

AN EMPIRICAL STUDY ON GOVERNANCE OF STATE
ZAKAT INSTITUTION AND ITS IMPACT ON ZAKAT
PAYMENT COMPLIANCE IN SAUDI ARABIA: THE
CASE OF THE GENERAL AUTHORITY OF ZAKAT
AND TAX

BY

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ABSTRACT

Zakat institutions have a crucial role within the Islamic financial system, which is to maintain the prosperity and social harmony in Muslim communities. However, the role of current zakat institutions has been insufficient, which can be attributed to two main factors, i.e. inefficient zakat management and low zakat payment compliance. Hence, this study attempted to investigate these two factors in the Saudi Arabia case which has a regulated zakat system that could produce significant impacts from zakat contributions, whether locally or even abroad. Accordingly, the study adopted a mixed-method approach to investigate zakat compliance issues and examine the influence of governance-related factors of the Saudi Zakat Authority, the GAZT, on zakat payment compliance. Based on an extensive review of the literature and the analysis of qualitative data collected via interviews with zakat experts in SA, the study has developed the Zakat Governance-Compliance Relationship (ZGCR) model. In addition, the analysis of the qualitative data suggested several issues affecting zakat payers' compliance in the GAZT context. These issues included the lack of control mechanisms that ensure zakat payers' compliance, the perceived image of the GAZT role in relation to zakat, the lack of trust, and issues affecting the perceived procedural fairness. Subsequently, the quantitative process involved testing the developed ZGCR model using questionnaire survey on actual zakat payers in SA. Accordingly, the findings based on the analysis of 125 questionnaires using PLS-SEM technique suggested that the perceived transparency and disclosure and the perceived procedural fairness had significant positive relationships with zakat payment compliance. In addition, trust was found to have a mediating effect on the relationship between the perceived governance of the GAZT and zakat payment compliance. However, two governance-related factors showed insignificant relationships with zakat compliance, which are the perceived administration and the perceived performance of the GAZT. Overall, the findings of this study have contributed to zakat literature and provided practical implications to zakat administrators, especially the GAZT. Limitations of the study and suggestions for future research were highlighted in the Final Chapter.

Keywords: Governance, state zakat institutions, zakat compliance, trust, Saudi Arabia

خلاصة البحث

تلعب مؤسسات الزكاة دورًا مهمًا في النظام المالي الإسلامي وهو الحفاظ على الرخاء والانسجام الاجتماعي في المجتمعات الإسلامية، ولكن دور مؤسسات إكافة المعاصرة يبدو ضئيلاً لأسباب يمكن أن تعزى إلى عاملين رئيسيين، وهما: ضعف كفاءة إدارة مؤسسات الزكاة من جهة وضعف حصيلة الزكاة بسبب قلة الامتثال لدفع إكافة عبر المؤسسات الرسمية، وعليه حاول الباحث دراسة هذين العاملين في المملكة العربية السعودية التي لديها نظام زكوي يدار من قبل مؤسسات رسمية ويؤمل أن تحقق حصيلة إكافة فيها آثارا كبيرة سواء داخل المملكة أو خارجها، ووفقاً لذلك تبنت الدراسة منهجية بحث مختلطة للتحقيق في قضايا ضعف الامتثال الزكوي وكيفية تأثره بالعوامل المرتبطة بالحوكمة لدى هيئة الزكاة السعودية GAZT، وقد طورت الدراسة نموذج (ZGCR) لتصور تأثير ممارسات الحوكمة لهيئة الزكاة على الامتثال لدفع إكافة بناءً على مراجعة شاملة للأدبيات والدراسات السابقة وتحليل لنتائج البيانات النوعية التي تم جمعها من خلال المقابلات مع خبراء إكافة في المملكة العربية السعودية، وأظهرت نتائج البيانات النوعية العديد من القضايا التي تؤثر على امتثال دافعي إكافة، وشملت هذه القضايا ضعف آليات الرقابة التي تضمن امتثال دافعي إكافة، والتصور السلبي لدور الهيئة فيما يتعلق بإدارة تحصيل الزكاة بجانب الضرائب، بالإضافة لضعف الثقة ووجود عدد من القضايا التي تؤثر على العدالة المتصورة للإجراءات المعمول بها في إدارة الزكاة، بعد ذلك هدفت المنهجية الكمية لاختبار نموذج ZGCR عبر استبيان موجه للمكلفين بدفع إكافة في المملكة العربية السعودية، وقد أشارت النتائج المستندة إلى تحليل 125 استبياناً باستخدام تقنية PLS-SEM إلى أن لعاملي التصور عن الشفافية والإفصاح وكذلك العدالة الإجرائية علاقة إيجابية ذات دلالة هامة مع الامتثال لدفع الزكاة، كما أظهرت النتائج أن للثقة تأثير وسيط على العلاقة بين جودة الحوكمة المتصورة وامتثال دافعي إكافة، ومع هذا لم تدعم النتائج الكمية فرضيتين تتعلق بوجود علاقة إيجابية وهامة بين عاملين مرتبطين بالحوكمة مع الامتثال لدفع إكافة، وهما: جودة الإدارة المتصورة وجودة الأداء المتصور، ويمكن القول أن نتائج هذه الدراسة ساهمت بإضافة أبعاد بحثية جديدة في أدبيات الزكاة، وقدمت تصورات ومقترحات عملية للمسؤولين في مؤسسات الزكاة لمعالجة ضعف الامتثال الزكوي خاصة في المملكة العربية السعودية، وقد تمت الإشارة إلى محددات الدراسة واقتراحات للأبحاث المستقبلية في الفصل الأخير من البحث.

