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ISLAMIC SOCIAL FINANCE AND THE IMPERATIVE FOR SOCIAL IMPACT MEASUREMENT

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Engku Rabiah Adawiah Engku Ali*

Abstract

This paper aims to highlight the imperative of social impact measurements in Islamic finance by exploring the growing interest of Islamic social finance and social impact. From critical review of literature, the paper finds that despite the tremendous growth of the Islamic finance industry, little is known about how Islamic finance institutions measure their social values, and how they report their social impact. The ongoing criticisms of Islamic finance failing to fulfil its “raison d’etre” and underlying objectives provides an indication of that there is a gap between its theory and practice. More focus towards developing Islamic social finance and integrating Islamic financial instruments with the mainstream social finance spectrum may help address these criticisms. In doing so, the paper posits the need to expand the definition of Islamic social finance beyond just zakāt, waqf and Islamic microfinance. Furthermore, the paper also proposes that mechanisms or frameworks for Islamic financial institutions to measure the social impact of their operations, products and services should be developed to realise the full potential of Islamic finance. This can be done through a stakeholder-based approach and assimilating frameworks of Value-Based Intermediation, Maqāṣid al-Sharī’ah, and Sustainable Development Goals.

Keywords: Islamic social finance, Social Impact Measurement, Value-Based Intermediation, *Maqāṣid al-Sharī’ah*, Sustainable Development Goals

1.0 Introduction

The Islamic finance industry has grown tremendously in the past few decades, concurrent with the progress of the Social Responsible Investment (SRI) sector. However, there are ongoing debates on the gaps between Islamic finance's theory and practices, as well as criticisms that it has failed to reach its full potential in achieving its underlying objectives (*Maqāṣid al-Sharī'ah*) through social development and impact. Among others, there is a severe lack of innovative financial tools that can help fulfil these underlying objectives while at the same time can provide the financial returns needed to ensure its sustainability.

Admittedly, despite the slow progress of developing such financial products, there has been some innovative breakthroughs. The likes of Social Impact Bonds (SIBs), Climate Bonds, Green Bonds, Vaccine Bonds, Vaccine *ṣukūk*, and Malaysia's SRI *ṣukūk* have provided evidence that financial returns and social responsibility can go hand in hand¹.

Nonetheless, there are many aspects to improve as 'impact investing' in Islamic finance is still underdeveloped as the question of whether the returns of innovative 'socially-responsible' products in Islamic finance actually reflect the impact that they have towards the society remain unanswered. Furthermore, to what extent do these socially responsible products fulfil the *Maqāṣid al-Sharī'ah* of Islamic finance and do they affect Islamic financial institutions (IFIs) in helping realise Sustainable Development Goals (SDGs)? Evidently, guidelines or frameworks on how social impact should be measured is still lacking in the industry.

There is an increasing realisation that there is a need for better ways to account for the social, economic and environmental value that results from financial activities². Often, the language used to describe this phenomenon varies, including: 'impact', 'returns', 'benefit', and 'value'. Nonetheless, the questions of what sort of a

¹ Syed Marwan and E. R. A. Engku Ali, "Sustainable and Responsible Investment (SRI): Trends and Prospects", *Jurnal Muamalat*, 9 (2016), 1-21.

² J. Nicholls, "A Guide to Social Return on Investment", The SROI Network, accessed on 25 August 2018, <http://www.socialvalueuk.org/app/uploads/2016/03/The%20Guide%20to%20Social%20Return%20on%20Investment%202015.pdf>.

difference and how much of a difference are these activities making remains the same. In recent years, the emphasis on understanding and managing this broader social value has been given more importance by stakeholders. This includes the governments who commission and invest in activities to create social value; social organisations working to create social value; investors seeking to ensure that their investments obtain social and financial returns; or private business that has come to realise the potential value from social impact of their operations³. Thus, there is a need to develop a measurement mechanism to help stakeholders understand the social values produced from financial activities, what more from institutions who inherent these values from their underlying objectives.

This paper seeks to emphasise the need for social impact measurement for Islamic finance and Islamic social finance (ISF) and thus explores the development of a Social Impact Performance Measurement for IFIs, by Integrating Social Development Goals (SDGs), Value-Based Intermediation (VBI), and *maqāṣid* of Islamic finance. In doing so the paper will look at the concepts of Islamic finance and Socially Responsible Investment in the next section. This would include the issue of ‘formalist deadlock’ in Islamic finance as well as the development of Islamic social finance (ISF). The next section then explores the topic of contemporary social finance sector including the spectrum of social finance practices and instruments. Here, the paper attempts to highlight the need to broaden the scope of Islamic social finance to be beyond just *zakāt*, *waqf*, and microfinance. The following section will then venture into social impact measurements including the importance of Islamic financial institutions to measure the social impact of their activities, products, and services. In the penultimate section, the paper explores the potential development of measuring social impact for Islamic financial institutions by integrating Value Based Intermediation (VBI), *Maqāṣid al-Sharī’ah*, and Sustainable Development Goals

2.0 Islamic Finance and Socially Responsibility Investment

The Islamic finance industry has seen tremendous growth over the

³ Ibid.

past four decades, developing comprehensive sectors of banking, capital market, and *takāful*. With the gradual convergence of standards, regulations, and infrastructure, the Islamic finance industry has also expanded across national borders, integrating into the global financial market. This growth has been concurrent with the progress of the Socially Responsible Investment (SRI) sector. The Social Investment Forum describes SRI as the integration of personal values and societal concerns with investment decisions, where investors' financial needs and investment impact on society are considered⁴.

Both sectors have outgrown their conventional financial market counterparts in recent years. With estimated assets of approximately USD2.4 trillion, and growth rate y-o-y of 11% from 2017, the Islamic finance industry has grown leaps and bounds⁵. This trend is similar in the SRI sector – in the United States alone, the estimated market size of sustainable, responsible and impact investing is estimated to be USD12 trillion in 2018, increasing 38% from USD8.7 trillion in 2016⁶. This value represents 26% of the total US assets under professional management. While the SRI study by Eurosif⁷ estimates SRI assets in 13 major European countries to be over EUR17.5 trillion. The similar growth trajectory comes to no surprise as with the growing interest from socially responsible and motivated investors following the global financial crisis of 2007-2009.

Islamic finance and SRI practices come from similar roots of religious doctrine, whereby financial objectives are aligned within religious belief. This includes focus on individual's moral

⁴ CIWM, "SRI & The Case for Islamic Investment Funds", Centre for Islamic Wealth Management, BNP Paribas, & INCEIF, accessed on 7 September 2016, <http://www.mifc.com/repository/0186SRI%20e-Book.pdf>.

