

# Issues And Challenges In The Adoption Of Good Governance At Islamic Social Finance Institutions In Kuwait: The Case Study Of Direct Aid Society

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## Abstract

Good governance is so vital and inventible, particularly in the context of governance within charitable social finance institutions in contemporary times. However, there are many issues and challenges that hinder the adoption of good governance in charitable institutions. The objective of this study is to examine the issues and challenges in adopting good governance practices at Islamic social finance institutions in Kuwait, focusing on Direct Aid Society. This study employs a qualitative research approach, utilizing interviews. The methodology is designed to capture and identify the issues and challenges in adoption good governance within the Direct Aid Society and how to overcome these issues. Semi-structured interviews were conducted with key stakeholders, including board members, management, and staff of the Direct Aid Society. The findings indicate that these institutions face several challenges due to their unique characteristics, the dynamics of their employees and board members, and the regulatory framework. Despite these challenges, Direct Aid Society has successfully implemented governance standards that prioritize public interests and stakeholder protection. However, ongoing issues such as the need for comprehensive policies and clearer procedural guides remain to be addressed to enhance governance practices further. Based on these findings, the study has implication for policy makers to address the challenges faced by Islamic social finance institutions, such as Direct Aid Society, in adopting good governance practices.

**Keywords:** Issues and Challenges, Adoption of Good governance practices, NGOs, Islamic social finance institutions, Direct Aid Society, Kuwait.

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## INTRODUCTION

Comprehensive scholarly research has extensively examined the importance of good governance practices as a major issue faced by non-governmental organisations (NGOs) (OrtegaRodriguez et al, 2024; Purnomo and Hartanti, 2024). This concept continues to receive considerable focus, particularly in relation to Islamic social funding institutions in the Muslim world (Widiastuti et al., 2022a; Widiastuti et al., 2022b; Binti Nazmi et al., 2022; Nasution et al., 2022). Considerable scholarly attention has been devoted to the analysis of governance techniques that align with Islamic principles (Binti Nazmi et al., 2022).

The study on Islamic social financing institutions has garnered renewed attention to some extent due to the emergence of significant economic, social, and environmental issues, which have resulted in several societal complications. Furthermore, governments have shown a growing inability to address socio-economic challenges (Jouti, 2019). The social finance concept has proliferated globally in various manifestations to tackle and bridge the financial shortfalls required to attain sustainable development goals (SDGs) (Dirie et al, 2023). For example, established organisations such as the MacArthur, Rockefeller, and Ford Foundations have allocated their endowments in a manner that aligns with social impact initiatives (Nicholls et al, 2015; Geobey and Harji, 2014). Conventionally, social finance operations rely on government grants and contracts from foundations as their main funding source. Nevertheless, during periods of financial limitation, these potential sources have become more restricted compared to previous eras (Moore et al., 2012). In broad terms, social finance encompasses several elements such as social finance providers, social entrepreneurs, and all stakeholders involved in and affected by social activities (Varga and Hayday, 2016).

The Islamic social finance sector, which is a component of the Islamic finance industry, is primarily comprised of conventional Islamic institutions rooted on charity, such as Waqf, Zakat, and Sadaqah, as well as cooperative instruments like Qardhassan and kafala, together with Islamic microfinance (Obaidullah, 2020). Islamic social finance has resemblance to conventional social finance in its shared

focus on generating social benefits for underprivileged and marginalised populations. Islamic social finance distinguishes itself from conventional social finance by many aspects, particularly in its activities related to waqf, microfinance, socially responsible investments, and social impact bonds. These Islamic social finance instruments utilise Shari'ah contracts, including Mudarabah, Murabaha, and Musharakah (Hassan, 2020; Lujja et al., 2016; Salman et al., 2017; Binti Ismail & Hassan, 2020; Wisham et al., 2011; Salman & Hassan, 2020; Salman, 2014; Htay & Salman, 2013; Htay et al., 2013). Put simply, all Islamic social finance instruments are directed by the core concepts of Maqasid al-Shari'ah (Zain & Ali, 2017).

The potential of Islamic social finance is significant, particularly in Muslim areas characterised by elevated poverty rates. The primary objective of Islamic social finance vehicles like Waqf, Sadaqat, and Zakat is to address the need of the impoverished and to mitigate the continuously increasing levels of poverty. Significantly, the yearly allocation of monies from Muslims is intended not only to eliminate poverty within the Muslim community, but also to address the global humanitarian crisis. Hamed (2020) reports that the annual disbursement of Sadaqah and Zakat to Muslim communities globally ranges from between US\$200 billion to US\$1 trillion, greatly surpassing the contributions of traditional global humanitarian relief (which amounted to little over US\$13 billion in 2011). A minimum of US\$600 billion in excess Zakat from 40 OIC nations is available for distribution each year for humanitarian purposes. Nevertheless, the Muslim communities have made a mere 5-7% contribution to the worldwide humanitarian system in recent years. Until 2006, Muslim countries have contributed less than 0.05% to the Central Emergency Response Fund of the United Nations. One reason for this is that Muslims are unable to transfer their Zakat collection to non-Islamic institutions due to stringent regulations on the allocation and administration of the monies. Remarkably, in 2014, under 1% of the yearly surplus in Islamic social funds was required to address the humanitarian deficit (Hamed, 2020).

Alternatively, Islamic social finance facilitates improved wealth distribution by means of its charitable mechanisms (such as Waqf, Zakat, and Sadaqah) and cooperative mechanisms (such as Qarad Hassan, Islamic microfinance, and Shari'ah compliant socially responsible investing). Within this study, the primary case study is the Direct Aid Society, which utilises a majority of Islamic social finance mechanisms such as Waqf, Zakat, Sadaqat, Qarad Hassan, and Islamic micro finance. Additionally, it engages in specific Islamic businesses and investments to ensure financial stability and generate social benefits for underprivileged populations engaged in development. In order to advance the Islamic social finance sector, it is imperative to tackle certain challenges that hinder its progress.