APPROVAL PAGE

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DECLARATION

I hereby declare that this thesis is the result of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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This thesis is dedicated to my beloved father Ahmed Madani Sawmar, my mother Mariam Mohamed Qasim, may Allah bless her soul, my dear wife Safieh and adorable daughters Leen and Maryam, with whom I always find love and courage, and my beloved brothers and sisters

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TABLE OF CONTENTS

Abstract	ii
Abstract in Arabic	iii
Approval Page	iv
Declaration	v
Copyright	vi
Dedication	vii
Acknowledgements	viii
List of Tables	xii
List of Figures	xiv
CHAPTER ONE: INTRODUCTION	1
1.1 Background of the Study	1
1.2 Statement of the Problem	8
1.3 Research Questions	9
1.4 Research Objectives	10
1.5 Significance of the Study	10
1.6 Scope of the Study	11
1.7 Organisation of the Study	12
CHAPTER TWO: LITERATURE REVIEW	14
2.1 Introduction	14
2.2 The Early History of the Institution of Zakat	14
2.2.1 Attributes of the Early Zakat Institution	17
2.2.2 The institution of Zakat after the Four Caliphs' Ruling	19
2.3 Contemporary Zakat Institutions	20
2.4 Governance of Zakat Institutions	22
2.4.1 Public Sector Governance	23
2.4.2 Governance in the Context of Zakat Institutions	25
2.4.3 Governance of the GAZT	29
2.4.4 Good Governance Principles: A Framework for Zakat Institutions	38
2.5 Zakat Payment Compliance	42
2.5.1 The Influence of Governance on Zakat Compliance	45
2.5.2 The Role of Trust	74
2.6 Chapter Summary	80
CHAPTER THREE: RESEARCH FRAMEWORK	83
3.1 Introduction	83
3.2 Underpinning Theories and Principles	83
3.2.1 The Organisational Legitimacy Theory	84
3.2.2 The Cognitive Evaluation Theory	88
3.2.3 The Islamic Accountability Principle	93
3.3 Development of the Conceptual Framework	99
3.3.1 The First Stage of Developing ZGCR Model	100
3.3.2 Modifications of the ZGCR Model	104

