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Islamic social business to alleviate poverty and social inequality

M. Nusrate Aziz
School of Economics, University of Nottingham, Semenyih, Malaysia, and
Osman Bin Mohamad
Graduate School of Management, Multimedia University, Selangor, Malaysia

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Abstract

Purpose – The purpose of this paper is to identify some well-set instruments in Islam that can efficiently alleviate poverty, solve social problems and reduce social inequality through a new operational framework called "Islamic social business (ISB)".

Design/methodology/approach – This is a conceptual research that is based on *Al-Quranic* principles as well as contemporary social welfare philosophies, such as, augmented stakeholder theory, social enterprise and social business. *Al-Quran*, *Al-Hadith* and existing traditional and Islamic literature are consulted for this study.

Findings – The study proposes an efficient system of Islamic wealth sourcing and management to make the process of poverty alleviation sustainable. Other social problems for disadvantaged people, such as, health-, shelter-, literacy- and environmental-related issues are also addressed in the proposed system. The study identifies the inefficiency in the current practices and makes some propositions that are in conformance with Islamic principles and implementable by Islamic institutions all over the world. The authors propose a theoretical framework and operational propositions for ISB.

Practical implications – In following this study, social policymakers, Islamic financial institutions, Islamic social enterprises and Islamic charity organizations will find organized guidelines to initiate "new entities" or "reshape existing entities".

Social implications – The study will be effective in solving social problems, alleviating poverty and reducing social inequality.

Originality/value – This is the first study that identifies all the potential Islamic sources of funding and the efficient management thereof through ISB. The study also proposes an ISB model and makes several propositions for different types of ISB.

Keywords Economic philosophy/theory, Poverty, Islamic banking/finance

Paper type Conceptual paper

1. Introduction

Historically, *Zakat, Sadaqah* (charity), *Waqf* (donation) and *Qard Al-Hasan* (loan not-for-profit) were practiced to reduce poverty in the time of Prophet Mohammad (PBUH) and his companions. Among these poverty reduction instruments, *Zakat*, including *Sadaqah Al-Fitr* (small donation at the end of *Ramadan*), is a compulsory component[1] that redistributes wealth from the rich to the poor, thereby reducing income inequality. Other sources of Islamic funds, such as, *Sadaqah*, *Waqf* and *Qard Al-Hassan*, are also highly encouraged instruments of poverty alleviation in Islam. Although some of them are compulsory and others are optional components, their ultimate target is to support the disadvantaged, i.e., the poor in the society. The eradication of poverty by managing the above-mentioned Islamic funds was one of the important aims of Prophet

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Mohammad (PBUH). Hence, the Islamic economic framework is based on a social consciousness that forbids "selfish" wealth creation. The salient principles of Islamic society are social equality, economic equity, brotherhood and unity, and justice (Shahzad, 2012).

Islam believes that although both rich and poor people exist in a society, the well-to-do Muslims have some accountability to the poor in their society. Prophet Mohammad (PBUH) said: "That man is not from me (not included into *ummah*) who sleeps contentedly while his neighbour sleeps hungry".

Islamic fundamentals are unchangeable. Consequently, *Zakat*, *Sadaqah*, *Waqf* and *Qard Al-Hasan*, and their weight, importance and consequences remain the same even in the twenty-first century. However, in this new economic and financial order, we have a variety of modes of investment that help us to grow charitable assets in multiple ways and thereby give us the opportunity to reduce social problems in a sustainable manner. A new framework, "Islamic social business (ISB)" is therefore introduced in this study, which is a sustainable model to solve social problems and alleviate poverty.

However, what do we mean by "social business" (SB) and "ISB"? Why do we need an ISB model if the traditional SB model can successfully alleviate social problems and poverty? These questions are answered in the following sections.

1.1 Social business

Existing theoretical and empirical research prescribes multiple ways of profit maximization for business. Traditionally, the business that earns maximum profit is considered to be the most efficient business. However, unfortunately, these typical businesses are not concerned about socio-economic welfare, such as the equitable distribution of wealth, and poverty reduction; or ethical issues, employee's rights, fair-trade, the environment and other welfare improving phenomena. This irresponsible and unforeseen business environment has led researchers and welfare activists to consider an alternative business practice that can earn profit with due commitment and responsibility towards social welfare.

The inefficient distribution of income and wealth leads to inequality and poverty in the society. In a free market economy, the market freely determines the allocation of resources, and, in a pure capitalist society, the social problems, inequality and poverty increase due to market failure. In a mixed economy, due to market failure and government failure, the distribution of income and wealth becomes unequal, which generates poverty and increases income inequality. Consequently, in the 1990s, different institutions emerged that attempted several social welfare activities through business. "Social enterprise (SE)" is one of them. The emergence of social enterprise is briefly illustrated in Figure 1.

Subsequently, Nobel Peace Prize Laureate Professor Muhammad Yunus introduced another idea, which he conceptualized as "SB". He prescribed this business for the overall welfare improvement of society. SB is a business that addresses and solves the "social problems", which is not to make profit for investors. It is a non-loss and

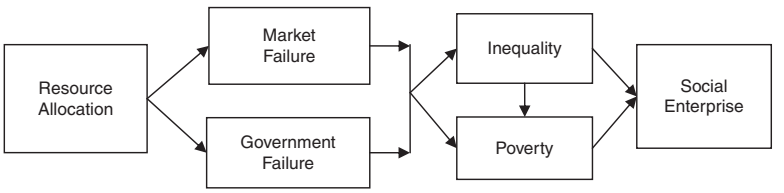


Figure 1.
The emergence of "social enterprise"

non-dividend enterprise (Yunus and Weber, 2009). Two different types of SB were suggested by Yunus and Weber (2009) – SB Type I and Type II.

SB Type I is a business that would be handled by a professional group of businesspeople, who would finance the business, but would not be entitled to any profit or dividend. The capital providers for this business can withdraw the principal amount once the business becomes self-dependent. The business should focus on products that ensure social, ethical and environmental goals. In contrast, SB Type II is a profit-oriented business that is owned by the poor and underprivileged people in the society.

SB has been defined as (see Yunus *et al.*, 2010):

$$Social\ business = Not\text{-}for\text{-}profit\ organizations + profit\ maximizing\ businesses$$

According to Muhammad Yunus, the two-step operation method of "SB" is very simple in nature.

Step 1: identify a specific social problem; and

Step 2: create a business model to solve the specified social problem.

For instance, the "Danone" company sells fortified yogurts to poor families at a very low price to fight malnutrition among poor children. Similarly, the "Veolia" company ensures a clear water supply in the rural areas to prevent health issues for poor people.

