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# THE IMPACT OF GOVERNANCE, ADMINISTRATIVE AND ORGANIZATIONAL STRUCTURE ON PERFORMANCE OF ZAKAT DISTRIBUTION IN MALAYSIA



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NORLIZAWATI BINTI ABD RAHMAN



Perpustakaan Tuanku Bainun  
Kampus Sultan Abdul Jalil Shah



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OF ZAKAT DISTRIBUTION IN MALAYSIA

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## ABSTRACT

This study was conducted to investigate the impact of governance and administrative mechanism on the distribution performance of zakat institutions; and to determine the differences in distribution performance across four types of zakat organizational structure in Malaysia. Secondary data were employed in obtaining data from 2010 to 2016. Tobit and Ordinary Least Squares (OLS) regression were used for the purpose of hypothesis testing, as well as the Kruskal-Wallis test. Regression analyses found that governance mechanisms of board size ( $\beta=0.070$ ;  $p=0.001$ ) and audit committee meetings ( $\beta=0.178$ ;  $p=0.001$ ) were positively correlated with financial efficiency of distribution performance. Besides, board size ( $\beta=0.031$ ;  $p=0.001$ ), board meetings ( $\beta=0.049$ ;  $p=0.001$ ), summary of audit committee report ( $\beta=0.143$ ;  $p=0.001$ ) and shariah committee meetings ( $\beta=0.075$ ;  $p=0.001$ ) were significantly associated with quality of distribution performance ( $R^2=0.740$ ). Conversely, administrative mechanism of bank agent ( $\beta=0.010$ ;  $p=0.001$ ) correlated negatively with the quality of distribution performance ( $R^2=0.740$ ). The study provided new evidence that there were significant difference in quality of distribution performance across different types of zakat organizational structure which included, “centralized without corporation under special enactment” was significantly different to “centralized with fully corporation” ( $p=0.001$ ) and “centralized without corporation” ( $p=0.001$ ); “decentralized without corporation” was significantly different to “centralized with fully corporation” ( $p=0.005$ ) and “centralized without corporation” ( $p=0.001$ ). The study concluded that the implementation of governance and administrative mechanism in zakat institutions have been carried out effectively but the critical weaknesses must be addressed. This study also signified that zakat institutions should provide the standard for the financial record which consistent with the payment behaviour by the zakat payer in order to control the issue of zakat surplus and review the current *haddul kifayah* used as distribution policy which is believed to be no longer relevant as the living cost is increasing.





## KESAN TADBIR URUSAN, PENTADBIRAN DAN STRUKTUR ORGANISASI TERHADAP PRESTASI AGIHAN ZAKAT DI MALAYSIA

### ABSTRAK

Kajian ini dilaksanakan untuk mengenalpasti kesan mekanisme tadbir urus dan mekanisme pentadbiran dalam mempengaruhi prestasi agihan zakat; dan mengenalpasti perbezaan yang wujud dalam prestasi agihan zakat diantara empat jenis struktur organisasi zakat di Malaysia. Data sekunder digunakan untuk memperoleh data dari tahun 2010 hingga 2016, analisis regresi Tobit dan Ordinary Least Square (OLS) digunakan untuk menguji hipotesis, serta ujian Kruskal Wallis. Analisis regresi mendapati bahawa mekanisme tadbir urus iaitu saiz lembaga ( $\beta=0.070$ ;  $p=0.001$ ) dan mesyuarat jawatankuasa audit ( $\beta=0.178$ ;  $p=0.001$ ) adalah berhubungan positif dengan prestasi kecekapan kewangan agihan zakat. Selain itu, saiz lembaga ( $\beta=0.031$ ;  $p=0.001$ ), mesyuarat lembaga ( $\beta=0.049$ ;  $p=0.001$ ), ringkasan laporan jawatankuasa audit ( $\beta=0.143$ ;  $p=0.001$ ) dan mesyuarat jawatankuasa syariah ( $\beta=0.075$ ;  $p=0.001$ ) adalah berhubungan positif dengan kualiti prestasi agihan ( $R^2=0.740$ ). Sebaliknya, mekanisme pentadbiran iaitu ejen bank ( $\beta=0.010$ ;  $p=0.001$ ) berhubungan negatif dengan kualiti prestasi agihan ( $R^2=0.740$ ). Kajian ini memberikan bukti baru bahawa terdapatnya perbezaan yang signifikan dalam kualiti prestasi agihan merentas empat jenis struktur organisasi zakat iaitu, “berpusat dan tiada sebarang aktiviti pengkorporatan dibawah akta khas” terdapatnya perbezaan yang signifikan diantara “berpusat dan dikorporatkan” ( $p=0.001$ ) dan “berpusat tanpa dikorporatkan” ( $p=0.001$ ); “tidak berpusat tanpa dikorporatkan” terdapatnya perbezaan yang signifikan diantara “berpusat dan dikorporatkan” ( $p=0.005$ ) dan “berpusat tanpa dikorporatkan” ( $p=0.001$ ). Kesimpulan kajian ini adalah pelaksanaan mekanisme tadbir urus dan mekanisme pentadbiran di institusi zakat telah dijalankan dengan efektif namun kelemahan yang kritikal perlu diberikan perhatian. Kajian ini mencadangkan agar institusi zakat menyediakan piawaian rekod kewangan yang selaras dengan amalan pembayaran pembayar zakat bagi mengawal isu berhubung lebihan zakat dan mengemaskinkan kadar yang ditetapkan dalam haddul kifayah semasa yang digunakan sebagai dasar menetapkan agihan yang dipercayai tidak lagi relevan memandangkan kos sara hidup yang semakin meningkat.



