

EXPLORING THE POTENTIAL OF USING ZAKAT FUNDS OF ISLAMIC BANKS FOR MICROFINANCING

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Abstract

Zakat-based microfinancing is presented as an innovative approach towards productive Zakat distribution, despite the different viewpoints among classical Muslim jurists towards its permissibility. Distributing Zakat through microfinancing can enable and promote Asnaf (Zakat recipients) self-sustainability in generating additional income and improve their financial standing. This study has two objectives, which are to examine the opinion of contemporary Shariah scholars towards using Islamic bank's Zakat funds for microfinancing and to investigate the justification behind the acceptance and rejection of implementing Zakat-based microfinancing among the Islamic banks in Malaysia. This study adopted a qualitative research methodology where in-depth interview sessions were conducted with Shariah scholars and bankers who were directly involved with Zakat-based microfinancing. Findings reveal divergence among Shariah scholars regarding the utilisation of Zakat funds for microfinancing, with some endorsing the practice and vice versa. Additionally, the majority of Islamic banks refrain from adopting Zakat-based microfinancing for various reasons, including differing opinions among Muslim jurists on its permissibility, the availability of alternative assistance sources for the Asnaf, and the absence of a fatwa addressing this matter. However, this study identified one Islamic bank in Malaysia actively committed to implementing Zakat-based microfinancing. They believe that this approach serves as a Zakat distribution method that enables the growth of Zakat funds and uplifts Asnaf entrepreneurs. To conclude, Zakat-based microfinancing offers a targeted and impactful strategy to support the financial needs of Asnaf, thus enhancing their socio-economic well-being. Regulatory support and guidance from Bank Negara Malaysia could further encourage the facilitation of this innovation's implementation.

Keywords: Asnaf, Islamic Banks, Microfinancing, Zakat, Malaysia.

INTRODUCTION

Bank Negara Malaysia (BNM) highlighted in its financial sector blueprint 2022 that Zakat is one of the Islamic Social Finance tools used to help the poor and needy in social and economic development. This is in line with the Value-Based Intermediation (VBI) framework that was introduced by BNM in 2017. It encourages Islamic banks to go beyond compliance with Shariah principles and to actively contribute to the well-being of individuals and the broader community. The Islamic bank Zakat fund plays an essential role in the economic growth of the poor and needy. Zakat is an Islamic financial principle that

was used in almost all Muslim communities which ideally serve as a means of poverty alleviation and bridging the socio-economic gap between rich and poor (Abubakar et al., 2021).

Geremewe (2019) states that microfinance has been renowned worldwide for its potential to effectively and sustainably alleviate poverty and promote economic growth by enhancing income-generating opportunities. However, microfinance provided by financial institutions is difficult to obtain, particularly for the poor and low-income households, because it is subject to certain restrictions and limitations. Therefore, Zakat is considered as having a great potential to be one of the solutions for the above-mentioned predicament for micro financing in the form of social entrepreneurial capital financing (Muhd Adnan et al., 2022). Innovation in the distribution of Zakat through a shift from simply being a social protection instrument to meet basic needs in a consumptive nature to an effective instrument that generates household income through entrepreneurship must be expanded without abandoning Zakat's original function as a social protection instrument to ensure that the *Asnaf* are well looked after. Thus, the objectives of this study is to examine the opinion of contemporary Shariah scholars towards using Islamic bank's Zakat fund for microfinancing and to investigate the justification behind the acceptance and rejection of implementing Zakat-based microfinancing among the Islamic banks in Malaysia.