Since, a SB does not give any dividend to the capital owner, where does the profit go? The solution is simple. First, the profit will be used for reinvestment; consequently, the business will be expanded. Second, the funds will be utilized for improvement of the product or service quality, and, finally, the profit will be utilized to design new technology or improved technology to reduce the product (or service) costs. In the long run, the capital owner will take out the principal amount but not the dividend. Accordingly, the capital owner is contributing to the economic and social welfare. However, it is acknowledged, that, in reality, this is a much weaker motivation to the selfish agents in an economy. Hence, the accumulation of capital for the traditional SB Type I would be very difficult in a capitalist society.

The second type of SB is a business that is run by a professional body, but owned by poor people. Yunus *et al.* (2010) have given the example of "grameen bank" (GB) in this regard. In total, 95 per cent of the ownership of GB belongs to poor people who earn the dividend from the business.

Both the SB Type I and Type II indicate the business initiatives for welfare improvements of the society. The social welfare includes both economic welfare, (such as reduction of poverty and inequality), and socio-environmental improvements (through fair-trade, environment-friendly production and production by ensuring the rights of the workers). If SB can eradicate poverty, reduce inequality and improve social welfare, why do we need to introduce an alternative idea called, ISB? The reasons are discussed below.

1.2 Weakness of SB

There are various fundamental problems in SB, which motivate us to develop an alternative model.

First, although the objective of the traditional SB concept and ISB are the same – "social welfare improvement" – the traditional SB concept was formulated based on "capitalism". Hence, a traditional SB/SE allows interest-based financing and investment, whereas interest is prohibited in Islam.

Second, a traditional SB/SE allows any and every possible traditional competition and cooperation technique to be implemented for the maximization of profit, which is contradictory to the economic principles of Islam.

Third, sourcing funds is one of the great challenges for traditional SB. In the capitalist society, all agents, such as, consumer and producer are "economic men" (Mannan, 1984, 1991) who are absolutely motivated by "utility" and "profit", respectively. "Economic men/agents" are considered to be individualistic and selfish people. If these so called "rational economic agents" change their "individualistic and selfish attitude" and become "cooperative and socially responsible people", only then can capital for SB be accumulated. Specifically, if there are people in a capitalist society who are willing to spend for the welfare of the society, then funds for SB can be accumulated. However, unfortunately, the present number of such individuals in the capitalist society is not sufficient.

On the other hand, Islam clearly indicates the sources of charity funds. Hence, the source of funding is not a concern for Islamic finance. The main concerns in ISB are that of an efficient fund collection method and a sustainable fund management system.

1.3 Islamic social business

ISB will be an interest-free and profit-loss-sharing (PLS)-based business, which will maintain corporate social responsibility (CSR) and the principles of brotherhood. The business itself and the profit will be devoted to mitigate social problems and alleviate poverty. The business will follow the Islamic principles, and, ultimately, will be motivated by the satisfaction of Allah (SWT).

About 1,500 years ago, Prophet Mohammad (PBUH) had established an Islamic state in which he introduced *Zakat* and highly encouraged *Sadaqah*, *Waqf* and *Qard Al-Hasan* to eradicate social problems and poverty. These are the potential sources of funds for ISB.

Islam does not allow any interest-based transaction[2] (financing or investment). In addition, Islam does not permit selfishness profit maximization. Hence, although ISB will be motivated by profit, just the same as any general business, it has to be in accordance with the basic principles of Islam, such as, practising "non-interest-based transactions", maintaining the competitors' rights and consumers' rights, and ensuring CSR (fair-trade, environment-friendly production, labour rights). Eventually, the profit from business will help to eradicate social problems including poverty.

Hence, typically, the method of "SB" in capitalism and the "ISB" method, cannot be the same. ISB has to follow the fundamentals of Islam. However, in this new financial order, all risks and returns must be taken into account by any type of business, which is common for both SB and ISB.

The rest of the paper is organized as follows. Section 2 reviews the relevant literature; Section 3 evaluates the potential sources of funds for ISB and the sustainability of the business; Section 4 presents the ISB framework and some propositions for ISB practice; and, finally, Section 5 concludes the study.

2. The literature

Economists and social scientists have acknowledged that the capitalist concept of utility and profit maximization by economic agents (consumer and producer, respectively) cannot solve many of the social and economic problems. Neither the typical Anglo-Saxon model nor the Anglo-American model of capitalism has been successful in ensuring the basic needs of a large segment of the population. Capitalism

has therefore been tampered with several times. In the new economic and financial order, moderate capitalists have looked for a suitable approach that will ensure the socio-economic development for the underprivileged segment of population. Subsequently, some blended methods, such as, "social market economy", "coordinated market economy", "social capitalism", "Nordic capitalism" and "corporate capitalism" ("third way") have been proposed to overcome the weaknesses of pure capitalism with insignificant success. The "third sector" (refers to the role of not-for-profit and non-governmental organizations and civil society) has been proposed under "Neoliberalism" to overcome both social problems and poverty (Salamon and Anheier, 1997; PotAucek, 1999). Consequently, some socio-economic noble notions, such as "social enterprise" and "SB" (Yunus and Weber, 2009), as well as some corporate concepts, such as the "stakeholder theory" (Freeman, 1984) and "CSR" (Carroll, 1979; Boatright, 1993; Tomer, 1994; Suchman, 1995; Mcwilliam and Siegel, 2001; Deegan, 2002) have emerged. Although Kuznets (1955) hypothesis discusses the phenomenon of inequality reduction through fostering economic growth, it does not suggest any policy to contribute to the welfare for the underprivileged segment of society.

The idea of "SE" emerged in the 1990s in the USA and Europe (Borzaga and Defourny, 2001). In Europe, the idea of a "third sector" or "social economy" (voluntary organizations, co-operatives) was legalized in 1991 through the creation of the legal form of "social solidarity co-operative" Types A and B. The target group for the social enterprises were initially the people with mental and physical disabilities, women at risk, minorities, low-qualified young people, or those with a social handicap (alcohol, drug addicts). The scope of "social enterprise", however, has been growing with the rising number of social problems. At the end of 2004, about 7,100 social co-operatives were established in Europe (Defourny, 2007).

Since the framework for traditional "social enterprises" emerged from developed economies, it focuses on the "social problems" rather than poverty alleviation. However, in developing countries, poverty and inequality are of fundamental concern along with social problems. Consequently, the "social enterprises" in developed and developing economies may select their socio-economic priorities differently.