⁵ Thomson Reuters, "Islamic finance Development Report: Building Momentum," Thomson Reuters, accessed on 27 November 2018, <https://repository.salaamgateway.com/images/iep/galleries/documents/20181125124744259232831.pdf>.

⁶ US SIF, "Report on US Sustainable, Responsible and Impact Investing Trends 2018", US SIF, accessed on 17 April 2019, <https://www.ussif.org/files/Trends/Trends%202018%20executive%20summary%20FINAL.pdf>.

⁷ Eurosif, "European SRI Study 2016", Eurosif, accessed on 19 July 2018, <http://www.eurosif.org/wp-content/uploads/2016/11/SRI-study-2016-LR-.pdf>.

responsibility and promotion of ethical activities, as well as striving towards social good⁸. *Shari'ah*-compliant investment is said to be a subset of SRI as there is a fusion between the two concepts. This has been translated in SRI and Islamic finance through negative screening practices where stakeholders avoid investing in companies that manufacturer 'negative' goods such as tobacco and alcohol and have socially and environmentally detrimental practices. Additionally, under Islamic finance practice, negative screening also includes exclusion of dealing with anything related to interest, gambling, and excessive uncertainty which are also seen as negative to the society at large⁹. More recently, a further proactive strategy of positive screening has been employed by stakeholders in both industries whereby there is an active and conscious search to invest in companies or financial instruments that are considered to be beneficial and provide positive impact to the society and environment¹⁰.

However, on the other hand, Balz¹¹ argues that contrary to claims, SRI and practices in the Islamic finance industry has minimal overlap. Similarly, Moghul and Safar-Aly¹² argue that whilst the conventional and Islamic finance practices have various commonalities, the worlds of SRI and Islamic finance, unfortunately, have rarely overlapped over the early years of its development until much recently. According to Balz¹³, as opposed to SRI's emphasis on

⁸ M.S. Bennet and Z. Iqbal, "How Socially Responsible Investing Can Help Bridge the Gap Between Islamic and Conventional Financial Markets", *International Journal of Islamic and Middle Eastern Finance and Management*, 6(3), (2013), 211-215.

⁹ K. Balz, "Breaking the Formalist Deadlock? Islamic Investment and Corporate Social Responsibility," in *Islamic finance: Innovation and Authenticity*, ed. S. Nazim Ali (United States of America: Islamic finance Project, Harvard Law School, 2010).

¹⁰ M.N. Barom "An Analysis of Social Responsibility Dimension in Islamic Investment Funds: Evidence from Malaysian Investors", (PhD Dissertation, Durham University, 2013).

¹¹ K. Balz, "Breaking the Formalist Deadlock? Islamic Investment and Corporate Social Responsibility.", op. cit.

¹² U.F. Moghul and S.H.K. Safar-Aly, "Green Sukuk: The Introduction of Islam's Environmental Ethics to Contemporary Islamic finance", *The Georgetown International Environmental Law Review*, 27(1), (2014), 1-60.

¹³ K. Balz, "Breaking the Formalist Deadlock? Islamic Investment and Corporate

values, mainstream Islamic finance practices tend to be more rule-oriented. He also posits that SRI and Corporate Social Responsibility (CSR) practices are stakeholder-oriented whilst Islamic finance has thus far neglected its stakeholders and underlying principles, providing more attention towards legal principles. Nonetheless, enhancing cooperation and development between SRI and Islamic finance can be beneficial and Balz¹⁴ provides several suggestions on what mainstream Islamic finance can learn from SRI. This includes the need for reorientation of Islamic finance to stakeholder perspective and focusing on values instead of making things rule-based.

2.1 The 'Formalist' Conundrum in Islamic finance

Despite the progress seen in the Islamic finance industry, there is still much contention of Islamic finance providing overwhelming focus towards legal and mechanistic aspects of *Shari'ah* compliance and financial returns whilst neglecting social impact and values. This is termed as a "formalist deadlock" by Balz (2013)¹⁵ who argues that Islamic finance practice has been more concerned with the formal adherence to Islamic legal rules while putting the substance and its true objectives of at the back seat.

Current Islamic finance Institutions' operations are often synthetically structured to be equivalent to its conventional counterparts especially in terms of economic substance. The underlying difference primarily focuses on ensuring that the operations, products and services genuinely comply with *Shari'ah* requirements as specified in the regulatory frameworks. This is affirmed by Chapra¹⁶ which questioned the authenticity of how Islamic finance has developed: "The way the Islamic financial system has progressed so far is only partly, but not fully, in harmony with the Islamic vision. It has not been able to come out of the straitjacket of conventional finance". He adds that if the Islamic

Social Responsibility.", op. cit.

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ M.U. Chapra, *Morality and Justice in Islamic Economics and Finance* (Cheltenham, UK: Edward Elgar, 2014).

finance industry does not make significant progress to achieve its genuine vision it may lose credibility, while the progress that it has made thus far may not be sustainable¹⁷.

In an attempt to address this issue, the Islamic finance industry is turning towards social finance and SRI products which have provided evidence that financial and social returns can go hand in hand¹⁸. Some progress has certainly been made, with SRI developments such as Green *ṣukūk*, vaccine *ṣukūk*, and SRI *ṣukūk* over the past few years¹⁹.

Nonetheless, there are still a lot of aspects to explore and improve as challenges to fulfil underlying values of Islamic finance persist. For example, questions remain on whether the returns of these SRI products actually reflect the impact that they give towards the society, and to what extent do these products fulfil the *Maqāṣid al-Sharī'ah* of Islamic finance and SDGs. Furthermore, the industry still lacks comprehensive guidelines or frameworks on *how* social impact is measured.

2.2 Islamic Social Finance

Islamic social finance (ISF) is defined as a sector comprising traditional Islamic institutions based on philanthropy - *zakāt*, *ṣadaqah* and *waqf*; institutions based on mutual cooperation e.g. *qard* and *kafālah*; and also the contemporary Islamic microfinance institutions²⁰. The primary objective of Islamic social finance is to

¹⁷ Ibid.

¹⁸ Syed Marwan and E. R. A. Engku Ali, "The Potential of Innovative Financial Tools: Social Impact Bond (SIB) and Sustainable and Responsible Investment (SRI) Sukuk, Towards the Sustainable Growth of the Islamic finance Industry", *European Journal of Islamic finance*, 4(March), (2016), 1-9.

