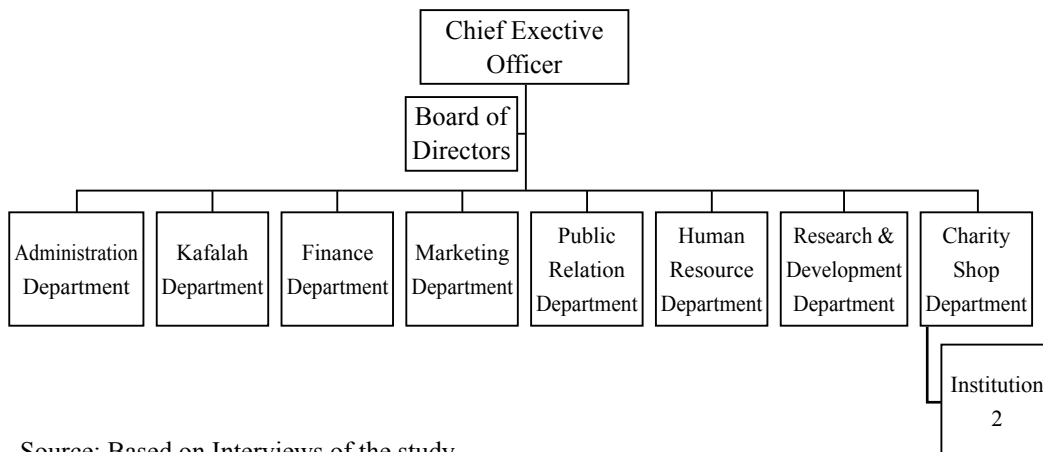
*... If someone walks-in and asks donations from us, we will take their names and addresses, then our worker will do the assessment.*

## 5.2. Case Study of Institution 2

### 5.2.1. Introduction

Institution 2 has been established as a left wing of the Parent institution, a local NGO that is registered as a company limited by guarantee under the Company Commission of Malaysia (CCM). The main mission of the Parent entity is to support the welfare and human rights of the Palestinian. In addition to humanitarian mission for Palestinian, it also covers another two countries, i.e. Syria and Lebanon. The establishment of Institution 2 is to increase the charitable-based income of the Parent company. There are eight departments under the Parent entity, where Institution 2 is established under the Charity Shop Department.

Figure 5.2. Structure of Malaysian-based Parent Entity and Institution 2



Source: Based on Interviews of the study

As at the date of the interview, there are five walk-in branches of Institution 2 operating in Johor, Penang, Sabah, Pahang and Perak, excluding the main branch in Selangor. The numbers of shops exclude the stockists that were set up in each of the Parent's branches that do not have their own shop.

### 5.2.2. Objectives of Establishment

Institution 2 has been established to generate income for its Parent entity as well as to cover the Parent's programs (based on interview). In addition, the other objective of its establishment is to fulfil the needs of the beneficiaries. This statement is highlighted by the respondent, as follows;

*Yes, it is. This is the other way to help people in need too. This concept of 'buy-and-donate' seems trending nowadays because it benefits everyone.*

There are two main sources of the merchandise sold by Institution 2; approximately 20 percent of the goods are contributions from the donors and another 80 percent are new goods under the Parent's brand. The decision to sell the goods under Parent's brand is to promote their mission. The new items that are offered in the premises are souvenirs, clothes, mafla, books, DVDs, and stickers.

### 5.2.3. Governance

Institution 2 is a subdivision under the Charity Shop Department of the Parent entity, where the main branch is located in Selangor and led by the Head Director of all subdivisions. There are 17 branches of the Parent's branches (branches of the NGO) that sell the merchandises, with five of them operating as proper walk-in charity shops. The governance system and process of this ISE is important to make sure the operation is put in place. For each of the branch of ISE, there are five staff who are employed, with two of them permanent staff (salaried staff) and the balance part time staff (volunteers paid by day). There are managers appointed in each branch. These appointed managers are controlled by a Head of Directors. The interview shows that the respondent believes there is a proper monitoring approach applied in Institution 2, where the ISE as a whole is monitored by the CEO and Trustee (based on interview). This element is shown when the respondent was asked on the charity sale;

*... they have to submit the report to the marketing department. For me, I will look through the inventory and budgeting. After that, I will submit it to the Finance and they will report it to the CEO. If CEO agrees, it's a deal.*

In another statement, the respondent highlighted that;

*... We, the managers frequently in thrice or four times per month arrange a meeting with the CEO at HQ (headquarter). There is a report to be submitted.*

The controlling process has also been performed where all monthly reports from all branches should be submitted to the Head of Director, who is responsible to combine and submit all the reports to the Parent entity. The flow of reporting is demonstrated in the statement as follows;

*... yes, there is a manager for each branch. And I am the Head Director for all subdivisions. All the monthly reports must be given to me and I will combine it before I submit it to the Finance Department.*

Auditing process is very important to ensure that the operation is performed properly. This control elements appear in Institution 2, where the Head of Division, together with HR and Finance Departments of the Parent entity audit the branches and stockists once a year (based on the interview).