Yunus and Weber (2009) address both the poverty and social problems and focus on the social and economic problems in both developed and developing economies. Yunus and Weber (2009) and Yunus *et al.* (2010) conceptualize the "SB model" as a socio-economic problem solving method irrespective of a country's level of development.

Hence, "social enterprise" focuses more on specific social problems. In contrast, "SB" addresses both general problems, such as poverty and inequality, and specific social problems, such as education for underprivileged people; providing food, shelter, and heath support for the hard-core-poor; and supporting charities and orphanages.

In addition, Freeman's (1984) "stakeholder theory" indicates that along with the business itself, the suppliers, employees, customers, environment and society as a whole are the claimants of a business entity. The disadvantaged segment of society, therefore, deserves some corporate initiatives to be taken by the corporate world to assist them to escape from poverty.

Interestingly, all these "neoliberal" concepts are embedded in the basic principles of Islam, which have been ignored by the traditional capitalist society. "Islamic economics" emphasizes "social equality" (all social beings have equal rights in the society) and "economic equity" (everyone deserves to have the minimum required amount of wealth and income that is necessary for their livelihood) in the society.

The sources of funding (compulsory and optional) to solve social problems, and reduce poverty and inequality are also stated clearly in Islam.

Islamic key instruments to combat poverty and inequality are *Zakat*, *Sadaqah*, *Waqf* and *Qard Al-Hasan*. Islamic scholars proposed different methods to efficiently utilize these funds. For example, Al-Gari (2004) suggests establishing a non-profit financial intermediary, "Qard Al-Hasan Bank". Khan (2003) outlines a *Takaful* scheme based on *Waqf* funds. A mutual fund by utilizing *Waqf* has also been proposed by the Council of Islamic Ideology of Pakistan (Ahmed, 2004). Yusoff (2004) suggests that a *Waqf* management firm should take the responsibility for the *Waqf* institution.

Sadeq (1997) points out that poverty eradication schemes in Islam are compulsory transfer (*Zakat*), recommended transfer (charity) and state responsibility. In addition, Sadeq (2002) argues that *Waqf* is an effective instrument in poverty alleviation. The study suggests a system to develop a *Waqf* administration, which issues a *Waqf* certificate that individuals or institutions buy. This will raise *Waqf* funds and alleviate poverty.

Historically, *Waqf* funds were collected and managed by the private sector, such as non-profit institutions (known as "trusts"), the *Fuqaha* and other social leaders. However, mismanagement and corruption in *Waqf* funds induced Muslim governments to take over *Waqf* assets in many cases. Many Muslim countries have established a *Waqf* administration at the central government level. However, due to bureaucratic attitude and inefficiency, the *Waqf* fund has never proved to be a successful instrument to combat poverty (Ahmad, 2004). The Islamic Development Bank (IDB) established the "*Awqaf* properties Investment Fund" (APIF) in 2001, since when, it has been mobilizing *Waqf* funds.

Another poverty reduction instrument, *Zakat,* is presently collected by the governments of some Muslim countries. Libya, Malaysia (in different Sultanates), Pakistan, Saudi Arabia, Sudan and Yemen collect *Zakat* through government initiative (Ahmad, 2004). Although Bahrain, Bangladesh, Egypt, Iran, Iraq, Jordan, Kuwait, Qatar, Indonesia and Oman have formed specialized public institutions, the payment of *Zakat* to the government institute in these countries is on a voluntary basis (Hassan, 2010; Kahf, 1989). Ahmed (2004) suggests that a corporate structure of *Zakat* collection could prove to be an effective way of *Zakat* administration by raising awareness about *Zakat* among Muslims.

An integrated framework of *Waqf* and *Zakat* with Islamic microfinance could prove to be a strong approach to poverty alleviation (also see, Hassan, 2010). Ahmed (2004) suggests that coordination between *Zakat* and *Waqf* institutes, government agencies, non-government organizations and civil organizations is essential to create a significant impact of Islamic funds on poverty alleviation. Çizakça (1998) suggests that *Waqf* and *Mudarabah* need to be combined within the framework of Islamic banks.

Consequently, the existing literature indicates that the current management practice of *Zakat* and *Waqf* funds is inefficient. An organized and collective use of these funds with a strong institutional framework could prove efficient in the effort to eradicate poverty.

3. ISB fund management

3.1 Sources of fund

Sourcing funds is one of the great challenges for traditional "SB". In the capitalist society, all agents, such as consumers and producers are "economic men" (agents) (Mannan, 1984, 1991) who are completely motivated by "utility" and "profit",

respectively. "Economic agents" are considered to be individualistic and selfish people. If these so called "rational economic agents" change their "individualistic and selfish attitude" and become "cooperative and socially responsible people", then capital for SB could be accumulated in traditional SB. Hence, if there are people in capitalist society who are willing to spend for the betterment of the society, then funds for "SB" can be accumulated. However, unfortunately, this group of people in capitalist society is not sufficient.

Muslims are "Islamic men" (Mannan, 1984, 1991), who are economic, cooperative, socially responsible and have high morals. Subsequently, unlike "traditional SB", funds for "ISB" would not be hard to accumulate. Specifically, first, some funds can be sourced from *Zakat*, which is a mandatory contribution by the rich Muslims. Second, Muslims are motivated by religion[3] to spend for *Sadaqah*, *Waqf* and *Qard Al-Hassan*; hence, if Islamic financial institutes (IFIs), Islamic Charity Organizations (ICOs) or governments can assure a proper fund management system; the accumulation and investment of the ISB fund would be a systematic and sustainable process that would lead to the growth of ISB funds.

The sources of Islamic funds for poverty alleviation are basically two types: refundable source and non-refundable source. The refundable source of funds is "*Qard Al-Hasan*". However, non-refundable sources can be classified into two categories: compulsory sources, such as "*Zakat*", and highly encouraged but optional sources, such as "*Waqf*" and "*Sadaqah*". Figure 2 illustrates a tree for the sources of Islamic funds.

Zakat. Paying *Zakat* is compulsory for the people who own a certain minimum amount (*Nisab*) of wealth. A Muslim who is adult, sane, free (not a captive/slave), not a debtor (if compared with his/or her total assets) and possesses a certain minimum amount of additional wealth (more than necessary, i.e. *Nisab*) has to pay *Zakat*.

There are eight groups of people who are eligible to receive *Zakat* funds. *Al-Quran* states: "The alms are only for the *Fuqara*' (the poor), and *Al-Masakin* (the needy) and those employed to collect (the funds); and to attract the hearts of those who have been inclined (towards Islam); and to free the captives; and for those in debt; and for Allah's Cause, and for the wayfarer (a traveller who is cut off from everything); a duty imposed by Allah. And Allah is All-Knower, All-Wise" (*Al-Quran* 9:60):

> They ask you as to what they should spend. Say: Whatever wealth you spend, it is for the parents and the near of kin and the orphans and the needy and the wayfarer, and whatever good you do, Allah surely knows it (*Al-Quran* 2:215).