3.4	Hypotheses Development	107
3.4.1	The Perceived Administration of the GAZT	108
3.4.2	The Perceived Performance of the GAZT	110
3.4.3	The Perceived Transparency and Disclosure Practices of the GAZT	113
3.4.4	The Perceived Procedural Fairness of the GAZT	114
3.4.5	Trust and Zakat Payment Compliance	116
3.4.6	The Mediating Effect of Trust.....	117
3.5	Operational Definitions	119
3.6	Chapter Summary.....	120
CHAPTER FOUR: RESEARCH METHODOLOGY		122
4.1	Introduction	122
4.2	Research Design.....	122
4.2.1	Philosophical Worldview of the Study.....	123
4.2.2	Research Approach	124
4.2.3	The Processes of the Study.....	127
4.2.4	Ethical Consideration	151
4.3	Summary	152
CHAPTER FIVE: RESULTS OF THE QUALITATIVE DATA		153
5.1	Introduction	153
5.2	Profile of the interviewees	154
5.3	Overview of the qualitative data	156
5.4	Discussion of the Emerging Themes	158
5.4.1	Zakat Payment Compliance	159
5.4.2	The Administration of the GAZT.....	169
5.4.3	The Board and Top Management of the GAZT.....	174
5.4.4	The Performance of the GAZT	179
5.4.5	The Transparency and Disclosure Practices of the GAZT.....	184
5.4.6	Fairness of Zakat Regulations and Administrative Procedures .	193
5.5	Chapter Summary.....	201
CHAPTER SIX: RESULTS OF THE QUANTITATIVE DATA		203
6.1	Introduction	203
6.2	Response Rates	203
6.3	Descriptive statistics.....	204
6.3.1	Respondents' Profile	205
6.3.2	Descriptive statistics of constructs	207
6.4	Data screening	208
6.4.1	Assessment of Outliers.....	209
6.4.2	Normality Test.....	209
6.4.3	Multicollinearity Test.....	210
6.4.4	Validating the Instrument and Factor Analysis.....	211
6.4.5	Exploratory Factor Analysis (EFA)	212
6.5	Assessment of the Measurement Model	219
6.6	Assessment of the Structural Model	228
6.6.1	Hypotheses Testing for Direct Relationships.....	229
6.6.2	Coefficient of Determination: R ² Value	230
6.6.3	Effect Size f ²	231

6.6.4	Predictive Relevance (Blindfolding) Q2	232
6.6.5	Testing the Mediating Effect of Trust	232
6.6.6	Hypotheses Testing Results	234
6.7	Chapter Summary.....	235
CHAPTER SEVEN: DISCUSSION AND CONCLUSION		237
7.1	Introduction	237
7.2	Discussion	237
7.2.1	Discussion of the Qualitative Data Results	238
7.2.2	Discussion of the Quantitative Data Results	245
7.3	Summary of the study	255
7.4	Implication of the study	259
7.4.1	Contribution to the Literature.....	259
7.4.2	Practical Implications and Policy Recommendations	260
7.5	Limitation of the study	263
7.6	Suggestion for future research	264
BIBLIOGRAPHY		266
APPENDIX A: THE INTERVIEW’S QUESTIONS.....		280
APPENDIX B: QUESTIONNAIRE ITEMS		284
APPENDIX C: THE QUESTIONNAIRE IN ARABIC		288
APPENDIX D: ITEM’S NORMALITY TEST		293
APPENDIX E: CORRELATION MATRIX AND ANTI-IMAGE		293

LIST OF TABLES

Table 3.1	The operational definitions of the study's constructs	119
Table 4.1	Processes of the current study	127
Table 4.2	The content of the developed questionnaire	144
Table 4.3	Internal reliability of the research variables in the pilot study	148
Table 4.4	Research model assessment procedures using PLS-SEM	150
Table 5.1	List of interviewees profile	154
Table 6.1	Response rate statistics	204
Table 6.2	The demographic statistics	205
Table 6.3	Descriptive statistics of the sample responses to the study constructs	208
Table 6.4	Normality distribution test	210
Table 6.5	Multicollinearity test	211
Table 6.6	KMO and Bartlett's Test	214
Table 6.7	Communalities	215
Table 6.8	The Total Variance Explained	216
Table 6.9	The Pattern Matrix	218
Table 6.10	Factor correlation matrix	219
Table 6.11	Cronbach's alpha and composite reliability results	223
Table 6.12	Results of Loadings for all Items	224
Table 6.13	Average variance extracted (AVE) results	225
Table 6.14	Results of discriminant validity by the cross-loading	226
Table 6.15	Results of discriminant validity by Fornell-Larcker criterion	227
Table 6.16	Results of discriminant validity by HTMT	228
Table 6.17	Structural path analysis result	230

