

# WAQF AND MICROFINANCE INTEGRATION FOR ENABLING SUSTAINABLE FINANCIAL INCLUSION: ANALYSIS OF SHARĪ'AH COMPLIANCE

Sa'id Adekunle Mikail

*ISRA Research Management Centre, INCEIF University, Kuala Lumpur, Malaysia*

Fares Djafri

*ISRA Research Management Centre, INCEIF University, Kuala Lumpur, Malaysia*

Mahadi Ahmad

*Islamic Financial Services Board, Kuala Lumpur, Malaysia*

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## ABSTRACT

**Purpose** — Sustainability has remained one of the most significant challenges facing the microfinance industry, and Islamic microfinance is no exception. The need for Sharī'ah compliance poses an additional challenge for the Islamic microfinance industry. Many practitioners have argued that, in practice, social missions should be sacrificed for profitability so that microfinance institutions (MFIs) could achieve sustainability and competitiveness in the finance market. This paper investigates the potential of integrating waqf and microfinance to allay the challenge of balancing social responsibility (outreach) and financial sustainability within Islamic MFIs. Additionally, it analyses the Sharī'ah compliance requirements underpinning this integration.

**Design/Methodology/Approach** — This study adopts a qualitative method of inquiry, utilising an inductive approach to understand the conceptual framework of waqf and financial inclusion and in discussing Sharī'ah compliance aspects of socially-oriented instruments in socio-economic development.

**Findings** — The research finds some historical antecedents to evidence the inherent social mission of waqf which, if integrated with microfinance, ensures the sustainability of Islamic MFIs. This affirms that outreach and sustainability may not be mutually exclusive under waqf and Islamic microfinance integration.

**Originality/Value** — This study, through historical antecedents and contemporary practices, establishes that waqf and microfinance integration can address the sustainability of the Islamic microfinance industry and preserve its social mission.

**Keywords** — Financial inclusion, Islamic microfinance, Sharī'ah compliance, Sharī'ah objective, Sustainability, Waqf

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## INTRODUCTION

In the modern financial system, financial inclusion is promoted to serve low-income and underserved groups in the community. Among the instruments of financial inclusion are microfinance and microinsurance, which aim to cater for the hard-core poor, known as the 'unbankable' in the formal financial services industry. The two institutions can be used to reduce the vulnerability of the poor and increase their resilience.

Another area that can be used to improve financial inclusion is through philanthropic tools, notably Islamic social finance (ISF) instruments such as zakat (alms), waqf (Islamic endowment) and *sadaqah* (charity). Unleashing the potential of Islamic finance through the introduction of innovative ISF products could improve financial inclusion and the stability of the financial sector; and eventually increase the contribution of Islamic finance to the United Nations Sustainable Development Goals (SDGs) (Laldin & Djafri, 2021). Raza (2018) argued that the private sector and philanthropic organisations need to be mobilised to help governments achieve financial inclusion and the SDGs. The philanthropic sector—which is classified as the third sector within Islamic economics—can play an important role in achieving the SDGs, such as reducing the vulnerability of the poor and developing the education and health sectors.

Specifically, waqf as a social, legal, and religious institution has been instrumental in providing education, funding infrastructure, offering medical care and financing many other needs of both Muslims and non-Muslims throughout Islamic civilisations. Waqf benefits even transcend humanity as animals can equally be among the beneficiaries of waqf. This practice started during the Prophetic era and has been flourishing throughout the Islamic world since. In modern times, cash waqf has proven to be an effective social finance tool (Abdul Aziz *et al.*, 2019).

This paper investigates the integration of waqf and microfinance, both integral to ISF, as a strategy to address the sustainability of Islamic microfinance institutions (Islamic MFIs) which inherently encompasses both social and economic missions. However, maintaining the delicate balance between their social mission and sustainability has remained a perennial issue for the Islamic microfinance industry. Previous researchers discussed the viability of integrating waqf with microfinance in addressing diverse challenges associated with capital accessibility (Hamber & Haneef, 2017; Moh'd *et al.*, 2017; Majid, 2021; Kakembo *et al.*, 2021; Hagawe *et al.*, 2023). As Sharī'ah-compliant institutions, Islamic MFIs must ensure and prioritise Sharī'ah compliance throughout the integration of waqf and microfinance. Therefore, this paper analyses pertinent Sharī'ah compliance requirements inherent in the integration process, aiming to achieve sustainable financial inclusion within the society. Leveraging the waqf instrument, the paper addresses the funding challenges encountered by the Islamic microfinance industry while upholding its Sharī'ah compliance mandate.

This paper is organised into five main sections. The first section introduces the paper. The second section presents relevant literature on the topic. The third section explains the research method employed in this study. The fourth section analyses the Sharī'ah compliance issues related to waqf and microfinance integration, specifically focusing on issues concerning the bindingness of waqf and Sharī'ah contracts underlying Islamic microfinance management. Finally, the fifth section concludes the paper and provides insights into the impact of the

integration on the sustainability of the socio-mission of Islamic MFIs, as well as related Shari'ah compliance aspects.

## LITERATURE REVIEW

### Microfinance and Financial Inclusion

The concept of financial inclusion dates back to 2003 when the United Nations Secretary-General Kofi Annan stressed on the need to build an inclusive financial sector that gives the poor and the underserved access to sustainable financial services, including savings, credit and insurance (United Nations, 2005). Since then, microfinance has emerged as a tool designed to meet the financing needs of the non-bankable and underserved individuals who lack access to financial services.

The Asian Development Bank (ADB) defined microfinance as 'the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and their microenterprises' (ADB, 2000, p. 2). It is widely believed that microfinance is a movement whose object is a world in which as many very poor, poor, and low-income households as possible have permanent access to an appropriate range of high-quality financial services, including credit, savings, insurance and fund transfers (Christen *et al.*, 2004, pp. 2–3). The fundamental philosophy behind microfinance services is the promotion of financial inclusion of the unbankable in the formal financial services industry. MFIs endeavour to address various household essentials within developing nations. Unlike conventional service providers, MFIs pursue not only financial objectives but also a set of social goals outlined in their declared social mission (Sierra *et al.*, 2020).