> (Alms are) for the poor who are confined in the way of Allah – they cannot go about in the land; the ignorant man thinks them to be rich on account of (their) abstaining (from begging); you can recognize them by their mark; they do not beg from men importunately; and whatever good thing you spend, surely Allah knows it (*Al-Quran* 2:273).

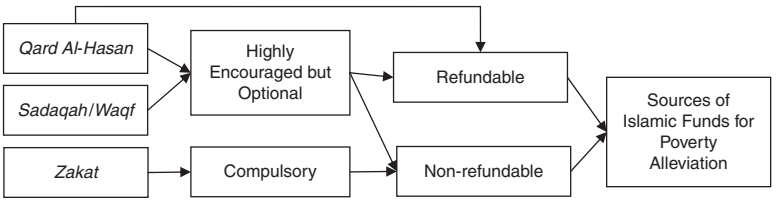


Figure 2. Classification of Islamic sources of funds for poverty alleviation

Note: A brief discussion about each source of fund is given as follows

Consequently, the following types of people are entitled to receive from *Zakat* funds: *Fuqaraa* (who does not own the *Nisab* level of wealth); *Masakeen* (extreme poor); *Aamileen* (*Zakat* collector); *Muallafatul Quloob* (newly converted Muslim who had to give up his/her wealth); *Ar-Riqaab* (to free slaves); *Ibnus-Sabeel* (traveller who needs financial assistance); *Al-Ghaarimeen* (debtors who are unable to pay back); and *Fi Sabeelillah* (*Dawah* to Islam).

Zakat can be utilized as an instrument to alleviate short-run and long-run poverty. While, *Fuqaraa*, *Masakeen*, *Aamileen* and *Al-Ghaarimeen* are immediate receivers of *Zakat*, the remaining *Zakat* is not distributed in the short-run. Hence, good management of *Zakat* funds creates the opportunity to save and mobilize *Zakat* funds for further investment.

At present, *Zakat* is distributed in three different ways: individuals' and corporations distribute *Zakat* directly to poor people; individuals' and corporations send *Zakat* to the charity institutions and the charity institutions distribute *Zakat*; and individuals' pay to governments and governments distribute it. Sometimes, the government distributes it directly to the poor segment in society. However, some governments distribute *Zakat* through charity institutions. The *Zakat* mobilization flow is given in Figure 3.

Taxation is also a similar concept that might reduce the income inequality at the cost of social polarization in the society. A progressive tax can reduce inequality by reducing the wealth of the rich people; however, it does not necessarily improve the poverty level of a society. Tax is basically a major source of government revenue and there is no pre-identified sector where the tax will be utilized. The allocation of tax revenue to alleviate poverty has therefore been the least prioritized sector to most governments in the developing world.

In contrast, there are eight specified sectors for *Zakat* distribution and almost all of them will lead to the alleviation of poverty and reduction in inequality if the *Zakat* funds are utilized efficiently.

Sadaqah. The fundamental sources of Islam (*Al-Quran and Al-Hadith*) advise Muslims to spend for charity. There are many verses in *Al-Quran* that advise humans to spend for charity[4]. For instance, the following verses of *Al-Quran* and a *Hadith* from *Al-Bukhari*, which highly encourage Muslims to spend for *Sadaqah*, are quoted here:

> And fear Allah as much as you can, listen and obey, and spend in charity for the benefit of your own souls. And those who saved from the covetousness of their own souls, they are the ones who achieve prosperity (*Al-Quran* 64:16).

> The Prophet Muhammad (s.) said, "Every Muslim must pay Sadaqah". The companions asked, "what about someone who has nothing to give?" The Prophet Muhammad (S.) replied, "then let him do something with his two hands and benefit himself. That will be charity." The companions asked, "but what if he cannot do that?" The Prophet replied, "then he should enjoin the doing of good." Still again they asked, "but what if he cannot do that?" The Prophet replied, "then he should give respite from evil, for that is a form of charity (*Al-Bukhari Adabul Mufrad*; *Hadith* No. 225).

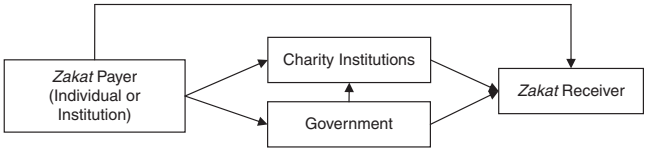


Figure 3.
Traditional distribution process of *Zakat*

Hence, well-to-do Muslims are motivated to spend for *Sadaqah*, which can generate ISB funds.

Waqf. *Waqf* is the endowment that wealthier people donate for charity in Islam. Typically, people donate buildings or plots of land or even cash for charitable purposes. According to Imam Abu Hanifa, *Waqf* is the detention of specific thinking in the ownership and devoting of its profit or products "in charity of poor or other good objects". *Waqf* is usually used to build and run *Masjid*, to fund the livelihood and education of orphans, to establish Islamic institutions and so on. *Waqf* funds are usually held and organized by charitable trusts. These funds can be used for the benefit of humankind. *Waqf* has historically played a significant role in Muslim society through establishing educational institutions, charitable hospitals, orphanages and so on (Zidani, 2010).

Waqf may or may not be conditional. The *Waqif* (the person who donates) can give the condition that the *Waqf* asset must be spent for a certain group of people, such as an "orphanage". This fund is known as *mushrut-ul-khidmat*. However, unconditional *Waqf* can be held and utilized as an ISB fund.

Qard Al-Hasan. *Qard Al-Hasan* is an interest-free-loan (beautiful loan)[5], in which the person or institution that provides the loan does not take any benefit therefrom. However, the principal amount must be paid back within a stipulated time. *Qard Al-Hasan* can be conditional. The owner of the fund may specify that the fund must be used in some particular sector, such as for charity.

Hence, Islamic financial institutions can allocate a certain amount of *Qard Al-Hasan* to invest in ISB. Subsequently, ISB institutions can invest *Qard Al-Hasan* and can grow the fund, which can be utilized to alleviate poverty and solve social problems.

Qard Al-Hasan funds can be compared with the funds in traditional SB (the SB Type I). However, it is worth mentioning that the concept of *Qard Al-Hasan* was introduced by Prophet Mohammad Bin Abdullah (PBUH) about 1,500 years ago.