LITERATURE REVIEW

Wakalah Zakat

Many previous studies acknowledge the significance of having a productive Zakat distribution. It is difficult for Zakat institutions to identify the proper recipients, from the screening process for the distribution of Zakat funds. This issue is significant as it may lead to unhappiness among Zakat payers, which could eventually prompt them to pay Zakat directly to *Asnaf* rather than through Zakat institutions (Nashwan et al., 2021; Owoyemi, 2020; Basarud-din et al., 2016). In response to the issue of Zakat distribution, Wakalah Zakat was introduced by the Zakat institutions (Razali et al., 2022; Wahid et al., 2021). Zakat refund or also known as Wakalah Zakat refers to the practice where Zakat institutions delegate Zakat payers the right to distribute Zakat refunds to the *Asnaf* group (Wahid et al., 2021). Nor Paizin and Abd Aziz (2021) state that the Wakalah system describes the procedure by which the Zakat institutions delegate the Zakat payer power to deliver Zakat funds directly to the qualified *Asnaf* via a sum amount of Zakat funds paid in compliance with stipulated conditions.

Pusat Pungutan Zakat (PPZ) Majlis Agama Islam Wilayah Persekutuan (MAIWP) has been a pioneer in collecting Zakat for the goal of redistributing it to the less fortunate in society (Nor Paizin & Abd Aziz, 2021). To increase Zakat collection and the total amount of Zakat collected annually, a number of strategies and methods have been used. One example of a development that has been effectively put in place is the Wakalah Zakat program. The achievement of the program is demonstrable by virtue of how it has boosted the amount of Zakat collected through the Wakalah Zakat program where 21 million of Zakat payments were recorded from applicants in the Wakalah effort. The Wakalah Zakat distribution system has given the chance for the community to deliver their Zakat to the poor which is seen as an effective Zakat distribution system and aids in increasing Zakat collection.

The implementation of Wakalah Zakat for microfinancing serves as an innovative approach to promote a more productive distribution of Zakat. Instead of merely providing financial aid for basic needs, this initiative empowers the *Asnaf* recipients by using Zakat funds as capital for microfinancing. This microfinance program aims to enable the *Asnaf* entrepreneurs to start or expand their small businesses, thereby enhancing their economic prospects and uplifting their overall socio-economic conditions. By incorporating the Wakalah Zakat model, Islamic banks can effectively contribute to the well-being of the *Asnaf* community and support their entrepreneurial endeavors. This approach aligns with the

principles of Islamic finance, which emphasize the equitable distribution of wealth and social justice.

Usage of Zakat Fund for Microfinancing

Zakat institutions use a variety of Zakat distribution techniques in order to ensure that Zakat funds reach those who deserve it. One of the techniques employed by the Zakat institutions is by giving Zakat funds in the form of business capital (Ali Arif et al., 2020). Recognising the significance of microfinance for the poor, Possumah and Ismail (2011) suggest that capital providers are required to contribute funds to ensure the microfinance program can be sustainable in the long run and is able to finance a large number of customers. The authors further recommend the inclusion of Zakat as the source of capital and it also acts as a capital provider for microfinance programs. This viewpoint is supported by a study conducted by Basarud-din et al. (2016) which suggests microfinance as the method that can be executed by the Zakat institutions in order to enhance the income of the *Asnaf*.

It is parallel with the view of Mikail and Saheed Adekunle (2020) who state that Islamic microfinance programs are a crucial component of Shariah-compliant financial inclusion programs that provide financial services to the underprivileged and needy at affordable costs. The study also notes that the primary goal of microfinance services is to encourage financial inclusion of the extremely poor, who are referred to as “unbankable.” This microfinance opens up channels for the *Asnaf* to have quick access to financial services, hence alleviating poverty and encouraging more entrepreneurial skills and business activities which therefore will contribute to a country’s economic growth.

Islamic microfinance is a platform for offering Shariah-compliant microproducts to low-income or non-income households in a society (Mikail & Saheed Adekunle, 2020). According to Tuan Mahmood et al. (2021), to help the impoverished in developing their entrepreneurship skills, specialised initiatives called entrepreneurship programs have been established. The *Asnaf* Entrepreneurial Program (AEP) was established to provide financial funding to qualified beneficiaries in order to create new ventures or expand their existing businesses. The authors state that the availability of microfinance programs indirectly aids the underprivileged in escaping their financial predicament. The improvement in their standard of life has encouraged the *Asnaf* to shift from receiving Zakat to contributing to Zakat (Tuan Mahmood et al., 2021).