#### 5.2.4. Financial Management

Three aspects emerged when questions were asked on the financial management activities, i.e. budgeting, financial sustainability and disclosure. Based on the interview, the Parent entity provides the capital to Institution 2 based on the prepared budget. In addition, the Parent will pay all the expenses (including the utilities), where the funds for management purpose is specifically coming from the government contribution and public donations. 15 percent of the donations are spent for management expenses of the whole organisations (including the ISE).

*Yes, it comes from our Parent. We also have our own budget, if let say for this year we get 1 million (profit).*

The managers will provide the budget (regular monthly budgeting) accordingly with the approval from the Parent. This is shown from the respondent's statement;

*... and it is my responsibility as a manager (of Institution 2) to do the budget and also, the manager of every branches of Institution 2 (also provides their own budget)*

The question on the readability of the institution to expand and their preparation for that

purpose was also asked to the respondents. The response shows that Institution 2 plans to manage the operation on its own. This is shown from the response;

*We are targeting in 2021, we could have our own mall. Also we still learn step-by-step to manage profit, cost etc.*

One of the governance mechanism in an organisation is disclosure. Reporting and disclosure is an important tool in communicating organisational performance and activities to the stakeholders. Institution 2 only provides reports directly to its Parent, and not directly to stakeholders. However, the Parent uses social media as disclosure mechanism to the stakeholders. The responds is given as follows;

*... by website and Facebook. We use flyers to promote the products.*

#### 5.2.5. Distribution of Income

The whole revenue of Institution 2 is contributed to the Parent. The Parent uses the consolidated account and thus all contributions of Institution 2 is reported as the total income of the Parent. Institution 2 passes through the daily sales revenue to the Parent. In some cases, it has some limitations to access the specific data on total profits, contribution to the needy, total cost of running the premises as well as all the financial expenses. The situation happens since all financial matters are managed by the Parent. Based on the interview, all the revenue earned by Institution 2 will be submitted to the Finance Department of the Parent entity and later will be distributed by another PIC to the beneficiaries. Regarding this issue, a few questions were asked on the financial matters. The response given is as follows;

*No, we don't (know) because it is under Finance's control. And later, there will be an amendment to have our own Finance people/staff (a part of the financial team). It is a transformation from our only function right now as a management and marketing only.*

No direct distribution to beneficiaries is performed through Institution 2 following the SOP, even though some beneficiaries also come to the premises to ask for donations. From the total yearly Parent's income (from collections of donations, grants and other revenues such as from ISE's activities, booths, and campaign), 60 percent will be channeled to countries outside Malaysia, specifically to Palestine, Syria and Lebanon. Another 40 percent of their income is distributed to the local, following the government's rules. This portion is distributed to the Palestinians and Syrians who study in Malaysia, where the details are provided by another

organisation, such as Palestinian Cultural Organisation. All the distribution is managed by the Parent.

*Actually, they have their own organisation, name PCOM (Palestinian Cultural Organisation). So we get any information about Palestinian students from the organisation. And sometimes, they got here by themselves to get sponsor for their studies. Eventually, they have to proceed to HQ to acquire sponsorship.*

## **VI. Discussions**

ISE is a new concept under the umbrella of the third economic sector. With limitations of studies and some rivals on its definitions, this study relates the meaning of ISE with several specific concepts. Some of these concepts are source of funding, trading activities and distribution of income for the beneficiaries. Within this scope, two ISEs were studied in order to explore the governance, financial management and distribution of the income under the light of the Adapted Stakeholder Theory as proposed by Iqbal and Mirakhor (2004). Within the setting of this theory, all stakeholders are considered as having contracts with the entity (explicit and implicit contracts) with some of them earning more privilege than others. The donors are considered as the main stakeholders, which should be taken into consideration by the Institution. The three elements in the model (governance, financial management and distribution of income) are important to be put in place in every ISE, for the purpose to achieve its objective and preserve rights of all stakeholders.

The two cases show that there are organised systems in placed in both of the organisations, with some divergence in certain aspects. Institution 1 is a section under the NGO that is operated as the branch of the international humanitarian organisation (the model of Institution 1 is shown in Figure 6.1) that has more coverage in terms of its mission. Institution 1 is led by Country Director and has Board of Trustee. Institution 2 is monitored by two layers of authority, i.e. at the management level (CEO) and Board of Directors, similar to Institution 1. Institution 2 has slightly different practice from Institution 1 (the model of Institution 2 is shown in Figure 6.2). The arrangement of reporting and control are highly stressed in this organisation, whereby auditing process is performed with the involvement of the Parent entity.

