

Role Of Practicing Good Governance In Tackling Islamic Social Finance Institutions' Challenges: A Case Study Of Direct Aid Society

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Abstract

Good governance is so vital and inevitable, particularly in the context of governance within charitable social finance institutions in contemporary times. The objective of this study is to explore the role of good governance practices in addressing challenges faced by Islamic social finance institutions (ISFIs), with a specific focus on the Direct Aid Society in the state of Kuwait. This study employs a qualitative research approach, utilizing a combination of official document analysis, library research, and interviews. The methodology is designed to capture a comprehensive understanding of the governance practices within the Direct Aid Society and their impact on overcoming institutional challenges. Semi-structured interviews were conducted with key stakeholders, including board members, management, and staff of the Direct Aid Society. These interviews were designed to elicit detailed insights into the practical challenges faced by the institution and the role of governance in addressing these challenges. The collected data were analyzed using thematic analysis, a method that identifies, analyses, and reports patterns (themes) within the data. This approach enabled the researcher to distil key themes related to governance practices and their effectiveness in tackling the challenges of Islamic social finance institutions. The present study contributes to the existing body of literature by examining the role of good governance practices on Islamic social finance institutions (ISFIs), a topic that has been relatively understudied. Through an examination of the Direct Aid Society as a specific case study, this research provides a distinctive viewpoint on the potential of governance principles derived from Islamic values to effectively tackle significant obstacles, including transparency, trust, and disclosure. This study not only makes a valuable contribution to the scholarly conversation around Islamic social finance, but also provides constructive recommendations for improving governance frameworks in comparable charitable institutions around the globe.

Keywords: Good governance practices, NGOs, Islamic social finance institutions, Direct Aid Society, Kuwait.

1. INTRODUCTION

Scholarly investigations have extensively examined the significance of good governance practice as a prominent concern encountered by non-governmental organisations (NGOs) (OrtegaRodríguez et al, 2024; Purnomo and Hartanti, 2024). This notion remains a subject of significant attention, notably within the context of Islamic social financing institutions in the Muslim world (Widiastuti et al., 2022a; Widiastuti et al., 2022b; Binti Nazmi et al., 2022; Nasution et al., 2022). Significant scholarly focus has been directed towards the examination of governance practices that are in accordance with Islamic beliefs (Binti Nazmi et al., 2022).

to a certain degree, a study on Islamic social financing organisations has attracted renewed attention because of increased economic, social and environmental challenges has led to various societal complexities. Governments have also become increasingly incapable of undertaking socio-economic issues (Jouti, 2019). As a result, the social finance concept began to spread in different forms all over the world to address and fill financing gaps needed in achieving sustainable development goals (SDGs) (Dirie et al, 2023). For instance, prominent institutions including the MacArthur, Rockefeller, and Ford Foundations have invested their endowments in a way that matches social impact activities (Nicholls et al, 2015; Geobey and Harji, 2014). Traditionally, social finance activities depend on grants and contracts from government and foundations as their primary source of funding. However, in times of fiscal constraint, such sources have become more limited than in the past (Moore et al., 2012). Generally, the concept of social finance includes various aspects including social finance providers, social enterprises, and all stakeholders who contribute to and are impacted by social activities (Varga and Hayday, 2016).

The Islamic social finance sector as part of the Islamic finance industry generally includes traditional Islamic institutions based on charity such as Waqf, Zakat, and Sadaqah, and instruments based on

cooperation such as Qardhassan and kafala, as well as Islamic microfinance (Obaidullah, 2020). Islamic social finance is seemingly similar to traditional social finance as both are concerned about social returns for disadvantaged and marginalized communities. However, Islamic social finance differs from traditional social finance in terms of its operations especially with waqf, microfinance, socially-responsible investments, and social impact bonds. Such Islamic social finance tools apply Shari'ah contracts such as 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). In other words, all Islamic social finance tools are guided by the principles of Maqasid al-Shari'ah (Zain & Ali, 2017).

Islamic social finance is supposed to have a great impact, especially in Muslim communities with high levels of poverty. The core purpose of Islamic social finance such as Waqf, Sadaqat, and Zakat is to meet the needs of the poor and to curb the ever-rising levels of poverty. More importantly, the total amount of funds collected annually from Muslims is not only supposed to eradicate poverty among Muslims, but also to close the humanitarian gap globally. According to Hamed (2020), around US\$200 billion to US\$1 trillion are disbursed annually in Sadaqah and Zakat to Muslim communities worldwide, i.e., several times greater than the contributions of conventional global humanitarian aid (just over US\$13 billion in 2011). At least of US\$600 billions of surplus Zakat from 40 OIC countries is distributable annually for humanitarian action. However, contribution from the Muslim communities to the humanitarian system in recent years is only 5-7%. Muslim countries' contribution to the Central Emergency Response Fund of the United Nations has been below 0.05% since 2006. This is because Muslims cannot give their Zakat collection to non-Islamic institutions as there are strict requirements on how the funds should be used and managed. More interestingly, only 1% of the annual excess in Islamic social funds were needed to fill the humanitarian gap in 2014 (Hamed, 2020).

On the other hand, Islamic social finance leads to better wealth distribution through its charity instruments (e.g., Waqf, Zakat, and Sadaqah) as well as cooperation-based instruments (e.g., Qard Hassan, Islamic microfinance, and Shari'ah compliant socially-responsible investment). In the context of this study, the underlying case study namely Direct Aid Society employs most of the Islamic social finance instruments including Waqf, Zakat, Sadaqat, Qard Hassan, and Islamic microfinance. It also participates in certain Islamic enterprises and investment for the purpose of financial sustainability so that it can secure social returns for developing disadvantaged communities. The Islamic social finance industry also faces many issues that must be addressed to move the industry to the next level.

According to Dan (2020), there is 36 challenges in the literature of social finance. One of the main issue is related to governance, which is an internal threat to social finance industry's sustainability. In the scope of Islamic finance, Islamic social finance institutions face unique governance challenges that differ from any other institutions. This is because their core structure set up is different from that of public and private institutions, whereby Islamic social finance institutions raise funds to undertake activities and the beneficiaries are not the fund providers. According to Wanyama (2014), transparency and accountability are two of the most crucial governance challenges whereby most of the beneficiaries do not have the capacity to ask for accountability, and that there is no connection between the beneficiary and the fund provider except in cases where the latter wants to track their finance process and interact with the beneficiary. Besides, the regulations of Islamic social finance institutions focus more on issues like registration and activities rather than governance, accountability, and transparency (Wanyama, 2014). Such practice weakens the application of corporate governance principles for Islamic social finance institutions. The World Bank (2005) summarized three main issues that contribute to the poor governance of non-profit organizations namely: (i) perceived weaknesses in the regulatory framework and in financial accountability, (ii) the influence, scope, and cost-effectiveness of non-for-profit projects and activities, and (iii) the implications of changes in non-profit organizations funding that result in the attainment of more funding through commercial activities and micro-finance returns. All these issues arise from the lack of good governance and poor monitoring in NGOs and non-for-profit organizations including Islamic social finance institutions.