METHODOLOGY

In this study, the qualitative thematic analysis methodology was employed. The research findings and analysis primarily relied on the insights, viewpoints and information provided by the representatives participating in the research during the semi-structured interview sessions, referred to as the informants. This study aimed to investigate the Shariah rulings on using Zakat funds for microfinancing by interviewing Shariah scholars, particularly from the Selangor Mufti Department and Mufti of Federal Territory’s Office and those from Islamic financial institutions. While the researchers initially intended to interview scholars from both the Islamic banking and Takaful industries, time constraints led to an interview with only a Takaful industry scholar. The study also involved interviews with Shariah practitioners from Islamic banks to understand their reasons for accepting or rejecting Zakat-based microfinancing. These interviews covered Islamic banks that implemented the Zakat-based microfinancing and those that did not. Obtaining permission and scheduling interviews with these informants posed a challenge due to time constraints and ensuring ethical standards and cooperation from the institutions were maintained. This process could be time-consuming, especially when dealing with busy informants in high-ranking positions.

The researchers managed to get the consent of three Islamic banks which one implementing Zakat based microfinancing and two of Islamic banks that not implement Zakat based microfinancing. Those Islamic banks are Alliance Islamic Bank Berhad, Ambank

Islamic and Bank Muamalat Malaysia Berhad. Hence, the research findings and analysis stem from the six interviews held with three informants of Shariah practitioners in Islamic banks and three informants of Shariah scholars. In this study, the informants were contacted by the researchers through email. Once the informant or the key person of the selected Islamic banks had been identified, the appointment for the interview was set. Approximately 30 minutes to 45 minutes was allocated for each interview. All six informants have expressed a desire for confidentiality, opting to remain undisclosed and anonymous. As a result, they will be designated as Informant 1 to Informant 6.

RESULTS AND DISCUSSION

The findings and analysis of the data acquired through semi-structured interviews conducted throughout the research are presented in this chapter. The first section of analysis discusses the opinion of Shariah scholars pertaining to the use of Zakat funds for microfinancing. The second part of this chapter illustrates the justification behind the acceptance and rejection of adopting Zakat based microfinancing among the Islamic banks in Malaysia.

The Opinion of Contemporary Shariah Scholars Towards Using Zakat Funds For Microfinancing

Based on the research findings, it can be observed that there are two perspectives from the contemporary Shariah scholars regarding the use of Zakat funds for microfinancing which are allowed and not allowed. The perspectives are obtained from three informants categorized as below.

Selangor Mufti Department

To examine the viewpoint and opinion of contemporary Shariah scholars on using Zakat funds for microfinancing, the representative from the Mufti Department was asked pertaining opinion on the use of Zakat funds for microfinancing. Informant 1 pointed out the following:

Table 1: Informant 1's quotes on the opinion of using Islamic bank's Zakat fund for microfinancing.

| Informant(s) | Quotes |
|--------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Informant 1 | "It is required. It is allowed but with conditions." |
| | "So, in the state of Selangor, it has been decided in a meeting on February 8th, the Selangor State Fatwa Committee has determined that the distribution of Zakat through microfinancing in Selangor can be done by any party via Wakalah Zakat." |
| | "Any party intending to implement microfinancing must fulfill the requirement, meaning that if it is a bank that wants to engage in microfinancing through Zakat, they must first fulfill the entire amount of Zakat allocated by the state of Selangor to the Zakat Board." |
| | "Next, for the purpose of implementing this microfinancing, any party granted the Wakalah right must ensure that the microfinancing meets the criteria of the eligible <i>Asnaf</i> ." |
| | "They must ensure that the microfinancing from the Wakalah Zakat funds is disbursed within a year. This must be ensured. Usually, the Zakat officer will monitor and request reports. They will check if the funds have been disbursed. Within a year, it must be given to the <i>Asnaf</i> ." |
| | "Also, they must ensure that the repayments returned by the eligible <i>Asnaf</i> are given to other eligible <i>Asnaf</i> within a year as well." |

“And the Wakalah Zakat funds for microfinancing must be fully distributed within a period of three years. This means it cannot be rolled over indefinitely.”