Table 6.18	Coefficient of determination result R^2	231
Table 6.19	Effect size f^2	232
Table 6.20	Predictive relevance (Blindfolding) Q^2	232
Table 6.21	Mediation analysis result	234
Table 6.22	Hypotheses testing results	234
Table 7.1	Summary of the study and findings	256

LIST OF FIGURES

Figure 1.1	Level of zakat non-compliance issues in the last two years	3
Figure 1.2	Ratio of collected zakat by GAZT to zakat estimates	4
Figure 1.3	Difference between the collected zakat by the GAZT and the distributed funds by the SSA	5
Figure 2.1	Classification of stakeholders, retrieved from (Mitchell et al., 1997)	63
Figure 2.2	Classification of zakat stakeholders, retrieved from (Abioye, 2013)	66
Figure 2.3	The interactions between power and trust in influencing compliance behaviours, retrieved from Kirchler et al. study (2008)	71
Figure 3.1	The first Zakat Governance-Compliance Relationship (ZGCR) model	103
Figure 3.2	The modified ZGCR model	105
Figure 3.3	The scales of the study's conceptual model	107
Figure 3.4	The research hypotheses	119
Figure 4.1	Qualitative data analysis process	136
Figure 6.1	PLS algorithm results (regression weights)	221
Figure 6.2	PLS bootstrapping (T Statistics)	229

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Zakat in the early history of Islam had played a crucial role in the socio-economic prosperity and development of Muslim societies. The success of the early institution of zakat can be attributed to trustworthy management by the public authority. The implementation of zakat through the state had encouraged greater zakat payment compliance from the Muslim public that led to achieving zakat objectives. For example, several reports suggest that zakat was effective in eradicating poverty in certain times. For instance, during the period of Umar bin Al-Khattab (13-22H) and Umar bin Abdul Aziz (99-101H), it was reported that zakat officers could not find needy recipients in some regions (Al-omar, 1996; Al-Qaradawi, 2002). These examples are evidence that zakat can be a powerful and effective mechanism in combating poverty and income inequality, especially if managed properly.

Despite the enormous achievement in the past, the role of zakat has been insignificant in contemporary Muslim countries. It is reported that the Muslim world suffers the most from widespread poverty and increasing income inequality across many Muslim countries. Many scholars argue that zakat has not been allowed to fulfil its potential role within the economic policies of current Muslim countries (Al-Qaradawi, 2002; Shaikh, 2016; Shihata, 2006). The absence of formal and regulated zakat institutions in the majority of Muslim countries are evidence of their negligence to the role of zakat. However, there are few Muslim countries which have established zakat regulations and institutions for managing zakat, such as Saudi Arabia, Sudan,

Malaysia, and Pakistan. Nonetheless, it is believed they are facing significant challenges concerning zakat payment compliance and improving their effectiveness (Guermat, Tucker, & Al-Utaibi, 2003; Saad & Haniffa, 2014; Shirazi & Amin, 2006).

Although Saudi Arabia is seen as an immensely wealthy and resourceful country, poverty exists on an increasing scale over the years. Despite the lack of official statistics concerning poverty in Saudi Arabia, several reports indicate the significant magnitude of poverty that exists in the Kingdom. For example, S. AlDamigh (2014) mentions that the Gulf oil states are hardly distinguished between the rest of the Arab countries in the Human Poverty Index (HPI). According to statistics from the human development reports and other social indicators, Saudi Arabia has a poverty range between 10 – 20%, which is in the same range with other Arab countries, such as Lebanon, Kuwait, Jordan, and Libya. In addition, cases of poverty in the Kingdom has seen increasing attention from the press reporting thousands of Saudi families living in tents and houses of tin with a complete absence of government services. It is worth noting that non-official reports claim that about 20% of Saudis live under the poverty line (S. AlDamigh, 2014).