¹⁹ R. Haneef, "Retail Sukuk and SRI Sukuk: The Malaysian Experience," accessed on 24 December 2018, <http://www.irti.org/English/Research/Documents/Conferences/IDB-AM-41/Retail%20Sukuk%20and%20SRI%20Sukuk-The%20Malaysian%20Experience.pdf>; IFFIm, "International Finance Facility for Immunisation Issues First Sukuk, Raising US\$ 500 million," accessed on 12 June 2015, [http://www.iffim.org/Library/News/Press-releases/2014/International-Finance-Facility-for-Immunisation-issues-first-Sukuk,-raising-US\\$-500-million/](http://www.iffim.org/Library/News/Press-releases/2014/International-Finance-Facility-for-Immunisation-issues-first-Sukuk,-raising-US$-500-million/); MIFC, "SRI & Green Sukuk: Challenges & Prospects," Bank Negara Malaysia, accessed on 25 March 2017, <http://www.mifc.com/index.php?ch=28&pg=72&ac=162&bb=uploadpdf>.

²⁰ IRTI and Thompson Reuters, "Islamic social finance Report 2017," ed. IRTI

meet the needs of the poor and to make a dent in their ever-rising levels of poverty²¹. Economic justice, inclusive participation and shared prosperity are the principles behind ISF²². These principles come from the values of Islamic philanthropy which include standard giving behaviours to meet the needs of the poor.

According to the UN Assistant Secretary-General, Sofeena Lalani (2019), ISF can help governments and communities meet a range of development needs²³. *Zakāt*, with its defined set of beneficiaries in need and rapid disbursement, can be vital for crisis response. While *waqf* is well-suited for building resilience through institutions, infrastructure, and permanent sources for funding the Sustainable Development Goals championed by the UNDP. She adds that ISF has a significant potential to address marginalisation and vulnerability when directed towards locally driven programmes promoting social and economic inclusion. While in the World Humanitarian Summit of 2016, the Sultan of Perak, His Royal Highness Sultan Nazrin Shah highlighted that ISF is one of the ways to address global shortages in humanitarian aid. He noted that the gap in humanitarian funding from the United Nations alone fell short of USD7.5 billion, and can be plugged by further developing ISF²⁴.

The potential for Islamic social finance remains unrealised. The reason being, among others, is the perceived incompetence and lack of trust towards Islamic social finance institutions²⁵. Reports estimate that most Muslim majority countries such as Indonesia, Malaysia, Pakistan, Sudan, Nigeria and even South Africa and India

(Jeddah, Saudi Arabia: Islamic Research and Training Institute, 2017)

²¹ Ibid.

²² S. Lalani, "Islamic social finance: The Future of Humanitarian Partnership?," bond.org, accessed on 9 June 2019, <https://www.bond.org.uk/news/2019/02/islamic-social-finance-the-future-of-humanitarian-partnership>.

²³ U. Modéer, "Unlocking Islamic social finance to Help Communities Address Vulnerability and Inequality," UNDP, accessed on 15 February 2019, https://www.undp.org/content/undp/en/home/news-centre/speeches/2018/Unlocking_Islamic_Social_Finance_to_Help_Communities_Address_Vulnerability_and_Inequality.html.

²⁴ H. Zainal, "Sultan Nazrin: Islamic social finance Can Address Shortages in Global Humanitarian Aid", *The Star Online*, 24 May 2016.

²⁵ N. Mustaffha, "Zakat Disbursement Efficiency - A Comparitive Study of Zakat Institutions in Malaysia", (Masters Thesis, International Islamic University Malaysia, 2007).

can totally alleviate poverty if they fully realise their *zakāt* collection²⁶. However, actual *zakāt* collected is far short of the potential. IRTI and Thomson Reuters²⁷ reported that the collections from *zakāt* can be sustainable and dependable if *zakāt*-related institutions acquire the necessary professionalism in fund-raising and continuously improve their social credibility through integrity, transparency and good governance. Globally, the Islamic Development Bank estimates the potential of *zakāt* alone to be as much as USD1 trillion²⁸.

Similarly, the potential resources that can be extracted from *waqf* are huge. In India for example, a significant number of *waqf* assets are located in prime locations such as city centres where their market value is much higher than their book value. Wherever *waqf* land have been developed efficiently, the average return generated is estimated to be approximately 20%²⁹. The resources generated, if combined with efficient *zakāt* collection, may not only alleviate poverty but can also provide a surplus to address other social issues. Further development, however, must be made in terms of *waqf* infrastructure. This includes the legal and regulatory framework, stakeholder participation, as well as more prudent and active investment of *waqf* assets³⁰.

In terms of the potential for Islamic microfinance, IRTI and Thomson Reuters³¹ argues that Islamic microfinance is better placed than its conventional counterpart to address the needs of the poor as it brings in philanthropy and cooperation into the microfinance model. This is opposed to profit-seeking conventional microfinance which may incur higher cost to beneficiaries and leave them in a debt spiral. In doing so, more unique products must be developed to fit the risk, appetite, and needs of microfinance beneficiaries³². While the demand for Islamic microfinance has been increasing, the supply has

²⁶ IRTI and Thomson Reuters, "Islamic social finance Report 2017, op. cit.

²⁷ Ibid.

²⁸ S.Lalani, "Islamic social finance: The Future of Humanitarian Partnership?", op. cit.

²⁹ IRTI and Thomson Reuters, "Islamic social finance Report 2017.", op. cit.

³⁰ Ibid.

³¹ Ibid.

³² Ibid.

been inadequate as a successful synergy between Islamic finance and Islamic microfinance has yet to materialise³³.

Evidently, ISF has great potential in addressing social and humanitarian issues. However, there is a need to expand the horizon and thinking of ISF - limiting the definition of ISF to the confines of *zakāt*, *waqf*, and Islamic microfinance may limit and impede its potential development. With the development of the Islamic finance and social finance industry there is opportunity to broaden the definition of ISF to include elements of the capital market, *takāful* and social impact. This has already been seen through the development of products such as green *ṣukūk*, SRI *ṣukūk*, vaccine *Ṣukūk*, and socially impactful Islamic crowdfunding. These products have indeed been applied to address various societal and humanitarian needs and thus should be considered as part of the ISF agenda³⁴. As shown in the following section, the contemporary “social finance” definition provides a holistic scope which would include the Islamic finance tools mentioned.

3.0 Social Finance

Social finance (SF) is simply defined as the allocation of capital primarily for social and environmental returns, and in some cases, financial returns³⁵. SF is also referred to as “three-dimensional capital” where capital is allocated according to conventional, financial, risk and return criteria and optimises a given social or environmental return. Such finance has also been referred to as ‘blended value investing’³⁶. SF is also seen beyond just simply the

³³ Ibid.