“Or receive a profit from the financing. Profit means the bank making a profit. The money can’t be taken by the bank. It should be added to the Zakat fund.”

The quotes in Table 1 demonstrates that the Selangor Mufti Department agrees with the implementation of Zakat based microfinancing in the Islamic banks as a means of maintaining and sustaining the Zakat fund. Informant 1 emphasises that there is a need to use the Zakat fund of Islamic banks for microfinancing but with certain conditions. Informant 1 outlined six requirements or conditions that must be fulfilled by Islamic banks to participate and offer Zakat based microfinancing to the *Asnaf* which are:

1. Prior to applying for Zakat Wakalah, it is necessary for individuals or corporations to fulfil their Zakat obligation by making a complete payment to the Zakat institutions.
2. Individuals or corporations should ensure that customers seeking Zakat based microfinancing meet the eligibility criteria as *Asnaf*.
3. The duration of Zakat based microfinancing provided to customers (*Asnaf*) is limited to one year at the maximum.
4. Once the first customer has made their repayment, it will be allocated to another customer within a year.
5. The utilization of the Zakat fund for microfinancing is limited to a period of three years.
6. Any profits generated from the activities involving the Zakat fund should be directed towards the Zakat fund account.

Therefore, the Islamic bank must fulfill all these conditions and requirements when incorporating Zakat-based microfinancing as one of their financing products.

Mufti of Federal Territory’s Office

It is undeniable that each Shariah scholar holds their own distinct perspective when faced with a new issue, resulting in a diversity of viewpoints. Informant 2 pointed out as follows:

Table 2: Informant 2’s quotes on the opinion of using Islamic bank’s Zakat fund for microfinancing.

| Informant(s) | Quotes |
|--------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | “We unanimously disagree with using Zakat funds for microfinancing.” |
| Informant 2 | “This contradicts the fundamental principle of Zakat itself, which dictates that if microfinancing is intended to assist the needy in obtaining financing or overcoming poverty, it should be given directly without the need for loans. It is their right. For us, providing loans can be considered as an act of oppressing the recipients themselves.” |

According to Informant 2, there is unanimous disagreement among the Fatwa Committees of Wilayah Persekutuan regarding the implementation of Zakat funds for microfinancing. Informant 2 pointed out that Zakat based microfinancing contradicts the core principle of Zakat, which asserts that if microfinancing aims to support the underprivileged in accessing funds and alleviating poverty, it should be given directly without any obligation of repayment.

Chairman of Shariah Committee of Great Eastern Takaful Berhad

The Chairman of the Shariah Committee plays a crucial role in upholding the Islamic financial institution's Shariah compliance, ensuring robust governance procedures and facilitating well-informed and sound decision-making regarding Shariah matters (Bank Negara Malaysia, 2019). The following are the remarks made by the Chairman of the Shariah Committee in one of Takaful operators in Malaysia.

Table 3: Informant 3's quotes on the opinion of using Islamic bank's Zakat fund for microfinancing.

| Informant(s) | Quotes |
|--------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Informant 3 | <p>"I believe the potential for it to be considered as financing, based on the context of Qard."</p> <p>"When we give Zakat, we can use it to pay off debts, just like when we lend money. If we give Zakat to someone to pay off their debt, it's good if we lend money to them because they need it. So, if Allah mentions in the Quran those who are in debt and they receive Zakat by debt, it aligns with the definition of 'al-gharimin', right? So, it doesn't go against that. It defines them as people in debt and they receive financing. That is how it is defined. It is true what Allah says in the Quran."</p> |

It can be observed from table above that Informant 3 strongly agrees with the innovation of productive Zakat distribution through microfinancing. Informant 3 pointed out that if Zakat can be given to the debtors (*gharimin*) to settle their debts, it is much better if it can also be used for the purpose of loan or financing. The informant analogises (*qiyas*) this matter with the definition of al-gharimin, whereby the one who receives Zakat based microfinancing is in the scope of al-gharimin and indeed, it aligns with what Allah states in the Quranic verse regarding the recipients of Zakat (*Asnaf*).