Al-Qur'an encourages Muslims to practice *Qard Al-Hassan*. Some verses from *Al-Quran* regarding *Qard Al-Hassan* are given as follows:

> He who will give Allah Qard Al-hassan, which Allah will double into his credit and multiply many times (*Al-Baqarah*, 2: 245).
>
> And give Allah Qard Al-hassan (*Al-Maidah*, 5: 12).
>
> Who is he that will give Allah Qard Al-hassan? For Allah will increase it manifold to his credit (*Al-Hadid*, 57:11).
>
> And give Allah Qard Al-Hassan, it will be increased manifold to their credit (Al-Hadid, 57: 18).
>
> If you give Allah Qard Al-Hassan. He will double it to your credit and he will grant you forgiveness (*Al-Tagabun*, 64:17).
>
> Establish regular prayer and give regular charity and give Allah Qard Al-Hasan (Al-Muzzammil, 73: 20).

Prophet Mohammad (PBUH) also advised his companions to practise "*Qard Al-Hasan*". It is reported in *Ibn Hisham* and *Ibn Majah* that Prophet Mohammad (PBUH) said, "in the night of the journey, I saw on the gate of heaven written, "reward for Sadaqah is ten times and reward for Qard Al-Hassan is eighteen times". So, I asked the angel, how is it possible? The angel replied, "Because beggar who asked had already had something but a loanee did not ask for loan unless he was in need".

In another *Hadith* of "*Sahih Al Muslim*", Abu Hurairah (R.) has reported that the Prophet (PBUH) said, "whoever relieves a believer from a difficulty in this world, Allah will relieve him from his difficulty and Allah will facilitate him in this world and world hereafter".

Hence, *Qard Al-Hasan* is a very powerful source of ISB fund. Since, this is a must refundable loan, the Islamic financial institution can easily practice this mode of financing.

3.2 Sustainability of ISB

Unorganized initiative and inefficiency. The Islamic financial industry is one of the fastest growing sectors with a double-digit annual growth for about 30 years (Iqbal and Molyneux, 2005). Dusuki (2008) indicates that Islamic banks, in the majority of Muslim countries, including the GCC regional Islamic banks, have experienced an enormous profit and excessive amount of liquidity. Islamic financial institutions may therefore endeavour to be the centre for promoting ISB. Islamic banks can fund (*Zakat*, *Qard Al-Hasan*) and invest in ISB.

Presently, many Islamic financial institutions are practising charitable activities, which include *Zakat* collection and *Zakat* distribution and allocation of *Qard Al-Hasan*. For example, Dubai Islamic Bank (DIB) allocates *Qard Al-Hasan* for marriage, medical treatment and education fees through the DIB Foundation. It also collects and distributes *Zakat* funds. Zaher and Hassan (2001) and El Qorch (2005) also indicate that Islamic Banks finance the *Qard Al-Hasan* to individuals and organizations. These funds go to the poor for their education, marriage, self-employment, medical support, shelter or other social purposes (Prelsey, 2012). There are many Islamic banks all over the world that perform similar social welfare activities through *Zakat* and *Qard Al-Hasan* funds.

However, the practise of *Qard Al-Hasan* funds differs in different Islamic financial institutions. Some Islamic banks provide the *Qard Al-Hasan* privilege to the holders of investment accounts with the respective banks; some allocate it for needy students and the economically weaker segment of people in society; while some other banks provide it to small businesses, farmers and producers who do not have access to the formal financial sector.

According to the Islamic banks and financial institutions information (IBIS, 2012), in total, 113 Islamic banks have mobilized US$686 billion assets in 27 countries in Europe, the Middle East, Asia, Africa and Australia in 2012. In addition, Islamic banks paid approximately US$1,502 million tax and *Zakat* in 2012. Figure 4 shows the amount of tax and *Zakat* paid by Islamic banks between 1990 and 2012.

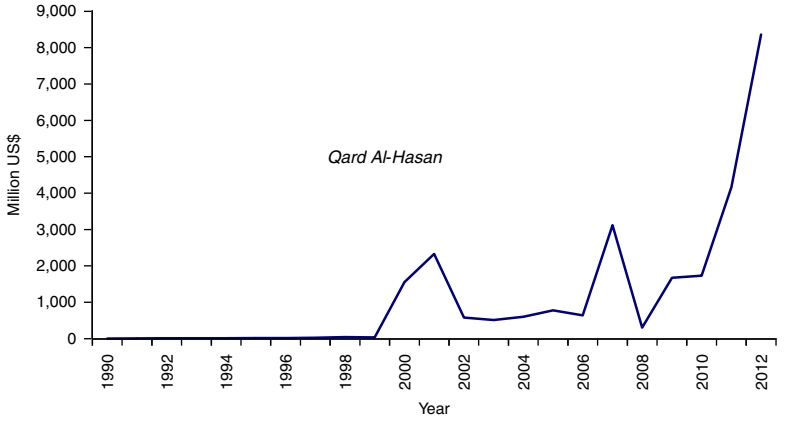
The figure indicates that there is a sharp upward trend of the amount of tax and *Zakat* paid by Islamic banks over time. Although, the tax and *Zakat* figures are not found separately in the existing databases, Figure 4 indicates that Islamic finance has been growing globally over time, as has the amount of tax and *Zakat*.

Some Islamic banks, but not all, practise *Qard Al-Hasan*, which is usually distributed, for example, for building houses, covering educational expenses and spending for marriages. Islamic financial institutions disbursed approximately US $8,358 million as *Qard Al-Hasan* in 2012 among the Muslim community, which is 1.96 per cent of total financing by Islamic banks. On average, IFIs only spend about 0.55 per cent of their total financing for *Qard Al-Hasan*. A time series statistic of Islamic banks between 1990 and 2012 is shown in Figure 5.