Even though such issues arise from within the social finance institution, it has a robust connection with the reduction of funds (Jepson, 2005). The mentioned adverse circumstances may also concern partners, beneficiaries, funding or regulatory bodies, and society at large. The potential consequences of a decline in legitimacy among stakeholders might be highly detrimental for these non-profit institutions (Samkin & Schneider, 2010; Yasmin & Ghafran, 2021), given that their primary sources of funding are public

subsidies and private contributions (Potluka et al., 2017). The primary obstacle now faced by these institutions is the need to establish a culture of trust among stakeholders (Harris et al., 2017). This task involves ensuring that the resources they receive are utilised in accordance with high-quality standards and are effectively allocated towards the achievement of Islamic social financing institutions goals. Therefore, these issues have garnered concern from both community and public authorities, prompting scholarly investigations in the realm of good governance (Lichtsteiner & Lutz, 2012) aimed at addressing the mismanagement of public donations and mitigating managerial opportunism (Harris et al., 2017; López-Arceiz & Bellostas, 2020; Lu et al., 2020).

Consequently, the primary objective of this study is to provide a comprehensive reference and reflective tool for policy makers who are interested in investigating effective governance methods to enhance the efficacy of Islamic social financing institutions in addressing their challenges. This imperative because good governance has become necessary for all organizations in the public, private, and not-for-profit sectors. This study uniquely contributes to the literature on Islamic social finance by focusing on the role of good governance in addressing the challenges faced by Islamic social finance institutions. Using the Direct Aid Society as a case study, the research highlights the significance of governance practices that align with Islamic principles and how these can effectively mitigate operational, financial, and organizational challenges. The study is innovative in its combination of qualitative methodologies, which provide deep insights into the practical implications of governance in an Islamic social finance context. The findings offer valuable guidance for policymakers, practitioners, and scholars seeking to enhance the efficiency and impact of Islamic social finance institutions.

2. LITERATURE REVIEW

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 first main 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 and 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.

2.1 Good Governance for Islamic Social Finance Industry

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 (Ministry of Human Resources and Social Development, 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 (Ministry of Human Resources and Social Development, 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. Hence, the next section discusses the role of good governance at NGOs, Zakat and Waqf institutions separately.

2.1.1 The Role of Good Governance in Zakat Institutions

The practice of governance in zakat institutions is mainly related to the institutional structures and mechanisms so as to maintain the appropriate and transparent management of zakat collection and zakat distribution (Abd Wahab & Abdul Rahman, 2011). This is to ensure that all parties can have adequate access to all information in order to raise the level of accountability therefore enhancing the zakat institution's performance. Some studies investigated the relationship between governance and the performance and efficiency of zakat institutions (Fadilah, 2013; Muftadi & Susilowati, 2018). Some others discussed the relationship between governance and zakat payers' trust (Abioye, 2013; Ghani, 2018). All these studies concluded that there is a need to implement good governance in order to maximize the performance of zakat institutions and enhance trust among the stakeholders. Another study on zakat institutions in Padang, Indonesia confirmed the urgent need for improving good governance practices in zakat institutions to better achieve socio-economic justice (Wahyuni-td, 2014). In terms of the relationship between good governance and fraud prevention, a study found that good governance and fraud prevention have a significant impact on the performance of zakat institutions. However, the same study also found that the fairness principle of good governance has an insignificant impact on zakat institution performance (Wahyuni-td et al., 2021).

2.1.2 The Role of Good Governance in Waqf Institutions

One of the main reasons to practice good governance for waqf institutions is that the Waqf sector has become similar to the government sector in terms of the bureaucracy system (Alhassan, 2011). Generally, people who work in a bureaucracy system tend to be very concerned about details and often disregard timely task completion (Adler and Borys, 1996). For example, the Waqf sector suffers from the complexity and instability of the regulation system and the absence of institutional administrative measurement and evaluation standards. There is also the prevalence of nepotism and the complexity of procedures (Vveinhardt and Sroka, 2020). Therefore, Waqf institutions are in need of governance standards that are

generally compatible with Awqaf purposes and laws. Good governance standards also protect the related parties' interests in Waqf institutions (Farhan and Hasan, 2021). According to Farhan and Hasan (2021), the governance principles for Waqf institutions can be grouped into five main principles namely: ensuring the basis for an effective governance framework, protecting the rights of the beneficiaries and Waqf owner, identifying the powers and responsibilities of the board of directors or the governing body, providing the disclosure and transparency requirements of the financial and administrative performance, and identifying the roles and rights of the stakeholders. These five principles aim to achieve Waqf sustainability and develop its assets as well as safeguard stakeholder interests, which are similar to the objectives of corporate governance. However, the application of governance principles for Waqf institutions is slightly different because the nature of the related parties is comparatively different.

In light of the above, the practice of good governance for Islamic social finance institutions and NGOs is generally the same as those for the public and private sectors. An organization is said to exercise good governance when it has put in place transparent internal systems of checks and balances which ensure that the public interest is served. Good governance is therefore based on the clear distinction between the management of the organization and the governing body (the Board). It also entails having clear and transparent processes for the distribution of decision-making powers. The governance structures provide checks and balances, ensuring that the Islamic social finance institutions' resources are well managed, safeguarding their public-service orientation. However, the practice of good governance at social finance institutions faces several issues that need to be addressed in order to better protect stakeholder interest, and enhance the practice of good governance at social finance institutions.