³⁴ Syed Marwan, "Social Impact Bonds in Light of Maqasid al-Shari'ah and Maslahah", *Journal of Islamic Economics, Banking, and Finance (JIEBF)*, 11(4), (2015), 31-40.

³⁵ Alex Nicholls, Rob Paton, and Jed Emerson, *Social Finance* (Oxford Scholarship Online: Oxford University Press, 2015).

³⁶ World Economic Forum, "From the Margins to the Mainstream Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors," World Economic Forum, accessed on 22 July 2019, http://www3.weforum.org/docs/WEF_II_FromMarginsMainstream_Report_2013.pdf; "Charting the Course: How Mainstream Investors can Design Visionary and Pragmatic Impact Investing Strategies " accessed on 22 July 2019, http://www3.weforum.org/docs/WEF_II_FromMarginsMainstream_Report_2013.pdf.

flow of money into social or environmental projects but also conceived as an ethos about the *way* money is being used. Hence, SF is a source of resources for social impact as well as a critique of the extent of the financial system which has caused market failure, social inequality and environmental negligence. SF, therefore, internalises the externalities of mainstream investment by setting social and environmental objectives as the *first* goal of its capital allocation strategies³⁷.

Under SF, the social investor allocates capital knowing from the start that some of the value created will be appropriated by someone else or something else (in the case of environmental investment). This is opposed to conventional investing where the assumption is that the owner of capital will appropriate *all* of the value created by his investment, referred to as ‘extractive investing’. Therefore, the separation of value creation and value appropriation allows for SF to focus on total blended social and financial outcomes across more than one interested party or stakeholder group³⁸. Over the past 2 decades, this approach has been expanded and developed from just philanthropic financial tools to further embrace multitudes of capital, investment approaches, and financial instruments³⁹.

3.1 The Spectrum of Social Finance

The social finance market has partly been developed as a response to the growing capital needs of organisations with a clearly defined social impact. Social impact organisations mainly relying on grant funding have struggled to access other sorts of finance to scale-up, often due to their projected financial returns failing to match their perceived levels of riskiness. This gap has been addressed by capital owners seeking to allocate their resources to generate social value

weforum.org/docs/WEF_ImpactInvesting_Report_ChartingTheCourse.pdf.

³⁷ A. Nicholls, "The Institutionalization of Social Investment The Interplay of Investment Logics and Investor Rationalitie", *Journal of Social Entrepreneurship*, 1(1), (2010), 70-100.

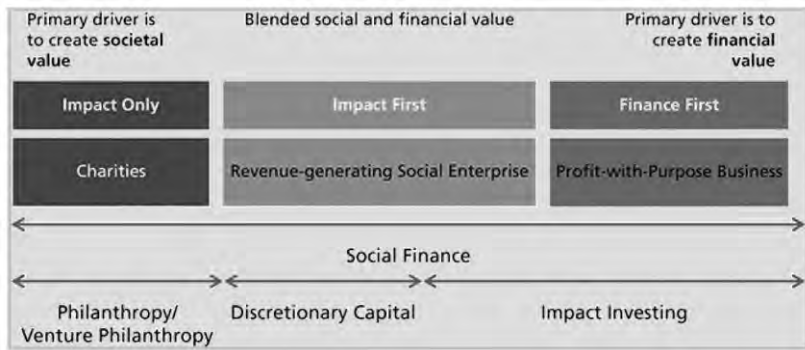
³⁸ J. Emerson, "The Blended Value Proposition: Integrating Social and Financial Returns.," *California Review Management*, 45(4), (2003).

³⁹ A. Nicholls and C. Pharoah, "The Landscape of Social Investment: A Holistic Topology Of Opportunities And Challenges," (United Kingdom: Skoll Centre for Social Entrepreneurship, 2008)

and financial returns.

Social finance includes a full range of investment strategies and solutions across asset classes that can provide an array of risk-adjusted returns tailored to investor and stakeholder intent⁴⁰. There is a wide range of these socially motivated stakeholders as seen in the social finance spectrum mapped in the figure below. The spectrum is best thought of as a total portfolio that not only includes conventional financial assets of debt and equity, but also includes grants and tailored asset types such as quasi-equity instruments or participation bonds.

Figure 1: Spectrum of Social Finance



Source: A. Nicholls et al.⁴¹

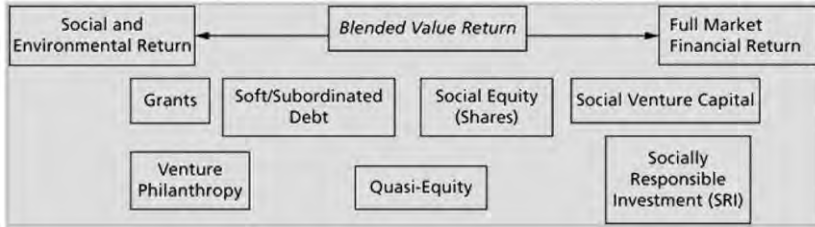
As seen in the figure, there are three main areas of social finance in the spectrum: impact-only, impact-first, and finance-first. On one end, ‘impact-only’ strives to create societal value, as seen in charities and philanthropies. Whereas on the other end, ‘finance-first’ looks towards creating financial value whilst social value *may* be obtained from it. This can be seen through profit-with purpose businesses and enterprises. While in the middle of the spectrum sits the ‘impact first’ approach which blends social and financial value, seen through social enterprises that generate revenue but prioritises

⁴⁰ Deloitte, "Social Finance: What is it and Why it Matters," Deloitte, accessed on 4 October 2018, <https://www2.deloitte.com/global/en/pages/financial-services/articles/social-finance.html>.

⁴¹ A. Nicholls, "The Institutionalization of Social Investment The Interplay of Investment Logics and Investor Rationalitie", op. cit.

social value first. These approaches can be translated through various financial instruments which are developed to address the demands of stakeholders with different degrees of social and financial values. This is shown in the following figure:

Figure 2: Spectrum of Social Finance Instruments



Source: A. Nicholls et al.⁴²

Instruments under the spectrum of social finance mapped under 3 main themes: ‘social and environmental return’ on one end to ‘full market financial return’ on the other end, while ‘blended value return’ sits in the middle. They can come in various forms such as grants, venture philanthropy, subordinated debt, equity and quasi-equity, social venture capital, as well as SRI. The position of these instruments would depend on their respective stakeholders’ expected returns as well as their underlying social and financial objectives. Where then, would Islamic finance and ISF fall under in this topology?