The World Bank announced 2005 as the year of microfinance. Likewise, microfinance has been recognised by the United Nations as a key factor for sustainable development and economic growth, and the most efficient tool to alleviate poverty (Saad & Duasa, 2010). Within this context, several literary works discussed the vast potential of microfinance and its contribution to economic development, poverty reduction and financial inclusion (Pitt & Khandker, 1998; Khandker, 2003; Rahman *et al.*, 2011; Riwayatanti, 2013; Sierra & Rodriguez-Conde, 2021; Rohman *et al.*, 2021; Ozdemir *et al.*, 2023). While microfinance provides access to financial services, it also helps in spurring entrepreneurial skills. Islam and Ahmad (2020) demonstrated that MFIs can empower women through product-related socialisation and education, as well as entrepreneurship training.

Cull *et al.* (2018) offered insights into global financial inclusion, exploring its impact on economies worldwide. They emphasised the empirical underpinnings of financial inclusion and underscored the importance of understanding its foundations. They examined the theories and practices shaping financial inclusion, highlighting its vital role in sustainable development. Shah & Ali (2023) analysed the macro dimensions by constructing a multidimensional index of financial inclusion at the macro level, incorporating socio-economic and financial dimensions. Hartarska and Cull (2023) discussed significant scope economies arising from rural and urban microfinance services. These covered the impact of microfinance on banking sector development and economic growth, as well as financial inclusion and poverty alleviation. Finally, the authors underscored valuable insights into the functioning and impact of MFIs.

Overall, microfinance plays a crucial role in promoting financial inclusion, empowering individuals and communities, as well as fostering SDGs. It helps in poverty alleviation, economic development, and social empowerment. Additionally, MFIs strive to accomplish their social mission alongside financial objectives, including the promotion of education, healthcare, and environmental sustainability. This combination of financial and social objectives demonstrates the broader role of microfinance in addressing the complex challenges encountered by impoverished communities.

### **Microfinance: Social Mission vs. Sustainability**

Achieving the noble goals of microfinance has not however been so easy over the years. This is because of the delicate balance between the social role of microfinance products and the sustainability of the microfinance industry. Therefore, many financial experts and researchers opined that the two are mutually exclusive and so, there is a trade-off in achieving the two objectives of microfinance (Mersland & Strom 2010; Hermes *et al.*, 2011; Hartarska & Mersland, 2013; Mia & Lee, 2017; Mersland *et al.*, 2019; Blanco-Oliver *et al.*, 2023). However, some other scholars believed that achieving both objectives is quite possible, and they may even be complementary; and thus, a trade-off might not necessarily prevail as both objectives can be accomplished together (Fadikpe *et al.*, 2022; Khalaf *et al.*, 2023). Kumar and Asmare (2024) asserted that both outreach and financial performance complement one another, therefore there is no trade-off between the two objectives.

For MFIs to accomplish a balance between their social mission and financial sustainability, various legal approaches have been proposed. In particular, there are two main approaches to regulate most MFIs, namely through institutional and functional regulation (Staschen, 2003; Christen *et al.*, 2008). The first stresses on the regulatory framework and oversight mechanisms by regulatory authorities to license, supervise, and regulate individual MFIs as separate entities. The second focuses on specific functions or activities within the microfinance sector. Emerging from how to strike a balance between the question of sustainability and social mission, diverse views have surfaced, while the consensus that has remained intact is that microfinance is meant for the poor (Rhyne, 1998). The germane question that arises is how the poor benefit from microfinance products? To address this question, two approaches have again been identified. The first advocates the targeting of the poorest. The second argues for the inclusion of the vulnerable non-poor. The first advocate prioritises the original social mission of MFIs; while the second argues that the availability and sustainability of microfinance funds cannot be compromised for achieving the social mission. It is argued that targeting a mix of the non-poor and the very poor will minimise the marginal cost of serving the very poor and will support MFIs in achieving sustainability.

Considering the sustainability of MFIs and the lack of internal resources to discharge their social mission, various external resources have been tapped into to fund their operations and business activities. Therefore, most MFIs depend largely on external resources such as funds from donors and governments. As part of their efforts to be sustainable, some MFIs have recourse to commercial banks which has caused a drain of profits in the microfinance industry. Other methods that have surfaced in addressing the sustainability issue of MFIs include

transforming the institutions into a financial company, integrating remittances and considering cross-border entrepreneurship (Laude, 2009, p. 20; Luong, 2010, p. 4).

Against this backdrop of the undisputable need of MFIs to be sustainable while achieving their social mission and their reliance on external resources to alleviate such a struggle, this study examines the integration of waqf and microfinance as an external resource to bridge the funding gap. The potential of leveraging on waqf as a source of funding has not been vastly examined. Previous researchers focused on the viability of using waqf for corporate social responsibility (CSR) initiatives and the integration of Islamic social and commercial finance through waqf. For instance, a model based on waqf has been developed to aid Malay Muslim micro-entrepreneurs in Singapore (Hamber & Haneef, 2017). Meanwhile, in Indonesia, to support the agricultural sector, Baitul Maal wat Tamwil (BMT) employed a Salam-Muzara'ah Linked Waqf (SMLW) model, which integrates returns from cash waqf to empower waqf land (Majid, 2021). In Zanzibar, an integration model between waqf and entrepreneurs, known as the Waqf Muzara'ah-Supply Chain Model (WMSCM), has been proposed to support the agricultural sector in addressing various existing challenges (Moh'd *et al.*, 2017). In the same vein, the integration of microfinance models has also been effective in assisting small and medium enterprises (SMEs) with capital challenges in various other countries, such as Uganda and the United Kingdom (UK) (Kakembo *et al.*, 2021; Hagawe *et al.*, 2023).

Despite all these initiatives and efforts which aim to provide capital for entrepreneurs by integrating waqf within Islamic MFIs and SMEs, the Sharī'ah compliance requirements underpinning the integration is missing. Therefore, this study provides a comprehensive analysis relevant to Sharī'ah compliance requirements involved in integrating waqf and Islamic microfinance to achieve sustainable financial inclusion in society. From the past to the present, waqf has been widely acknowledged as an important social finance instrument, representing a perfect match for promoting poverty alleviation as well as social and individual wellbeing, and thus can be considered, both, an important source of external funding and a crucial contributor to financial inclusion (Sadeq, 2002; Kahf, 2003; Lahsasna, 2010; Laldin *et al.*, 2021; Hapsari *et al.*, 2022).