2.2 Theories in consideration

the stakeholder theory posits that businesses or organisations modify their policies in order to meet the needs and expectations of diverse stakeholders, including investors, employees, regulators, government entities, and society at large (Freeman, 1984). The legitimate hypothesis, as proposed by Suchman (1995), posits that organisations must align their operations with the prevailing norms and values of the specific context in which they operate. The theory of resource reliance, as stated by Mudambi and Pedersen, (2007), posits that organisations rely heavily on the resources they possess and acquire. In order to ensure their survival, organisations must possess the ability to effectively and efficiently manage their resources. Non-governmental organisations (NGOs) such as Islamic social financing institutions engaged in addressing social and environmental challenges are likely to face scrutiny from diverse stakeholders who seek improved accountability and transparency from these organisations. Donors also anticipate that funds allocated to non-governmental organisations (NGOs) like Islamic social financing institutions are allocated in accordance with the commitments made by those organisations. These institutions play a significant role in facilitating the government's efforts to promote welfare. Furthermore, the establishment of NGOs necessitates governmental authorisation. Hence, the government aims to ensure that non-governmental organisations (NGOs) functioning within the nation remain aligned with their originally established objectives. Thus, these institutions significantly depend on donations from donors. Consequently, they must strategically devise methods to recruit additional donors by maintaining good governance practices in order to effectively accomplish the organization's objectives.

3. METHODOLOGY

The present study adopts a qualitative research methodology, incorporating a series of methods including official document analysis, library research, and interviews. The technique employed in this study aims to comprehensively examine the governance procedures implemented within the Direct Aid Society and their effectiveness in addressing institutional problems. This study entails a comprehensive examination of both internal and publicly accessible written materials sourced from the Direct Aid Society to gain deep understanding, and develop empirical knowledge (Corbin and Strauss, 2008). These materials encompass policy documents, yearly reports, and governance manuals. This facilitates the analysis of the governance framework and operational procedures of the organisation. Additionally, a comprehensive review of the library was undertaken to collect pertinent scholarly material and historical information pertaining to Islamic social finance, principles of good governance, and case studies of analogous institutions. 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 of the practical obstacles encountered by the institution, as well as the significance of governance in effectively tackling 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 governance methods and their efficacy in addressing the obstacles faced by Islamic social finance institutions. The in-depth face-to-face interviews with 10 respondents furnished valuable data that was generated, rearranged and refined using the NVIVO 14 software.

4. FINDINGS & DISCUSSION

The interview analysis and themes addresses the study objective, i.e., to examine the role of good governance practicing in tackling Islamic social finance institutions' challenges particularly the case of Direct Aid Society (DAS). This theme covers the implications of applying good governance standards on the institutional performance of Direct Aid Society. Lastly, it discusses how the application of good governance affects stakeholder protection. This theme was formed based on the answers given by the respondents. It was further grouped into sub-themes as shown below and in Figure 4.1:

- 1- Implications of practicing good governance in Islamic social finance institutions.
- 2- The application of good governance in Direct Aid Society.
- 3- Role of governance on the institutional performance of Direct Aid Society.
- 4- Role of governance on stakeholder protection in Direct Aid Society.

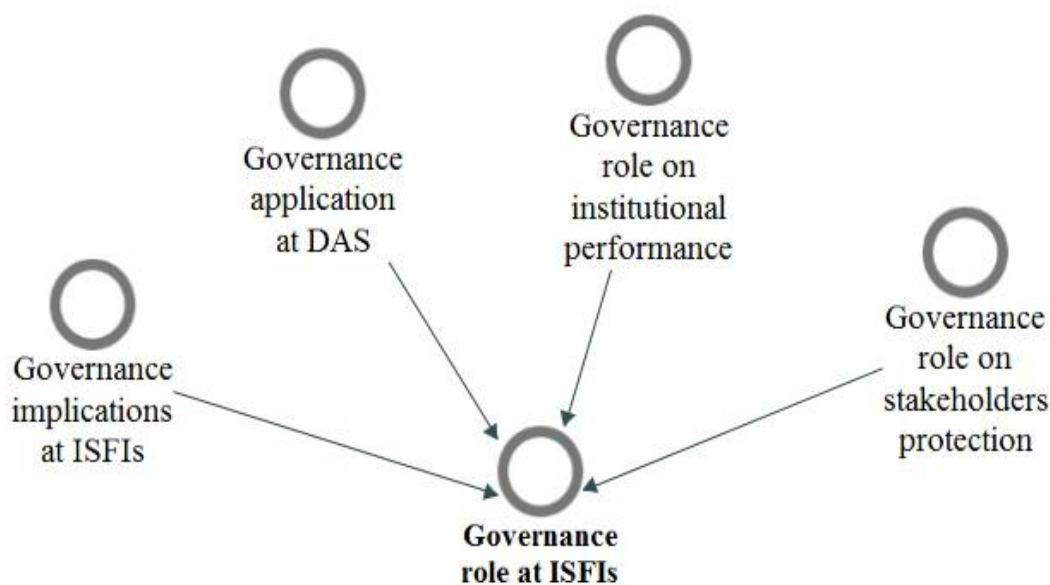


Figure 4.1 Model of the Role of Governance in Islamic Social Finance Institutions

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

4.1 Implications of Practicing Good Governance in Islamic Social Finance Institutions

In terms of the implications or benefits of practicing good governance standards in Islamic social finance institutions, the respondents mentioned that practicing good governance is a part of the teachings of Islam. Figure 4.2 below shows the responses regarding the benefits and implications of practicing good governance in Islamic social finance institutions.

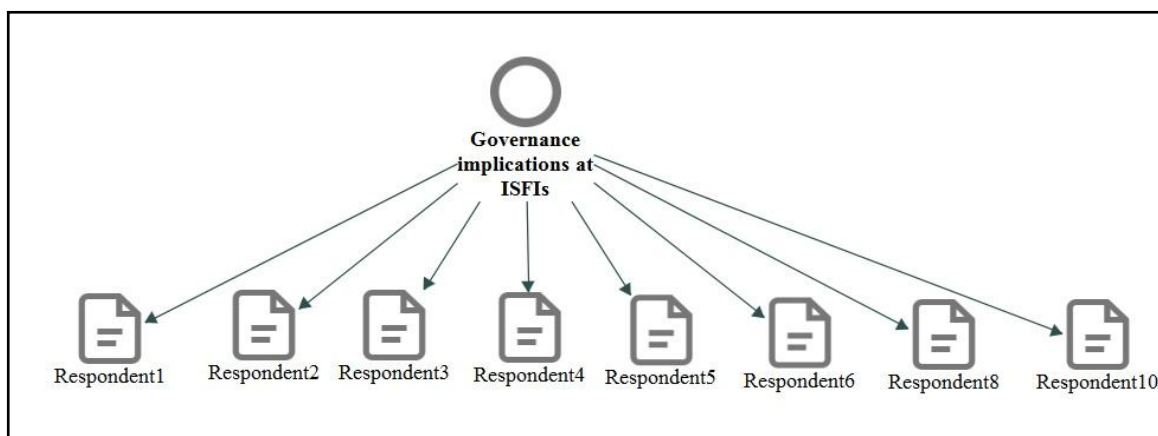


Figure 4.2 Model of Governance Implications in Islamic Social Finance Institutions