ISF instruments of *zakāt*, *waqf* would most likely be closer towards the ‘social and environmental return’ position, while SRI-type *ṣukūk* is likely closer to the extreme opposite, ‘full market and financial return’. In the middle may sit instruments such as vaccine *ṣukūk*, green *ṣukūk*, and socially impactful Islamic crowdfunding. What’s interesting to note here is that all these Islamic instruments are still categorised under ‘social finance’ but sit on different waves of the spectrum. On this note, the paper would like to reemphasise the need to widen the scope of definition of ‘Islamic social finance’ to be beyond just *zakāt*, *waqf*, and microfinance, but to include other instruments that also address and create social value and social impact.

⁴² Ibid.

4.0 Measuring Social Impact

Social impacts are defined as both ‘societal’ and ‘environmental’ changes - positive and negative, intended and unintended - that result from investments and activities. Societal impacts include issues such as equality, livelihoods, health, nutrition, poverty, security, and justice, while environmental impacts include issues such as conservation, energy use, waste, environmental health, resource depletion, and climate change⁴³.

While impact investing is defined as investments made into companies, organisations, and funds with the intention to generate social and environmental impact alongside a financial return. The practice of impact investing is defined by four core characteristics⁴⁴:

- i. Intention to have a positive social or environmental impact
- ii. The expectation of generating a financial return
- iii. Range of return expectations and asset classes targeted
- iv. Commitment to measure and report the social and environmental performance of investments

To know whether the impact has been achieved, it is therefore imperative for investors and institutions to have the commitment to measure and report the social and environmental performance and progress of their respective investments and operations.

4.1 Output and Impact

Social impact measurement is designed to identify changes in social impacts that result in the activities of the organisation or stakeholder⁴⁵. Most organisations measure the outputs produced (eg. Number of meals served, or jobs created). On the other hand, social

⁴³ M. J. Epstein and K. Yuthas, *Measuring and Improving Social Impacts: A Guide for Nonprofits, Companies, and Impact Investors* (San Francisco, California: Berrett-Koehler Publishers, Inc., 2014).

⁴⁴ GIIN, "The Business Value of Impact Measurement," Global Impact Investing Network, accessed on 12 January 2019, https://thegiin.org/assets/GIIN_ImpactMeasurementReport_webfile.pdf; "The Landscape for Impact Investing in Southeast Asia," Global Impact Investing Network (GIIN) & Intellectap, accessed on 12 April 2019, https://thegiin.org/assets/GIIN_SEAL_full_digital_webfile.pdf.

⁴⁵ M.J. Epstein and K. Yuthas, *Measuring and Improving Social Impacts: A Guide for Nonprofits, Companies, and Impact Investors.*, op. cit.

impact measurement assesses the ultimate impacts of those outputs on the society and the environment (eg. the quality of the meal to health, or the quality of job created to affect standard of living). The table below shows some examples of goals based on outputs as compared to that of impacts.

Table 1: Goals Based on Outputs vs. Goals Based on Impacts

Outputs	Impacts
We want to deliver meals to 10,000 homeless people	We want to reduce hunger by 5%
We want to provide 1 million insecticide-soaked bed nets	We want to reduce malaria by 5,000 cases
We want to convert 10,000 families from cooking with wood to cooking with gas	We want to reduce residential CO2 emissions by 50%
We want to teach reading to 500 primary school students	We want to increase literacy in the village by 10%

Source: Epstein and Yuthas⁴⁶

As seen in the table above, there are distinct aspects of outputs and impact, whereby it can be said that impacts are the results of outputs. It is therefore pertinent for institutions to ensure that the elements of their objectives are aligned with the expected outcomes of their investments, operations, and products in order to measure the impact that they produce.

4.2 Importance of Measuring Social Impact for Islamic Financial Institutions

As social investments continue to flow into the social finance markets, it is essential for the ISF sector to ensure that the funds' usage will have a social impact. Even conventional for-profit institutions and corporations have shown interest in understanding and managing the impact that they produce⁴⁷. Therefore, Islamic financial institutions (IFIs), the torchbearers of Islamic finance and what it represents, should also provide at least a similar initiative. As stakeholder awareness and information technology increases, social

⁴⁶ Ibid.

⁴⁷ Ibid.

issues can no longer take a back seat to profits as the expectation that companies contribute to society has never been greater. Almost all of the world’s biggest companies now routinely monitor their social impacts and produce annual sustainability reports. So far, however, IFIs have not provided the same commitment.

Taking a leaf out of the study by Epstein and Yuthas (2014)⁴⁸, IFIs and its stakeholders too should demand and commit to finding clear answers to questions such as: What are IFIs trying to accomplish? What do IFIs need to do to accomplish these goals? How do IFIs define success? How can IFIs measure success? How will IFIs know when they have succeeded? and How can IFIs do better over time? There may have been some attempts in answering these questions, but too often, the answers were not clearly understood, and in many cases, they were not clearly articulated to the stakeholders.

There are 3 main reasons for measuring impact as shown in the figure below:

Figure 3: Purpose of Impact Measurement

Measure for Learning	Measure for Action	Measure for Accountability
<ul style="list-style-type: none"> • To understand performance • To test assumptions 	<ul style="list-style-type: none"> • To guide behaviour • To communicate values 	<ul style="list-style-type: none"> • To report performance • To build relationships

Source: Epstein and Yuthas⁴⁹

The importance of measuring social impact for IFIs thus goes back again to the fundamental reason for existence (*raison d’etre*) and intended purpose of Islamic finance. To answer simply, it is to create sustainable social impact that provides betterment for the whole universe (*rahmatan lil’alāmīn*). As mentioned previously in the paper, the ‘formalist conundrum’ of Islamic finance has confined the role of IFI practices to focus on *Shari’ah*-compliance, whilst neglecting its social value and purpose. To go beyond *Shari’ah*-compliance and see whether IFIs have made any real and positive difference, they must learn to measure their performance and

⁴⁸ Ibid.

⁴⁹ Ibid.

test the assumptions of whether or not they are fulfilling their fundamental values. Without such measurements, there is no way to know if their actions have created positive social impact.

Another reason to measure, is that it forces the organisation, in this case, IFIs, to articulate their values and beliefs⁵⁰. In measuring their actions and operations, IFIs will have to understand what is being measured and decide which metrics to use. Hence, IFIs has to be clear in describing the constructs and what they represent, thus translating the underlying objectives (*Maqāṣid al-Sharī'ah*) into actionable and measurable results. Reporting impacts within the organisation can also help communicate what is valued throughout the organisation and also assists in aligning the priorities of the organisation. This in a way, becomes an automatic guide on how IFIs behave.