The findings show that both of ISEs do have elements of governance such as monitoring and authority-reporting. The two cases show that the Institution 2 has severer system, which is possibly being influenced by its growth such as size of the ISE and numbers of branches. The two cases support Hyndman and McDonnell (2009) as well as Spear, Cornforth and Aiken (2009) on the need to have proper governance system in the social-based entities to ensure the achievement of their targets.

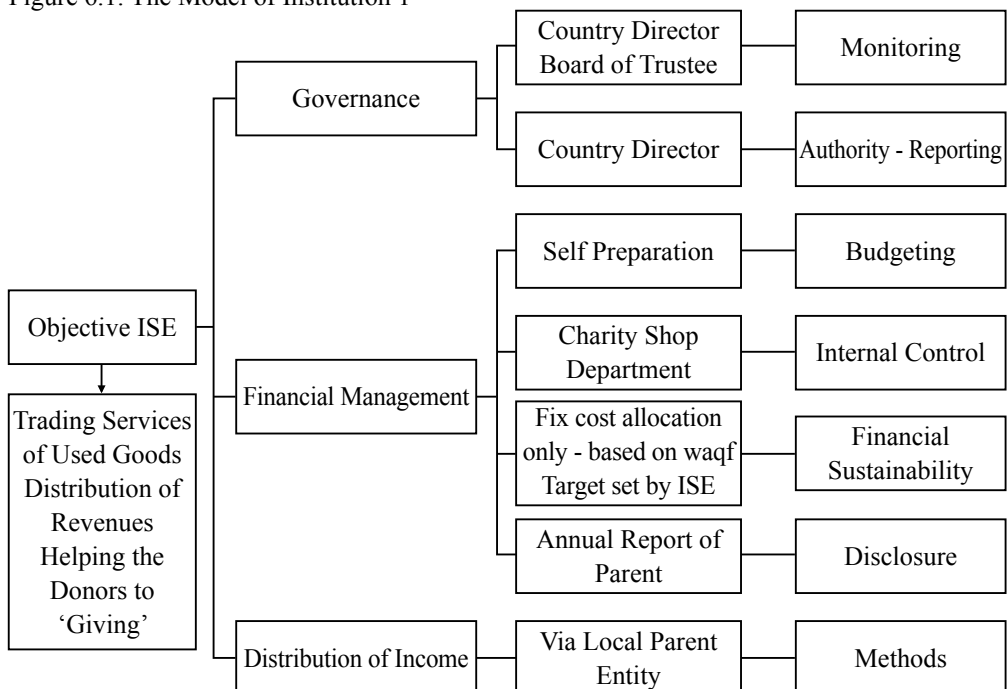
In terms of the financial management, Institution 1 reports to the Charity Shop



Department which directly reports to CEO. Institution 1 provides its own budgeting, and is only supported by the Parent on fixed cost. Other expenses (such as utilities) are paid from its own revenue prior being submitted to the Parent. The ability of paying certain costs indicates its capacity to sustain in the future. One of the emerged theme of Institution 1 in terms of financial management is the usage of the *waqf* concept on the fix assets which is granted by the Parent, i.e. the premise. This institution have some elements of disclosure, however, in a limited scope since it is provided together with the Parents’ annual report. Compared to Institution 1, Institution 2 has higher dependency on its Parent in terms of paying all expenses. Parent entity bears fix and variable costs at certain level, and this Institution have limited access on the data. Institution 2 shares the same approach with Institution 1 on the disclosure. As shown in this finding, the two ISEs have different approaches of financial management. However, the process are clear and put in place. As suggested by Palmer and Randall (2005), the charity based entities should have proper management to ensure they can keep the trust of the stakeholders, as the funds come from the donors.