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

One of the respondents linked the practice of good governance with Direct Aid Society' main value of IHSAN:

"IHSAN is the highest level of worshipping Allah, and why I mentioned IHSAN when I talk about good governance adoption; because achieving IHSAN starts with being the best of yourself in order to get the best of Allah's reward." (Respondent 1)

The same respondent mentioned a part of the famous Hadith that stipulates a dialog between Prophet Muhammad (PBUH) and the Angel Gabriel regarding the meaning of IHSAN. The Messenger (PBUH) said that it means: "To worship Allah as if you see Him, and if you cannot achieve this state of devotion then you must consider that He is looking at you" (Sahih Al-Bukhari-50). The respondent said that this Hadith applies to outward and esoteric actions. Therefore, any practice of governance is considered IHSAN, which is highly encouraged in Islam (Respondent 1). Besides that, practicing good governance has two main benefits. The first is related to the aspect of worship (IBADAH), i.e., entailing the protection of property (mal) and the efficient delivery of the donation to its beneficiaries (Respondent 1). The second benefit is related to the prevention of administrative corruption and mitigation of conflicts of interest (Respondent 1).

Similarly, Respondent 2 also mentioned that the practice of good governance is a part of worship, and that the Holy Qur'an is a governance system for mankind on earth. According to the respondent, governance is needed for everything, particularly institutions that are related to Islam:

"In my point of view, any Islamic project or institution must practice the highest level of governance, and the highest level of governance is the ethics (AKHLAAQ) which is basically honesty and integrity. Moreover, in my opinion, the Islamic social finance sector is most required to practice good governance more than any other sectors, such as private and governmental sectors. This is because anything related to Islam is extremely important, and Allah said, 'Greatly hateful in the sight of Allāh is that you say what you do not do' (Surah As-Saff-2). The Prophet (PBUH) also said, "Keep away from the seven fatalities". He was asked: "What are they, O Messenger of Allah?" He mentioned, one of them, is devouring the property of an orphan (Riyad as-Salihin-1614). Therefore, any corruption or abuse will not only harm the institution, but also Islam." (Respondent 2)

Respondents 3 and 4 mentioned that practicing good governance in Islamic social finance institutions can enhance trust and eliminate corruption. This is because Islamic social finance institutions depend largely on the culture of donors' giving. In this regard, any processes or actions aimed at enhancing trust such as auditing or controlling would help in acquiring the donors' trust (Respondent 3). In addition, it would enhance stakeholders' interests whether they are beneficiaries, donors, authorities, or general assembly members apart from positively affecting the reputation of the Islamic social finance institutions (Respondents 4 and 10). Respondents 5, 6, and 8 elaborated that the practice of good governance in Islamic social finance institutions increases the level of transparency and disclosure of periodic reports (administrative, financial, and others). It also facilitates the establishment of policies on conflicts of interest. Respondent 8, being a governor, confirmed that the practices of good governance in Islamic social finance institutions in The State of Kuwait facilitate supervision and auditing:

"The tracking system at the Ministry of Affairs has an auto quarterly reminder to all charity institutions in The State of Kuwait to send their reports to the ministry. After receiving such reports, we can make

field visits to the charity institutions and compare the received reports with their actual works and documents which make the overseeing and auditing of activities much easier and more accurate.” (Respondent 8).

Respondent 10 highlighted the importance of the charter and by-laws of Islamic social finance institutions. He mentioned that the commitment of such charter is considered the first step towards the application of a good governance system. In addition, the formation of a board of directors by election in the general assembly is an important initial stage towards implementing a good governance system in Islamic social finance institutions. This is because The State of Kuwait does not commit Islamic social finance institutions to implement good governance practices. Hence, any Islamic social finance institutions in The State of Kuwait that are committed to their charter are actually already applying good governance practices (Respondent 10). Some of the respondents agreed with Respondent 10, especially regarding the initial stages of good governance application in Direct Aid Society, as mentioned in the following analysis of the second sub-theme.

Based on the interview output, the practice of good governance is required more in Islamic social finance institutions than any other sectors due to the setup of its core structure. Islamic social finance institutions raise funds to undertake activities and the beneficiaries are not the fund providers; the beneficiaries do not have the capacity to ask for accountability, and there is no connection between the beneficiary and the fund provider except if the latter asks for one (Wanyama, 2014). Likewise, a majority of the respondents agree on the necessity for good governance in Islamic social finance institutions. They mentioned that anything related to Islam is extremely crucial, and that any acts of corruption or abuse will not only harm the institution, but also Islam entirely. The following are the main findings regarding the necessity to practice good governance in Islamic social finance institutions.

Firstly, the findings emphasize the essential role of good governance in Islamic social finance institutions, rooted in the core teachings of Islam, where the highest form of governance is embodied in Akhlaaq—ethics, honesty, and integrity. The study underscores that adopting good governance practices is crucial for safeguarding the interests of various stakeholders, including beneficiaries, donors, mentors, authorities, and general assembly members. This not only enhances the reputation of these institutions but also fosters greater trust and credibility.

Furthermore, the regular publication of administrative, financial, and other reports is identified as a key factor in improving transparency and disclosure within Islamic social finance institutions. The study also highlights that good governance practices do not serve as restrictions but rather facilitate and expedite auditing and supervision processes, making them more efficient. Finally, adherence to the charter and by-laws is recognized as the foundational step in implementing a robust governance system, ensuring that Islamic social finance institutions operate with integrity and accountability.

4.2 The Application of Good Governance in Direct Aid Society

The adoption of good governance standards in Direct Aid Society has elevated since the governance guide and the first performance measurement of good governance application were issued in 2020. In the following years, the application of good governance has developed several times to meet the new regulations in The State of Kuwait and to improve the adoption of governance standards. Figure 4.3 below shows the responses regarding the application of good governance in Direct Aid Society.