Finally, measuring social impact is an important measure of accountability. Stakeholders have an interest in the impact of the organisation that they are invested in and are affected by, and thus would react to the impact that they see and experience. Investors, for example, may decide on increasing or decreasing their investment depending on a particular impact measurement that they are interested in. While customers can also decide to increase or reduce their participation with the IFI. Reporting impact is also a form of engagement with stakeholders which can help improve stakeholder relationships as well as communicate the values of IFIs to attract new customers to buy-into IFIs products and services.

Ultimately, the goal of social performance measurement is to improve the social impacts valued by the organisation, its beneficiaries, as well as the Investors⁵¹.

5.0 Potential Development of Measuring Social Impact for Islamic Financial Institutions

In answering why they don't measure their impact, the common excuses given by organisations are⁵²: Measurements are too costly, misleading, difficult, and dysfunctional, but the most likely reason

⁵⁰ Ibid.

⁵¹ Ibid.

⁵² Ibid.

why organisations do not measure impact is that they simply do not know *how*.

Developing a social impact measurement mechanism can be a difficult process that requires careful planning. In general, components of impact measurement best practices should include the following⁵³:

- i. Establishing and stating social and environmental objectives to relevant stakeholders
- ii. Setting performance metrics and targets related to these objectives, using standardised metrics wherever possible
- iii. Monitoring and managing the performance of investees against these targets
- iv. Reporting on social and environmental performance to relevant stakeholders

While investment objectives and opportunities should align on at least four important dimensions⁵⁴:

- i. The social impact mission
- ii. The roles available and resources needed
- iii. The financial risk profile
- iv. Accountability requirements

Admittedly there are hundreds of ways of approaching social impact measurement. Many organisations are unsure on which approach is best for their need, while those who do finally choose the perceived best approach may be adjudged by others that they can do much better. Nevertheless, the demand for greater focus on impact measurement is increasing and organisations need to prepare. This section highlights some of the approaches that can be considered by IFIs.

The approaches to impact measurement can be divided into four basic categories⁵⁵:

- i. Trained judgment: Discussions and observations of programs by experienced professionals.

⁵³ GIIN, "The Business Value of Impact Measurement"., op. cit.

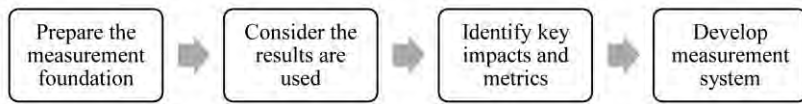
⁵⁴ M.J. Epstein and K. Yuthas, *Measuring and Improving Social Impacts: A Guide for Nonprofits, Companies, and Impact Investors.*, op. cit.

⁵⁵ *Ibid.*

- ii. Qualitative research: Systematic, in-depth research on social impacts that can include site visits, structured interviews, and focus groups.
- iii. Quantification: Data and reports in numerical form. These can include direct measurements as well as survey responses.
- iv. Monetisation: Quantitative evaluation that converts some or all of the measured impact into monetary values.

Based on the impact measurement roadmap developed by, the paper proposes 4 main steps which IFIs can undertake to develop a social impact measurement system:

Figure 4: The Impact measurement Roadmap



Source: Epstein and Yuthas⁵⁶

The first step in creating social impact is to be as clear as possible about the organisation's social mission, its products, clients, and social change goals. Therefore, IFIs must prepare the measurement foundation by defining the impacts expected to result from their operations and products, as well as other positive and negative impacts that may be produced. Then, IFIs must link planned actions to the desired results

Secondly, IFIs must determine the purpose of the measures and how they will be used. There is a cost to the measurement effort undertaken. Therefore, it is important to be selective in the choice of measurement and ensure the most accurate measurement possible is chosen. IFIs must consider the actions that will be undertaken once the results are obtained, and determine how the actions will ultimately affect the ability of IFIs to improve impacts. The measures can, therefore, be used to control behaviour of the organisation, and/or to provide better understanding of the progress of the impact throughout the life of the product or operation.

Based on this information, IFIs determine which measures are

⁵⁶ Ibid.

most critical to their mission, objectives and stakeholders, and then will choose the appropriate metrics. To identify the key impacts and metrics, IFIs must, therefore, ask the right questions, beginning with the end in mind. For example, what social problem does the IFI address? and what actions can the IFI take to solve it? Once these questions are answered and the action or product is designed, then IFIs must ask whether their plan or product is working. The fundamental question would be, is it making an impact? This is where the choice of metrics comes into play to answer the question.

Finally, IFIs develop a performance measurement system for gathering, analysing, and communicating the results and take actionable measures to improve those impacts. In developing this performance measurement system, several existing frameworks related to Islamic finance can be integrated: Value-Based Intermediation (VBI), *Maqāṣid al-Sharī'ah* of Islamic finance, as well as Sustainable Development Goals (SDG).

5.1 Value Based Intermediation

In an attempt to move the Islamic finance industry forward towards a level of growth that is sustainable with clear value propositions involving socio-economic impact, Bank Negara Malaysia (BNM)⁵⁷ introduced the Value-Based Intermediation (VBI) strategy.

VBI is defined as “An intermediation function that aims to deliver the intended outcomes of *Sharī'ah* through practices, conduct and offerings that generate positive and sustainable impact to the economy, community and environment, consistent with the shareholders’ sustainable returns and long-term interests”⁵⁸.

VBI seeks to ensure Islamic banking offerings and practices not only comply with *Sharī'ah* requirements but also achieve the intended outcomes of *Shariah*. This includes the enhancement of the

⁵⁷ Bank Negara Malaysia, Value Based Intermediation: Strengthening the Roles and Impact of Islamic finance. BNM/RH/DP 034-2, Malaysia, 2018.; Bank Negara Malaysia, Value-based Intermediation Financing and Investment Impact Assessment Framework Consultative Document. BNM/RH/DP 034-3, Malaysia, 2018. ; Bank Negara Malaysia, Implementation Guide for Value-based Intermediation. BNM/RH/DP 034-4, Malaysia, 2018.

⁵⁸ Bank Negara Malaysia, "Value Based Intermediation: Strengthening the Roles and Impact of Islamic finance.", op. cit.

well-being of the people through preservation of wealth, faith, lives, posterity and intellect. For the preservation of wealth, it includes encouragement to generate, accumulate and distribute the wealth in a just and fair manner⁵⁹.