Dan (2020) identifies 36 issues in the social finance academic literature. An important challenge is to governance, which poses an internal risk to the sustainability of the social financing sector. More precisely, Islamic social finance organisations encounter distinct governance issues that set them apart from other institutions. The reason for this is that the fundamental structure of Islamic social finance organisations differs from that of public and private institutions. In order to carry out operations, these institutions raise funds, and the recipients of the funds are not the ones providing the funds. Wanyama (2014) asserts that transparency and accountability are significant governance issues. Many beneficiaries lack the ability to request accountability, and there is very little interaction between the beneficiary and the fund provider, unless the fund provider wishes to monitor their financial process and engage with the beneficiary. Furthermore, the legislation governing Islamic social finance institutions primarily emphasise matters such as registration and operations, rather than governance, accountability, and transparency (Wanyama, 2014). Practices of this nature undermine the implementation of corporate governance norms in Islamic social finance institutions. The World Bank (2005) identified three primary factors that contribute to the inadequate governance of non-profit organisations: (i) perceived deficiencies in the regulatory framework and financial accountability, (ii) the impact, extent, and cost-efficiency of non-profit projects and activities, and (iii) the consequences of changes in non-profit organisations' funding models that lead to increased funding through commercial activities and micro-finance returns. The aforementioned problems stem from the absence of effective governance and inadequate oversight in non-governmental organisations (NGOs) and financial institutions, particularly Islamic social finance institutions.

Although these problems originate from within the social finance organisation, they are closely linked to the drain of funds (Jepson, 2005). The aforementioned negative conditions may also affect partners, beneficiaries, funding or regulatory entities, and society as a whole. The potential ramifications of a decrease in credibility among stakeholders could have severe negative effects on these non-profit

organisations (Samkin & Schneider, 2010; Yasmin & Ghafran, 2021), considering that their main sources of financial support are public subsidies and private donations (Potluka et al., 2017). Presently, the main challenge encountered by these organisations is the necessity to develop a culture of trust among stakeholders (Harris et al., 2017). This endeavour entails ensuring that the resources received are used in compliance with rigorous standards and efficiently allocated towards the attainment of objectives of Islamic social financing institutions. Consequently, these problems have raised awareness among both the community and public authorities, leading to academic enquiries in the field of good governance (Lichtsteiner & Lutz, 2012) with the goal of resolving the mishandling of public contributions and reducing managerial opportunistic behaviour (Harris et al., 2017; López-Arceiz & Bellostas, 2020; Lu et al., 2020).

Consequently, the significance of this study lies in its exploration of the specific challenges faced by Islamic social finance institutions, such as Direct Aid Society, in adopting good governance practices. This research is particularly important as it provides a focused analysis of governance within charitable social finance institutions, a topic that has received limited attention in the context of Islamic finance. The study's novelty stems from its qualitative approach, using semi-structured interviews with key stakeholders to uncover unique insights into the governance dynamics and the practical difficulties encountered by these institutions. By highlighting the distinctive challenges posed by the institutional characteristics, employee dynamics, and regulatory frameworks, this study contributes to a deeper understanding of governance issues in Islamic social finance. Moreover, the research offers actionable recommendations for policymakers and institution leaders to enhance governance frameworks, ensuring they are more aligned with the societal context and the needs of stakeholders.

## 2 LITERATURE REVIEW

Traditionally, corporate governance principles are applied in large public companies with various shareholders to ensure the separation of ownership and management. Corporate governance, therefore, aims to bridge the information gap between ownership and management through accountability and disclosure mechanisms (Institute of Directors, 2009). However, the good governance has become necessary for all organizations in the public, private, and not-for-profit sectors as stated in the King III Code of Corporate Governance for Southern Africa: "The code applies to all entities regardless of the manner and form of incorporation or establishment and whether in the public, private, or non-profit sectors. We have drafted the principles so that every entity can apply them and, in doing so, achieve good governance." This is a good example of obligating all institutions and organizations to apply good governance principles especially for not-for-profit organizations in developing countries, specifically the case study of The State of Kuwait.

The Ministry of Human Resources and Social Development (HRSD) of Saudi Arabia has obligated not-for-profit organizations to practice good governance standards in order to enhance their performance and to ensure that all their procedures and activities adhere to the set laws and regulations (HRSD, 2020). Such standards include: i) Compliance and Commitment Standard, i.e., to measure the extent of compliance and commitment of civil organizations with the laws, regulations, and guidelines that regulate their activities, ii) Transparency and Disclosure Standard, i.e., to measure the extent to which NGOs are willing to publish information about their reasons for existence, their implemented activities and financial statements, as well as operations to the stakeholders, and iii) Financial Integrity, i.e., to measure the performance of NGOs by evaluating their efficiency, ability, and financial sustainability (HRSD, 2020).

Generally, good governance is highly important for the social finance industry as well as Islamic social finance institutions for these reasons: i) the nature of seeking fund from external individuals and organizations, which increasingly requires better governance structures and accountability systems, ii) the need for the social finance industry to conduct partnerships with governmental entities and private organizations which require transparency and accountability, and iii) the nature of the social finance industry in supporting critical issues such as human rights in food security, education, and healthcare, as well as in providing development and public benefit projects which in return requires robust good governance standards and accountability mechanisms (Wanyama, 2014).

In the context of this study, from the regulation perspective, Islamic social finance tools may come under non-profit or non-governmental organizations (NGOs) that can practice Sadaqat, Waqf, Zakat, and microfinance tools collectively. Alternatively, Islamic social finance tools can be practiced in a solid

Islamic social finance institution such as Zakat institution, Waqf institution, and microfinance institution.

