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Non-Governmental Organizations (NGOs) Perspective on the Use of Sukuk for Humanitarian Initiatives

Nurul Fathiyah Kamarul Bahrin^{1,2}, Amirul Afif Muhamat^{2*},
Norzifah Abdul Karim², Mohamad Nizam Jaafar³, Nurul Najihah Zainol⁴

*Corresponding Author

¹ Faculty of Management, Universiti Sultan Azlan Shah, 33000, Perak, Malaysia

² Faculty of Business and Management, Universiti Teknologi MARA, 42300, Selangor, Malaysia

³ Arshad Ayub Graduate Business School, Universiti Teknologi MARA, 40450, Selangor, Malaysia
Suceo Retail Sdn Bhd, Pusat Teknologi Sun Suria, 47810, Selangor, Malaysia

nurulfathiyah@usas.edu.my, amirulafif@uitm.edu.my, norzifah@uitm.edu.my, mnizam7520@salam.uitm.edu.my, nurulnajihahzainol@gmail.com
Tel: +6011569260111

Abstract

The matter of inadequate financial resources for humanitarian missions has provoked a significant discourse on a global scale. The current capacity for aid is insufficient to adequately address the escalating demand, and there is growing interest in the use of sukuk, also known as Islamic bonds, as a potential new instrument for humanitarian financing. This study provides preliminary findings (from a bigger research project) based on an interview with three key informants affiliated with a non-governmental organization (NGOs) in Malaysia. While acknowledging the limitations of a small sample size, this study offers valuable insights that can inform future research endeavors.

Keywords: humanitarian sukuk; humanitarian financing; non-governmental organization; bond.

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1.0 Introduction

The humanitarian funding system necessitates a shift in mindset and alterations to its standard operating procedures. The elements of urgency, preparedness, scalability, effectiveness and flexibility should receive consideration. Furthermore, the engagement of a complete range of financial instruments, mechanisms, and partners is necessary to ensure the growth of humanitarianism is met. According to the United Nations (2022), 81.7 percent of the total required funds in the year 2023 are underfunded and do not fulfill the commitment requirements for humanitarian missions. Hence, the underfunded amount will prompt the humanitarian teams to take action. Additionally, the actions from the country and global phases must complement and be coherent with each other to ensure all the phases of the organizations.

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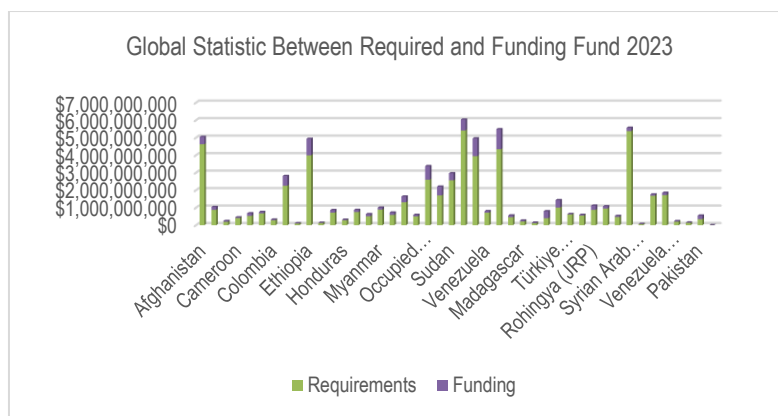


Fig. 1: Global Statistics of Required and Funding Fund in 2023.

Currently, at the global phase, the humanitarian fund is pooled under centralized country-based pooled funds (CBPF) and central emergency response fund (CERF) set up for emergency circumstances. Both of them received contributions from government, UN agencies, individuals, charities, foundations and companies. CBPF funds focus on setting up complex emergencies to ensure the funds are available when people are in need. CERF funds focus on the huge-scale sudden-onset emergencies that incur deterioration phenomena. However, issues arise in CERF funds, whereby, in terms of strategic coordination, the funds fail to be channeled out during sudden on-set emergency problems. This was proven during Myanmar's 2015 flood response, whereby CERF channels the funds after 30 days to reach secondary agencies. Additionally, CERF cannot facilitate greater subsidiary efficiencies for local NGOs, making no difference with any bilateral grant through intermediaries.