### **Social Mission of Waqf**

Waqf plays immensurable roles in development across Islamic territories and beyond. Its impacts are not limited to a single aspect of human life but cut across several spheres of human experience (Magda *et al.*, 2016). It contributes to human development through the building and maintenance of schools, training centres, universities, *madrasahs* (Islamic study schools), and public libraries; helps in the provision of health care through the building and maintenance of hospitals, clinics, maternity centres; finances the development of infrastructure such as roads; and contributes in the provision of humanitarian and social services such as public toilets, orphanages, widows and guest houses, and security equipment. The following are few of the many ways Muslims have made use of waqf to achieve its social mission and for financial inclusion:

- Created job opportunities: While waqf has been used to develop various social infrastructures, it has in turn created job opportunities for many people in the society (Al Baahth, 2001/1422). It was commonly said that during the Ottoman empire a person

could have been born in a waqf house, slept in a waqf cradle, drank from waqf properties, read waqf books, been taught in a waqf school, received his salary from waqf administration, be put into a waqf coffin after death and be buried in a waqf cemetery (Baskan, 2002).

- Industrial development: Waqf is instrumental to industrial development in Islamic history. Al Baaḥṡ (2001/1422) noted that the establishment of libraries through waqf funds resulted in the diffusion of paper trade and the development of manufacturing institutions that produced papers that were widely spread in some Muslim territories, including Baghdad, Samarkand, Damascus, Tripoli, Palestine and Andalusia. Following the paper trade diffusion, the technical development in the art of binding was also widely spread. The manufacturing of carpets, lamps and perfumes became widespread following waqf donations to build mosques in the Muslim society. Furthermore, waqf donors invested in other factories such as ammonia plants, oil and sugarcane extraction, olive, palm and oil seeds factories (Al Kharafi *et al.*, 2013).
- Trade development: The approach taken by waqf institutions to support trade activities is by providing necessary facilities to ease trade development. The inflow of waqf money, for instance, increases market and business activities. In real estate investment, waqf management institutions used waqf funds to build business centres and lease them to retailers. Waqf heritages involve agricultural firms, gardens, orchards, real estates, shops, commercial agencies, various production tools, coffee houses, tanks, laundries, gypsum factories, textile factories, and commercial ships (Kuwait General Directorate of Awqaf, 2017, Vol. 1, p. 26).

All the above contribute immensely to the smooth running of business activities at the local level, while commercial ships significantly help boost transactions and business activities across borders and regions. It is noteworthy that waqf funds can be used to support import businesses of goods that are not being produced locally. This supports the demand for local consumption of foreign commodities and in turn increases the exchange of goods/capital across international territories (Al Kharafi *et al.*, 2013; Kuwait General Directorate of Awqaf, 2017, Vol. 1, p. 72). The exchange of goods and capital across international borders ensures a balance between local production and domestic demands which translates into achieving effective demand and supply.

- Healthcare development: Al Kharafi *et al.* (2013) cited historical efforts of Sultan Nurdeen the martyr who established An-Nur Hospital in Damascus in 549 AH/1154. He donated the hospital for the poor and needy. It is said that it existed until 1317 AH. It is also reported that Sultan Salahudeen established a waqf dedicated to providing milk for breastfeeding women. He made two water pipes at one of the gates of his castle. One pipe released milk and another sugar water. Breastfeeding women came twice in a week to get milk and sugar for their babies (Kuwait General Directorate of Awqaf, 2017, Vol. 1, pp. 71–75). Another notable recent initiative is the use of waqf to help disadvantaged people access health care at minimal cost. For example, in Malaysia, the Waqaf An-Nur company has established a network of waqf hospitals and clinics called Klinik Waqaf An-Nur (KWAN). As of January 2019, there were one hospital (Waqaf An-Nur Hospital in Pasir Gudang), six clinics in Johor, two clinics each in Sarawak and Negeri Sembilan,

eight clinics in Selangor, one clinic each in Perak, Penang and Kelantan as well as five mobile clinics. Outpatient treatment costs only MYR5 and dialysis treatment costs MYR90 compared to private dialysis centres which charge between MYR150 and MYR200 per session. Since 2017, the management and supervision of these hospitals and clinics has been transferred to KPJ Healthcare Bhd. At the end of 2017, 1,443,674 patients were being treated in the KWAN network, of whom 116,859 (8%) were non-Muslims (Laldin *et al.*, 2021).

- Social wellbeing of the poor: Another historical waqf contribution explained by Al Kharafi *et al.* (2013) is that of Caliph Walid ibn Abdul Malik who established orphanages and special care centres in 88 AH. He employed doctors and nurses and prescribed remuneration and allowances. One particular waqf heritage recorded in Islamic history is the donation of a park for the poor in Darya village by Sultan Nurdeen Mahmud Zanki, known as the palace of the poor. Such a generous donation was made because the Sultan felt that the amusement park was becoming restricted only for the rich and well-to-do in society, while the poor had no access to such enjoyment (Kuwait General Directorate of Awqaf, 2017, Vol. 1, p. 47). Waqf funds were also established to train women widows and get them to learn crafts and tailoring, fashion designing, etc. (Al-Nu‘aymī, 1990).
- Wellbeing of other creatures such as birds, horses, etc.: It is reported that in Damascus, there is a dedicated waqf fund to take care of lost pets such as cats. In the city of Fez in Morocco, there is a dedicated waqf fund that caters for migratory birds so that they can survive. Sick animals are also not left out, as the waqf fund and donations have been extended to them. Such practice has been dated back to the seventh century of Hijra during the time of Ibn Baytar (one of the veterinary doctors of that century) (Al Kharafi *et al.*, 2013; Kuwait General Directorate of Awqaf, 2017, Vol. 1, p. 50).
- Education sector: In 859, Fatima Al Fihri, the daughter of Mohammed Al Fihri, a wealthy merchant in Morocco, established a waqf-based university named the University of Al Qarawiyyin or Al Karaouine in Fez, Morocco. Her sister built an adjacent mosque, and the complex became Al Qarawiyyin Mosque and University. In 1963, it was eventually incorporated into Morocco’s modern state university. Among the distinguished students produced by the citadel of knowledge are Muslim philosopher Averroes, the geographer Muhammad Al Idrisi, the famous Muslim historian Ibn Khaldun, the Dutch orientalist and mathematician Jacobus Golius, and many other historical figures.

It is recorded that commandants Nurdeen from Damascus established a waqf-based school named *Waqf Al-Madrasat An-Nuriyyah*. Similarly, Caliph Al Mustansir bi Allah established a waqf-based school named *Al Madrasah Al Mustansiriyyah* in 625 AH on the east side of Tigris River. Students stayed in the school’s hostel and the school management provided them with food and clothes.