### **2.1 Issues in social finance industry**

The extent and severity of the issues and challenges facing social finance institutions in developing countries are different (Bromideh, 2011). However, there are common and important issues including those related to the decision-making process. Tensions typically arise between the senior managers and staff because the latter expects that they would be equal partners in the decision-making process. Another common issue is the lack of governance and poor internal relations between staff and board members (Read and Turbide, 2012). Over the years, however, social finance institutions have proven their value to society; their management is gradually becoming more professional in line with their growing familiarity with the business models adopted by for-profit institutions (Renz, 2016). Dan (2020) found 36 challenges in the literature of social finance. The study extracted the most common challenges and analyzed them, including: 1) effective communication, 2) trust, 3) collaboration with the government, 4) people management/conflict resolution, 5) the exodus of knowledge workers, and 6) funding.

Meanwhile, Kusmanto (2013) discussed several prominent issues faced by social finance institutions in Malaysia. The first issue is the decline in funds due to severe recession in the donors' countries (Baxi & Saikia 2003; Lekorwe & Mpabanga, 2007; Ottka, 2010; Okorley & Nkrumah, 2012). The Global Humanitarian Assistance (2012) observed a relationship between the economic conditions in the donors' countries and their donation size. However, Velaphi (2012) proved that most NGOs could properly manage the issue of funding decline, i.e., by tapping the full potential of new sources of funding. The second issue is related to governance, which is an internal threat to social finance industry's sustainability. Even though such issues arise from within the social finance institution, it has a robust connection with the reduction of funds (Jepson, 2005). The third issue is related to management, which is also an internal issue. According to Amos-Wilson (1996) and Okorley and Nkrumah (2012), this issue occurs due to the underestimation of the social finance industry's management.

The lack of Islamic social finance institutions' standards and regulations, low experience, lack of knowledge in management, and low compliance behaviors have also been indicated as the main causes of low performance in Islamic social finance institutions (Ahmad, 2019). Evidently, these issues are linked directly or indirectly to poor governance (Sawmar & Mohammed, 2021). The International Federation of Accountants and the Chartered Institute of Public Finance and Accountancy, among others, define governance as a comprehensive system that benefits all related parties and is responsible for achieving the mission of the institution. A framework for governance has also been developed with the aim of promoting robust public sector governance. The framework identifies several principles of good governance namely integrity, the rule of law, participation or stakeholder engagement, clarity of strategic vision, efficiency and effectiveness, capacity development, risk management and internal control, and transparency and accountability (IFAC and CIPFA, 2014). The researcher agrees with the statement that most Islamic social finance industry issues could be solved or at least reduced once the issue of governance is addressed.

### **2.2 Issues in Good Governance for Social Finance Industry**

Generally, organizations such as companies, NGOs, and associations face governance challenges. Nevertheless, social finance organizations have unique governance issues related to their organizational set up. Among these issues is the lack of transparency and accountability. Such issues arise from raising funds to undertake projects where the beneficiaries are not the fund providers. Besides that, the beneficiaries are not capable of demanding for accountability. Generally, both the beneficiaries and fund providers are not part of the organizational structure; therefore, it is not easy for them to access information and check the organizations' operations. Most of the fund providers do not meet and interact with the beneficiaries except if the funders request to visit the beneficiaries and check on them (Simeon, 2014). According to the World Bank (2005), the issue of weak governance in non-for-profit organizations is driven by three main factors: (i) perceived weaknesses in the regulatory framework and in financial accountability, (ii) the influence, scope, and cost-effectiveness of non-for-profit organizations' projects and activities, and (iii) the implications of changes in NGO funding that led to the attainment of funds through commercial projects and micro-finance returns. All these issues arise from the lack of good governance adoption and overseeing of non-for-profit organizations including Islamic social finance institutions (World Bank, 2005).

The practice of good governance in NGOs is linked to high levels of organizational complexity (Bloodgood et al., 2014). This occurs from the practical side, with the remarkable increase in NGO operations which results in the inability of the founders to manage the organization's activities and operations (Moore & Stewart, 1998). The creation of governance mechanisms denotes the interests of some individuals and bodies, confirming that the decisions of managers are suitably associated with the interests of such individuals and bodies (Coule, 2015; Morck & Steier, 2005).

In short, most of the issues related to the practice of good governance for NGOs including Islamic social finance institutions resulted from the lack of compliance, trust, accountability, and transparency, which would affect stakeholder protection. However, the use of FinTech tools has significant potential in facilitating the achievement of good governance objectives (Sachdeva, 2002). When information technology activities – including that of FinTech – are appropriately aligned with governance objectives, they can help enhance effectiveness and efficiency (Kalsi & Kiran, 2015). In other words, they enhance the level of transparency and trust in the application of good governance in general (Kalsi & Kiran, 2015).

### **2.3 Case Study - Direct Aid Society- In The State Of Kuwait**

Direct Aid Society is a non-governmental organization established in 1981 with the aim of raising the level of empowerment in African societies, with a focus on knowledge-based development. The focus on sustainability in all its projects makes Direct Aid Society a unique and valuable contributor to the betterment of communities in Africa. This is achieved through the provision of education, healthcare, relief, orphan care, and public benefit projects such as the supply of clean drinking water and the construction of mosques. All these are in addition to providing Da'wah (awareness) and various development projects to support the needy and improve their lives on top of fostering positive change in Africa (Direct Aid, 2022).

In 2021, Direct Aid Society was recognized with a 3-star excellence rating by the European Foundation for Quality Management (Direct Aid Society, 2021). This is the only classification of its kind in The State of Kuwait in terms of performance and quality excellence. This helped the institution to improve its performance and leaders, which in turn improved its good governance and FinTech applications. For over three decades, the European Foundation for Quality Management model has garnered the trust of numerous global organizations, earning its reputation as a reliable tool for managing change and enhancing performance (Direct Aid Society, 2021). Throughout its extensive history, the model has demonstrated its proficiency in supporting organizations across the globe. Leveraging on its world-leading methodologies, model, and technology, it has successfully facilitated the improvement of performance for over 50,000 organizations, all of which have benefitted from the incorporation of best practices (Direct Aid Society, 2021). Consequently, the combination of FinTech application and the best use of good governance by the selected case study helps the current study in concluding better outputs for the Islamic social finance industry and the researcher in exploring the role of FinTech tools in the adoption of good governance at Islamic social finance institutions.