Source: IBIS (2012)

Figure 4.
Tax and *Zakat* paid by Islamic banks worldwide over time



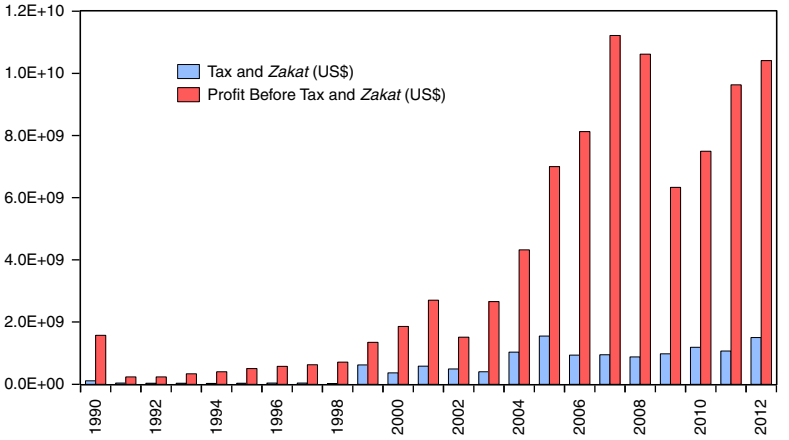
Source: IBIS (2012)

Figure 5.
Qard Al-Hasan contribution by Islamic banks worldwide over time

Statistics show that the amount of tax and *Zakat* has been growing with the growing trend of Islamic finance. However, if *Zakat* is isolated from the combined tax and *Zakat* figure (unfortunately, existing datasets do not provide the figure for *Zakat* only), the contribution to *Zakat* will be an insignificant sum. A comparison between the total profit of Islamic Banks and their expenditure for tax and *Zakat* is given in Figure 6.

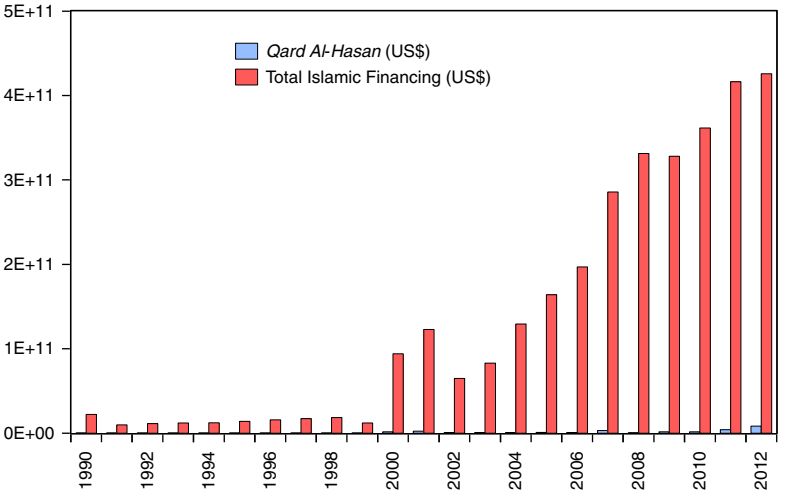
If we compare the financing for *Qard Al-Hasan* with the total financing by Islamic banks, which includes *Murabaha* and deferred sales, leasing and hire purchase, *Mudarabah*, *Musharakah*, *Salam* and *Istisna*, it can be concluded that Islamic financial institutions distribute less than one per cent in *Qard Al-Hasan* (see Figure 7). Presently, this is the only product by Islamic banks that contributes to social welfare.

Although these charitable activities by IFIs undoubtedly help the poor and reduce some sort of poverty, the efficiency of these charitable activities is questionable, as they can almost certainly improve. If funds are accumulated from different Islamic financial institutions, it will be a sufficiently large fund to invest in ISB. Second, if these



Source: IBIS (2012)

Figure 6.
Tax and *Zakat* compared to profit by Islamic banks worldwide, over time



Source: IBIS (2012)

Figure 7.
Qard Al-Hasan compared to total Islamic financing by Islamic banks worldwide

funds are collectively invested in ISB, it will be an efficient and sustainable process for poverty alleviation.

Similarly, Islamic charity organizations, such as *Rabita al-Alam al-Islami*, Islamic Relief (works for sustainable livelihood, education, health and nutrition, orphan and child welfare, water and sanitation, emergency relief and disaster preparedness), Muslim Aid (international relief and development agency), International Islamic Charity Organization (work for poor in education, health, urgent relief and development sectors), Hidaya Foundation (allocate funds in education, environment, social welfare, health care and self-employment of the poor), Amanah Ikhtiar Malaysia (microfinance organization) and many other international and local charity organizations have been collecting donations, *Sadaqah*, *Waqf* and *Zakat* funds and distributing them among

the poor. These organizations have mainly (with some exceptions) been collecting and distributing donations. However, they can be defined as ISB if they not only collect and distribute but also utilize and increase the Islamic funds.

Collective scheme and ISB: a proposal. Social responsibility is one of the key principles in Islam. Islam instructs the well-to-do Muslims to take responsibility for the poor. This responsibility partly extends to IFIs, which are capable of solving social problems and reducing poverty. Consequently, IFIs should be the key supply-side stakeholder for ISB. The initiatives that can be taken by IFIs are as follows.

First, IFIs can allocate a certain amount of *Qard Al-Hasan* for ISB and invest it as their product. Each IFI can individually invest for ISB or alternatively a group of IFIs can accumulate funds and invest in ISB on a larger scale. The fund can be raised in two ways: through the contributions of IFIs over time; and retain and reinvest the ISB profits. IFIs can withdraw the principal amount (of *Qard Al-Hasan*) once the ISB becomes self-sufficient. Subsequently, this will turn ISB into a sustainable business, which will continuously generate funds. This type of financing and investment mechanism can be defined as "Islamic social business Type I" (ISB-T1).

As a part of this initiative, IFIs need to increase the budget for *Qard Al-Hasan*. Presently, the average allocation for *Qard Al-Hasan* by Islamic banks (worldwide) is less than 1 per cent (0.55 per cent). We propose that at least 5 per cent of total financing should be allocated for *Qard Al-Hasan,* which will accelerate the eradication of poverty and provide a solution to social problems. A "*Qard Al-Hasan* Trust" can be established which will manage the *Qard Al-Hasan* funds from Islamic banks.

Second, similar to *Qard Al-Hasan* Trust, IFIs can work collectively for *Zakat* collection, utilization and distribution in the society. All IFIs in a country can establish a collective *Zakat* fund. If the government is one of the stakeholders of *Zakat*, the IFIs can propose to the respective government that as a part of the poverty alleviation scheme the IFIs will accumulate all *Zakat* from their fellow institutions. The *Zakat* has very well-defined sectors of distribution, of which some are short term and others are long term. For instance, funds for freeing captives, for travellers and for *Da'wah* are long-term expenditure. Consequently, part of the Zakat fund (long-term expenditure) can be held for ISB. IFIs may distribute *Zakat* to the short-term receivers immediately. However, the part for long-term *Zakat* receivers (if none exist) may be invested in ISB to speed up poverty alleviation.

Third, Islamic charity organizations or IFIs can collect *Sadaqah*, *Waqf* and *Zakat* from individuals and institutions. In the case of conditional *Sadaqah* and *Waqf*, the fund has to be utilized in a specified sector indicated by the donator; however, unconditional *Sadaqah* and *Waqf* can be utilized in ISB.