- Socio-economic impact: Islamic financial institutions have played a key role in providing various products with socio-economic impact. For example, Bank Muamalat Malaysia Berhad (BMMB) has launched a cash waqf programme that supports education, healthcare, infrastructure development and young entrepreneurs. Similarly, Khazanah Nasional Berhad issued the Ihsan Sukuk as the first Sustainable and Responsible Investment (SRI) in Malaysia. Proceeds from the *ṣukūk* offering, intended solely for

selected institutional investors, were donated to Yayasan Amir, a non-profit organisation established in 2010 to improve the quality of education in Malaysian public schools. The beneficiaries have reached over 65,000 students from 83 trust schools in 10 states of Malaysia. This demonstrates that Islamic finance can be used positively to improve and promote quality education.

### **Cash Waqf and Microfinance**

Several literary works have suggested waqf-based credit facilities through different Islamic finance sectors namely banking, *takāful* and capital market to cater for the diverse needs of poor households in different communities. Cizakca (2004) suggested a cash waqf model to serve the social objectives in society such as cash waqf microfinance to support poor households. Similarly, Elgari (2004) proposed the establishment of a non-profit financial intermediary, the *qard hasan* bank where interest-free loans are provided to finance consumer lending for poor households. The source of capital injection to the bank would come from cash waqf donated by wealthy Muslims. Ahmed (2003) and Kahf (2003) proposed the establishment of zakat, *awqāf*, and *sadaqat*-based microfinance institutions. They suggested that the returns from *awqāf* and *sadaqat* funds can be used to finance productive microenterprises at subsidised rates. This is to balance the need for profitability and sustainability of Islamic MFIs as highlighted by Wang & Ran (2019) in the case of Rishenglong Ltd. (RSL), an MFI in Pingyao, Shanxi. In line with that, Lahsasna (2010) analysed and evaluated the role of cash waqf as a new financial model in the Islamic financial system. He argued that the cash waqf model can be used to develop and enhance the financial services for micro, small and medium-sized enterprises (MSMEs). He suggested that cash waqf is considered an effective tool for fund mobilisation and is of extraordinary significance for financing MSMEs.

Against this backdrop, cash waqf has long been proven to make waqf an effective social finance tool (Abdul Aziz, 2019). In particular, cash waqf is now being actively used in many Muslim countries as a powerful tool for social finance and social programmes such as the promotion of scholarships and health facilities. For example, in Malaysia, several Islamic banks promote and practise cash waqf, known as cash-backed waqf among Islamic banks. For example, Bank Muamalat Malaysia Berhad (BMMB) launched a cash waqf programme in partnership with Perbadanan Wakaf Selangor (PWS) (Selangor Waqf Corporation). Also, BMMB launched the first Sharī'ah-compliant debit card called 'Aisya Debit Card-I'. It is the first of its kind in Malaysia and globally as it includes socially responsible features. BMMB decided that part of the commission that the bank takes for the interchange fees received from the merchant should be paid to a waqf fund (BMMB, 2016).

In the context of integrating waqf and microfinance, Mohd Thas Thaker *et al.* (2021) showed that the integrated cash waqf micro-enterprises investment (ICWME-I) model can be used to upgrade micro-enterprises through the Human Capital Development (HCD) programme with financial support from cash waqf. It is expected that the ICWME-I model will provide ongoing support to micro-enterprises in the form of educational programmes and training. Similarly, Zauro *et al.* (2020) affirmed that the integration of waqf with MFIs could ensure financial inclusion in the northern region of Nigeria and promote economic growth and socio-economic development. Kachkar (2017) proposed a Cash Waqf Refugee Microfinance

Fund (CWRMF) as a financial solution model for refugee micro entrepreneurs with entrepreneurial knowledge. The study revealed that cash waqf can be used to fund microfinance which in turn can contribute to the socio-economic development of refugees around the world. Likewise, Haneef *et al.* (2015) showed that integrating the cash waqf model with Islamic MFIs could play a vital role in poverty alleviation in Bangladesh. Hence, the integration of waqf with microfinance is potentially an impactful financing mechanism that could address socio-economic development as well as provide low-cost financing options to MSMEs. More importantly, such integration will facilitate sustainable financial inclusion that expedites financial stability and economic revival in the aftermath of COVID-19.

Another contemporary example of managing waqf property based on the Sharī'ah principles is the establishment of the Labuan International Waqf Foundation (LIWF) as an extension to its enabling law on foundations, the Labuan Foundation Act 2010. The aim is to provide an international foundation to manage waqf properties based on Sharī'ah principles. One of the uniqueness of the foundation is that it recognises different types of waqf to attract domestic and international participants, including charitable waqf (*al-waqf al-khairi*), family waqf (*al-waqf al-ahli*), joint waqf (*al-waqf al-mushtarak*) and self-dedicated waqf (*al-waqf 'ala al-nafs*). The LIWF is committed to introduce waqf with more simplified procedures, thus making the registration of waqf less bureaucratic. Another important feature of the waqf framework in Labuan is that the foundation can operate waqf independently without the need to get the approval from the State Islamic Religious Council, which adds bureaucracy to the process (Laldin *et al.*, 2021).

### **Possible Scenarios of Waqf and Islamic Microfinance Integration**

Historically, waqf is proven to be an effective instrument of financial inclusion, while the same holds true for microfinance operations with a social mission. In addition, the modern practices in key Islamic finance jurisdictions such as Bangladesh, Indonesia, Kuwait, Malaysia, Saudi Arabia and Turkey, where various forms of waqf have developed—including the most relevant form, notably cash waqf, according to the Abdul Aziz *et al.* (2019)—has proven the instrument's efficiency as an important tool of social finance. This is in addition to many literary works that affirm its efficiency (Elgari, 2004; Cizakca, 2004; Ahmed, 2007; Magda *et al.*, 2016; Ascarya, 2018; Aulia, 2019; Rana *et al.*, 2020). Further, as Ascarya (2018) mapped various ISF instruments and the 17 SDGs, it is clear throughout the process of alignment that waqf is the sole ISF instrument that is capable to transform the 17 SDGs into reality. Given the above examples of waqf across Islamic history that even transcend wellbeing to include other creatures such as birds, cats and lakes, it gives a clear message that all 17 SDGs set by the United Nations can be easily taken care of using the waqf mechanism. In fact, waqf is a flexible instrument whereby the potential for violating Sharī'ah requirements is quite slim compared to other ISF instruments like zakat, *hibah*, *ṣaqadah* and *qard*.