## TABLE OF CONTENTS

	<b>Pages</b>
<b>DECLARATION OF ORIGINAL WORK</b>	<b>ii</b>
<b>DECLARATION OF DISSERTATION</b>	<b>iii</b>
<b>ACKNOWLEDGMENTS</b>	<b>iv</b>
<b>ABSTRACT</b>	<b>v</b>
<b>ABSTRAK</b>	<b>vi</b>
<b>TABLE OF CONTENTS</b>	<b>vii</b>
<b>LIST OF TABLES</b>	<b>xiii</b>
<b>LIST OF FIGURES</b>	<b>xv</b>
<b>LIST OF ABBREVIATIONS</b>	<b>xvi</b>
<b>LIST OF APPENDICES</b>	<b>xvii</b>
<b>CHAPTER 1 INTRODUCTION</b>	<b>1</b>
1.1 Introduction	1
1.2 Background of the Study	2
1.3 Problem Statement	5
1.4 Research Objectives	10
1.5 Research Questions	11
1.6 Research Framework	12



1.7 Hypotheses	13
1.8 Significance of the Study	14
1.8.1 Theoretical Aspect	14
1.8.2 Methodological Aspect	15
1.8.3 Practical Aspect	16
1.9 Scope and Limitation of the Study	17
1.10 Operational Definition	20
1.10.1 Zakat	20
1.10.2 Zakat institutions	21
1.10.3 Zakat performance	21
1.10.4 Governance	22
1.10.5 Administrative Mechanism	24
1.10.6 Size	25
1.10.7 Organizational Structure	25
1.11 Summary	26
<b>CHAPTER 2 LITERATURE REVIEW</b>	<b>27</b>
2.1 Introduction	27
2.2 Zakat Concepts and Background of Zakat Institutions in Malaysia	28
2.2.1 Definition and Objective of Zakat	28
2.2.2 Development of Zakat Institutions in Malaysia	30
2.2.3 Management of Zakat Institution in Malaysia	32

2.2.4 Issues in Zakat Distribution Performance	47
2.3 Research Theory	52
2.3.1 Agency Theory	52
2.3.2 Stewardship Theory	55
2.3.3 Principal-Agent Relationships from A Stewardship-Agency Perspective	56
2.4 Organizational Performance	60
2.4.1 Measuring Performance of Non-Profit Organizations	61
2.5 Governance	64
2.5.1 Principle of Governance	66
2.5.2 Governance Mechanisms	69
2.6 Shariah Governance	74
2.6.1 Function of Shariah Governance	75
2.6.2 Shariah Governance Mechanisms	76
2.6.3 BNM Governance of Shariah Committee	79
2.7 Organizational Structure	80
2.7.1 Decentralization and Corporatization	81
2.8 Prior studies on Zakat Distribution Performance Measurement	82
2.9 Development of Hypotheses	85
2.9.1 Governance Mechanism	85
2.9.2 Administrative Mechanism	99
2.10 Size of Institution (Control Variable)	100

2.11 Summary	101
--------------	-----

## **CHAPTER 3 METHODOLOGY 102**

3.1 Introduction	102
------------------	-----

3.2 Research Design	103
---------------------	-----

3.3 Sample Selection Technique	105
--------------------------------	-----

3.3.1 Sources of Data Collection	107
----------------------------------	-----

3.4 Research Model	109
--------------------	-----

3.5 Construction of Variables	110
-------------------------------	-----

3.5.1 Dependent Variable	110
--------------------------	-----

3.5.2 Independent Variable	115
----------------------------	-----

3.5.3 Control Variable	122
------------------------	-----

3.6 Data Analysis Method	124
--------------------------	-----

3.7 Summary	125
-------------	-----

## **CHAPTER 4 ANALYSIS OF RESULTS AND RESEARCH FINDINGS 126**

4.1 Introduction	126
------------------	-----

4.2 Data Screening	127
--------------------	-----

4.2.1 Dealings with Missing Observation	127
---	-----

4.2.2 Dealings with Outliers	129
------------------------------	-----

4.3 Regression Analysis Assumption Test	131
---	-----

4.3.1 Normality Test	131
----------------------	-----

4.3.2 Linearity Test	136
----------------------	-----

4.3.3 Heteroscedasticity	136
4.3.4 Multicollinearity Test	138
4.4 Descriptive Statistics	139
4.4.1 Descriptive Analysis for Dependent Variable and Independent Variable	139
4.4.2 Distribution of Sample by Type of Organization	143
4.4.3 Correlation Analysis	144
4.5 Initial Analysis	148
4.5.1 Financial Efficiency of Distribution Performance Analysis	150
4.5.2 Quality of Distribution Performance Analysis	151
4.6 Results from Hypothesis Testing	151
4.6.1 Financial Efficiency of Distribution Performance Model	152
4.6.2 Quality of Distribution Performance Model	159
4.6.3 Result of Control Variable	165
4.7 The Difference in Performance Score across Four Types of Zakat Institutions	166
4.8 Summary of Research Findings	167
4.9 Summary	170
<b>CHAPTER 5 DISCUSSION OF RESULT AND CONCLUSION</b>	<b>172</b>
5.1 Introduction	172
5.2 Discussion of Research Finding	173
5.2.1 Zakat Distribution Performance	173

5.2.2 Governance mechanisms	175
5.2.3 Administrative mechanisms	182
5.2.4 Size of Institution	183
5.2.5 Zakat Distribution Performance Across Different Types of Organizational Structure	184
5.3 Significance of Study	185
5.4 Limitation of Research	188
5.5 Suggestions for Future Research	190
5.6 Summary of Study	191
<b>REFERENCES</b>	193
<b>APPENDICES</b>	209