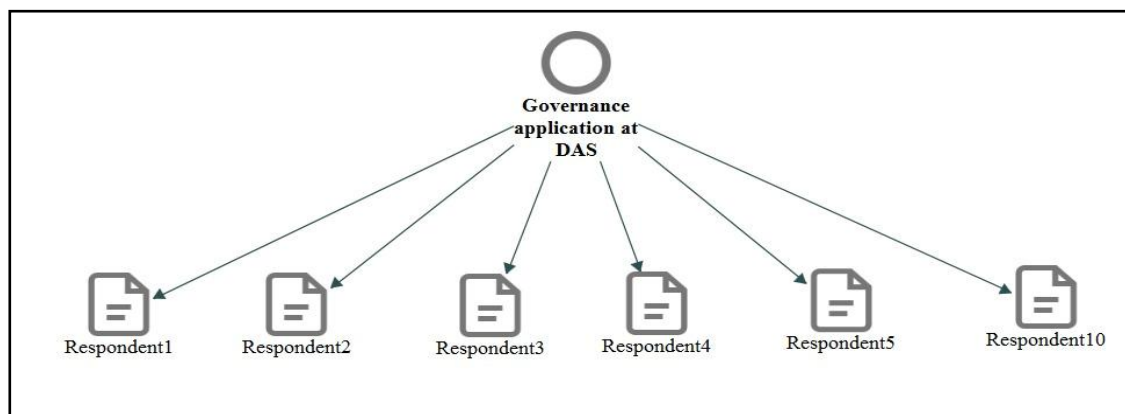


Figure 4.3 Model of Governance Application in Direct Aid Society

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

Respondents 1, 2, and 4 elaborated that the adoption of good governance in Direct Aid Society started long before the institution embarked on establishing the first governance guide in 2020. Respondents 1 stated that Direct Aid Society' good governance adoption started when the institution transformed individual actions into the first institutional work in 1987. This was when the institution established the first electronic system to manage its donations and started working on media for documenting all the activities and sending them to donors for the purpose of transparency (Respondent 1). Another respondent believes that the beginning of good governance in Direct Aid Society was when the first board of directors was formed, as the board of directors must provide audited reports to the supervisory bodies which is a part of good governance practices (Respondent 4). Meanwhile, Respondent 2 believes that the good governance practices in Direct Aid Society started with the issuance of its charter and by-laws. Also considered part of good governance practices are the completion of Direct Aid Society' representative offices in 40 African countries in the 1990s in order to be closer to the beneficiaries and protect their interests, as well as the establishment of a clear organizational structure for its branches and headquarter in The State of Kuwait (Respondent 1). All Direct Aid Society branches in Africa are supervised by the governments in their countries to the extent that every branch must provide a periodic report to the government (Respondent 4). In the mid-1990s, Direct Aid Society began developing its internal audit and quality systems in addition to its authority matrix and the separation of powers between the board of directors' chairman and the executive manager, as well as establishing its specialized board of director committees (Respondent 1).

Meanwhile, Respondents 3, 5, and 10 explained that Direct Aid Society first adopted good governance in 2018 when the board of directors decided to establish a governance guide. In this regard, Direct Aid Society scrutinized the good governance standards of the non-for-profit sector of the Kingdom of Saudi Arabia and other regimes such Malaysia and the United Kingdom, while taking into consideration the related legislation in The State of Kuwait (Respondent 1). In 2018, Direct Aid Society began to fulfill the requirements of institutional excellence as set by the European Foundation for Quality Management, of which most are related to the practice of good governance. Hence, European Foundation for Quality Management was very supportive of Direct Aid Society in building a governance system (Respondents 1, 2, and 10).

Many of the regulations, guidelines, and initiatives in The State of Kuwait are considered a robust basis for building a governance system in Islamic social finance institutions. Among them are regulations related to money laundering, electronic payments for donations, and the e-portal for humanitarian work (Respondent 10). Direct Aid Society was inspired early to adopt a good governance system due to the governance motivations mentioned by Respondent 10:

"For example, skeptical attacks towards the third sector in The State of Kuwait, European Foundation for Quality Management requirements and increasing online donations, all such causes made the necessity of publishing the administrative and financial reports in order to mitigate the reputation risk and strengthen Direct Aid Society's institutional and financial performance."

All the respondents confirmed that in 2020, Direct Aid Society drafted the first governance guide which was approved by the board of directors. In the same year, the board of directors formed a governance committee consisting of seven members including a member from the board of directors, two managers from the executive management, three governance experts, and the executive manager to follow up the application of good governance standards (Respondents 3 and 5). By the end of 2020, the first governance measurement results were issued in the annual report of Direct Aid Society (all respondents). In this regard, the governance measurement in Direct Aid Society was developed by asking 296 questions to its management, divisions, and offices, and of which answers were evaluated at 0, 50, or 100 degrees, and some others between 0 or 100 (Respondent 5). The first year of assessment derived a result of 81%, whilst in the second and third year it was 98% each (Respondent 5).

Respondent 10 concluded that Direct Aid Society gradually applied good governance practices at its headquarters in The State of Kuwait and some in its branches in Africa.

The progression of the implementation of robust governance standards in Direct Aid Society has evolved through successive stages, culminating in the issuance of a governance guide and the inaugural assessment of governance performance in 2020. Subsequently, in response to evolving regulatory frameworks in The State of Kuwait and with the aim of enhancing adherence to governance norms, the application of good governance practices has undergone iterative refinement over the ensuing years. The following are the main findings regarding the practice of good governance in Direct Aid Society over the last three years.

Firstly, there is a notable distinction between merely implementing good governance practices and having a formal governance system or guide. Direct Aid Society initiated crucial governance practices even before the official governance guide was issued in 2020. The organization's efforts have been significantly supported by adherence to national and international standards related to quality management and institutional excellence, particularly through their pursuit of the European Foundation for Quality Management (EFQM) rating, which has played a vital role in shaping their governance system.

Additionally, the study highlights the importance of governmental initiatives and guidelines in promoting good governance, especially in non-compulsory environments, as they are instrumental in the early stages of building governance systems. Direct Aid Society also strategically leveraged best practices from the non-profit sector in the Kingdom of Saudi Arabia, Malaysia, and the United Kingdom, while aligning these with Kuwait's legislative framework. The findings further emphasize the need for clear governance measurement tools to track progress annually, acknowledging that initial results are often unsatisfactory. The study underscores the importance of gradual implementation and development, particularly for institutions with international branches, to ensure sustainable and effective governance practices over time

4.3 Effect of Governance on Direct Aid Society' Institutional Performance

The adoption of good governance in Direct Aid Society has affected its institutional performance positively, where it obtained a 3-star excellence rating from the European Foundation for Quality Management after only one year of adoption (Respondent 10). Figure 4.4 shows the responses regarding the impact of governance on Direct Aid Society' institutional performance.