Waqf and microfinance integration comprises six components, namely waqf, Islamic microfinance, human resources, *takāful*, project financing and poverty alleviation. There are few scenarios in which waqf funds can be integrated into Islamic microfinance operations, notably:

1. Waqf funds to support existing Islamic MFIs.
2. Waqf funds to finance a new Islamic MFI.

3. Waqf funds used for the establishment of a micro-*takāful* institution.

In the first and second scenarios, waqf funds would be considered an external resource supplementing the contribution (internal resources) from the shareholders of Islamic MFIs.

In the case of waqf funds to finance a new Islamic MFI, the waqf institution would employ an Islamic MFI administrator as the waqf trustee to manage and distribute revenue to waqf beneficiaries. The waqf-based MFI management would come up with a plan and means to reach beneficiaries, if not identified by waqf donors. These scenarios are applicable to philanthropic forms of waqf where waqf assets are dedicated for social and charitable purposes including poor and vulnerable non-poor households, hospitals, schools, orphanages, and public utilities. Additionally, religious forms of waqf can also be included. This occurs when waqf assets are dedicated to religious purposes such as religious schools (*madrasahs*).

Waqf funds used for the establishment of a micro-*takāful* institution for MFIs involve a group of donors committing to donate cash or other highly liquid assets to fund micro-*takāful* coverage. The institution aims to provide a safety net and protection for the less privileged and low-income earners in society. It could be established at various levels: local, state, national and international. As a philanthropic form of waqf, Muslims and waqf experts should explore various human needs as identified in the United Nations' SDGs to structure the waqf model to suit the needs in conformity with the *maqāṣid al-Sharī'ah* (objectives of Islamic law) (Mikail *et al.*, 2017).

**Table 1** describes some of the experiences of waqf and Islamic microfinance integration, as practised in Malaysia and Indonesia. Among notable experiences are Amanah Ikhtiar Malaysia (AIM), and Bank Wakaf Mikro (BWM) as well as Baitul Maal Wat Tamwil (BMT) in Indonesia.

## RESEARCH METHODOLOGY

This study adopts a qualitative method of inquiry, utilising the inductive approach to understand the conceptual framework of waqf and financial inclusion. It aims to shed light on the Sharī'ah compliance aspects of socially-oriented instruments in socio-economic development. The qualitative instruments and design provide a holistic understanding of the integration process by capturing the perspectives, experiences, and contexts of stakeholders involved, thereby enriching the analysis and informing policy and practice in waqf and Islamic microfinance integration and related Sharī'ah compliance requirements. The paper analyses relevant documents, reports, policies, and literature related to waqf, Islamic microfinance and their integration. It provides insights into the historical, legal, and institutional frameworks that shape the integration process. It draws from the integration process the relevant Sharī'ah compliance issues, specifically focusing on the issues concerning the bindingness of waqf contracts and Sharī'ah contracts underlying Islamic microfinance management.

**Table 1: Experiences of Waqf and Islamic Microfinance Integration in Malaysia and Indonesia**

Salient Features	Malaysia	Indonesia	Indonesia
	Amanah Ikhtiar Malaysia (AIM)	Bank Wakaf Mikro (BWM)	Baitul Maal Wat Tamwil (BMT)
Flexibility and Humanistic Approach	AIM is fully supported by the Malaysian government and is widely known for its flexible and humanistic approach in providing microfinance products and services.	BWM offers very small-sized loans to people who really need financing with relatively easy requirements, and it is a non-deposit taking form of microfinance.	BMT offers a flexible and humanistic approach in providing financing, simplifying the access for beneficiaries.
Main Functions	AIM is a replica of the Grameen Bank model which provides loans to low-income individuals, thereby contributing to economic and social impact through job creation in rural areas.	BWM is a waqf-based microfinance institution that has been in operation since 2017, playing a crucial role in supporting women's micro-businesses in Indonesia.	BMT comprises both Baitul Maal (social fund) and Baitul Tamwil (commercial fund), which integrate the functions of social fund and commercial activities within the Islamic microfinance framework.
Shari'ah Model	AIM employs interest-free microcredit ( <i>qard hasan</i> ) as a financing method to alleviate the financial burden of the poor and low-income households in rural and urban areas in Malaysia.	BWM employs cash waqf models to enhance its capacity and extend its Islamic microfinance products and services. It integrates traditional ISF instruments, such as zakat, <i>infaq</i> , <i>sadaqah</i> and waqf, fostering sustainable and socially responsible financial practices.	BMT is unique as it is waqf-based microfinance aimed at poverty alleviation and social and economic wellbeing. Characteristics, governance, and social capital are significant in shaping BMT's sustainability, performance, and risk management.
Challenges	AIM imposes a management fee of 10 per cent for loans that it provides to its clients. This could be due to the unique characteristics of microfinance operation.	Both BWM and BMT face more or less similar challenges, notably regulatory environment, capacity building, technological adoption, public perception and awareness, challenges in financing poor people, limited resources, influence of critical groups, and literature gap on practical challenges.	
Prospects	It is more appropriate if <i>qard hasan</i> is only given to the hardcore poor and the service charge is waived or kept at the minimum to reflect the true spirit of <i>qard hasan</i> . In addition, Shari'ah compliance, livelihood improvement, human capital development, effective poverty alleviation, sustainable development and value addition are key to restore the positive image of waqf institutions.	Similar to the prospects in the Malaysian experience, BWM and BMT characteristics, governance and social capital are significant in shaping its sustainability, performance, and risk management.	

Source: Extracted from different sources with some modifications (Saad, 2012; Mason *et al.*, 2015; Haneef *et al.*, 2015; Duasa & Mohd Thas Thaker, 2021; Edris *et al.*, 2021; Hussain-Azeemi *et al.*, 2022; Yusgiantoro *et al.*, 2022).

## RESULTS AND DISCUSSION

### Perennial Issues of Microfinance

Based on the aforementioned, MFIs face perennial issues in the accomplishment of both the social mission and sustainability of the industry. Bangladesh, Bolivia and Indonesian models which are prototypical models of the microfinance industry demonstrate the mission drift through high interest rates and profitability-orientation, adverse selection of solidarity lending, mis-targeting and social failure (Maclean, 2010; Dowla, 2012; Revindo & Gan, 2017; Wang & Ran, 2019). The focus on finance performance also leads to a mission drift (Xu *et al.*, 2016; Mia & Lee, 2017). Nonetheless, the manner to balance the paradoxical missions is not clear yet. The approach to balancing the two opposite sides does not yield positive results except through the introduction of external resources to buttress the shortfall that may arise in satisfying the social mission at the expense of sustainability of the fund. MFIs will not face the Sharī'ah compliance issue as long as the ISF instruments are properly employed.