Direct Aid Society has a core advantage which was earned by its founder, Dr. Abdelrahman Al-Sumait, when he chose to stay for long periods in each targeted African country, i.e., from 1981 to 2013 to establish a fully affiliated office responsible for the implementation of Direct Aid projects and performance follow up (Alowayed, 2016; Huda, 2020). As such, Direct Aid Society does not depend on any intermediary local agent to implement its charitable and development projects. This increased the level of trust among donors, especially non-for-profit organizations. Indirectly, the number of Direct Aid employees also increased to more than 9,000 (Direct Aid, 2023). This motivates the institution to practice good governance standards in an accurate manner so as to improve its performance and elevate the level of transparency and disclosure for the betterment of stakeholder protection.

According to the official website of Direct Aid (2023), it had attained second place in the Forbes Middle East Award for Most Transparent Association in 2011. This accolade is awarded based on specific factors, i.e., that the NGO must be authenticated and endorsed by the official authorities in its country, and that it must provide its audited annual financial reports (Huda, 2020). Direct Aid Society has an advantage in this sense as it had undergone external and internal financial audit, Shari'ah audit, and external legal audit (Huda, 2020).

In terms of its usage of FinTech, Direct Aid Society won first place for The State of Kuwait Best Website Award in 2012 (Direct Aid, 2023). Subsequently, the institution elevated its FinTech usage by establishing a robust crowdfunding system, an e-wallet, mobile apps for android and Apple systems, as well as an auto-

donation function. This solidifies its status as the institution with the best user-friendly FinTech tools in The State of Kuwait, whereby only 5 seconds are needed to complete the donation process on its website. Its advanced FinTech tools also allow stakeholders – especially donors – to access reports or to track their donations in an easier and faster manner. All these had increased the institution's level of transparency, accountability, and disclosure as well as the trust of its stakeholders. Chapter Four will discuss the case study in more detail.

## METHODOLOGY

The present study adopts a qualitative research methodology in the form of interviews. The technique employed in this study aims to comprehensively identify the Issues and challenges in the adoption of good governance at Islamic social finance institutions in Kuwait particularly a case study of Direct Aid Society. The scope of the interview is limited to a single case study, namely Direct Aid Society the study population hence encompasses the external governance experts of Direct Aid Society and regulators in The State of Kuwait who collectively witnessed, handled, and supervised the process of applying good governance standards. A series of semi-structured interviews were undertaken with important stakeholders of the Direct Aid Society, encompassing top management and board of directors. This is the most predominant qualitative method in management and organization research (Bluhm et al., 2011). It is one of the methods for primary data collection (Hackett, 2003). Generally, the interview method can either be a standard or structured interview, unstructured interview, or semi-structured interview (Holloway & Daymon, 2002). The primary objective of these interviews was to obtain comprehensive and in-depth understanding the issues and challenges in the adoption of good governance at Islamic social finance institutions in Kuwait particularly a case study of Direct Aid Society and how they effectively address these issues. The data acquired were subjected to thematic analysis, a research methodology that involves the identification, interpretation, and reporting of patterns or themes present in the data (Braun and Clarke, 2006). In other words, data in qualitative research is usually recorded in the form of words, descriptions, beliefs, and feelings rather than numbers and figures (Drew et al., 2007). By employing this methodology, the researcher was able to extract fundamental themes pertaining to these issues and challenges and how the institution in question addresses them effectively.

## 4 FINDINGS & DISCUSSION

The interview analysis and theme addresses the study objective, i.e., to examine the obstacles in the application of good governance in Islamic social finance institutions in general and Direct Aid Society in particular. Lastly, the theme discusses how Direct Aid Society overcame the obstacles of adopting good governance. This theme was formed according to the answers of the respondents, and is further divided into the sub-themes below (See Figure 4.1):

- 1- Issues of good governance application in Islamic social finance institutions
- 2- Issues of good governance application in Direct Aid Society
- 3- Overcoming the issues of good governance application in Direct Aid Society

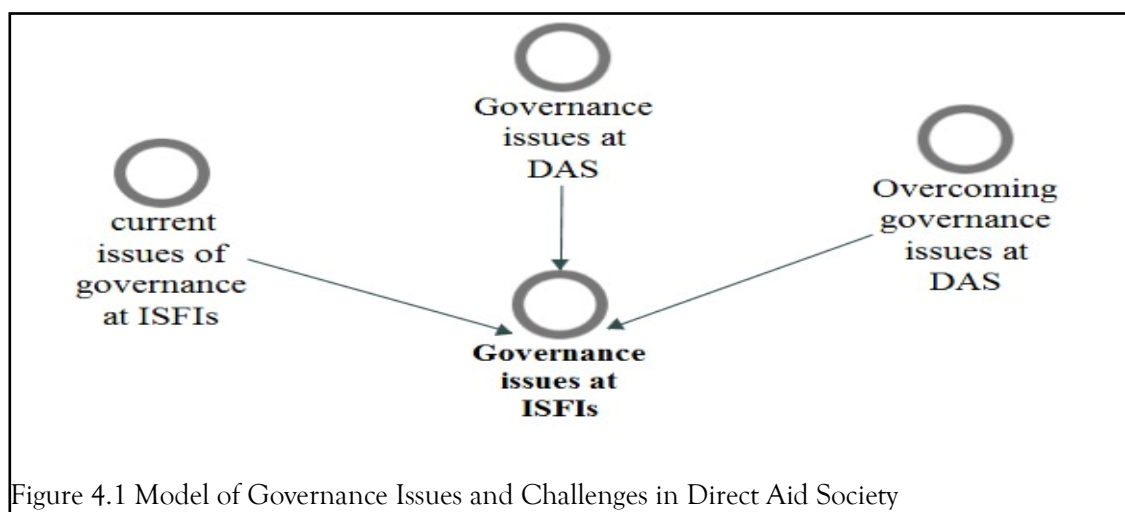


Figure 4.1 Model of Governance Issues and Challenges in Direct Aid Society

Source: Output of NVivo 14 generated from the interviews (2024)

#### 4.1 Issues of Good Governance Application in Islamic Social Finance Institutions

Figure 4.2 below shows the responses regarding the issues and challenges of applying good governance in Islamic social finance institutions. The issues are mainly related to the nature of the institutions, their employees and board of directors, as well as the regulations that supervise Islamic social finance institutions.