Respondent 1 highlighted that the adoption of good governance had significantly facilitated the establishment of the regulations, procedural guides, charters, and policies for most of the units and divisions in Direct Aid Society. It also helped in connecting the management with the divisions effectively, which in turn enhanced Direct Aid Society' institutional performance.

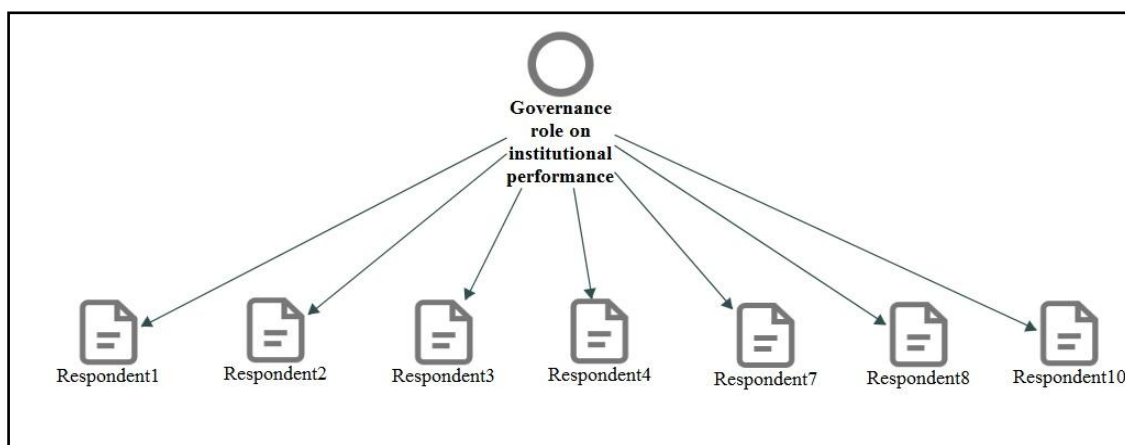


Figure 4.4 Model of Governance's Role on Direct Aid Society' Institutional Performance

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

Besides that, the adoption of good governance had also encouraged Direct Aid Society to appoint skillful executive leaders and acquire the services of Big Four audit firms (Respondent 2).

"For example, Direct Aid Society appointed a new skillful CFO 2 years ago as well as appointed Ernst & Young as an audit firm. And very recent, Direct Aid Society has appointed PWC firm for assuring the internal audit activities and for the purpose of enhancing the administrative and financial activities." (Respondent 2)

According to Respondents 1, 7, and 10, individual decision-making – especially those related to the usage of money and strategic decisions – is significantly reduced with the application of good governance practices (Respondent 1). This is because good governance requires data-driven and reasonable decisions made by specialized committees or via teamwork. Consequently, individual opinions and mistakes have been greatly reduced (Respondent 7). In the same vein, Respondent 10 said:

"Among many benefits of governance application are eliminating or reducing fraud, individual decision-making and misuse of power to achieve the best value for the beneficiaries." (Respondent 10)

Moreover, the application of good governance confirms the existence of a matrix of powers and responsibilities, i.e., the separation of power between the board of directors and the executive management (Respondents 1 and 3). For example, the board of directors cannot take any executive actions; the executive management cannot take any supervisory actions; and strategic and fateful decisions cannot be made by the executive management (Respondent 1). In this regard, Respondent 1 mentioned that:

“Before the adoption of good governance, the executive manager would take an individual decision, but now after the application of governance there is a power and responsibilities matrix. And any manager can refuse or disagree with my decision if against any regulations at the institution, and they ask me to get an exception first from the board of directors to implement the executive manager’s decision.” (Respondents 1)

The application of good governance also stipulates that every unit or management has to have its own powers and responsibilities matrix, as stated by Respondent 3:

“The importance of forming powers and responsibilities matrix is because the charter and by-laws at Islamic social finance institutions in The State of Kuwait is general and has no details pertaining to the responsibilities and powers of each management and division at the institutions.” (Respondent 3)

One of the benefits of forming a power and responsibilities matrix is that in the occasion that an employee, manager, executive manager, or even the chairman wants to leave the institution, its performance will not be negatively affected (Respondent 1).

In different aspects, Respondents 3, 4, 5, 7, and 10 mentioned that the adoption of good governance improves the accuracy and ease of the internal audit system and renders documentation processing to be more systematic. In this regard, Respondent 2 highlighted the significance of the audit committee in the application of good governance. This committee reports directly to the board of directors regarding the activities of the internal audit management (Respondent 6).

Consequently, Respondents 2, 3, 4, 7, and 8 confirmed that good governance practices, especially those that enhance institutional performance, would increase the level of trust in Islamic social finance institutions. In this regard, Respondents 2 and 3 said:

“The main goal of applying good governance is immersing the trust in the institution, because it is related to the fundraising action.” (Respondent 3)

“Me as a donor, I consider the organization that has a higher degree of practicing good governance, I give it my priority to donate to.” (Respondent 2)

Respondent 10 explained that the application of good governance ensures a safe and stable administration process and financial management in Islamic social finance institutions. In short, it ensures that donations are channeled directly to the proper beneficiaries. Good governance also helps in maintaining quality donors and boosting their trust, on top of increasing the institution’s growth (Respondent 10). Indeed, the practice of good governance not only positively affects the beneficiaries, but also all the stakeholders in general as discussed in the following sub-theme analysis.

The implementation of good governance practices in Direct Aid Society has yielded a discernible positive impact on its institutional performance. In 2021, Direct Aid Society attained a 3-star excellence rating from the European Foundation for Quality Management (EFQM). Remarkably, this notable achievement was realized within a relatively brief period of just one year subsequent to the adoption of good governance in Direct Aid Society. The following are the main findings regarding the impact of practicing good governance on Direct Aid Society’s institutional performance.

Firstly, the findings reveal that the practice of good governance has significantly enhanced the institutional performance of Direct Aid Society. By adopting good governance, the organization has been encouraged to establish comprehensive procedural guides, charters, and policies across all its divisions, fostering a stronger connection between management and various units. This has not only streamlined operations but also improved overall performance. The emphasis on governance has led to the appointment of skilled executive leaders and collaboration with reputable audit firms, further elevating the institution’s credibility and operational standards.

Moreover, the implementation of good governance practices has eradicated individual decision-making in critical areas such as financial management and strategic planning, thereby minimizing the risk of grave mistakes and misuse of power. This has ensured that decisions align with the best interests of all stakeholders, enhancing accountability and value creation. Additionally, good governance has facilitated the development of a clear matrix of powers and responsibilities, delineating the roles and authority of

the board of directors and executive management, which has improved organizational structure and efficiency. The accuracy of internal audits and documentation processes has also become more systematic and reliable, further strengthening the institution's operational integrity. Finally, the practice of good governance has bolstered donor confidence, helping to maintain and grow the donor base, which in turn supports the institution's continued growth and impact.