From Malaysia's insight, contributions to humanitarian activities receive significant attention from the government, companies, individuals, and non-governmental organizations. Most of the humanitarian distribution channels are from government schemes, crowdfunding, and payroll deductions. However, non-decentralized humanitarian funds present difficulties among donors in controlling the transparency of funds. The uncoordinated funds between all the NGOs, companies, and governments make it difficult for commitments to be made to fulfil humanitarian needs due to the different goals to be achieved by the entities. This has been corroborated by Mohd *et al.* (2018), who have revealed that the absence of Standard Operating Procedures (SOPs) to explicate the roles and responsibilities of humanitarian NGOs impedes the coordination of their contributions, which in turn affects the efficacy of the humanitarian distribution process.

To address the comprehensive humanitarian needs both domestically and internationally, it is essential to introduce a new financial mechanism targeted toward humanitarian purposes (Muhamat *et al.*, 2023). Given Malaysia's global reputation as a leading Islamic financial market, with the largest issuance of the sukuk market, it is conducive to streamlining humanitarian financing assistance through the issuance of humanitarian sukuk. Complementary with a humanitarian mission, non-governmental organizations will be involved in this research study as successful entities that execute humanitarian entities. In light of this it is imperative to explore the contribution of humanitarian NGOs in facilitating the use of humanitarian sukuk, thus bridging the gap in this area of study.

2.0 Overview of Sukuk for Humanitarian Financing

Sukuk, a financial instrument, is issued through a special purpose vehicle as certificates or notes for Muslims for the purpose of raising funds to finance large-scale projects. The issuance of *sukuk* complies with *Shariah*, which is Islamic religious law. It serves as a viable alternative to traditional interest-bearing bonds. Meanwhile, *sukuk* is a tradable *Shariah*-compliant capital market product providing medium to long-term fixed or variable rates of return. It provides regular periodic income streams during the investment period with easy and efficient settlement and a possibility of capital appreciation of the *sukuk*. It is also a liquid instrument and can be traded in secondary markets (Pegah, 2017). However, Stoddard *et al.* (2017), criticize the operational aspects of *sukuk* with respect to risk and structure. They give a huge weightage of costs rather than benefits, including the performance and innovation of *sukuk*. Jobst *et al.* (2008), opined that the default of *sukuk* has arisen due to the mismatches between ill-defined property rights and the choice of legal structures. In contrast, Refinitiv (2022) states that the issuance of *sukuk* in the sustainable financial market has shown tremendous growth year by year. *Sukuk* structures can be an alternative supporting financing tool to improve the social sector. The issuance of social *sukuk* can help developers get an affordable price for the house, vaccine *sukuk* for health, and *sukuk* Prihatin to overcome the COVID-19 pandemic (Bix, 2021). Henceforth, in order to address the quandary of funding for humanitarian efforts, it appears that *sukuk* could potentially serve as a viable option, despite the criticisms leveled at its operational exposure. Nonetheless, it remains in high demand among *sukuk* players.

2.1 Social Sukuk Analysis for Humanitarian Sukuk Context

Previously, novel financial instruments of a social hybrid nature had been introduced to enhance the domain of social financing. In reality, this constitutes one of the myriad endeavors undertaken to bolster the realm of socially responsible investment (SRI) through the fusion

of financial objectives with ethical tenets. Hence, a comprehensive evaluation is imperative to ascertain the merits and demerits of the extant social configuration of *sukuk* to satisfy the humanitarian context of *sukuk*.

i) Sukuk Al-Intifa'

Sukuk Al-Intifa' is a certificate of usufruct ownership that is acquired by leasing an asset or property for a specific period. The *Sukuk Al-Intifa'* structure, as explained by M. Hasan (2014), comprises the build-operate-transfer (BOT) and *ijarah* contract components. It is noteworthy that the BOT mechanism in *Sukuk Al-Intifa'* is an innovative Islamic contract that caters to the needs of contemporary infrastructure developments. Similar to the *musyarakah* concept, the BOT structure allows two parties involved in different distribution channels, where one party is responsible for financing, designing, constructing, and operating a project for a specific time. Meanwhile, the other party will recover their investment and earn a profit through the operating and charging fees of the projects. Upon maturity, the ownership will be transferred for public usage. According to Kholid *et al.* (2008), the BOT method allows both parties to have equal rights, with private companies paying finance through toll collection and the other party owning the project after the maturity term. Furthermore, the linking of the BOT method enables issuers not to be tied up with the ownership of assets.