In the viewpoints of the researchers, Zakat based microfinancing can be implemented as one of alternatives for Zakat productive distribution. As stated in the legal maxim "*evolution of Shariah rulings due to changing times is not to be denied*", means that changes in Shariah rulings pertaining to the change of time and place are possible. As a result of the evolving times, the distribution of Zakat funds through consumptive purposes can be expanded by exploring alternative avenues such as distributing Zakat funds through microfinancing. It recognises that the needs of society may change over time and therefore, the distribution of Zakat should adapt accordingly to address evolving challenges and opportunities.

The Justification Behind The Acceptance And Rejection Of Adopting Zakat Based Microfinancing Among The Islamic Banks

Zakat based microfinancing can be considered as a new product and innovation in Islamic banking, which may contribute to the productive Zakat distribution. As such, the Islamic banks involved were split into two categories which are those experienced in the implementation of Zakat microfinancing in their respective Islamic banks and those that have yet to receive exposure in this matter.

Islamic Bank Implement Zakat Based Microfinancing

- **Alliance Islamic Bank Berhad**

Alliance Islamic Bank Berhad (AIS), a subsidiary of Alliance Bank Malaysia Berhad, is the only Islamic bank in Malaysia that implements productive distribution of Zakat funds via microfinancing. It could be observed from the Table 4 that AIS strongly supports the opinion of a Shariah scholar regarding the permissibility of utilising Zakat funds for microfinancing purposes.

Table 4: Informant 4's quotes on the opinion of using Islamic bank's Zakat fund for microfinancing.

| Informant(s) | Quotes |
|--------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | "We can consider ourselves pioneers in this field, particularly as pioneers of Zakat microfinancing." |
| Informant 4 | "So, at the Alliance Bank level, we see a need to utilize Zakat for microfinancing purposes. Why? It is one of the first ways to sustain Zakat funds. If we distribute the funds directly, they will eventually run out." |
| | "With microfinancing, we aid that is not consumptive. It is not for them to buy groceries or personal items." |
| | "For the poor B40 group or the <i>Asnaf</i> , where else can they obtain financing? It's challenging for them to access other sources." |

Informant 4 has identified three key reasons why AIS believes the adoption of Zakat based microfinancing as necessary. Firstly, stated that the objective of Zakat based microfinancing is to sustain the Zakat Fund. Secondly, through entrepreneurship, the *Asnaf* will experience a sense of empowerment, breaking free from the constraints of poverty and enhancing their living standards. Last but not least, Zakat based microfinancing can be an excellent alternative financing approach for unbankable individuals such as *Asnaf*.

Islamic Bank Not Implement Zakat Based Microfinancing

- **Ambank Islamic**

Informant 5 mentioned that Ambank Islamic did not fully reject the idea of Zakat based microfinancing, as observed in Table 5.

Table 5: Informant 5's quotes on the opinion of using Islamic bank's Zakat fund for microfinancing.

| Informant(s) | Quotes |
|--------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Informant 5 | "We do not deny the possibilities. However, at the moment, we have not fully explored them yet. That's our response. So, I cannot say whether it is possible or not because we have not reached that stage. There is no current need for us to launch this product. We have an alternative source to continue providing benefits and assistance to <i>Asnaf</i> ." |

It was revealed from the Table 5 above that AmBank Islamic has not yet introduced Zakat based microfinancing as one of their Islamic banking products. The main reason for this is that instead of relying on the Zakat fund, AmBank Islamic has an alternative source to provide benefits and assistance to the *Asnaf*. Informants 5 emphasised that by utilising this alternative source, there is no repayment obligation imposed on the *Asnaf*. Consequently, AmBank Islamic has chosen not to implement Zakat based microfinancing, opting for a different approach to support *Asnaf* in their business ventures.