4.4 Impact of Governance on Stakeholder Protection in Direct Aid Society

Figure 4.5 below shows the responses regarding the impact of governance on stakeholder protection in Direct Aid Society. This sub-theme focuses on how the practice of good governance impacts Direct Aid Society' stakeholders including donors, beneficiaries, regulators, employees, and the board of directors. Good governance has a significant impact on the protection of stakeholders in Direct Aid Society as donors generally do not contact the beneficiaries. Therefore, the rights of donors and beneficiaries must be truly protected by the practices of good governance (Respondents 4 and 10).

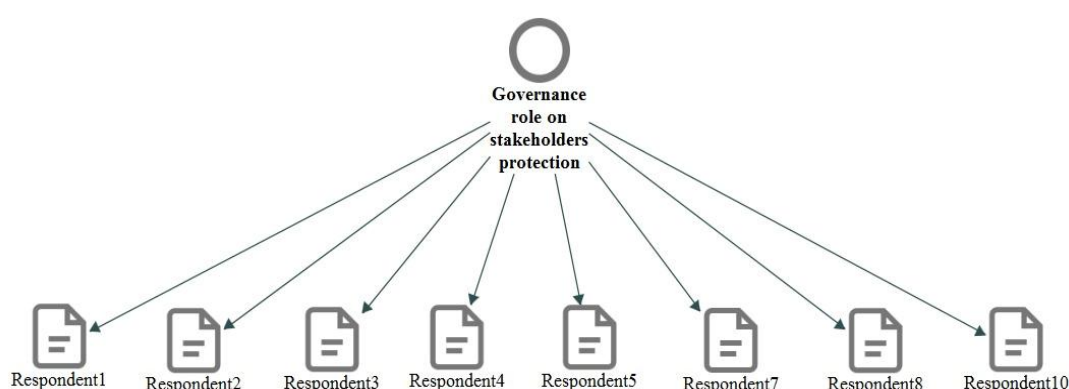


Figure 4.5 Model of the Impact of Governance on Stakeholder Protection in Direct Aid Society.

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

In this regard, Respondent 4 explained that in Direct Aid Society, the donors are allowed to track their donations via the donation meter on Direct Aid Society' website. They will receive a receipt once their donation is completed, as well as detailed reports of their project's execution. Donors can also easily browse Direct Aid Society' website to see the published reports (financial, administration, and others) which address the indicators under the third governance standard of transparency, disclosure, and accountability (Respondents 4, 7, and 10). Respondents 7 and 10 said:

"Donors' rights at Direct Aid Society are clear, even the least amount of donation on our website with 100 fils which equals 33 cent USD is recorded and documented, and donor receives a receipt for it. And whenever any donor wants to return their money back, they can do so easily, as well as they can easily review any information related to their donation at any time through Direct Aid Society's website, or they can contact the call center." (Respondent 7)

"Moreover, donors' rights are protected because of the conducted quality actions, projects maintenance and sustainability process to fulfill some governance indicators at Direct Aid Society." (Respondent 10)

Regarding the beneficiaries, Respondents 4, 7, and 10 said that the beneficiaries are usually involved in the evaluation of almost every project and activity, i.e., by filling up surveys and feedback assessments to measure their satisfaction with Direct Aid Society' projects as part of the governance requirements. This in return affects positively designing the next projects and increase the quality of the provided projects and therefore protect the beneficiaries' rights (Respondents 4, 7 and 10). Respondents 7 and 10 said:

"The conducted feasibility studies before each project and the documentation of projects' execution as well as measuring the social impact before and after are protected the beneficiaries." (Respondent 7)

"In other words, governance guarantees for the beneficiaries to get the most possible benefit of the provided projects at Direct Aid Society." (Respondent 10)

Regarding the protection of suppliers and partners, Respondents 1, 5, 7, and 10 said that the application of good governance in Direct Aid Society has significantly affected work tendering. Although randomly

selected based on certain criteria, following the adoption of governance, all work tenders are publicly announced for bidding; the bids are handed over in closed envelopes and later opened transparently in a pre-arranged appointment (Respondents 1 and 5). Such transparent governance actions increase the level of trust towards Direct Aid Society. In addition, all contracts with suppliers and partners are documented and reviewed from the Shari'ah and legal perspective to protect their rights and raise the level of transparency and trust (Respondent 7).

In terms of employee protection, Respondents 1 and 7 confirmed that the practice of good governance had enhanced the rights of Direct Aid Society employees. All Direct Aid Society employees have clear tasks and responsibilities, on top of KPIs that every employee can access. All regulations related to employees are published and are accessible on an internal platform, thus ensuring that all internal stakeholders are truly protected (Respondent 1). In this regard, Respondent 7 said that the practice of good governance in Direct Aid Society has maintained its employees' rights in terms of the documentation process of their work. Consequently, the employees' performance level, volume of tasks, and quality of work are assured because good governance requires the measurement of employee performance and the creation of a historical work record for each employee (Respondent 7).

Respondents 1, 8, and 10 said that one of the good governance actions taken by Direct Aid Society entails sending periodic reports to the supervisory authorities. Respondent 1 said:

"Direct Aid Society sends administrative and financial reports quarterly to the government in The State of Kuwait and each government in all 31 country Direct Aid Society works at, whether they request them or not, we send them quarterly." (Respondent 1)

The commitment of Direct Aid Society to receive donations only via digital channels helps ease and ensure the accuracy of the supervision process by The State of Kuwait government, hence protecting the rights of the supervisory body (Respondent 8). In addition, the adoption of digitalization by the many charity institutions in The State of Kuwait, including Direct Aid Society, has eased the handling of more than 3000 administrative and financial reports (Respondent 8).

Meanwhile, according to Respondents 3 and 4, the application of good governance in Direct Aid Society has activated the complaints and reporting system which in turn enhances the institution's stakeholder engagement and protection. In this regard, Respondent 3 said that if any stakeholder witnesses a wrong action or is subjected to injustice, they can file a complaint to a certain committee in Direct Aid Society while keeping their identity anonymous. All responses to the complaints and reports system must be recorded and documented to identify and solve similar future issues effectively (Respondent 3). Respondent 4 said that the report and complaints system is easily accessible from the website of Direct Aid Society:

"The complaints and reports that we receive are sometimes very tough, for example in our office in Mauritania at our Islamic microfinance offices, some of the beneficiaries said that: You are not appreciating our effort, because your offices are far away from our homes and some other complaints." (Respondent 4)

According to Respondent 1, Direct Aid Society has a KPI system for all employees including the board of directors and that they are evaluated based on the KPI results each year. These results are published and can be accessed by all stakeholders.