Another indication of the extent of poverty in Saudi Arabia can be seen in the numbers of beneficiaries from the social welfare programs provided by the Saudi government and partially funded from zakat proceeds. According to the latest reports, there are 1,222,411 citizens registered in the Social Security Agency under the Ministry of Labour and Social Development (Saudi Ministry of Labour & Social Services, 2016). The number of social welfare recipients represents about 16% of the Saudi population, excluding the non-Saudi citizens. However, it worth noting that social welfare subsidies are given based on meeting certain criteria and conditions stipulated by the Social Security Agency, which may not be inclusive of all the needy and poor living in the

kingdom. For example, there are significant numbers of the poor who are excluded from the poverty estimates and the financial subsidies provided by governmental agencies based on their foreign nationalities.

The rising poverty and increasing cost of living in the Kingdom have raised the public concerns over the effectiveness of zakat authority in combating poverty issues. Such concerns have frequently been voiced, especially by zakat payers who are legally obligated to pay their zakat to the General Authority of Zakat and Tax (GAZT), which is the official zakat collection body in Saudi Arabia. Despite the fact that zakat has long been legally enforced by the Saudi government, zakat payment compliance is deemed to be a significant challenge facing the GAZT. The lack of zakat payers' compliance is evident according to recent statistics published by the GAZT, which reported the numbers of submitted zakat statements in comparison with the total registered businesses subject to zakat laws in the last two years (see figure 1.1). Furthermore, previous studies estimating zakat potential have indicated to the significant zakat gap in Saudi Arabia between the formally collected zakat proceeds through the GAZT and the estimated zakat potential (see Farhan, 2008; Shaikh, 2016, Kahf 1989).

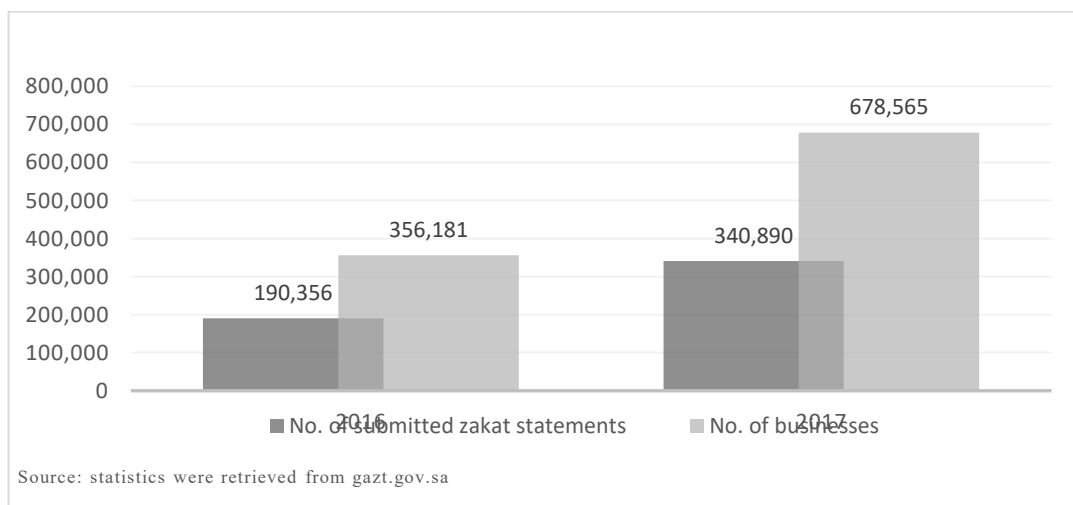


Figure 1.1: Level of zakat non-compliance issues in the last two years

For example, Based on Kahf (1989) estimates of zakat, the least estimate of zakat collection in the case of Saudi Arabia should be 1.2% of its GDP. This estimation is based on traditional shariah scholars' view concerning the collection of zakat from apparent assets. Based on this estimate, the statistics of zakat collection by the GAZT during the years 2010 -2016 show an average of 33% ratio between the collected zakat to the least estimates (see figure 1.2). The low zakat proceeds collected by the GAZT necessitates that the Saudi government allocates additional funds from the public revenue to the social security recipients every year (See figure 1.3).