Over time, these funds will grow and can then partly be distributed among the poor and the rest can be re-invested in business. These funds belong to the poor, and, therefore, can be termed as "Islamic social business Type II" (ISB-T2).

For example, the IDB has been practising some sort of ISB-T2. A brief discussion about IDB's fund management and growth is given as follows.

The IDB established a *Waqf* Fund in 1979, which was a trust fund to support Muslims of non-member and less-developed member countries. *Waqf* net assets stood at US$1,328 million by the end of 2012 (IDB, 2013). The APIF of the IDB was established in 2001. The objective was to invest and develop *Waqf* real estate properties following the principles of *Shariah*. By the end of 2012, the value of *Waqf* assets increased to US$71.8 million. Between 2001 and 2012, APIF approved

US$850 million for 40 projects in 20 countries. The World *Waqf* Foundation (WWF) was founded in 2001 to support *Waqf* organizations, alleviate poverty and solve social problems (such as education, health and other social and cultural support). The WWF has been growing and contributing significantly to Muslim communities over time.

The *Waqf* fund, APIF and WWF by the IDB are examples of the ISB initiative. Islamic financial institutions and Islamic charity organizations all over the world can take similar initiatives at the country level.

4. ISB framework

If a concept is not contradictory to the fundamental law of *Shariah*, we do not need to change that concept. We therefore do not want to change the notion about the type of "SB". If funds come through "*Qard Al-Hassan*" (or Islamic microfinance), we call the business "ISB-T1"; and if funds are generated from *Sadaqah*, *Zakat*, *Waqf* or any other donation, we call the business "ISB Type II". Therefore, the following framework may be suggested for ISB (Figure 8).

An efficient and extensive use of Islamic microfinance and *Qard Al-Hasan* funds through ISB (Type I) should significantly contribute to poverty eradication. International development organizations, governments and financial institutions may provide finance (non-interest based) to establish Islamic microfinance institutions (in some countries they already exist, such as Amanah Ikhtiar Malaysia). Islamic banks may consider the establishment of such business projects (ISB) as their social responsibility.

Second, both Islamic financial institutions and Islamic charity organizations can accumulate and efficiently utilize Islamic obligatory contributions as well as optional contributions, such as, *Zakat*, *Waqf*, *Sadaqah* and other charity funds. Although these funds can be used to solve social problems, they should not be limited to solving social problems and may be utilized for poverty alleviation.

The objective of ISB is to alleviate poverty and solve social problems, which, ultimately, will reduce social inequality. "Solving social problems" includes ensuring health facilities (pure drinking water, minimum nutrition), medical support, educational funds and housing facilities for the poor. ISB may also address other social problems in the society. A certain amount of annual income and self-sufficiency of a poor household can be considered as the standard of poverty reduction. This may vary across countries.

A collective initiative by Islamic financial institutions and Islamic charity organizations through ISB will significantly reduce poverty, and, therefore, social inequality.

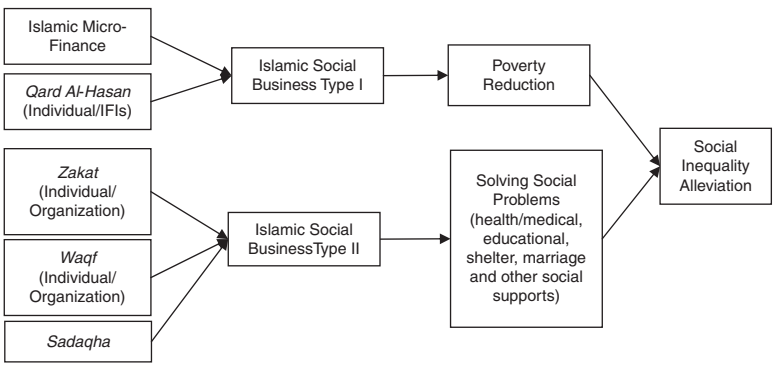


Figure 8.
Islamic social business model

ISB can be "new entities" or "reshaped entities" from existing ones. Some salient features (but not limited to) of the ISB mechanism are highlighted as follows.

4.1 ISB Type I

P1. (Not-for-profit business) Islamic financial institutions will provide "*Qard Al-Hasan*" for ISB. A group of professionals will run the usual PLS business who will receive remuneration from the business. Profit will be used to pay back the "*Qard Al-Hasan*" in a lump-sum amount or through an instalment basis. IFIs can change a reasonable amount of administrative costs in addition to the principal amount. Once the total loan has been repaid, the profit will be partially distributed among the poor people and the receiver of funds will be encouraged to invest it in some productive sectors. The rest of the profit will be re-invested in the ISB. Contributing to the not-for-profit business will be an opportunity for IFIs to address their social obligation, "CSR".

P2. (ISB products) Islamic financial institutions will set aside an amount of funds for ISB. The bank itself will invest the (*Qard Al-Hasan*) funds simultaneously with its own regular products (investments). Different accounts will be maintained for the IFIs' own business and for ISB. When the ISB product matures, i.e., ISB product starts generating profit, then, gradually, the principal amount will be withdrawn from the ISB and once repayment has been completed, IFIs will continue running ISB products. The profit will be partially used for poverty reduction and the rest will be re-invested. The professionals involved who run the ISB products, will be given remuneration from the ISB profit. Similar to *P1*, this may also be considered for IFIs as community service:

P3. (Microfinance without interest) Islamic financial institutions will train-up poor people in SME business and provide them with small and medium size loans as *Qard Al-Hasan*. The IFIs will monitor the business until the principal amount is paid back. Alternatively, "social collateral" (see Besley and Coate, 1995; Hulme and Mosley, 1996) can be used to finance the *Qard Al-Hasan*. The principal amount along with the administrative expenses can be obtained from business profit. Once repayment has been completed, then the poor people will be completely responsible for their own business. Although apparently there is no incentive for IFIs, through this mechanism, IFIs can serve their CSR:

P4. (Microfinance with PLS/Mudarabah microfinance) Islamic financial institutions will finance microenterprises on a PLS basis and financially insolvent clients will manage the business. This financing can also be based on other Islamic banking products, such as *Bay'-mu'ajjal*, *murabaha*, *ijarah* and *ijarah wa iqtina'*. Both IFIs and poor people will benefit from the profit of the business:

P5. (Pro-poor human capital) A share of the ISB profit, which will be generated from any or all of the above-mentioned types of business, will be utilized to establish the vocational training institutes for the poor people. The poor will be provided vocational training for free, which will lead to pro-poor human capital growth in the society.