- **Bank Muamalat Malaysia Berhad**

Based on the findings presented by Informant 6, it can be concluded that Bank Muamalat currently does not offer any products or financing that utilise Zakat funds as their capital, as indicated in Table 6.

Table 6: Informant 6's quotes on the opinion of using Islamic bank's Zakat fund for microfinancing.

| Informant(s) | Quotes |
|--------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Informant 6 | "The answer to your question is that we do not currently offer financing based on Zakat funds. That's one aspect. Secondly, the reason is that there is no existing fatwa permitting the use of Zakat funds for financing purposes. |

It was revealed by Informant 6 that there is no specific fatwa addressing the permissibility of utilising Zakat funds for microfinancing. The absence of a fatwa in this context can be attributed to the crucial role played by fatawa (legal edicts) issued by the respective muftis of each state, which hold binding authority for all Muslims residing within the state. Therefore, the lack of a fatwa addressing the use of Zakat funds for microfinancing contributes to Bank Muamalat's current stance on this matter.

The research findings indicate that the majority of Islamic banks do not adopt Zakat-based microfinancing, with Alliance Islamic Bank Berhad being the only exception in implementing this innovation. In the viewpoint of the researchers, there are many benefits behind the implementation of Zakat based microfinancing by Islamic banks compared to its drawbacks. Islamic banks should acknowledge the implementation of Zakat based microfinancing as one of the ways to support the agenda of BNM, Value-Based Intermediation. Moreover, Zakat based microfinancing can be utilised to promote economic development and entrepreneurship particularly within the *Asnaf* community.

CONCLUSION

Zakat based microfinancing is viewed as an innovative approach towards productive Zakat distribution. Simply providing Zakat funds to cover basic living expenses is insufficient and concerning for the *Asnaf*. Instead, distributing Zakat in a way that enables self-sustainability can be likened to providing a fishing rod and bait, allowing them to acquire more income. Based on the research findings above, it can be observed that there are two perspectives from the Shariah scholars regarding the use of Zakat funds for microfinancing which are allowed and not allowed. As times change, new situations and issues arise that may not have existed at the time of Revelation. Shariah scholars, tasked with applying Islamic principles to these evolving circumstances, engage in the process of *ijtihad* to derive legal rulings or fatwa that are relevant and appropriate for the present context and in line with the *maslahah* of the *ummah*.

Meanwhile, the research findings from the interview sessions indicate that most Islamic banks do not implement Zakat based microfinancing into their scope of Islamic banking products and services. Among the banks in Malaysia, only Alliance Islamic Bank Berhad stands out as the sole Islamic bank that implements Zakat based microfinancing. Interestingly, they express a positive perspective regarding the utilisation of Zakat funds from Islamic banks for microfinancing purposes. However, it should be noted that other Islamic banks do not totally reject the idea of implementing Zakat based microfinancing as one of their products and services. They have their own reasons behind their current refusal to adopt Zakat based microfinancing. It is important to recognise that each bank holds its unique viewpoint on this issue.

In the viewpoint of the researchers, there are many benefits behind the implementation of Zakat based microfinancing by Islamic banks compared to its drawbacks. Islamic banks should acknowledge the implementation of Zakat based microfinancing as one of the ways to support the agenda of BNM, Value-Based Intermediation. To conclude, Zakat based microfinancing provides a targeted and impactful approach to support the *Asnaf*, addressing their financial needs and promoting their socio-economic well-being. It serves as an alternative financing avenue for those who are typically excluded from formal banking systems, promoting financial inclusion and offering opportunities for economic growth. This research focus on three Islamic banks highlights the need for future research to delve into more Islamic banks' perspectives on Zakat-based microfinancing. This broader

exploration would provide a comprehensive insight into how different Islamic banks perceive and engage with this unique financial model. Furthermore, it is recommended to explore the risk management system specific to Zakat based microfinancing. Investigate the potential risks involved in disbursing funds to *Asnaf* entrepreneurs and developing sustainable microfinance models.

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