"For example, donations reports, did they reach donors on time or not? Another indicator of disbursement of donations, how much is the disbursement versus the revenues? and was the disbursement done according to the budget approved by the Board of Directors, or are there overruns and gaps? All these matters that I mentioned and many others that I did not mention, lead to the protection of donors and their money." (Respondent 1)

Finally, there is a positive relationship between transparency and accountability, whereby the greater the accountability, the greater the protection of the stakeholders' interests (Respondent 2).

The practice of good governance in Direct Aid Society exerts a notable influence on stakeholders encompassing donors, beneficiaries, regulatory bodies, employees, and the board of directors. The positive impact of applying good governance on the protection of stakeholders in Islamic social finance institutions is rather significant because donors mostly do not have contact with the beneficiaries. Therefore, the rights of donors and beneficiaries should be truly protected by the practices of good governance. The following are the main findings regarding the impact of practicing good governance on stakeholder performance in Direct Aid Society.

Firstly, the findings highlight the significant impact of practicing good governance on stakeholder performance within Direct Aid Society, emphasizing transparency, accountability, and the protection of stakeholder rights. For donors, all contributions are meticulously recorded and documented, with provisions in place for easy refunds if needed, ensuring donor confidence and trust. Governance practices also necessitate guaranteed procedures, such as quality actions and sustainability measures, to protect the rights of all stakeholders. For beneficiaries, good governance involves their active participation in the evaluation of projects through surveys, ensuring their satisfaction is measured and considered. Their rights are further safeguarded through comprehensive feasibility studies, thorough documentation of project execution, and social impact assessments conducted before and after project completion. For suppliers and partners, governance guarantees transparency by publicly announcing tenders and thoroughly reviewing and documenting contracts from both Shari'ah and legal perspectives, thereby protecting the interests of both parties.

Employee rights are protected through clear documentation of tasks and responsibilities, with open access to key performance indicators (KPIs) that allow for the traceability of performance, task volume, and work quality. Additionally, all regulations and guidelines concerning employees are published on an internal platform, promoting internal transparency. For supervisory bodies, the quarterly submission of administrative and financial reports simplifies the supervision process, enhancing oversight and accountability. Lastly, the adoption of good governance has activated an effective complaints and reporting system within Direct Aid Society, which not only improves stakeholder engagement and protection but also facilitates the early identification and resolution of potential issues. These practices collectively contribute to a more transparent, accountable, and effective organizational environment that benefits all stakeholders involved.

CONCLUSION AND POLICY IMPLICATIONS

This study primarily sets out to examine the adoption of good governance standards in the third sector of non-for-profit organizations in general and the social finance industry in particular, which are confronted by many challenges in the aspects of transparency, disclosure, accountability, and financial stability. These issues mainly stem from the core structure of social finance institutions which is different from that of public and private institutions. Social finance institutions mostly raise funds to undertake projects and activities, and of which beneficiaries are not the fund providers. Additionally, the beneficiaries do not have the capability to ask for accountability, and there is no connection between the beneficiary and the fund provider except for when the latter wants to track the progress of their fund and interact with the beneficiary. Therefore, the interview analysis reveal that the practice of good governance positively impacts and addresses the challenges faced by ISFIs i.e. lack transparency, trust and disclosure. In addition, this means that good governance practices significantly contribute to the institutional performance – specifically administrative performance – of Islamic social finance institutions in general and Direct Aid Society in particular. In addition, good governance standards elevate the protection of stakeholders including beneficiaries, donors, suppliers, partners, supervisory bodies, and employees.

The study provides some policy implications which could help in improving the adoption of good governance and ultimately enhancing and addressing the challenges faced by ISF institutions like the case of direct aid institution. For a starter, regulatory authorities must differentiate between Islamic social finance institutions that are already in a mature stage and the ones in the initial stage of applying good governance standards. In addition, smaller Islamic social finance institutions should enforced to applying some good governance standards based on their charter and by-laws, building an organizational structure, and taking into account the related regulations and laws. Thus, the application of good governance standards must be implemented gradually by both regulatory authorities and the related Islamic social finance institutions. These steps can pave the way for them in applying a robust good governance system in the future. Similarly, regulatory authorities should develop specific governance indicators for enabling financial sustainability in Islamic social finance institutions in order to strengthen their financial stability and sustain their social impact. Furthermore, each Islamic social finance institution based in a non-mandatory regime of the application of governance should set their own noble goals and motivation for applying governance. This may include resisting skeptical attacks, enhancing the level of trust and transparency for their stakeholders, increasing donations, and achieving financial stability and sustainability. A dedicated governance unit should be established in Islamic social finance institutions with the role of issuing periodic governance reports and monitoring all financial, administrative, and

sustainability reports prior to their final approval. An internal control system should be developed in Direct Aid Society and all Islamic social finance institutions to control all departmental operations and facilitate the internal audit, therefore strengthening the adoption of good governance. Therefore, establishing an internal audit unit in Islamic social finance institutions is highly recommended in order to audit all the activities of the executive management, especially the internal control systems. Lastly, the mandatory implementation of a good governance system should be accelerated in all social finance institutions in The State of Kuwait so that the country can sustain its global prominent reputation in the social finance industry. These policy implications aim to create a more robust governance framework within ISFIs, thereby addressing their challenges and contributing to their overall effectiveness and impact.

This study has limitations that is worth noting. This study only focuses on one legal form of an Islamic social finance institution, i.e., the single case study of Direct Aid Society, a non-for-profit organization that provides many projects and programs to receive general Sadaqah, zakat, and waqf. Future studies should investigate microfinance, waqf, zakat, and Islamic social investment institutions to better understand the role of practicing of good governance in Islamic social finance institutions. In addition, this study used the qualitative research method of conducting interviews with related leaders in the case study institution, one external governance expert, and one regulator from the supervisory body of the Ministry of Social Affairs in The State of Kuwait. Future studies can focus on conducting interviews with regulatory authority personnel and external governance experts. Future studies can also conduct surveys on governance leaders as well as experts and regulators in Islamic social finance institutions from different regions in the world to better understand the role of practicing good governance in the Islamic social finance institutions particularly the case study of Direct Aid.

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