Nonetheless, the linking between BOT and the *sukuk* structure also exposes risks. According to R.P. (2023), the embedding of BOT requires many entities, resulting in a complicated legal framework. Thus, the upfront cost needs to be considered, including the time. Additionally, the embedding of BOT also requires building institutional capacity to take full advantage of this model by conducting a fair and transparent bidding process, as well as entering into an effective dispute resolution procedure. It involves professional expertise and training.

ii) Sukuk Musyarakah based on Waqf Project

Sukuk Musyarakah has been employed to support the social sector through waqf projects in Singapore. The *musyarakah* agreement, which comprises a 70:30 profit distribution between two parties, involves one entity providing financing while the other entity provides property. The structure of *sukuk musyarakah* fulfills both local and global market demands (Shaikh *et al.*, 2017). Moreover, its *shariah* principles have gained approval from most Muslim jurists. However, there are some discrepancies between AAOIFI and Malaysia standards concerning the ruling on liquidity facility and purchase undertaking. This variation in standards may limit the contribution of issuers and investors, leading to reduced investor confidence and discouraging investment and cross-border opportunities (Samantha, C., 2017).

The involvement of *waqf* in the social sector is highly beneficial, as it is an essential institution within the Islamic social framework that efficiently utilizes selfless charitable giving for better economic impact in targeted social segments of society. Under the waqf system, an owner donates and dedicates an asset (movable or immovable) for permanent societal benefit (Shaikh *et al.*, 2017). *Waqf sukuk* represents a tradable certificate of equal monetary value that preserves money for any social projects (as the waqf assets) (Nissa, A. 2023). However, the involvement of other entities in the social sector is limited. *Waqf* institutions themselves suffer from financial shortages due to insufficient funds, leading to the inability to execute numerous development projects. Additionally, the transition period constraints between the phases of transformation to the IT system result in costs for *waqf* institutions (Hasyeilla & Selamah, 2018). Nevertheless, the government does not provide any financial support to waqf institutions, and all management and fund utilization are under their jurisdiction. Furthermore, *waqf* institutions face a lack of expertise in the development of *waqf* assets, as they have limited personnel skills and qualified manpower (Umar & Aliyu, 2019). This dilemma has a significant impact on the performance of *waqf* institutions.

iii) SRI Sukuk

The design of SRI *Sukuk* was motivated by the social impact bond (SIB) concept, which is a new financial instrument that was developed through collaborative efforts by the government, corporate sector and non-profit organizations to generate funds (Noya & Galitopoulou, 2015). The SIB structure comprises three primary parties: the public sector, private sector, and service provider, and employs the pay-for-success approach. Financial intermediaries issue *sukuk* to investors to raise capital. In return, investors receive returns based on the success of social programs. Meanwhile, funds obtained from intermediaries are channeled to service providers (NGOs) that provide social services to the targeted population (Chiapello & Knoll, 2020).

According to Kociemska & Poltorak (2021), the SIB features are derived from the partnership and risk-sharing concepts to alleviate the government's burden of covering basic social needs. The SIB structure is not limited to hybrid securities but can also be structured for donation purposes (Humphries, 2014). Therefore, regarding capital and return, the SIB utilizes the partnership concept, where the government acts as a guarantor for the payment of principal and profits. However, the SIB structure mobilizes the fixed income payment concept for the distribution of income payment, which involves the element of *riba* in the SIB structure (Ahmad *et al.*, 2019). Thus, some *Shariah* scholars argue that the SIB structure does not meet the *Shariah* requirement. However, Marwan *et al.* (2020), opined that SIB and SRI *Sukuk* issuance fulfil the requirement of the *maqasid shariah* element. Therefore, to avoid any uncertainty elements in the impact investing structure, the SRI *sukuk* structure has been developed as an alternative approach to attract the attention of investors, particularly in Muslim countries.

Table 1: A Comparison Between Social *Sukuk* Products.