## LIST OF TABLES

Table No.		Pages
1.1	Statistic of Zakat Collection and Distribution in Malaysia for the Year 2010 until 2012	6
2.1	List of Zakat Institutions and Types of Institutional	35
2.2	Definition of the Eight Categories of <i>Asnaf</i>	41
2.3	Categories of Household Members in the Determination of <i>Haddul Kifayah</i>	43
2.4	Monthly Haddul Kifayah in Selangor	45
2.5	Monthly Haddul Kifayah in Terengganu	46
2.6	MCCG 2012 Principles and Elaboration	68
3.1	List of Zakat Institutions in Malaysia	106
3.2	Actual Distribution Score Based on Shafie Mazhab	113
3.3	Total Difference of Maximum Score	114
3.4	Example Calculation for the Amount of the Difference Score on Eight Categories of <i>Asnaf</i>	115
3.5	Summary of the Variables and Measurements	123
4.1	Descriptive Statistics for All Variables Including Observation with Missing Values	128
4.2	Normality Test	134
4.3	Descriptive Statistics for All Variables	140
4.4	Distribution of the Sample according to Types of Organization	144
4.5	Correlation Matrix of the Independent Variables and Control Variable	147
4.6	Performance of Zakat Distribution	149



4.7	Hypothesis Testing Results Using Tobit Regression: Financial Efficiency of Distribution Performance Model	154
4.8	Hypothesis Testing Results Using OLS Regression: Quality of Distribution Performance Model	161
4.9	Summary of Research Findings	168





## LIST OF FIGURES

Figure No.		Pages
1.1	Research Framework	12
2.1	Position Principal Agent on Zakat Governance	54
2.2	Six Core Principles of Good Governance Source: The Independent Commission on Good Governance in Public Services	69
2.3	Internal Mechanism Factor of Good Governance	71
2.4	Four Pillars of Shariah Governance Model	78
4.1	Multinormality Test (Residual): Financial Efficiency of Distribution Model	135
4.2	Multinormality Test (Residual): Quality of Distribution Model	135







## LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
BNM	Bank Negara Malaysia
COSO	Committee of Sponsoring Organizations of the Treadway Commission
IFSB	Islamic Financial Services Board
IIA	Institute of Internal Auditors
JAWHAR	Department of Awqaf, Zakat and Hajj
MAIN	Majlis Agama Islam Negeri
MCCG	Malaysian Code of Corporate Governance
OECD	Organisation for Economic Co-operation and Development
SAC	Shariah Advisory Committee
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific



## LIST OF APPENDICES

- A Univariate Outlier (Z-Score)
- B Mahalanobis Distance ( $D^2$ ) And P-Value ( $\chi^2$ )
- C Leverage Plot
- D Heteroscedasticity Test (Financial Efficiency of Distribution Model)
- E Heteroscedasticity Test (Quality of Distribution Model)
- F Collinearity Diagnostics
- G Kruskal-Wallis Test



## CHAPTER 1

### INTRODUCTION



#### 1.1 Introduction

Organizational performance essentially denotes the ability of a company in managing the resources. The challenges towards the best organization performance are not limited for the company but also faced by several types of institution such as public and private sectors, profit and non-profit institutions, as well as cooperative. Zakat institutions as a non-profit organization are no exception on this matter. In addition, these institutions are the prime agent appointed to manage zakat funds provided by payers. The zakat institutions are the trusted body to distribute the zakat collection for *asnaf* (zakat recipient) according to the Islamic laws. For this reason, the best practice of governance is looking as the mechanism, which could enhance the distribution performance of zakat institution. Hence, this study tries to investigate the impact of governance and administrative factors, as well as organizational structure on performance of zakat



distribution in Malaysia. This chapter begins with the background of the study, followed by problem statement, research objectives, research questions and hypotheses; continue with significant of the study, scope and limitations; and the operational definition of terms.

## 1.2 Background of the Study

Zakat plays an important role in life of the Muslims. It is a compulsory act of worship for all Muslims besides the other pillars in Islam (Muneeza, 2017). Zakat is the third from the five pillars of Islam and is pertaining the welfare of fellow human beings (Akram & Afzal, 2014). It is the pillar that seeks to give back to the society by transferring a certain amount of wealth at the rates fixed, to some categories of recipients based on the rates fixed (Bremer, 2013). Others clarify that zakat creates love and brotherhood between the poor and rich (Ahmad Fahme & Muhammad Ridhwan, 2014). Therefore, zakat institution is a perfect system that can help in poverty alleviation within the society (Hossain, 2012). The eight eligible receivers are clearly indicated in al- Qur'an (Surah at-Taubah, 60), namely the poor; the needy; zakat administrators (*amil*), new Muslims member (*mualaf*), slaves (*ar-riqab*), people in debt (*gharimin*), Muslims who strive for Allah (*fisabilillah*), and the travellers (*ibnu sabil*) (Mohd Rodzi, Roshaliza, & Mohd Nazli, 2013). Generally, zakat is important to the financial and structure of economic in shifting reserves of the assets and shared with the community (Qardawi, 2009); which may help to close the gaps between the rich and the poor.

The management of zakat has been practiced earlier by Prophet Muhammad, s.a.w. which focused on the welfare of poor and needy and increases the brotherhood among Muslims who are new converts in Islam until the new law of zakat are revealed (Hafizah, Siti Khalilah, Rahayu, & Siti Nur Zahirah, 2016). Prophet Muhammad s.a.w. has set upon a strong foundation in zakat administration, such as the principle of separation of powers; the distribution of tasks; recording; and enforcement elements in the management of zakat. The Qur'an clearly mentions that either departments of state or a public fund body are the officials appointed as zakat administrators (*amil*) (Qardawi, 2009). Today, zakat administrations are systematically managed by the committee appointed in recognition from state or an Islamic organization in the absence of an Islamic state (Adetunji, 2017).