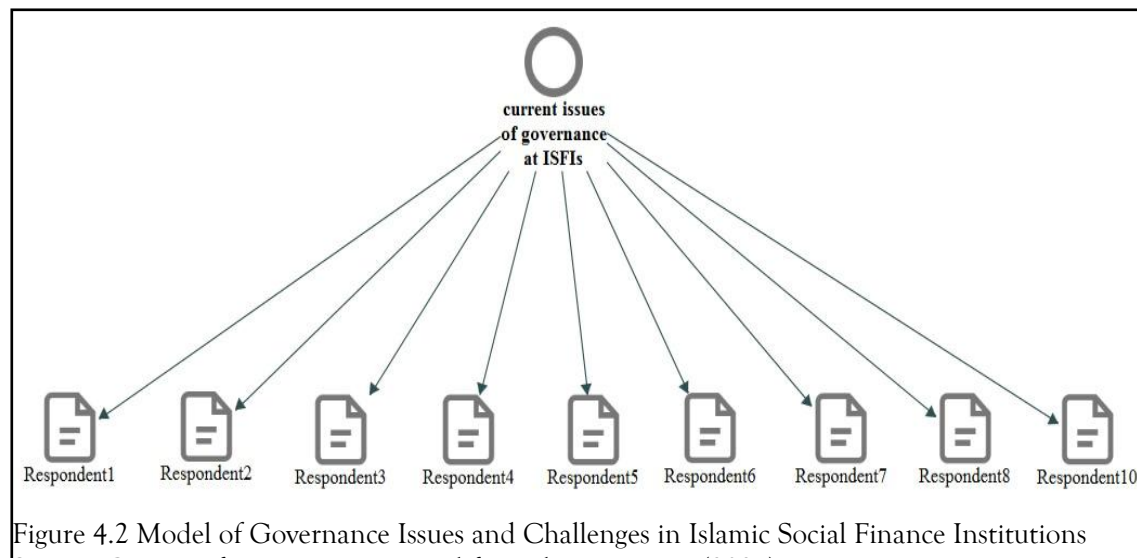


Figure 4.2 Model of Governance Issues and Challenges in Islamic Social Finance Institutions

Source: Output of NVivo 14 generated from the interviews (2024)

Respondents 1, 3, and 10 confirmed that there is a misperception that the application of good governance obstructs workflow, and that it is not necessary for Islamic social finance institutions.

“This misperception I have heard it many times from different institutions in this field. And the supervisory authorities and the institutions that applied good governance should spread out the benefits of applying good governance and how it is a protection for the institutions and not a restriction.” (Respondent 1)

“Governance is mostly a new concept to Islamic social finance institutions therefore, they did not see its benefits in order to be encouraged to apply it, and they believe it is kind of restriction for them more than beneficial.” (Respondent 3)

In addition, the application of good governance requires additional administrative procedures that would slow down the decision-making process (Respondent 10). Besides that, many Islamic social finance institutions believe that the requirements for the application of good governance are rather overwhelming (Respondent 10). For example, there are various requirements for the establishment of a reporting policy, a conflict-of-interest policy, a matrix of powers, and others which require significant administrative effort (Respondent 10). Another example is reports that would require a long time to address, hence increasing the administrative burden (Respondent 10). As such, many Islamic social finance institutions are unenthusiastic about applying good governance, especially if the country is not committed to do so as in the case of The State of Kuwait.

Another issue is the lack of knowledge or awareness among the regulatory authorities in The State of Kuwait regarding the principles, standards, indicators, and measurements of good governance (Respondents 1 and 3). Furthermore, there are no set frameworks for organizing the application of good governance in The State of Kuwait, except for some random practices from the Ministry of Social Affairs (Respondent 1).

“If there is an umbrella or entity responsible for the application of good governance to guide Islamic social finance institutions, the statues of good governance in The State of Kuwait would be much better.” (Respondent 1)

There are also no laws and regulations that support the application of good governance in Islamic social finance institutions in general and in The State of Kuwait in particular, except for certain conferences and professional studies that contribute to spreading awareness about good governance (Respondent 4). This lack of commitment for the application of good governance in Islamic social finance institutions in The State of Kuwait hence hinders its adoption (Respondents 3 and 5).

Another issue of applying good governance at Islamic social finance institutions is related to lack of knowledge or awareness of employees and decision makers in The State of Kuwait regarding principles, standards, indicators and measurement of good governance standards (Respondents 3, 4, 5, 6 and 7).

“In my opinion, the main issue of applying good governance standards at Islamic social finance institutions is lack of sufficient awareness among employees and decision makers regarding the objectives and importance of governance practices.” (Respondent 4)

The application of good governance standards requires additional work from the employees, and therefore their enthusiasm. The leaders in Islamic social finance institutions do not possess adequate awareness and knowledge to adopt governance (Respondent 7). In addition, there is a lack of specialized personnel in the field of charity work in The State of Kuwait in general and governance experts in the field of social finance in particular (Respondent 10).

Respondent 6 mentioned that the quality of internal audit systems in Islamic social finance institutions is generally poor, and many of them do not even have an internal audit system. Respondent 8 said that many Islamic social finance institutions in The State of Kuwait do not have organizational structures.

“He said, now we do not accept the establishment of any new organization without a clear organizational structure, and we mean a clear form of the executive management and not only the board of directors.” (Respondent 8)

Organizational structure is important because it is the base for adopting a good governance system in any institution.

Another important issue that obstructs the application of good governance in Islamic social finance institutions is the financial cost, especially with small institutions (Respondents 3, 7, and 10). In this regard, there are certain costs for creating detailed regulations and instructions as well as monitoring such instructions by appointing experts and in some cases appointing new skilled employees; generally, however, the requirements for adopting good governance should be different between big and small institutions (Respondent 3).