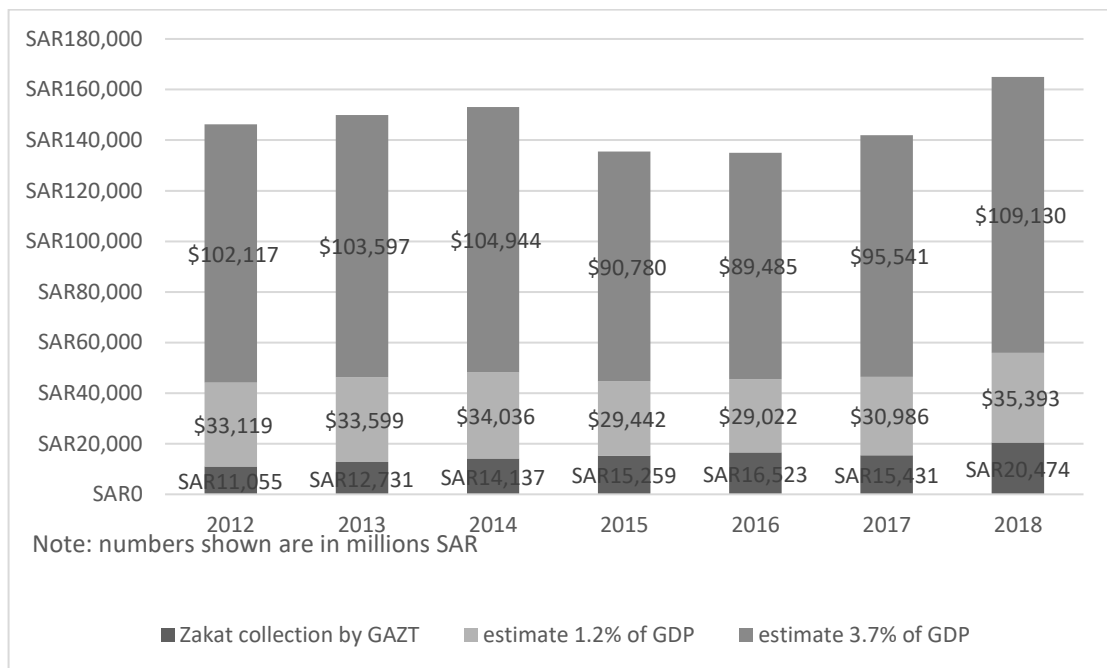


Figure 1.2: Ratio of collected zakat by GAZT to zakat estimates proposed by Kahf (1989)

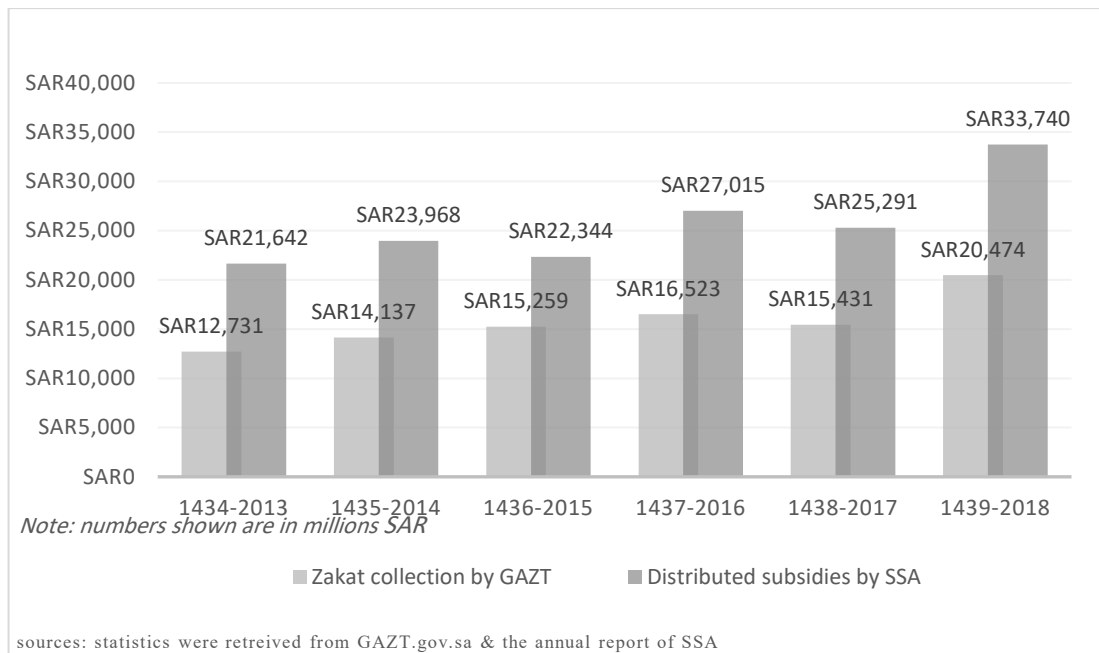


Figure 1.3: Difference between the collected zakat by the GAZT and the distributed funds by the SSA