In Malaysia, Majlis Agama Islam Negeri (MAIN) administers zakat institution, or known as "Baitul Mal". There are fourteen zakat institutions under each MAIN, and are being coordinated by the Department of Awqaf, Zakat and Hajj (JAWHAR). Mainly, JAWHAR was formed to promote zakat institutions as well as to increase efficiency of MAIN in all states across the country, since different enactments are formulated separately in each states (Norazlina & Abdul Rahim, 2013). This is due to the circumstances that zakat administration practiced is different between each state. For example, the councils in the state of Selangor, Pulau Pinang and Sarawak, have privatised both their zakat collection and distribution. In the Federal Territory of Kuala Lumpur, Negeri Sembilan, Melaka and Pahang, only their zakat collection units are privatised (Azman, Mohammad, & Syed Mohd Najib, 2012).



Zakat institution is a non-profit organizations established to implement all matters related on collecting and distributing zakat to qualified recipients (Eza Ellany, Mohd Rizal, & Mohamat Sabri, 2014). The institution exercises the power and authority over an organization on behalf of the community it serves. In order to become the survivor of the Islamic service provider to community, the institutions have collect zakat and effectively distribute the funds to the recipients (Sani Adamu & Ram Al Jaffri, 2016). For this reason, the implementation of governance practices is significantly important in order to ensure its sustainability in long-run (Zaemah & Norhafiza, 2016) especially in zakat institutions. Prior studies (Hafizah, Azizi, & Ram Al Jaffri, 2016) find that the equitable distribution of zakat income in society could be achieved through the effectiveness of zakat management.



In the context of zakat institutions, governance refers to the procedure and structure in managing and directing the activities of the organization. It is important towards increasing the social welfare of zakat recipients as well as establishing accountability to the zakat payers. According to Norazlina and Abdul Rahim (2013, 2015) believed that good governance is one of the mechanisms significant in improving the management of the zakat distribution system and its performance. This is consistent with Eza Ellany et al. (2014) that the efficiency of zakat distribution performance can influence the zakat collection in the future. Therefore, the implementation of good governance is perceived to bring significant impact towards the efficiency of zakat institutions in Malaysia.





### 1.3 Problem Statement

Generally, current performance of the zakat institution in Malaysia is highly encouraging, especially in the aspect of zakat collection. Based on the statistics of JAWHAR (2014), in year of 2014, approximately RM 2,472 million have been successfully collected from the payers which showed that zakat collection has increased by 9.09% as compared to RM 2,248.2 million in the previous year (Refer **Table 1.1**). A significant improvement of zakat collection is likely caused by many factors, including easy payment methods either by online or offline system (Nor Asiah, Nathasa Mazna, Nurul Aini, & Izlawanie, 2016) and the corporatization efforts by zakat institutions (Norazlina & Abdul Rahim, 2013, 2015). Although the zakat institutions were successful in the collection function year by year, but records lower efficiency in zakat distribution (Ismail & Masturah, 2014). This phenomenon depicts to Malaysian society that zakat distribution performance does not have good performance contradict with zakat collection that grow averagely each year. The discussions below explained the problem concerning about the performance of zakat distribution have continued to be unresolved issues.





Table 1.1

*Statistic of Zakat Collection and Distribution in Malaysia for the Year 2012 Until 2015*

Zakat Institution	Total Collection (RM Million)				Total Distribution (RM Million)				Surplus/ (Deficit) of Zakat (Percentage)			
	2012	2013	2014	2015	2012	2013	2014	2015	2012	2013	2014	2015
JZNK	105.8	110.0	134.1	140.3	99.7	105.9	110.8	145.0	6	4	17	(3)
TBS	50.8	69.5	67.3	68.6	36.8	35.2	40.5	45.0	28	49	40	34
LZS	451.3	517.3	582.3	627.2	401.7	463.5	595.1	676.3	11	10	(2)	(8)
PUZ	72.3	80.8	82.2	88.3	70.1	71.6	80.1	101.3	3	11	3	(15)
MAIWP	408.0	491.2	538.6	563.4	272.0	328.4	419.2	608.7	33	33	22	(8)
MAINS	N/A	78.9	88.2	95.2	61.5	76.8	97.8	96.9	N/A	3	(11)	(2)
MAIM	44.0	53.1	58.3	66.0	49.0	54.0	57.2	72.0	-12	(2)	2	(9)
MUIP	N/A	115.8	109.3	118.1	N/A	94.8	109.0	113.4	N/A	18	0	4
MAIJ	N/A	200.6	212.8	240.0	143.3	159.5	191.4	244.2	N/A	20	10	(2)
MAIPk	103.2	111.8	120.0	136.3	82.1	101.6	130.3	164.3	20	9	(9)	(21)
MAIP	78.9	115.0	162.3	N/A	N/A	99.1	104.5	123.6	N/A	14	36	N/A
MAIK	113.2	134.1	144.6	161.9	100.4	134.4	151.2	196.7	11	(0)	(5)	(21)
MAIDAM	107.1	120.9	120.1	126.6	84.6	67.4	79.2	122.0	21	44	34	4
PZS-MUIS	48.9	49.2	52.8	61.8	36.9	49.9	65.0	72.9	25	(1)	(23)	(18)

Sources: Majlis Agama Islam Negeri (MAIN) and Department of Awqaf, Zakat and Hajj (JAWHAR)







The inefficiency of zakat institutions in managing the zakat distribution is clearly proved when there are surplus of zakat not being distributed (Eza Ellany et al., 2014). In year 2014, as the states of Sarawak, Perlis and Terengganu had recorded high percentage of unallocated fund by 40%, 36% and 34% respectively. According to Eza Ellany et al. (2014) if the average of zakat surplus is more than 22.8%, the financial performance of zakat distribution is low. It is very surprising when comparing between the total amount of zakat collection and zakat distribution in Malaysia; whereby there are more than RM 241.6 million (9.77%) of the funds not being allocated. There are some factors that contributed to the surplus of undistributed zakat funds (Abd Halim, Nor Azizah, Norida, & Nur Zehan, 2015). One reason is the trend of paying zakat at the end of the year, and the zakat institutions are unable to distribute the fund in the same year. Secondly, the amount of zakat distribution yearly also depends on the distribution budget proposed by the institutions (Abd Halim et al., 2015). Although the following reasons are lawfully accepted, but when the high amount of undistributed funds are being reported, this could affect the level of confident from the payers on zakat institution, either the funds were effectively distribute or not. Therefore, this issue is also one of the setting of the problem statement of the zakat distribution performance.