The use of these instruments may vary from one institution to another, and each has a peculiar ruling which must be satisfied. However, throughout Islamic history, waqf has been employed to cater for various human needs in all ramifications as it enjoys flexibility that other instruments cannot offer. In fact, as highlighted above, even animals and the environment can enjoy the facilities and flexibility of waqf benefits like human beings.

### Approaches to Waqf and Microfinance Integration

After analysing the main challenges facing microfinance, including Islamic microfinancing, it becomes evident that various approaches have been employed by these institutions. These include managing trade-offs between social and financial performance, financing through external resources, and others. This research identifies external resources, such as waqf, as crucial elements for ensuring the sustainability of Islamic MFIs without leading to mission drift. The outreach and sustainability of Islamic MFIs are not mutually exclusive.

A historical examination of waqf underscores its effectiveness in bridging gaps within financial systems. The main concern in waqf and microfinance integration lies in Sharī'ah compliance, particularly regarding the binding nature of all types of waqf including cash waqf. Additionally, the Sharī'ah contracts that govern the various roles of the Islamic microfinance manager need careful consideration.

These roles include:

1. Waqf as a supporting fund: Using waqf to bolster the financial resources of Islamic MFIs.
2. Waqf as a funding instrument: Leveraging waqf funds for specific financing needs within the microfinance framework.
3. Waqf as capital for microfinance operations: Utilising waqf to establish and sustain microfinance operations.

As ensuring Sharī'ah compliance is crucial, balancing the social and financial performance is equally important for the successful integration of waqf and microfinance.

## Sharī'ah Fundamentals of Waqf

Waqf literally means to prevent something from movement. It is technically defined in AAOIFI Sharī'ah Standard No. 60 paragraph 2/1 as 'making a property invulnerable to any disposition while donating its generated benefit' Al-Mūsā (2012, vol. 2, p. 240) defined it as 'appropriation [allocation for a particular purpose] of an asset and donating its benefit such that the asset is not sold, gifted, donated or encumbered to facilitate its usufruct for the named beneficiary/ies'. Its legitimacy is well established in the Sunnah and through *ijmā'* (consensus). Ibn Hubayrah (2002, vol. 2, p. 45) said that scholars unanimously agreed to the legitimacy of waqf. It has been a common phenomenon from the first generation of Islam until the present, and no one has expressed disapproval of it. As for the nature of waqf assets, there are various types of waqf assets as provided in AAOIFI Sharī'ah Standard No. 60, paragraphs 2/4/5 to 2/4/15, but whatever the waqf asset may be, it must fulfil the following conditions highlighted in AAOIFI Sharī'ah Standard No. 60 paragraph 2/4/5/1:

- a. It should be a Sharī'ah-wise appraisable asset (*māl mutaqaawwim*), and it should be known or to be known.
- b. The *waqif* should own the waqf asset in full ownership, or it should be appurtenant to an asset owned by the *waqif*, e.g., to create waqf of yet-to-be-declared dividends on shares held by him.

The waqf assets—irrespective of their type—must be effectively and efficiently managed and kept safe to conform with the perpetual nature of waqf. For example, in the case of a waqf of cash or shares, the money should be invested prudently, and only the profits generated from the investment should be used to take care of waqf beneficiaries. As perpetuity of the waqf asset is a Sharī'ah requirement, its Sharī'ah compliance necessitates that the income is used to ensure the sustainability of MFIs. For instance, in the case of cash waqf and corporate waqf, waqf assets are first invested and the income generated from these investments are used to fund, establish or support Islamic microfinance projects. Additionally, an important Sharī'ah element to consider is the binding nature of the waqf contract, especially in cash waqf where the donor is committed to contributing to the waqf account.

### ***Binding Nature of Waqf Contract***

It should be noted that the fundamental rule of waqf is permissibility, provided it does not involve prohibited elements such as donation of a prohibited subject, e.g. endowment of idols, production of wine, and others. Additionally, a waqf may be disliked (*makruh*) if a father donates to some of his children while excluding others. For instance, if he donates only to his sons and excludes his daughters.

The waqf contract is like most Sharī'ah contracts which is obligatory as enshrined in the Qur'ānic verse (5:1) 'O ye who believe! Fulfil your undertakings'. The Prophet (SAW) also said, 'If you wish you can keep it as an endowment to be used for charitable purposes' (Al-Bukhari, hadith no. 2772).

Most scholars—including the Mālikīs, Shāfi'īs and Ḥanbalīs as well as Abū Yūsuf and Muḥammad al-Shaybānī from the Ḥanafī School—viewed waqf as a binding contract to donate. The basis for their argument is the statement of the Prophet (SAW): 'The waqf asset should not

be sold, or be given as a gift, or be inherited' (Al-Bukhārī, 1433, vol. 4, p. 12, hadith no. 2772). Thus, a contract of this nature should not be amenable to rescission or termination. Abū Ḥanīfah, on the other hand, considered it a non-binding contract. As such, it is allowed but disliked for a donor to retrieve his waqf. If he does reclaim it, his heirs would inherit it. Abū Ḥanīfah, however, recognised two scenarios in which waqf becomes binding:

- a. if the ruler or a judge passes judgement to that effect;
- b. if the donor makes a bequest, dedicating one-third of his property as waqf to be effected after he dies.

The weightier view is that waqf is a binding contract based on the above-mentioned hadith. Also, it is a kind of donation; as such, selling and gifting, which indicate transfer of ownership, are not allowed. Once it is decided, it is binding. To elaborate further, the commitment to donate, which forms the key component of the concept of *ta'āwun* (cooperation) in *takāful* (Islamic insurance) operations and other Sharī'ah contracts, is strongly related to the bindingness of the waqf contract. This applies when waqf funds are dedicated to complementing participants' contributions in a microfinance plan. There is a need for the waqf fund as a donor to commit himself to continuously channel waqf funds in support of the mission to ensure that the prospective beneficiaries can receive the underlying benefits when necessary. The same also goes for the second and third scenarios where waqf funds are used to finance a microfinance plan or to establish an Islamic MFI. If the waqf contract were not considered binding, realising the commitment to donation for a microfinance plan would be a daunting task. Inversely, the bindingness of the waqf contract facilitates the commitment to donation to establish an Islamic MFI once it is agreed.