Nonetheless, there have been limited studies addressing zakat payment compliance, particularly in a mandatory zakat collection system. Prior studies on zakat compliance have used various approaches and theories in exploring the factors and determinants of zakat payers' intentions and decisions to pay zakat, whether income or business zakat. For example, Saad & Haniffa (2014) used the Theory of Reasoned Action (TRA) in studying and formulating a behavioural model of zakat compliance. However, due to the limitation of the TRA theory, other researchers have used multiple theories to explore other factors that influence zakat compliance (Izlawanie Muhammad, 2016; S. Ahmad, Nor, and Daud, 2011). The proposed factors in the past studies can be internal, such as knowledge, awareness, and religiosity, or external variables that relate to business zakat, such as profitability and length of business operation.

In addition, a few studies have also looked at factors related to zakat organisations, such as the role of trust and access to a zakat payment channel (Ahmad, Nor, & Daud, 2011). Another recent study has taken a broader approach to explore the influence of governance mechanisms of zakat institutions on zakat payers' trust (M. M. O. Abioye, Mohamad, & Adnan, 2013). Although the latter study may have similar focus with the current study, there can be significant differences in its exploratory nature and the different legal system of zakat where the study was conducted in Nigeria. Evidently, unlike Nigeria, zakat in Saudi Arabia is regulated and legally imposed by the state.

Likewise, the literature on the Saudi zakat system and the issues pertaining to zakat compliance is also lacking. However, few studies have indicated the existence of compliance issues and zakat evasion cases in the GAZT context (AlSaad, 2013; Guermat et al., 2003). Specifically, AlSaad's study (2013) concerning the zakat evasion in the context of the Saudi Zakat Authority (GAZT) have mentioned that the lack of trust is found to be a significant factor leading to zakat evasion. It is also mentioned that the lack of transparency of the GAZT regarding the distributions process raised zakat payers' concerns over its compliance with shariah. Moreover, the issue of trust has also been highlighted in Guermat et al. (2003), which partially referred to the absence of shariah supervisory as a concern for zakat payers.

Accordingly, this study has taken a new approach to consider the role of governance-related factors and examine their influence on zakat payment compliance in the GAZT. The term governance can be defined as "the arrangements put in place to ensure that the intended outcomes for stakeholders are defined and achieved" ((IFAC) & (CIPFA), 2014). The process of governance includes making and implementing decisions, setting strategies, and giving directions in compliance with the regulations

and objectives of the entity. Several studies have addressed the governance of zakat institutions in various setting and contexts. For example, Fadilah' study (2013) discussed the relationship between governance and performance; Abd Wahab & Abdul Rahman (2011) discussed the links between governance and efficiency, and Abioye et al. (2013) discussed governance and zakat payers' trust. However, the influence of governance on zakat payment compliance has received little attention in the literature despite the instrumental role of the zakat administration in the collection and management of zakat funds.

Therefore, the current study attempted to bridge this gap by investigating the influence of governance of the Zakat Authority on zakat payers' compliance in Saudi Arabia. Moreover, the novelty of the governance term and its use required a qualitative investigation of the governance dimensions that likely influence zakat compliance in the GAZT context. Accordingly, the purpose of this sequential mixed-method study was to examine the influence of governance of the Saudi Zakat Authority (GAZT) on zakat payers' compliance. Specifically, the first process involved a qualitative investigation of the issues and factors influencing zakat compliance by interviewing experts of the phenomenon under investigations. The findings from the first qualitative stage were used in the development of the quantitative instrument used in the second stage. The reasons for collecting both qualitative and quantitative data were to provide a better understanding of the factors and variables influencing zakat compliance that relate to the governance of the GAZT. This multiple-approach methodology was significant to provide an in-depth understanding of the research problem and achieve the study objectives.