The imbalance between the performance of zakat collection and distribution also lead to the recorded of deficit budget. Deficit budget happened when the total amount of distribution more than the total amount of collections. The excess of the surplus occurred due to the closing date of the financial statements in institutions for the purpose of preparing the annual report for auditing purposes. Besides, the trend of paying zakat at the end of December. Normally, the institutions will distribute the



collection until the mid of January before closing the account for distribution but still redundant. This collection will satisfy for the extremely low zakat collection from January to mid-year. Over the last 3 to 4 years some of zakat institutions experience deficit budget. In year 2015, the highest recorded of deficit budget presented by MAIK (21%) and MAIPk (21%). This trend also recorded by the other institutions and clearly showed that the performance of zakat institution was unable to manage the financial appropriately.

Currently, zakat distribution pattern of each institution is different among several states and showed the different level of efficiency on distribution performance (Hairunnizam, Sanep, Mohd Ali, & Maryam, 2016). Nevertheless, at present, there is still no standardization in the management funds among zakat institutions in Malaysia. Although the administrative structure of zakat management varies by each states, but the efficiency of the distribution have to be assessed taken together not specific to each country. Many studies have indicated that the effectiveness of zakat depends on the method of distribution and also the purpose of it (Fuadah, Ahmad Fahme, & Muhammad Ridhwan, 2015). The problem arises whether the ultimate purpose of zakat to help the Muslim community in Malaysia could be achieved through the divergent pattern of distribution among zakat institutions. Therefore, the differences in zakat distribution performance must be evaluated across several types of zakat institutions in order to examine the best practice of zakat management especially for distribution purposes.



In conclusion, the above discussions conclude that there are four major statement of problem regarding the performance of zakat distribution. The problems include: the issue of imbalance between excellence performance of zakat collection and zakat distribution; high surplus of undistributed zakat; deficit budget between zakat collection and distribution; and divergent pattern of distribution among zakat institutions. These problems to contribute the low performance in zakat distribution. Due to prolonged unresolved problems pertaining to zakat distribution performance, it shows that there are weaknesses in governance practices and supervision in the management of zakat institutions (Abd Halim, Mohamed Saladin, et al., 2015). These statements of problems have become the setting point for the further investigation on the zakat distribution performance in Malaysia. Therefore, this study evaluate several expects of zakat distribution performance views, which are the level of distribution (refers to the issue of surplus zakat and deficit budget) and also to the investigation the management functions in governance, administrative and organizational structure towards the performance of zakat distributions.





#### 1.4 Research Objectives

Based on the problem statement above, therefore the primary goal of the study is to investigate the impact of governance, administrative and organizational structure on the performance of zakat distribution in Malaysia. In particular, this research intends to achieve the following objectives:

- i. To evaluate the level of zakat distribution performance based on financial efficiency and quality of distribution;
- ii. To identify the governance mechanism, which becomes the tool that could improve the zakat distribution performance;
- iii. To evaluate the administrative mechanism that can enhance the zakat distribution performance; and
- iv. To identify the difference in zakat distribution performance across four types of organizational structure in Malaysian zakat institutions.