“For example, the Capital Markets Authority in The State of Kuwait requires more governance requirements for big companies compared to small companies due to the high level of maturity in the big companies, and they have more financial ability to bear the costs, while small companies are not required fulfilling the same scope of requirements.” (Respondent 3)

Lastly, most of the board of directors’ members in Islamic social finance institutions are volunteer members; hence, they cannot allocate significant time for the institution, resulting in reduced quality in their work (Respondent 2)

“In my opinion, this is one of the biggest issues because usually free work does not provide as high a quality as paid work, in addition it is difficult to expose them to accountability. In other words, some members may say we are volunteers and hold of accountable.” (Respondent 2)

Therefore, the poor-quality volunteer work extended by these board members weakens the application of governance. Giving rewards to them may not necessarily improve the quality of their work, as they are still primarily volunteers (Respondent 2). The following sub-theme analysis discusses the issues faced by Direct Aid Society in its application of good governance.

The implementation of good governance in Islamic social finance institutions encounters various challenges stemming from the distinctive characteristics inherent to these institutions, their employees, and board of directors, alongside the regulatory framework overseeing Islamic social finance institutions. The findings reveal several challenges in adopting good governance practices within Islamic social finance institutions. A major issue is the misconception that good governance obstructs workflow and is unnecessary, leading to resistance against its implementation. Administrative procedures associated with governance are seen as slowing down decision-making processes. There is also a lack of commitment to governance from supervisory bodies and regulatory authorities in Kuwait, where discussions about its importance are ongoing, and formal frameworks are limited. Additionally, there is a general lack of awareness among employees about the benefits of governance, a shortage of governance experts in the social finance sector, and an immature internal audit system. The high financial cost of implementing good governance, particularly for smaller institutions, poses a significant barrier, as does the volunteer nature of the board of directors, which can hinder effective governance practices.



#### 4.2 Issues of Good Governance Application in Direct Aid Society

Figure 4.3 below shows the responses regarding the issues and challenges of good governance application in Direct Aid Society. A majority of the respondents agree that the main challenge lies in the lack of awareness among its employees in terms of administrative procedures and processes as well as supervision actions (Respondents 4, 5, 6, 7, and 10). In this regard, Respondent 4 mentioned that the application of good governance in Direct Aid Society comes from the top management, and that the employees are not a part of such decision. Therefore, the employees consider it as a restriction and a form of supervision upon them. Another crucial issue is related to the high cost of applying good governance, as Direct Aid Society is required to spread governance awareness among its employees through trainings, workshops, experts consultations, and the establishment of new committees and others (Respondent 4).

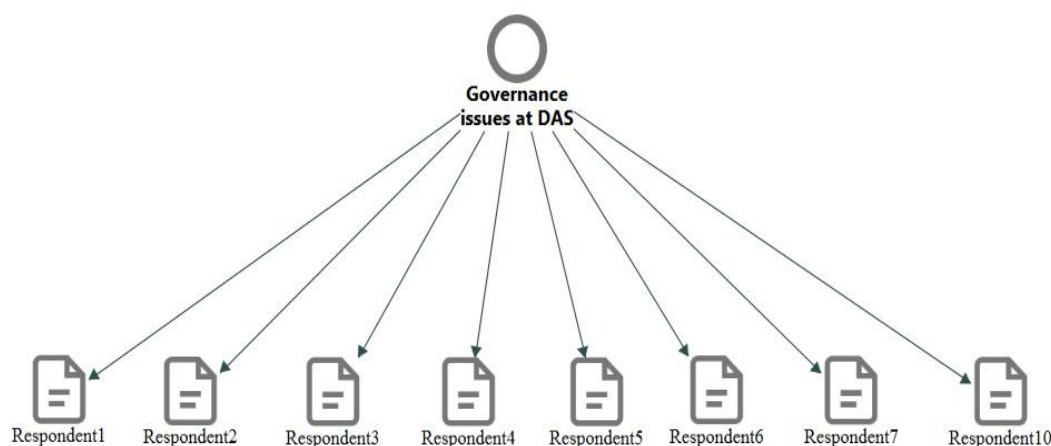


Figure 4.3 Model of Governance Issues and Challenges in Direct Aid Society

Source: Output of NVivo 14 generated from the interviews (2024)

Another issue is related to the improvement of administrative processes and procedures. For example, after the application of good governance in Direct Aid Society, some employees found that extra actions are needed so that they can gain the same results attained before governance application (Respondent 10). This led some of them to think that the adoption of governance burdens the institution with many unnecessary actions and procedures (Respondent 10). In addition, some employees found that their power at the institution has decreased; due to the introduction of the matrix of powers, some employees can object certain decisions as the decision maker is no longer responsible for such decisions (Respondent 10).

Respondent 3, being a member of the board of directors and a governance expert in Direct Aid Society, explained that one of the governance issues in Direct Aid Society is convincing the board of directors about the importance of adopting good governance:

“Especially, we faced some governance issues among the board of directors at Direct Aid Society, for example in respect to the conflict of interests, some of us are members at other competitive institution in The State of Kuwait. This in corporate governance is considered as conflict of interests, but regarding charitable institutions, we agreed that there is a scarcity of qualified The State of Kuwaitis in this field. Therefore, we need those members, so we agreed that the members of the board should disclose the charitable institutions in which they are members, and if there is any suspicion of a conflict of interest, the member shall abstain from voting.” (Respondent 3)

“Another example of governance issues related to the board of directors at Direct Aid Society is the assessment of the board members as a governance requirement, this assessment causes an embarrassment for the board members as they work voluntarily at Direct Aid Society, especially some of them are ex ministers. Therefore, we agreed at the board to assess ourselves, and in the future, after few years of practicing governance we may conduct such assessment through a third party.” (Respondent 3)

Another issue in applying good governance in Direct Aid Society is related to the high sensitivity of charity work in The State of Kuwait, i.e., balancing between benefit and harm, especially with the disclosure of financial information (Respondent 1).