	<i>Sukuk Al-Intifa</i>	<i>Sukuk Musyarakah based on Waqf project</i>	<i>SRI Sukuk</i>
Types of techniques embedded in <i>sukuk</i> structure	Build-of-Transfer	<i>Musyarakah</i> Agreement	Pay-for-Success
Global attraction for distribution channel	Yes	No (mismatch of standards)	Yes
Profit earned by the investor	Yes	Yes	Yes (Upon the success of the project)

Source: Author

3.0 Role of Non-Governmental Organizations (NGOs)

Non-governmental organizations (NGOs) have been instrumental in the community, particularly in the global humanitarian network. Their invaluable contribution entails the mobilization of resources towards addressing various challenges, such as providing aid and support to refugees in the form of shelter, food, medical care and education (Macalister-Smith, 1987). Furthermore, NGOs are active in advocating for the rights of refugees and raising awareness regarding their predicament. However, the absence of standardized operating procedures (SOPs) to coordinate the activities of different NGOs has led to a dearth of cooperation and coordination in long-term projects (Mohamad *et al.*, 2022). Additionally, the involvement of NGOs in government spheres is crucial in resolving humanitarian issues. Unfortunately, the relationship between NGOs and the State has not received the required attention (Sarah Stroup,2020).

4.0 Methodology

The present study offers a preliminary finding from a bigger segment of a comprehensive research project, specifically focusing on the potential of humanitarian *sukuk* with regard to NGOs. To accomplish this, a qualitative technique suggested by (Yin, 2018) and (Merriam, 2014) was adopted to delve into the phenomenon based on expert judgment and knowledge in their respective fields. The interviews probed themes based on the potential criteria of humanitarian *sukuk*, and the transcribed data were analyzed using Atlas Ti to identify and report the themes. The interviews were conducted online via Google Team, as requested by the key informants due to their busy schedules.

5.0 Findings & Discussion

The findings were obtained through the input of three essential informants to the criteria requirements of non-governmental organizations (NGOs) in adopting humanitarian *sukuk* as a substitute financial instrument. The informants unanimously acknowledged the potential of *sukuk* instruments as a viable alternative for humanitarian financing, particularly for the medium to long term. Nevertheless, the involvement of *sukuk* specialists is necessary, given that most volunteers come from diverse backgrounds.

“*Sukuk* represents a viable avenue for sustainable humanitarian financing, particularly for large-scale projects. However, the lack of knowledge among some members of NGOs regarding *sukuk* warrants the necessity for a skilled workforce in the financing field. Before agreeing to issue humanitarian *sukuk*, training and seminars are required. A commitment to the entity is crucial once the decision to issue humanitarian *sukuk* has been made.”

(Respondent 1)

Furthermore, there exists a noteworthy apprehension concerning the supplementary worth that may be obtained through the utilization of humanitarian *sukuk*. Similarly, the nascent advancement of humanitarian financing necessitates the resolution of all the inadequacies inherent in conventional instruments.

“The present modus operandi for obtaining funds is through crowdfunding. Although it is a swift process, public donors remain skeptical about the transparency of fund allocation and expenditure. Hence, the necessity for alternative financial instruments that do not solely rely on public funding to ensure the sustainability of humanitarian funds over a prolonged period.”

(Respondent 3)

Besides, a significant aspect of concern for the entity is the added value that is provided to the donors. These donors are charitable organizations that heavily rely on the funds provided to them.

“The inherent qualities of *sukuk* possess immense appeal for benefactors. When given attention by the government, the humanitarian *sukuk* can serve as a means to raise funds for the company. While tax relief is a contributing factor that attracts investment from other companies, the lack of such relief often leads them to seek alternative entities.”

(Respondent 2)

Additionally, the first informant places significant emphasis on the potential dangers associated with excessive subscription to humanitarian *sukuk*, given their charitable nature.

“Non-governmental organizations express concern regarding the financial instruments that may facilitate the recuperation of marketing costs and the initiation of new projects. However, it is important to note that risk exposure remains a salient factor that must be taken into account, particularly in the event of project default. The existence of protections that can effectively shield NGOs from such risks may render humanitarian *sukuk* a viable and attractive alternative solution.”

(Respondent 1)

Therefore, by the results obtained from the primary sources, the following are the abridged versions of the preceding discourse from the principal sources. The researcher has distilled that four key components are of utmost importance to NGOs concerning the potential of humanitarian *sukuk* as a viable alternative for humanitarian financing. Therefore, the four components that need to be considered are as follows:

The first point is the added value element. The NGO's insight received positive feedback regarding the replacement of new humanitarian financing. Nevertheless, the apprehension regarding the additional worth of the novel tools must be taken into account in the utilization of these newly introduced financial instruments. This is necessary to ensure the effectiveness and durability of the instruments for the organizations that can address the existing financial approaches. Therefore, the authorities need to provide comprehensive information on the novel alternative financing instrument.