## 1.5 Research Questions

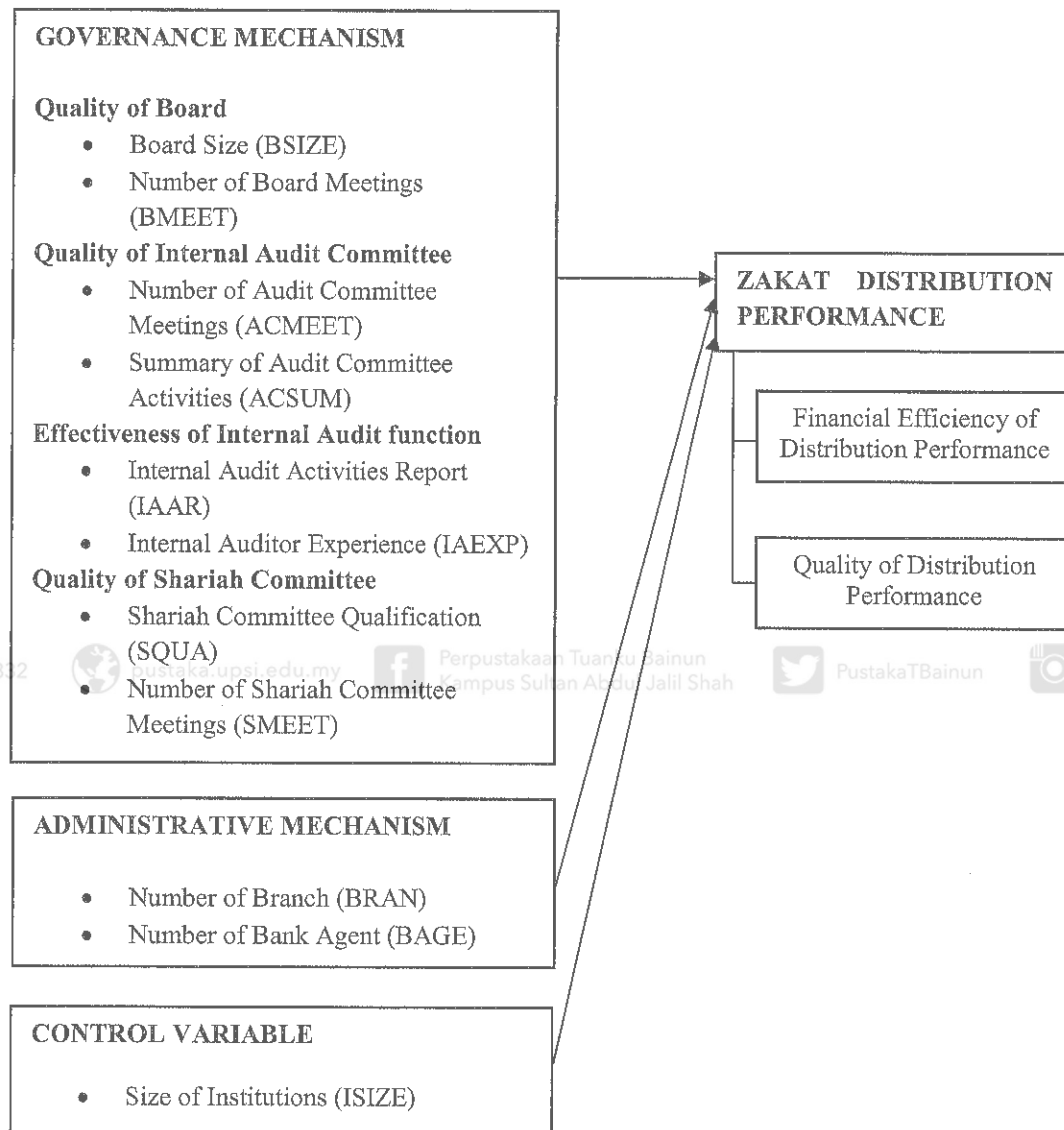
Under those circumstances, the research objectives lead to the following questions:

- i. What are the level of zakat distribution performance based on financial efficiency and quality of distribution?
- ii. What are the governance mechanism which become the best tools that could improve the zakat distribution performance?
- iii. What are the administrative mechanism that can enhance the zakat distribution performance?
- iv. Is there a difference in zakat distribution performance across four types of organizational structure in Malaysian zakat institutions?



## 1.6 Research Framework

Figure 1.1 represents the research framework model for this study:



Sources: Adaptation from Eza Ellany et al. (2014) and Norazlina & Abdul Rahim (2015)

Figure 1.1. Research Framework



## 1.7 Hypotheses

The following hypotheses have been developed:

- H1 There is a positive significant relationship between board size and zakat distribution performance.
- H2 There is a positive significant relationship between number of board meetings and zakat distribution performance.
- H3 There is a positive significant relationship between number of audit committee meetings and zakat distribution performance.
- H4 There is a positive significant relationship between summaries of audit committee activities and zakat distribution performance.
- H5 There is a positive significant relationship between internal audit activities report and zakat distribution performance.
- H6 There is a positive significant relationship between internal auditor experience and zakat distribution performance.
- H7 There is a positive significant relationship between shariah committee qualification and zakat distribution performance.
- H8 There is a positive significant relationship between number of shariah committee meetings and zakat distribution performance.
- H9 There is a positive significant relationship between number of branch and zakat distribution performance.
- H10 There is a positive significant relationship between number of bank agent and zakat distribution performance.



## 1.8 Significance of the Study

The following are the significance of the study based on the theoretical, methodological and practical aspects:

### 1.8.1 Theoretical Aspect

In this study, theories of governance are the lenses that help to understand the contemporary of zakat institutions. The theories used ideally support, predict and explain the variable of this study. In general, the objective of this study is to evaluate the relationship between governance mechanisms on the performance of zakat distribution in Malaysia. The prime theory underlying in this study is agency theory. Specifically to zakat governance, the agency relationship between the principal and the agent are among zakat payer (the principal); zakat institutions (agent); and zakat recipient (sub-agent) (Syawaluddin et al., 2016). Thus, this study also explained in detail the roles of zakat institution's governance towards the trust given of zakat payers and the transparency of zakat distribution to the recipients. However, based on agency theory alone, it cannot fully explain how governance mechanisms can act as a monitoring agent in an organization. Therefore, the stewardship theory also will be used to support governance mechanisms variables. Many previous studies provide mixed results on the theory that is suitable in describing the related organization (Donaldson & Davis, 1991). Thus, this research attempts to clarify the relationship of governance mechanisms on zakat distribution and organizational structure control mechanism, effects on zakat distribution performance in Malaysia. This study is hoped to assist and



provide reference to other researchers, especially in the field of governance in the public sector and non-profit organizations.

### 1.8.2 Methodological Aspect

This study is deemed significant due to the different components of governance mechanisms used by previous studies. In particular to the study, this research will focus on the study of governance mechanisms, namely the board of directors, audit committees, internal audit function and internal control systems in management of zakat institutions.

Although studies by Norazlina and Abdul Rahim (2013, 2015) have reviewed the mechanisms of corporate governance, but those studies only focused on the mechanism of the board and the audit committee. Therefore, this study adds another internal mechanism of governance on quality of internal audit function as the independent factors that may enhance the performance of zakat distribution.

In other Islamic country, the non-profit institution has certainly established the shariah committee to supervise and observe the shariah in terms of products, programs and operations. This is in line with the opinion of Briston and El-Ashker (1986) that shariah committee has three main roles: advisory providing, performance monitoring and the audit of zakat fund. Since, there is a gap where no research that provides on shariah governance mechanism of zakat institution in Malaysia, it is significant for the

study to review the impact of shariah governance mechanism towards enhancing the institution's performance. Therefore, this study will include the mechanisms of quality pertaining to shariah committee qualifications and number of meetings as the variable to be examined.