“For example, the financial information was ready to be published since 2012, but the first publishing was in 2016, and we were awaiting and challenging what the reaction would be from the public to the financial information published on the website, whether there would be attacks on us and whether there would be skepticism or not. This is because The State of Kuwaiti community is so connected and if there any information released it would spread widely and quickly and mostly in a negative manner. More interestingly, with the first publishing for the financial information and the governance measurement results at Direct Aid Society, the response was extremely positive from all stakeholders.” (Respondent 1) Another respondent explained that Direct Aid Society is a very famous institution, and all the public and supervisory authorities consider it as a leading institution in the social finance industry in the Gulf and Middle East area (Respondent 2). Thus, Direct Aid Society bears the burden of taking into consideration all the responses and reactions from the public in respect to any published information on its website, causing it to delay the application of good governance practices (Respondent 2).

Respondent 2 added that it is difficult for Direct Aid Society to apply good governance standards in all its 30 offices in Africa and Yemen as each country has its own regulations and laws. The effectiveness of the application would be negatively impacted. In this regard, Direct Aid Society commits to its legislations and regulations as a basis or first step for the application of good governance practices:

“The minimum level of good governance practices for any institution is achieving compliance and commitment with the relevant laws and regulations of the country that the institution is subject to.” (Respondent 2)

Meanwhile, in The State of Kuwait, there are not any laws and regulations that commits Islamic social finance institutions to apply good governance standards. Therefore, many governance actions are controversial and result in complex negotiations among the governance committee of Direct Aid Society (Respondent 1).

“For instance, publishing the minutes of the Board of Directors meeting on the website. Is there anything positive from publishing it? Is it a governance practice or not? Is it one of the matters on which there is consensus in publishing it? Do we publish the summary of the meeting or not? Is this considered a governance application or not? as well as many other matters are up for debate.” (Respondent 1)

Consequently, Direct Aid Society tries to apply the highest standards of governance in a way that does not harm the interests of the general assembly and individuals. In short, Direct Aid Society applies what suits its society and protects its stakeholders (Respondent 1). In the following section, the researcher analyses how Direct Aid Society overcomes and deals with the issues of applying good governance standards.

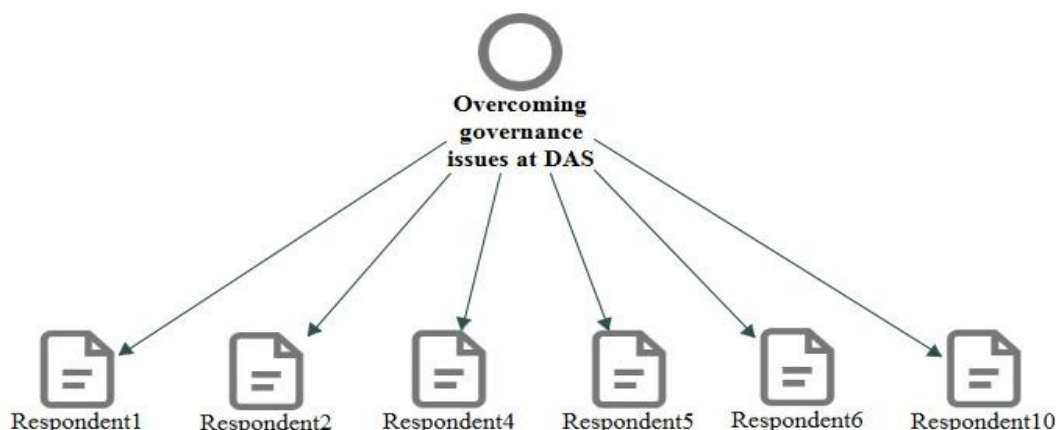
Direct Aid Society implements good governance standards in a manner that safeguards the collective interests of the public rather than individual interests. It adheres to governance practices that are aligned with the societal context and prioritizes the protection of stakeholders.

The findings highlight several challenges faced by Direct Aid Society in adopting good governance practices. These challenges include a lack of awareness among employees about new administrative procedures, which are often perceived as restrictive; difficulty in convincing the board of directors of the importance of governance reforms; and the sensitivity involved in evaluating volunteer board members, especially those with high-profile backgrounds like ex-ministers. Additionally, there has been a delay in disclosing financial information due to concerns about potential negative media reactions and reputational damage. As a prominent institution in the social finance sector, Direct Aid Society has faced challenges in responding adequately to public scrutiny, leading to delays in governance implementation. The difficulties are further compounded by the need to apply governance standards across 30 branches in Africa and Yemen, each with its own regulatory environment. Moreover, since good governance is not mandatory in Kuwait, there has been internal controversy and complex negotiations within the governance committee regarding the extent and nature of governance actions to be implemented.

#### **4.3 Overcoming the Issues of Good Governance Application at Direct Aid Society**

Figure 4.4 below shows the responses regarding the issues and challenges in applying good governance practices in Direct Aid Society. The first action entails approaching experts, especially those who are aware of the Islamic social finance industry, as they had participated in raising the awareness of good governance among employees, executive management, and board of directors (Respondents 1, 2, 4, 5, and 10).

Figure 4.4 Model of Overcoming Governance Issues and Challenges in Direct Aid Society



Source: Output of NVivo 14 generated from the interviews (2024)

When it first started applying good governance, Direct Aid Society formed a voluntary team consisting of internal and external governance experts to educate the managers and employees about the importance of governance adoption (Respondent 5). The appointed governance experts helped in conducting many workshops and training to build a clear vision in establishing a governance guide and in drawing the indicators, scope, and questions of the guide (Respondent 5).