Further, another issue is the requirement for possession of waqf assets by the beneficiary. Some scholars argue that possession is mandatory, while most scholars view it is not required (Ibn 'Ābidīn, 1431, vol. 4, p. 348). For instance, in the case of waqf microfinance integration, waqf beneficiaries receive benefits through a delegated party, such as the Islamic microfinance administrator, who disburses the fund to selected customers eligible as waqf beneficiaries. In contrast, Ibn Quddāmah (1441, vol. 8, p. 187) argues that direct possession by the waqf beneficiary is not applicable in the case of general waqf, as the benefits are directed to the public rather than to specified individuals, unlike in family waqf or specific waqf which target particular individuals.

### ***Effect of Bindingness of Waqf and Related Sharī'ah Matters***

As discussed earlier, the preference is given to the view of most scholars that waqf once decided is binding and it is closely connected with the commitment to donate (*iltizām bi tabarru'*) in the *takāful* operation. For example, in the three scenarios of waqf and microfinance integration mentioned above, the donor's obligation to continue contributions remains binding until the maturity or the realisation of the target amount. This is crucial because waqf is a charitable contract, and there maybe instances where donors, after concluding the contract, choose to discontinue their contributions prematurely without informing the waqf administrator and the Islamic MFI administrator. Such actions should not be regarded as a temporary waqf. In contrast, a temporary waqf involves a commitment to donate under specific terms, including the

possibility of receiving a refund at the agreed maturity date. This distinction is important for maintaining the integrity and effectiveness of waqf contributions in supporting microfinance initiatives.

Bindingness and commitment to donate, whether through periodic cash payments or lumpsum contributions, must align with the target principal or maturity specified in the waqf deed (*hujjah* waqf). Similarly, waqf assets in physical form must adhere to the binding nature of the waqf contract once it is concluded. These stipulations ensure that the waqf's integrity and purpose are maintained throughout its duration, reflecting the donor's commitment and the waqf's intended impact.

As for the choice of Sharī'ah contracts underlying the various roles of the waqf administrator including the Islamic microfinance manager, it also follows the scenarios highlighted above. For example, in the first and second scenarios, the waqf is an external fund channelled to either support or finance Islamic microfinance operations. To ensure perpetuity of the benefit from the waqf fund, it can be structured using *wakālah bi al-istithmār* (investment agency) and *mudārabah* (profit sharing) contracts, provided it is not commingled with the microfinance fund. If the funds are commingled, a *mushārah* (profit and loss sharing) agreement should be arranged. However, in the third scenario, where the waqf fund is used to establish microfinance initiatives and microfinance experts are engaged as employees or *nāzir* waqf (waqf administrators), the investment of waqf funds should be based on either *wakālah bi al-istithmār* or *mudārabah* contracts.

Another scenario that may affect all three scenarios is a shortfall in the waqf fund, especially due to inflation. This may necessitate calling on waqf donors to contribute additional funds to prevent the total depletion of the waqf fund. This has been discussed by classical and contemporary scholars under *'imarat al-mawquf* (preservation of waqf asset). This occurs in two ways. First, it is a commitment to preserve, maintain and ensure continuous benefit from the waqf asset, even if it is currently fit for use and free from defects such as cash waqf, corporate waqf like share waqf and other physical waqf assets. Ibn Abideen said 'it starts with the waqf reserve (*imārāt*) from the income generated by the waqf before being disbursed to the waqf beneficiaries' (Ibn 'Ābidīn, 1431, vol. 4, p. 368). Second, it is the preservation of physical waqf assets through construction, restoring, and plastering existing buildings that have cracked or been demolished. Al-Kharshi states that 'perseveration of waqf begins with the restoration and reform of the waqf asset, ensuring its original form is maintained and its continued benefit is secured' (Al-Kharshi, 1431, vol. 7, p. 93).

The majority of scholars unanimously agree that the preservation of the waqf asset takes precedence over the disbursement of its income or of usufructs (Ibn 'Ābidīn, 1431, vol. 4, p. 368; Wizārat al-Awqāf wa al-Shu'ūn al-Islāmiyyah, 1404–1427, vol. 44, p. 189). In the event of a shortfall in the cash waqf fund, the waqf administrator may seek additional contributions and consider borrowing.

Regarding borrowing, most scholars argue that it is permissible if stipulated in the waqf deed or with the consent of the relevant authority. Mālikī scholars permit borrowing, asserting that the waqf administrator, as a trustee acts in the interest of the waqf when the need for borrowing arises (Wizārat al-Awqāf wa al-Shu'ūn al-Islāmiyyah, 1404–1427, vol. 44, p. 193).

For additional contributions, since waqf donors initiate the waqf contract e.g., cash waqf, it is preferable to request further contributions to address any shortfall and achieve the objective of the waqf. It is also of paramount importance that waqf as a Sharī'ah instrument, ensures that all components and requirements of the waqf model are vetted by qualified Sharī'ah experts to confirm they satisfy Sharī'ah requirements. Additionally, exploring various tools, such as blockchain technology, can enhance the outreach and effectiveness of the waqf mission.

It is noteworthy that the integration of waqf and microfinance should be viewed as a product rather than an attempt to create a separate legal entity. This approach helps avoid interference from waqf authorities, particularly in jurisdictions where waqf administration is overseen by state bodies, such as the State Islamic Religious Councils (SIRC) in Malaysia.