BNM argues that VBI can provide benefits beyond the financial shareholders' but also towards wider stakeholders such as the regulators, the government, customers, the community, as well as the society at large⁶⁰. To achieve this, there must be an enabling environment which includes nurturing talent, strategic networking, enhanced disclosure, as well as performance measurement. In practice, banks must undertake: impact-based assessments; comprehensive performance measurements covering financial and non-financial indicators; implement impact-focused disclosures; venture into constructive collaboration with stakeholders; as well as engage in multi-stakeholder decision-making process.

To do so, the future landscape of the Islamic finance industry must consider performance measurement considerations of both financial and non-financial aspects that affect the society at large⁶¹.

5.2 *Maqāṣid al-Sharī'ah*

"*Maqāṣid*" is an Arabic word that is the plural of "*maqṣad*", which brings the meanings of; the straightness of a path (*istiḳāmat al-tarīq*), justice and balance (*al-'adl*), and a directive destination (*al-i'timād*)⁶². While "*Sharī'ah*" is translated as a source of water or a path towards it. The *Sharī'ah* epitomises the teachings of Islam, which establishes a set of norms, values, and laws that governs every single aspect of life. In other words, the *Sharī'ah* establishes rulings (*aḥkām*) which cover the whole belief system (*āqīdah*), the concept of morality and ethics (*akhlāq*), the relationship between man and God (*'ibādah*), and the relationship established between man and man (*mu'amalāt*)⁶³.

⁵⁹ Ibid.

⁶⁰ Ibid.

⁶¹ Ibid.

⁶² M.A. Laldin and H. Furqani, "Developing Islamic finance in the Framework of Maqasid al-Shari'ah", *International Journal of Islamic and Middle Eastern Finance and Management*, 6(4), (2013), 278-289.

⁶³ Ibid.

Under traditional classifications, *Maqāṣid* is divided into three levels: necessities (*ḍarurīyyat*), needs (*ḥājīyyāt*), and luxuries (*taḥsīniyyāt*). Abū Ḥamīd al-Ghāzalī classifies five key necessities under the *Sharī'ah* (*Al-Ḍaruriyyat al-Khams*), namely: safeguarding the people's faith (*deen*), lives (*nafs*), intellect ('*aql*), posterity (*nasl*), and wealth (*māl*)⁶⁴. While some jurists add another dimension, which is 'the preservation of honour'. These necessities are considered essential to promote the well-being of people⁶⁵.

Islamic finance seeks to ensure that financial practices and their accompanying legal instruments comply with Islamic law (*Sharī'ah*), but beyond that is the whole purpose of Islam in financial activities. Most literature on *Maqāṣid al-Sharī'ah* in Islamic finance classifies it under the protection of wealth (*ḥifẓ al-māl*) as per al-Ghazali's classification of types of *maṣlahah*⁶⁶. As finance deals with wealth allocation and appropriation (from mobilisation until utilisation), the underlying objectives of *ḥifẓ al-māl* should, therefore, be understood and discussed by looking at the nature, function and role of wealth in relation to the objective realising human wellbeing, by acquiring benefit (*maṣlahah*) and preventing harm (*maḥṣadah*). These objectives include facilitating the circulation of wealth in society, advocating fair and transparent financial practices and promoting socio-economic justice. These objectives at the end serve the financial and social needs of human beings⁶⁷.

In doing so, there must be certain means (*wasā'il*) of achieving these goals. While principles and objectives are fixed, established and permanent, the *wasā'il* are subject to change as they must be tailored to effectively realise those fixed goals in the context of ever-changing circumstances. Among others, Laldin and Furqani⁶⁸

⁶⁴ A.W. Dusuki and S. Bouheraoua, "*The Framework of Maqasid Al-Shariah (Objectives of Sharī'ah) and its Implications for Islamic finance*", (Malaysia: International Shari'ah Research Academy for Islamic Islamic finance 2011).

⁶⁵ Jasser Auda, "Maqasid Al-Shariah: an Introductory Guide," International Institute of Islamic Thought, accessed on 29 May 2013, https://www.jasserauda.net/new/pdf/maqasid_guide-Feb_2008.pdf.

⁶⁶ M.A. Laldin and H. Furqani, "Developing Islamic finance in the Framework of Maqasid al-Shari'ah", 278-89., op. cit.

⁶⁷ Ibid.

⁶⁸ Ibid.

suggest that the *wasā'il* include models such as: facilitating financial contracts, establishing values and standards, and instituting social responsibility.

Moving forward for the Islamic finance industry, fulfilling minimal *Sharī'ah* legal compliance in product structuring is viewed as insufficient. Instead, the movement towards realising aspects *Maqāsid al-Sharī'ah* is highly valued as the means to give Islamic banking and finance a meaningful presence. This would have an impact of economic substance in the form of just and fair allocation of resources, real economic sector development, and fair and transparent financial dealings with all the ethical hallmarks of brotherhood, cooperation and risk-sharing⁶⁹. This movement is also in line in achieving the SDGs as set by the UN.

5.3 Sustainable Development Goals (SDGs)

The 2030 agenda for sustainable development is an action plan set by which provides a shared blueprint for peace and prosperity for people and the planet, now and into the future. Central to this are the 17 Sustainable Development Goals (SDGs) adopted by world leaders in September 2015 at a historic UN Summit. With the SDGs in mind, countries are expected to mobilise efforts to end all forms of poverty, fight inequalities and tackle climate change, while ensuring that no one is left behind.

The SDGs are as follows:

- i. Goal 1: No poverty
- ii. Goal 2: Zero hunger
- iii. Goal 3: Good health and well-being for people
- iv. Goal 4: Quality education
- v. Goal 5: Gender equality
- vi. Goal 6: Clean water and sanitation
- vii. Goal 7: Affordable and clean energy
- viii. Goal 8: Decent work and economic growth
- ix. Goal 9: Industry, Innovation, and Infrastructure
- x. Goal 10: Reducing inequalities
- xi. Goal 11: Sustainable cities and communities
- xii. Goal 12: Responsible consumption and production

⁶⁹ Ibid.