In addition, Direct Aid Society formed a governance committee affiliated with the board of directors (Respondent 1). When the application of governance standards and evaluation began, there was a need to form a committee that does not interfere with the stakeholders in governance and is external to the executive management (Respondent 1). Therefore, a committee was established and affiliated with the board of directors comprising two members of the board, an independent expert in governance, and a coordinator to receive the governance results and present them to the committee for evaluation, give recommendations, and monitor governance applications in Direct Aid Society (Respondent 1). In this regard, Respondent 1 said:

“We formed a governance committee to confirm that the board of directors and the executive management are serious in adopting good governance and to ensure the quality of its practices.” (Respondent 1)

Subsequently, the number of committees affiliated with the board of directors increased from two committees to four or five. The number of meetings increased as well to ensure the accuracy of the good governance practices (Respondent 2). Subsequently, Direct Aid Society established an internal audit office affiliated with the board of directors to ease the application of governance and its measurement (Respondent 6).

It also promotes the value of benevolence (IHSAN), considers governance as part of IHSAN which is an act of worshipping Allah, and spreads this culture among employees and leaders (Respondent 1). Therefore, governance has become not only a slogan, but also an application for everyone (Respondent 1). On top of that, many leaders from the executive management and the board of directors in Direct Aid Society attended several courses to improve their awareness of governance practices and other main knowledge related to finance, accounting, and investment (Respondent 2).

“This is because any awareness is related to governance, and there is governance at the level of the institution, and governance for every sector, office, and department. As well as every employee requires governance, such as a job description, job rank and should read all the policies and procedures of the department in which they work, in other words, the most important factor in governance is awareness of human capital.” (Respondent 2)

In addition, Direct Aid Society built a connection with the regulatory authorities in The State of Kuwait in respect of its application of good governance. It also presented the good governance model, which improved transparency and support from the regulatory authorities towards enhancing the application of governance (Respondent 1). This helps in overcoming the issue of high sensitivity within the Islamic social

finance industry, especially charity work in The State of Kuwait, and preventing laws and regulations non-compliance.

Respondents 5 and 6 explained that one of the factors that helped ease the application of good governance in Direct Aid Society is having a clear vision of the importance and benefits of good governance practices. This is in addition to establishing a comprehensive governance guide according to the related laws and regulations in The State of Kuwait. This includes all rules and principles of governance for each division, office, branch, and external related parties in order to maintain a robust and effective governance system for all Direct Aid Society units (Respondents 5).

Respondent 10 mentioned that in order to overcome the lack of awareness and knowledge among employees, Direct Aid Society opened the participation for all employees by giving suggestions. Direct Aid Society also established continuous improvement systems for all employees to improve the application of governance while giving room for mistakes (Respondent 10). By creating a teamwork of employees, department heads, and managers, rather than a closed committee, a space for communication and exchanging opinions was established (Respondent 10).

Even with all the aforementioned efforts, there are still some ongoing issues that need to be addressed, such as establishing policies and procedural guides and charters for certain units in Direct Aid Society (Respondent 6).

Direct Aid Society has successfully navigated numerous challenges associated with the implementation of good governance, particularly during the initial stages. However, certain ongoing issues remain to be addressed, including the formulation of comprehensive policies and procedural guides, as well as charters for certain units within Direct Aid Society.

The study's findings reveal several key strategies employed by Direct Aid Society to overcome challenges in implementing good governance. These include consulting governance experts familiar with the Islamic social finance sector to enhance awareness among stakeholders, conducting workshops and training sessions to develop a clear governance framework, and establishing a governance committee outside of executive management to ensure quality and accuracy. Additionally, there is an emphasis on fostering a culture of governance as part of religious duty, maintaining strong connections with regulatory bodies in Kuwait to enhance transparency, and creating a continuous improvement system to involve employees in governance efforts. Finally, the formation of collaborative teams, rather than closed committees, is highlighted as an effective approach to encourage open communication and collective decision-making in governance practices.

## CONCLUSION AND POLICY IMPLICATIONS

The study set out to examine the issues and challenges in adopting good governance practices at Islamic social finance institutions in Kuwait, using the Direct Aid Society as a case study. The analysis reveals that the implementation of good governance within these institutions faces several challenges. These challenges arise from the unique characteristics of the institutions themselves, the specific dynamics of their employees and board of directors, and the regulatory framework governing Islamic social finance in Kuwait. Despite these challenges, the study finds that Direct Aid Society has managed to implement good governance standards effectively. The organization focuses on safeguarding the collective interests of the public over individual interests, aligning its governance practices with the societal context, and prioritizing the protection of stakeholders. This approach has enabled Direct Aid Society to overcome many challenges associated with the initial stages of implementing good governance. However, the study also identifies ongoing issues that need to be addressed to further enhance governance practices. These include the need for developing comprehensive policies, procedural guides, and charters for certain units within Direct Aid Society. Addressing these areas will be crucial for the organization to continue improving its governance framework and to effectively meet the needs of its stakeholders.

Based on the study's findings, several policy implications can be suggested to address the challenges faced by Islamic social finance institutions, such as Direct Aid Society, in adopting good governance practices. First, there is a need to develop comprehensive governance policies and procedural guides that are specifically tailored to the unique characteristics of Islamic social finance institutions. This includes establishing clear roles, responsibilities, and accountability measures for the board of directors and employees to ensure transparency and effective decision-making. Additionally, regulatory bodies should consider revising the current governance framework to better accommodate the distinct needs of Islamic

social finance institutions, providing guidelines that align with both Islamic principles and contemporary governance standards. Training and capacity-building programs for employees and board members on good governance practices could also be beneficial, fostering a culture of accountability and ethical conduct. Lastly, developing charters for specific units within the institution can provide a clearer governance structure, improving operational efficiency and enhancing stakeholder trust.

This study has limitations that is worth noting. The findings are based on a single case study, which may limit the generalizability of the results to other Islamic social finance institutions in different contexts. Additionally, the reliance on interviews may introduce biases related to personal perspectives and experiences. Future research could expand the scope by including a comparative analysis of multiple institutions across different regions or incorporating quantitative methods to provide a broader understanding of governance practices and challenges in Islamic social finance institutions. Further studies could also explore the impact of governance reforms on the performance and sustainability of these institutions over time.

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