### **Institutional Collaboration between Waqf Institutions and Islamic MFIs**

The integration necessitates institutional collaboration between waqf institutions and Islamic MFIs to provide financial and non-financial services. Such integration creates a synergistic approach to address poverty and support socio-economic development which comes in different forms as follows:

1. Direct funding of Islamic MFIs through cash waqf and waqf investment in Islamic MFIs.
2. Indirect funding of Islamic microfinance projects by using waqf assets, e.g. waqf property (such as land or buildings) to implement an Islamic microfinance project; or using the income generated from investments of waqf assets to channel into microfinance initiatives.
3. Collaboration in the form of public-private partnerships between waqf institutions and MFIs to create blended financial solutions; and community-based initiatives that aim to create tailored financial products that address the unique needs of specific communities.
4. Micro-*takāful* scheme which aims at utilisation of waqf funds to establish micro-*takāful* institutions that provide *takāful* coverage to low-income households.
5. Waqf-based *qard ḥasan* which aims to provide *qard ḥasan* to productive waqf beneficiaries, microentrepreneurs and small business owners. Additionally, waqf funds can be used to subsidise the cost of microfinance loans, making them more affordable for low-income beneficiaries.
6. Hybrid waqf-MFI entity which aims to establish a combined waqf and microfinance institution serving both waqf and microfinance mission under one umbrella.
7. Harnessing technology opportunities which aim to develop digital platforms that integrate waqf funding with microfinance services using blockchain technology to track waqf funds and microfinance transactions, ensuring efficient disbursement, fund monitoring, transparency and accountability.
8. Education and capacity building which aims to provide training and capacity building programmes for the existing and prospective waqf administrators and microfinance practitioners. Additionally, conduct awareness campaigns to educate the community about the benefits of waqf and microfinance integration.

From a Sharī'ah perspective, these various collaborations can take the form of either *mushārahah*, *mudārabah* or *wakālah bi al-istithmār*.

## CONCLUSION AND RECOMMENDATIONS

This research critically examined the perennial issues affecting the outreach and sustainability of Islamic microfinance, particularly focusing on the paradoxical missions that inhibit these aspects. Although literary works have proposed several approaches, this research emphasises the integration of waqf and Islamic microfinance as a viable solution to these challenges. The study concludes that the dual missions of social impact and financial sustainability in Islamic MFIs should not be viewed as mutually exclusive, given the effective application of ISF instruments, especially waqf, which has a proven inherent social mission and flexibility.

The research highlights the importance of Sharī'ah compliance, particularly by ensuring the bindingness and commitment of waqf donors. This includes maintaining the agreed upon contributions, whether lump sum or periodic payments, until the target amount is reached or the agreed maturity date is met.

Furthermore, it examines the Sharī'ah contracts underlying the structure of waqf microfinance integration, particularly the three scenarios discussed. It also details the roles and responsibilities of waqf administrators, microfinance managers, *nāzīr* of waqf, investment agents, and designated partners.

To ensure Sharī'ah compliance and effectiveness, the relevant Sharī'ah rules and principles should be vetted by competent Sharī'ah experts and communicated to stakeholders such as waqf donors, waqf beneficiaries/microfinance customers, regulators and waqf authorities.

By adopting synergetic approaches including—direct funding of microfinance by waqf funds, financing microfinance projects through waqf assets, establishing partnerships and collaborations, setting up micro-*takāful*, utilising waqf-based *qard ḥasan*, fostering institutional integration, leveraging technology and innovation, and focusing on education and capacity building—will achieve greater social impact and promote sustainable financial inclusion in a manner consistent with Sharī'ah requirements.

In addition, the main contribution of this research lies in harnessing waqf and microfinance integration to balance outreach and sustainability for Islamic MFIs. It also addresses related Sharī'ah compliance requirements. This embodies considering outreach and sustainability of Islamic MFIs as mutually inclusive, commitment to donate by waqf donors, relevant Sharī'ah contracts underlying the three scenarios and approaches of waqf and microfinance integration as well as ensuring oversight by competent Sharī'ah scholars. The waqf-microfinance integration requires specialised knowledge in designing and structuring products and services that align with relevant Sharī'ah rules and principles while meeting the sustainability and social mission of Islamic MFIs. Besides the required knowledge to integrate waqf and microfinance, other challenges necessitate collaborative efforts from regulatory bodies and other stakeholders to create a supportive environment for sustainable waqf-microfinance integration. These challenges can be summarised as regulatory support, Sharī'ah compliance requirements, technological integration, capacity building, risk management, public awareness, perception, and acceptance.

## LIMITATIONS AND FUTURE DIRECTIONS

This study was limited to the possibility of achieving both social mission and sustainability through waqf and microfinance integration along with preservation of Sharī'ah compliance and related Sharī'ah matters. It does not explore the practical aspects in which Islamic MFIs, through the introduction of innovative products involving other ISF instruments such as zakat and *sadaqah*, can improve financial inclusion and social welfare, and eventually increase the contribution of Islamic finance to the SDGs. Moreover, this study adopts a qualitative method of inquiry, utilising the inductive approach to understand the conceptual framework of waqf and microfinance for the attainment of financial inclusion through microfinance products and services and Sharī'ah compliance requirements. However, quantitative or mixed method can also be used in future research. Finally, this study recommends further research to examine the challenges in developing comprehensive Sharī'ah governance and compliance framework for waqf-microfinance integrated products and services as well as explore the ways that it could be incorporated with ISF instruments for a sustainable and inclusive microfinance ecosystem.

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## ABOUT THE AUTHORS

**Sa'id Adekunle Mikail, PhD**, is an associate professor at ISRA Research Management Centre, INCEIF University and an AAOIFI Certified Shari'ah Advisor and Auditor (CSAA). His areas of research involve Islamic banking and finance, *takāful*, Shari'ah and regulatory aspects, *ṣukūk* and Islamic capital market, Islamic social finance, and contemporary Shari'ah issues. Dr Sa'id Adekunle Mikail is the corresponding author and can be contacted at: [saidmikail@inceif.edu.my](mailto:saidmikail@inceif.edu.my)

**Fares Djafri, PhD**, is the Head of Research Innovation Unit and a Senior Research Fellow at ISRA Research Management Centre, INCEIF University, Kuala Lumpur, Malaysia. He is an AAOIFI Certified Shari'ah Advisor and Auditor (CSAA). His areas of research involve Islamic banking and finance, *takāful*, sustainable finance, Shari'ah governance and Islamic social finance.

**Mahadi Ahmad, PhD**, is a Senior Specialist, Shariah Review and Translation at the Islamic Financial Services Board, Kuala Lumpur, and an AAOIFI Certified Shari'ah Advisory and Auditor (CSAA). His areas of research involve zakat, waqf, Islamic banking and finance, *takāful*, Shari'ah and regulatory aspects, *ṣukūk* and Islamic social finance.

## DECLARATION

### Credit Authorship Contribution Statement

- Sa'id Adekunle Mikail: Coordination, analysis, write up, review and editing.
- Fares Djafri: Conceptualization, analysis, write up, review and editing.
- Mahadi Ahmad: Write up and review.

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The authors declare that they have no known competing financial interest or personal relationships that could have influenced the research work.

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