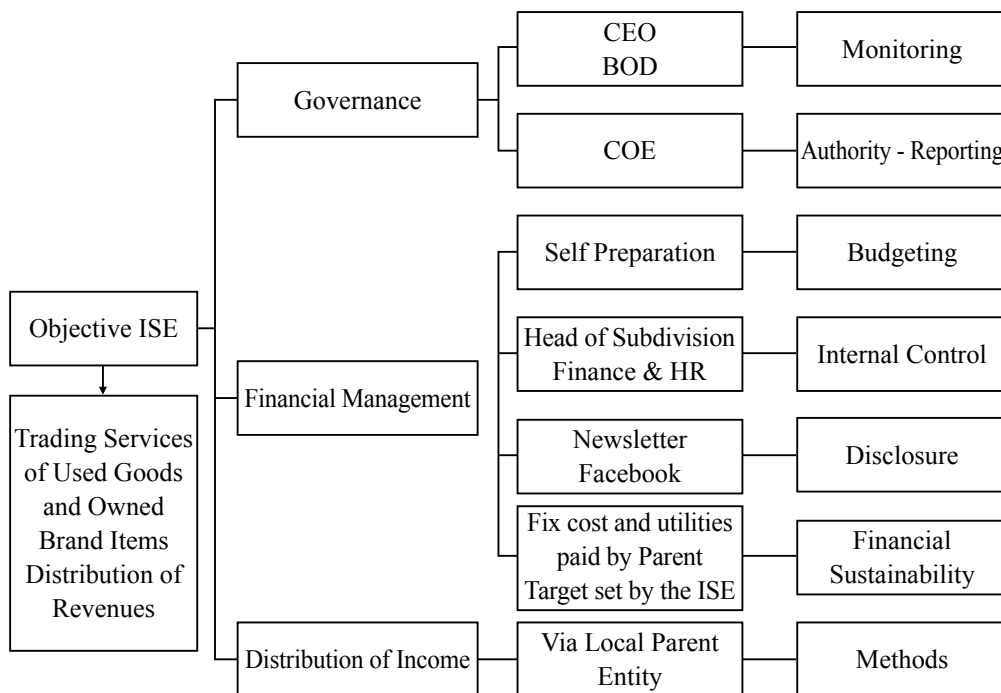
While there are different approaches on the usage of the income of the SE following the regulations of the countries (Kerlin, 2006; Defourney & Nyssens, 2008), the findings show that there is no strict restriction on the ISE in Malaysia. Results indicate that these ISEs have their own internal SOP that obstruct them from distributing income directly to beneficiaries. The distribution is made through their Parent entity.

Figure 6.1. The Model of Institution 1



Source: Based on the Study

Figure 6.2. The Model of Institution 2



Source: Based on the Study

As the whole, these two ISEs are consistently focusing to promote the foundation of *maqasid shariah*. On one hand, these ISEs provide and supply products at affordable price to the needy in order to reduce the community’s burden. On the other hand, they also function as the right wing to support the mission of their Parents. Both of the two ISEs also manage their own stakeholders by disclosing their activities to the public. Findings on these two ISE are shown in Table 6.1.

Table 6.1: Summary of Findings

Items	Institution 1	Institution 2
Governance	-Monitored by Country Director and Board of Trustee -Reported to Country Director	-Monitored by CEO and BOD -Reported to CEO
Financial Management	-Budgeting via self-preparation -Internally controlled by Charity Shop Department -All expenses borne by this ISE Financially sustainable through <i>waqf</i> -Target sets by its own -Disclosure through parent’s annual report	-Budgeting via self-preparation -Internally controlled by Head of Subdivision Finance & HR All expenses paid by Parent -Target sets by Parent -Disclosure through newsletter and Facebook
Distribution of Income	-Distribution is made by local Parent entity	-Distribution is made by Parent entity

Source: Based on the study

In general, there are a few differences on monitoring and managerial aspects observed in these two ISEs. Institution 1 basically has been given much more autonomy in terms of decision making on its direction as well as responsibility towards its liability. Institution 2, on the other hand, is highly dependent on the parent company. The interview evidently shows that the Institution 1 manage to work by its own and has continuous income with support from *waqf*, besides its trading activities. Freedom gives it large opportunity to grow using its staff efforts, creativity and innovation.

The result shows pro and cons on the adoption of each model. The approach of decentralization on decision making, yet with uncompromising monitoring, is believed to be able to enhance the creativity of the staff to strengthen the position of the ISE. This finding suggest that the management to provide some flexibility to ISE in order for them to grow and contribute more to community. In addition, the management however should encourage ISE to progressively build connection with stakeholders such as donors and volunteers, to ensure that they can get continuous support from these stakeholders.

## **VII. Conclusion**

The establishment of ISE is currently gaining attention as the institutions cover the economics of underprivileged. This paper explains the model of ISEs owned by two largest NGOs in Malaysia in terms of the institutional governance, financial management, and distribution of income. As is apparent from this study, it was found that both ISEs operations are in an organised system with some differences in the aspect of governance, financial management and distribution of revenues. In terms of governance, the two ISEs viewed governance as an important mechanism in ensuring the organisations do not divert from their objectives. In addition, both institutions placed importance on financial management to ensure the financial sustainability of the ISE. Distribution of income for both ISEs depends on the ISE's objectives of establishment; however, the ultimate aims of ISE establishment is to fulfil the society's needs.

The study provides indication that the *maqasid shariah* as well as the stakeholders' assentation are in line with ISE's practices. This paper suggests that the management to provide some room to ISE to perform their task independently in order for them to grow. Future researchers should further investigate and explore the operation of ISE in Malaysia using different methods. It is critical to assess the operation of ISE to find a feasible model for the establishment of any new ISE in Malaysia.

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