4.2 ISB-T2

P6. One of the Islamic financial institutions (or a specialized "*Zakat* Trust") can take responsibility for accumulating *Zakat* from all the Islamic banks in the country and distributing a reasonably large amount of funds to some selected poor households. Professionals from IFIs can guide the receivers (of *Zakat*) to establish a small enterprise. As identified earlier, there are some long-run *Zakat* distribution sectors, such as freeing the captives and spending for wayfarers, which are not regular phenomena. If there is no receiver of such *Zakat* funds, the Islamic financial institutions can invest these funds in certain Islamic Bank products. Unlike *P2*, this investment does not require any return for Islamic banks except the remuneration for the professionals involved.

P7. Islamic charity organizations or IFIs can collect *Waqf*, *Sadakah* and *Zakat* from general people and institutions. At the time when these funds are collected from the sources, the IFIs will clearly inform the donators that their *Waqf* and *Sadaqah* funds will be invested in ISB, and the remuneration of the staff who will be involved in ISB, will be paid from the ISB. The profit will be re-invested for the expansion of ISB. A share of the profit will be distributed among the poor every year. However, *Zakat* funds can be utilized following *P6*.

P8. Finally, *Sadaqah* and *Zakat* can be accumulated and can be partially disbursed among the poor for their consumption. However, the balance of the funds will not be given to poor people as cash, instead, an Islamic charity organization or IFI will set-up businesses for the poor and will give them training for SME business. Selected poor people will run their businesses and both the capital and profit will belong to them.

ISB can be innovative, which will generate more ideas to alleviate poverty and social inequality.

5. Conclusion

Social business, social enterprise, stakeholder theory and CSR are the contemporary thoughts and innovations that suggest the world should be diverted from "selfish" capitalism to "selfless" social capitalism. However, these are embedded and compulsory responsibilities for Muslims.

One of the teachings of Prophet Mohammad (PBUH) is that the rich cannot sleep contentedly while his neighbour sleeps hungry. Prophet Mohammad (PBUH) has not only ordered the payment of *Zakat* – which is one of the fundamental pillars of Islam – but also highly encouraged the practice of *Qard Al-Hasan*, and the spending of *Sadaqah* and *Waqf* to alleviate poverty. *Zakat*, in Islam, is not considered as a contribution by rich Muslims to the poor, it is rather considered as a right of the poor people to the wealth of rich Muslims. *Sadaqah* and *Waqf* are the transfer payments from wealthy people to the poor that the rich have to practice to perform their duty towards "one brotherhood" (see footnote 3).

Due to the religious commitments, IFIs (compared to the traditional financial institutes) should play a greater role in ensuring social and economic welfare through

the equitable distribution of income and wealth, social justice, environmental balance and promoting economic development.

In the last three decades, the Islamic finance industry has been experiencing continuous development and growth all over the world, which proves the superiority of Islamic financial management. However, the key objective of this industry is to not only earn profit and to sustain in a challenging environment, but also to serve humankind. Consequently, this is perhaps the right time for IFIs to take responsibility for the poor and underprivileged people in the society, and to attempt to solve the social problems.

Islamic charity organizations, especially IFIs can introduce "ISB products", perhaps by utilizing their own funds, but definitely by allocating *Qard Al-Hasan*. IFIs can mobilize these funds and contribute to mitigating social problems and reducing poverty. Second, either IFIs or Islamic charity organizations or both can collectively accumulate *Zakat*, *Sadaqah* and *Waqf* funds and can initiate ISB at a larger scale.

Finally, in addition to the propositions suggested in this study, IFIs can apply diversified financial instruments and mechanisms that can promote ISB, encourage entrepreneurship amongst the poor, and, consequently, alleviate poverty and reduce social inequality.

Further research direction

Empirical analysis of the current practises of *Qard Al-Hasan,* and *Zakat* collection and distribution by Islamic banks, as well as the utilization of the *Waqf* fund by Islamic charity organizations will give further insights into the potential of ISB operation. Furthermore, utilizing Islamic banking products, such as *mudaraba* and *murabaha* mechanisms, can be considered in different forms in ISB. It is also worth mentioning that the responsibility of the state (which is beyond the scope of this study) in alleviating poverty and reducing inequality may also be investigated in further research.

Notes

1. *Al-Quran*, in several occasions, has ordered the capable Muslims to pay *Zakat* (see, e.g. *Al-Baqarah*: *Ayat* 43, 83, 110, 177). In his last sermon, Prophet (PBUH) reminded about *Zakat* which is a compulsory obligation for wealthy Muslims. Prophet Mohammad (PBUH) says: "O People, listen to me in earnest, worship Allah, say your five daily prayers (Salah), fast during the month of Ramadan, and give your wealth in Zakat. Perform Hajj if you can afford to".
2. Muslim are only allowed to make transactions of capital, such as, *Qard Al-Hasan* and can take the capital amount back; however, any type of interest is clearly prohibited in Islam. *Al-Quran* states, "But Allah has permitted business and forbidden Riba (interest)". Prophet Mohammad (PBUH) stated in the "last sermon", "O people […] Allah has forbidden you to take usury (interest), therefore all interest obligation shall henceforth be waived. Your capital, however, is yours to keep. You will neither inflict nor suffer any inequity".
3. Allah says: "The Believers are but a single Brotherhood" (*Al-Hujurat* 49:10). Muslims all over the world constitute one brotherhood and help each other. Rich Muslim has the responsibility to help the poor Muslim. In fact, as human all capable people are responsible to help the entire mankind. Prophet (PBUH) in his 'last sermon' says: "All mankind is from Adam and Eve, an Arab has no superiority over a non-Arab nor a non-Arab has any superiority over an Arab; also a white has no superiority over black nor a black has any superiority over white except by piety and good action. Learn that every Muslim is a brother to every Muslim and that the Muslims constitute one brotherhood".

4. *Al-Quran* has highly encouraged people to spend for charity. It could be in the form of *Sadaqah* or *Waqf*. See, for example, *Al-Baqarah*: 83, 117, 261, 263, 265, 267, 270, 274, 276, 277; *Al Imran*: 92, 134; *An Nesaa*: 77, 162; *Al Maaidah*: 12, 55; *Al A'raaf*: *Ayat* 156.
5. "Abdullah Yusuf" Ali, in "The meaning of the Holy Qur'an" has translated *al-qard al-hasan* as beautiful loan. *Al-Quran* has also encouraged people to practise "*Qard Al-Hasan*". See, for example, *Al Maaidah*: 12. For detail about *Qard Al-Hasan*, also see: www.albaraka.com.pk/glossary/qs.php

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Corresponding author
M. Nusrate Aziz can be contacted at: nusrate@yahoo.com

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