### 1.8.3 Practical Aspect

The practical aspect of the study can be used as a reference and guidelines by the zakat institutions to take appropriate action in order in improving the performance of zakat distribution. Input from the result of the study will help institutions to develop and execute zakat management strategies to be more effective in the future. The study will also focus on the governance mechanism that complements with the shariah governance mechanism compared to previous studies. The results of this study is hoped to be as a reference for the improvement of zakat governance in Malaysia. Besides, the study is aimed to identify the best practice between for organizational structure of decentralization and corporatization implementation in zakat institutions. As a result, the input from this research may possibly lead towards efficient performance on zakat distribution. Thus, the issue on surplus of zakat distribution could be controlled.

Finally, this study is significant to highlight the issue of distribution performance in zakat institutions. In addition, the efficient distribution of zakat will assure the Muslim community to implement the obligation of zakat through zakat institutions. At the same time, it is expected to reduce negative perception of zakat



payers and increase their confidence to continue paying zakat to the formal institution appointed. Importantly, the payers have to believe that zakat payment through zakat institutions is the best medium in the economic growth in Malaysia.

### 1.9 Scope and Limitation of the Study

The issue is related to the inefficiency of zakat distribution performance that has affected the confidence of the Muslim community, particularly the zakat payers. Two evidence of the inefficiency of zakat distribution are the surplus of undistributed zakat (Eza Ellany et al., 2014) and the failure in distributing the funds to all categories of recipients based on priority (Abd Halim, Mohamed Saladin, et al., 2015; Eza Ellany et al., 2014). Both the cause of this inefficiency has affected the confidence of zakat payers to pay funds to zakat institutions. According to Eza Ellany et al. (2014) surplus of zakat can be seen as an indicator of the financial efficiency of zakat distribution performance. Besides, the distribution of zakat by priority of *asnaf* becomes the indicative for the quality of distribution performance. Therefore, this research will study the actual performance of zakat institutions based on the surplus of zakat score (financial efficiency) and priority of *asnaf* score (quality of distribution).

Good governance brings better management to prudent allocation of the firm's resource and also enhances the performance of an organization (Brenes, Madrigal, & Requena, 2011). Zakat institutions are also of no exception in these circumstances, as the organizations also have to keep increasing their performance every year. According to Norazlina and Abdul Rahim (2013, 2015) the determinants of governance





mechanisms such as board sizes, meetings per year and audit committee have significant impact on the performance of the zakat institution.

While most studies discussed on the general perspective of governance in zakat institution in Malaysia, there is still a need for study on another view of zakat governance. As zakat institutions are mandated to receive, utilize and distribute zakat which is entrusted by Muslims community, thus, it is important to oversee the activities of Islamic financial institutions to ensure compliance with the rules and principles of Islamic law (Mediawati, 2016; Al-shammari, 2012). Thus, this study aims to evaluate governance mechanism in zakat institution, as well as shariah governance mechanism related to the quality of shariah committee in order to provide assurance of continuous shariah compliance as well as to achieve the objectives of Islamic law. Misangyi and Acharya (2014) revised several classifications of governance mechanisms and highlighted the absence of strong evidence related to the organization effectiveness. After that used together as complements (bundle) or as substitutes, as a result, it could lead to better effectiveness. With this consideration, the study have been performed to evaluate the relationship between governance mechanisms and shariah governance mechanism towards the zakat distributions performance in Malaysia.

Syawaluddin, Ananda, Manzilati, and Hoetoro (2016) provided an understanding on administrative control mechanisms, rules, and normative prominent of governance practices in zakat institutions. On the other hand, Norazlina and Abdul Rahim (2015) revealed that structural factor such as corporation, technology and number of branch also enhance the performance of zakat institutions. Since general



studied found that the organizational structure control mechanisms could enhance the performance of the institutions, thus, this study attempts to include the mechanisms as well. This study included the number of branch and bank agent as the organizational structure mechanisms that could enhance the zakat distribution performance.

The diversity of organizational practice of zakat institutions in Malaysia allows the study to evaluate the difference in zakat distribution performance across four types of zakat institutions. There are four different types of institutions, which are classified based on the administration of zakat collection and distribution activities. Some of the zakat institutions have centralized the activities and transformed into corporatization. The transformation of institutional structure may give difference performance result for their institutions. Therefore, this study also investigates the difference in zakat distribution performance across four types of zakat institutions in Malaysia.

However, this study has several limitations. The first limitation is due to the small population size with only 14 zakat institutions in Malaysia. Therefore, it could lead to difficulty to analyse the data because of the small sample size. Even so, this study attempts to address this lack of data by developing the set of zakat institutions data from seven consecutive years. In that case, the pool data analysis can be used even if the data is a panel study. Second, the difficulty in obtaining data through the annual report provided by the zakat institutions. This is due to the limitations of the information disclosed by several zakat institutions. Furthermore, not all zakat institutions produce complete annual report with all the necessary information for the study.

Under those circumstances, this study have overcome the limitations by collecting the information through the questionnaire, which covers the items on institutional background; administration and governance; and operational management of zakat collection and distribution for the past seven years. Although the study has limitation but the result could be still relevant and significant, especially for enhancing the zakat distribution management in Malaysia. Through this study, the characteristics of good governance, which is appropriate to be applied in the zakat institutions in Malaysia also could be identified.