- xiii. Goal 13: Climate action
- xiv. Goal 14: Life below water
- xv. Goal 15: Life on land
- xvi. Goal 16: Peace, justice and strong institutions
- xvii. Goal 17: Partnerships for the goals

The SDGs bring forward the unfinished business of the Millennium Development Goals (MDGs) and go even further through the 169 targets it seeks to achieve. The Goals and targets will stimulate action over the next fifteen years in areas of critical importance for humanity and the planet. The 5Ps of SDGs summarises the overall objectives:

- i. **People:** We are determined to end poverty and hunger, in all their forms and dimensions, and to ensure that all human beings can fulfil their potential in dignity and equality and in a healthy environment.
- ii. **Planet:** We are determined to protect the planet from degradation, including through sustainable consumption and production, sustainably managing its natural resources and taking urgent action on climate change, so that it can support the needs of the present and future generations.
- iii. **Prosperity:** We are determined to ensure that all human beings can enjoy prosperous and fulfilling lives and that economic, social and technological progress occur in harmony with nature.
- iv. **Peace:** We are determined to foster peaceful, just and inclusive societies which are free from fear and violence. There can be no sustainable development without peace and no peace without sustainable development.
- v. **Partnership:** We are determined to mobilize the means required to implement this Agenda through a revitalised Global Partnership for Sustainable Development, based on a spirit of strengthened global solidarity, focussed in particular on the needs of the poorest and most vulnerable and with the participation of all countries, all stakeholders and all people.

The interlinkages and integrated nature of the SDGs are of crucial importance in ensuring that the purpose of the new Agenda is

realised. If we realise our ambitions across the full extent of the Agenda, the lives of all will be profoundly improved and our world will be transformed for the better. Reflecting on Islamic finance's principles which support socially inclusive and development promoting activities, the Islamic financial sector has the potential to contribute to the achievement of the SDGs.

The World Bank Research paper by Habib Ahmed et al. (2015) on SDG and Islamic finance summarises that the role of the Islamic financial industry in supporting the SDGs will depend on the extent to which stakeholders can influence its direction⁷⁰. In order to be more effective in the implementation of the SDGs, the Islamic finance industry must strive to supply innovative mix of products, adequate governance of Islamic finance intermediaries, and a supportive legal and regulatory framework. The report also emphasised on the need for high-quality data in order for Islamic finance to contribute towards SDG.

In principle, Islamic finance support socially-inclusive, environmentally-friendly and development-promoting activities. However, in practice, the industry's contribution to these objectives has been below its potential⁷¹. Furthermore, despite the fact that it has been growing, its share globally remains small, even in Muslim countries. Therefore, more practical measures are required to enhance the contribution of the Islamic financial sector to achieve the SDGs. There are five tracks through which Islamic finance could support efforts to achieve the SDGs⁷²: financial stability, financial inclusion, reducing vulnerability, social and environmental activities, and infrastructure finance.

From this context, Islamic finance has the potential to play a major role in supporting all four of these pillars. Given the magnitude of the SDGs and the important role that can be played by Islamic finance in supporting their implementation, the opportunity to more closely link Islamic finance with sustainable development surely cannot be missed. One way to help achieve this is by IFIs

⁷⁰ Habib Ahmed, "On the Sustainable Development Goals and the Role of Islamic finance", in *Policy Research Working Paper* (World Bank Group, 2015).

⁷¹ Ibid.

⁷² Ibid.

commitment of measuring its social impact in relation to SDGs.

6.0 Conclusion

The progress of Islamic finance has been significant, but there needs to be a shift in its practice and the paradigm of its Islamic Financial Institutions (IFIs) in order for it to fulfil its underlying objectives and become sustainable. The development of Islamic social finance (ISF) may address this as its activities directly affect the social values emphasised in the theory of Islamic finance. However, similar to the Islamic finance industry, the potential of ISF remains unrealised and have fallen short of its intended objectives. This paper proposes that the development of ISF can be progressed further by looking beyond the confines of simply *zakāt*, *waqf*, and Islamic microfinance, but also towards other Islamic finance tools which also provide social values such as SRI *ṣukūk*, *takāful*, and socially-impactful Islamic crowdfunding. As such, these tools should also be seen as part of the ISF sphere thus should be considered as tools to push the ISF agenda of value creation and social impact. However, to know whether ISF and IFIs really create value, there is a need to measure the impact of their activities, services, and products. The paper proposes that an impact measurement mechanism can potentially be developed through a stakeholder approach and integrating together existing frameworks of Value Based Intermediation, *Maqāṣid al-Sharī'ah*, and Sustainable Development Goals. While it is true that measures can never fully reflect the underlying reality of IFI activities, they can still provide value in terms of learning, guiding behaviour, and also provide accountability to stakeholders. Although measurements will never be perfect, there are many ways to get closer to understanding the impact. What's important is the commitment towards implementing and continuously improving the measurement mechanisms, to fulfil the underlying objectives of Islamic finance.

TRANSLITERATION TABLE

CONSONANTS

Ar=Arabic, Pr=Persian, OT=Ottoman Turkish, Ur=Urdu

Ar	Pr	OT	UR	Ar	Pr	OT	UR	Ar	Pr	OT	UR	
ء	ء	ء	ء	ز	z	z	z	گ	—	g	g	g
ب	b	b	b	ژ	—	—	ʀ	ل	l	l	l	l
پ	—	p	p	ژ	—	zh	j	م	m	m	m	m
ت	t	t	t	س	s	s	s	ن	n	n	n	n
ث	—	—	ṭ	ش	sh	sh	ʃ	ه	h	h	h ¹	h ¹
ث	th	th	th	ص	ṣ	ṣ	ʃ	و	w	v/u	v	v/u
ج	j	j	c	ض	ḏ	ḏ	ḏ	ی	y	y	y	y
چ	—	ch	çh	ط	ṭ	ṭ	ṭ	ة	-ah	—	—	-a ²
ح	ḥ	ḥ	ḥ	ظ	ẓ	ẓ	ẓ	ال	al ³	—	—	—
خ	kh	kh	kh	ع	‘	‘	‘	—	—	—	—	—
د	d	d	d	غ	gh	gh	ğh	—	—	—	—	—
ڈ	—	—	d	ف	f	f	f	—	—	—	—	—
ذ	dh	dh	dh	ق	q	q	q	—	—	—	—	—
ر	r	r	r	ك	k	k/g	k/ñ	—	—	—	—	—

¹ – when not final
² – at in construct state
³ – (article) al - or l-

VOWELS

	Arabic and Persian	Urdu	Ottoman Turkish
Long	ا	ā	ā
	آ	Ā	—
	و	ū	ū
	ي	ī	ī
Doubled	ي	īy (final form ī)	īy (final form ī)
	و	uww (final form ū)	uvv
	و	uvv (for Persian)	uvv
Diphthongs	و	au or aw	ev
	ی	ai or ay	ey
Short	ا	a	a or e
	ا	u	u or ū
	ا	i	o or ö
	ا	i	i

URDU ASPIRATED SOUNDS

For aspirated sounds not used in Arabic, Persian, and Turkish add h after the letter and underline both the letters e.g. چ jh گ gh

For Ottoman Turkish, modern Turkish orthography may be used.

AL-SHAJARAH

Special Issue

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