1.2 STATEMENT OF THE PROBLEM

The potential of zakat, particularly in a wealthy country as Saudi Arabia, could have enormous benefits in the development of the socio-economic prosperity locally and even abroad. However, achieving such potential would require zakat payers' cooperation and compliance with the payment of zakat. Despite the fact that the Saudi government has imposed a mandatory collection of business zakat since 1951, the collected zakat through the official zakat body GAZT has been insufficient. Evidently, zakat revenues have been far from satisfying the basics of the needy Saudi families receiving funds from the Saudi Social Security Agency.

Prior studies have indicated that low zakat payment compliance in the GAZT context can be attributed to several reasons. Among the significant reasons, which were cited by zakat payers, are the issues of trust, lack of transparency, and concerns over the legitimacy of the processes concerning the collection and distribution of zakat (AlSaad, 2013; Guermat et al., 2003). Accordingly, improving zakat compliance requires a broader investigation into the influence of governance practices on zakat payers' decisions to pay their zakat through the official channel, of which the literature has been silent. Specifically, the knowledge gap is seen in the missing theory and framework which explain the relationship between the governance of zakat institutions and zakat payment compliance.

Therefore, this study employed a mixed-method approach aiming to provide a better understanding of the relationship between governance and zakat compliance in the GAZT context. The mixed methodology is significant to achieve the objectives of this study by gaining insights from the experts' viewpoints of the possible influencing factors related to governance. Subsequently, the quantitative part served the purpose of this study by examining the influence of the perceived governance of the GAZT on

zakat payment compliance. Overall, understanding such influence is crucial for zakat administrators in order to improve zakat compliance by embracing good governance and being attentive to zakat payers' concerns.

1.3 RESEARCH QUESTIONS

This study is concerned with the major question regarding the influence of governance of the Saudi Zakat Authority GAZT on zakat payers' compliance. Particularly, the current study intends to answer the following questions:

1. What are the issues pertaining to the governance of the GAZT that influence zakat payment compliance?
2. What are the factors relating to the governance of the GAZT, that influence zakat payment compliance in Saudi Arabia?
3. How does the perceived governance of the GAZT influence business zakat compliance?
 - A. To what extent does the perceived administration of the GAZT influence zakat payment compliance?
 - B. To what extent does the perceived performance of the GAZT influence zakat payment compliance?
 - C. To what extent does the perceived transparency and disclosure practices of the GAZT influence zakat payment compliance?
 - D. To what extent does the perceived procedural fairness of the GAZT influence zakat payment compliance?
4. To what extent does trust influence zakat payers' compliance?
5. To what extent does trust mediate the relationships between the perceived governance of the GAZT and zakat payment compliance?

The mixed-method design was adopted to answer these questions. Specifically, the first two questions were answered using a qualitative approach, whereas the remaining questions were answered through quantitative data, respectively.

1.4 1.4 RESEARCH OBJECTIVES

The primary objective of this study was to examine the role of governance of the Saudi Zakat Authority GAZT in influencing zakat payment compliance. Particularly, this study aimed to fulfil the following objectives:

- 1- To investigate the issues pertaining to the governance of the GAZT that could influence zakat payment compliance in Saudi Arabia.
- 2- To develop a model that explains the relationship between the governance of the GAZT and zakat payment compliance in the context of Saudi Arabia.
- 3- To examine the relationships between the perceived governance of the GAZT and zakat payment compliance.
- 4- To examine the relationship between trust and zakat payment compliance?
- 5- To examine the mediating effect of trust between the perceived governance of the GAZT and zakat payment compliance.

1.5 SIGNIFICANCE OF THE STUDY

This study has addressed the issue of low zakat compliance through investigating the influence of governance of state zakat institutions following a mandatory collection of zakat. By employing mixed-method in approaching the research problem, it is expected that the results of this study can contribute to both theory and practices.

Considering the significance of zakat in the socio-economic development of Muslim societies, the literature concerning the theories explaining the influence of zakat