The second point is government support. The support from the government can be seen as a key element that appeals to donors to engage in social finance investment, as the objectives of such investments are not profit-driven. Thus, the alternative forms of support offered by the government can serve as a valuable incentive for donors to invest in humanitarian endeavors.

The third point is the risk exposure. The main distinguishing characteristics of NGOs, especially if a default occurs, are their risk exposure. This is because they are built upon a charitable foundation. Hence, NGOs must have protective measures in place to manage any risks that may arise.

The fourth point is training staff. The sufficiency of personnel and devotion to facilitating the execution of *sukuk* in the humanitarian establishment is crucial since a large portion of the workforce originates from various backgrounds. Consequently, it is imperative to employ a committee of experts to enforce the establishment and undertake the responsibility of implementing the *sukuk* instrument within non-governmental organizations.

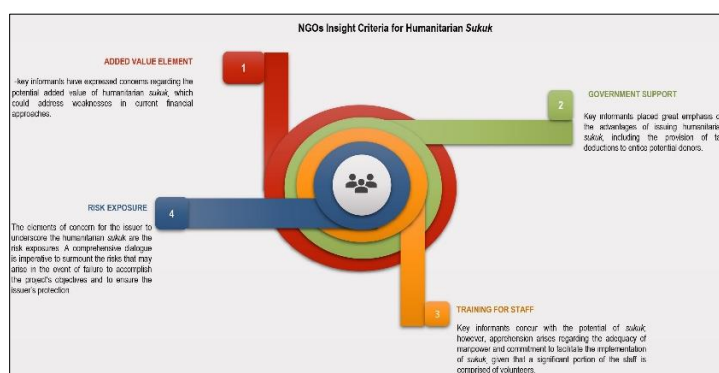


Fig. 2: Summary of Discussion Among Key Informants.

6.0 Conclusion

Humanitarian *sukuk* presents as a potential financial instrument to address the issue of humanitarian financing. However, the implementation of such an instrument for Non-Governmental Organizations (NGOs) requires a thorough discussion with policymakers. It should be noted that the adoption of humanitarian *sukuk* may not be suitable for all NGOs, particularly those that only provide humanitarian missions on a smaller scale. Nevertheless, for well-established and renowned NGOs that offer international charitable aid in larger project missions, the issuance of humanitarian *sukuk* can be highly beneficial to the entity. Furthermore, NGOs are also concerned about the risks associated with issuing humanitarian *sukuk*, especially if the project's goal is not achieved, as they are charitable organizations. Therefore, there is a need for elements of protection. Nonetheless, NGOs concur that humanitarian *sukuk* can serve as an alternative solution for humanitarian financing, particularly for significant projects. If there exist additional value components, training, and governmental endorsement, these can be incorporated. However, they only partially agree with the adoption of humanitarian *sukuk* for all NGOs.

It is imperative to recognize this particular study is constrained by the use of a limited sample size of respondents. As a result, there may be certain facets of the research that remain unexplored. Therefore, to ensure a more comprehensive analysis, the number of respondents must be increased, with due consideration given to the diversity of backgrounds and experiences within the field of social finance. The participation of the authorities is equally crucial as they are the bodies responsible for issuing policies and legislation to the organization. As a result, the implementation strategies and comprehension will be more effectively accomplished between the policymakers and NGOs. Furthermore, the absence of quantitative studies on social *sukuk* poses a significant challenge for this research, as it necessitates a reliance on the perspectives and experiences of experts without allowing an in-depth critical analysis.

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Paper Contribution to Related Field of Study

The findings of this research have the potential to enhance the understanding of scholars, humanitarian organizations, and governments regarding the utilization of sukuk as a substitute for humanitarian funding. Accordingly, this inquiry will furnish future scholars interested in Islamic social finance with valuable insights gleaned from experts in the humanitarian sector. Presently, there is limited research on sukuk within the realm of Islamic social finance and this phenomenon remains largely unexplored. The involvement of NGOs and government entities in this research endeavor has the potential to broaden the scope of knowledge on local and global humanitarian agencies.

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