#### 1.10 Operational Definition

Relevant terms discussed throughout the study are defined as follows:

##### 1.10.1 Zakat

Zakat is the third of the five basic pillars in Islam, which is obligatory to all the Muslims. The term zakat is derived from the Arabic word of *zaka*, which means pure and clean (Lewis, 2001). The word zakat in this study refers to spending some specific property or wealth to be given to deserving people to receive the zakat funds namely *asnaf*.

### 1.10.2 Zakat institutions

Zakat institutions, or known as “Baitul Mal” under the MAIN in each state in Malaysia, are responsible for collecting and distribution of zakat (Norazlina & Abdul Rahim, 2015). The zakat institutions in this study refers to the fourteen zakat institutions established in every state in Malaysia.

### 1.10.3 Zakat performance

Zakat performance is the effectiveness of the zakat institution in carrying out its duties would depend on several measurement such as the collection of zakat from tangible and intangible properties, systematic zakat management, efficient zakat distribution and the thoroughness of implementation of Islamic rules (Azman et al., 2012). Zakat performance in this study refers to the performance of zakat distribution based on the financial efficiency and quality of distribution.

#### 1.10.3.1 Financial Efficiency

Financial efficiency measures how productive input converted to output (Abdul Rahim, 2007). Financial efficiency in this study refers to the determined of zakat performance based on the percentage of surplus distribution. Surplus distribution refers to zakat collection which is still available and not distribute in the corresponding year.

### 1.10.3.2 Quality of Distribution

Quality of distribution is measuring the non-financial performance of zakat (Eza Ellany et. al, 2014) and can be measured based on the view recommended by Shafie mazhab (Mohamad Uda, 2005). Quality of distribution in this study is determined based on the justice of efficiency according to the priority of *asnaf* who are the only eight groups of zakat recipients who are deserving categories that qualify to receive zakat which are *Al-Fuqara'* (poor), *Al-Masakin* (needy), *Amil* (Zakat administrators), *Muallaf* (new Muslims member), *Al-Riqab* (slaves), *Al-Gharimin* (people in debt), *Fi-sabilillah* (Muslims who strive for Allah) and *Ibnsabil* (travellers).

A generic definition of governance can be used in radial categorizations of different types of governance (Torfing, Peters, Pierre, & Sørensen, 2013). In this study, governance refers to the elements in management incorporated together in formulating and implementing policies towards the effectiveness of an organization which focus on the mechanism of governance in zakat institutions, which are board, audit committees, internal audit function and shariah committee.



#### **1.10.4.1 Board**

Board is a group of leaders who are involve in monitoring and control; strategic planning; and independence (Charitou, Georgiou, & Soteriou, 2016). In this study, board refers to the group of people who are demonstrating good governance, developing the capacity and capability of the zakat institutions to be effective. The quality of board are measured by the board size and number of board meetings.

#### **1.10.4.2 Audit Committee**

Audit committee is the group of members who are monitoring overall layout of governance includes the quality, professionalism and integrity (Hasnah, 2009). In this study, audit committee refers to quality of the committee which measured by number of audit committee members and summary of audit committee activities.

#### **1.10.4.3 Internal Audit Function**

Internal audit function is the unit which involve in assessing the organizational processes and activities compliance with the management policies, procedures, standards and ethical requirements (Bursa Malaysia, 2016). In this study, internal audit function refers to the effectiveness of this unit in promoting good governance of zakat



institutions through the review of internal audit report activities and number of experience auditor.

#### 1.10.4.4 Shariah Committee

Shariah committee is an independent body and it reports directly to the board of director (BNM, 2004). In this study, shariah committee refers to the quality of this board in regulate the shariah governance through its quality which measured by the qualification or possess necessary knowledge, expertise or experience in Islamic jurisprudence (Usul al-Fiqh); or Islamic transaction/commercial law (Fiqh al-Mu'amalat) and the frequency of meetings.



#### 1.10.5 Administrative Mechanism

Administrative mechanism is the other structural factor in performing, coordinating and controlling the organization's resources. In this study, administrative mechanism are focusing on the effectiveness of the quantity of branches and bank agent in zakat institutions towards the efficiency of zakat distribution.





### 1.10.6 Size

Size of the firm always become the common control variables that influence the firm performance (Agyei-Mensah, 2016). In this study, the size of the firm indicate by the proxy natural log of total zakat collection.

### 1.10.7 Organizational Structure

Organizational structure is the management mechanism in performing, coordinating and controlling the organization's resources (Cosh, Fu & Hughes, 2012). In this study, organizational structure refers to the activities of decentralization and corporatization of zakat collection and distribution activities involve in zakat institutions which are classified as follows: (i) centralized by special enactment control with none corporation; (ii) centralized and fully corporatized; (iii) decentralized with partly corporatized; and (iv) centralized with none corporation.



### 1.11 Summary

In conclusion, this chapter discussed the basis and importance for the study on the impact of governance towards the performance of zakat distribution in Malaysia. The problem statement in this research is pertaining the surplus of zakat and the imbalanced of distribution of zakat among *asnaf*, which consequences may contribute to the lower performance of zakat distribution. Thus, the research objectives are developed to evaluate the level of zakat distribution performance based on financial efficiency and quality of distribution; to identify the governance mechanisms, which become the best tools that could improve the zakat distribution performance; and to identify the administrative mechanism that can enhance the zakat distribution performance. Besides, the study also manages to evaluate the difference in zakat distribution performance across four types of zakat institutions in Malaysia. In addition, several hypotheses are proposed to be used as directions for the study. This study contributes to the literature for other researchers, especially in the field of zakat governance, as well as guidelines to the zakat institutions in order to improve the performance of zakat distribution. The remainder chapters of the study are structured as follows. Chapter 2 discusses the literature review and presents the development of hypotheses. Chapter 3 discusses on research methodology followed by a descriptive of findings in Chapter 4. Chapter 5 discusses the findings and presents the conclusions of this study.