



AN EXPLORATORY STUDY ON *SHARI'AH*-
COMPLIANT SOCIAL IMPACT BONDS IN MALAYSIA:
STAKEHOLDERS' PERSPECTIVE

BY

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ABSTRACT

Social Impact Bond (SIB) is a financial instrument used by socially motivated investors to fund programmes that aim to improve social outcomes, the returns of which are dependent on the impact achieved. The SIB model is seen as a suitable means (*wasa'il*) to address the issue of *maqasid al-Shari'ah* discourse Islamic finance, as well as the issues of social service inefficiency and financial constraints. The potential of SIB has created a global interest, but its development in Malaysia is still nascent. This study explores the potential development of *Shari'ah*-compliant Social Impact Bonds (SC SIBs) in Malaysia from the perspectives of stakeholders. It focuses on four research objectives: Firstly, it investigates stakeholders' perception of SIBs, conventional bonds (CBs), and SRI *sukuk*; secondly it investigates the factors influencing stakeholders' intention to invest in SC SIBs; Thirdly, it identifies the critical success factors (CSFs) and their order of importance; and finally, it identifies the priority social areas for SC SIB implementation in Malaysia. Through a survey, the views of 260 (44% response rate) Malaysian stakeholders (i.e. investors and financial developers) were gathered. The data was analysed using descriptive statistics, non-parametric tests, multiple regression analysis (MRA) and ranking techniques. The key findings indicate that stakeholders' general understanding of the salient features of SIBs is very low, as compared to CBs and SRI *sukuk*. SIBs are also perceived to be significantly different from CBs and SRI *sukuk*. A hypothesised MRA model based on the Extended Theory of Planned Behaviour, extracted "attitude" as the most influential factor of stakeholders' intention to invest, followed by "subjective norm" and "moral norm", with a 67.1% of the variance explained. However, "perceived behavioural control" was found to be statistically insignificant. Results of the tests suggest that these factors exercised a bigger influence on developers than investors. In terms of the critical success factors, the top five are "good governance framework", "fulfilment of ethical standards", "transparent procurement process", "well-defined scope", and "viable feasibility study", while the bottom three CSFs are the "existing social programmes adopted", "SIB guarantors", and political will. These important factors must be considered in SC SIB development. Results of the tests showed that investors and developers differ in the CSF ranking. The areas of "Education", "healthcare", and "children" were ranked as the top three priority areas, while the least prioritised areas were "socioeconomic disparity" and "repeat offending". This research finding is important as it indicates the social areas that should be prioritised to ensure the viability and sustainability of SC SIBs in Malaysia, while stakeholders' low understanding of SIBs implies that the stakeholder engagement must be increased. As investors and developers differed in opinion, different strategies must be utilised when engaging with different stakeholder groups. Additionally, what stakeholders perceived to be the differences between SIBs and CBs and SRI *sukuk* brings into question whether the existing frameworks of CB and SRI *sukuk* are suitable for SC SIB implementation. Overall, the research discovered that stakeholder interest in developing and investing in SC SIBs in Malaysia is encouraging but many the challenges must be overcome for its realisation.

ملخص البحث

سندات التأثير الاجتماعي (SIB) هي أدوات مالية تستخدم من قبل المستثمرين الذين لديهم دوافع اجتماعية لتمويل برامج تهدف لتحسين النتائج الاجتماعية، بحيث تعتمد عوائدها على التأثير الاجتماعي الذي تم تحقيقه. يُنظر إلى نموذج SIB كوسيلة مناسبة للربط الأحسن بين التمويل الإسلامي ومقاصد الشريعة، بالإضافة إلى معالجة قضايا عدم كفاءة الخدمات الاجتماعية والقيود المالية. تطورت هذه السندات في مختلف دول العالم بشكل متقدم، ولكن تطورها في ماليزيا لا يزال ضعيفاً. تحاول هذه الدراسة تحليل التطور المحتمل لسندات التأثير الاجتماعي المتوافقة مع الشريعة الإسلامية (SC SIBs) في ماليزيا من منظور أصحاب المصالح. يركز البحث على تحقيق أربعة أهداف: أولاً، دراسة إدراك وتصور أصحاب المصلحة لسندات التأثير الاجتماعي، السندات التقليدية، وصكوك SRI. ثانياً، يقوم بدراسة العوامل التي تؤثر على قصد أصحاب المصلحة في الاستثمار في سندات التأثير الاجتماعي المتوافقة مع الشريعة الإسلامية. ثالثاً، يحدد البحث عوامل النجاح الأساسية (CSFs) وترتيبها حسب الأهمية. وأخيراً، يحدد البحث المجالات الاجتماعية ذات الأولوية لتشغيل سندات التأثير الاجتماعي المتوافقة مع الشريعة الإسلامية في ماليزيا. تم جمع آراء 260 شخص من خلال مسح إحصائي، وكانت معدل الاستجابة 44.4%. من أصحاب المصلحة الماليزيين (مثال: المستثمرين والمطورين الماليين). تم تحليل البيانات باستخدام الإحصاء الوصفي والاختبارات غير المعلمية وتحليل الانحدار المتعدد (MRA) وتقنيات التصنيف. وتشير النتائج الرئيسية للبحث إلى أن الفهم العام لأصحاب المصلحة للسندات البارزة في نظام SIBs في أدنى درجاته، مقارنة بالسندات التقليدية CBS وصكوك SRI. كما يُنظر إلى SIBs على أنها تختلف اختلافاً كبيراً عن السندات التقليدية CBS وصكوك SRI. إن نموذج تحليل الانحدار المتعدد MRA يستند إلى النظرية الموسعة للسلوك المخطط، بحيث يعتمد على "السلوك" باعتباره العامل الأكثر تأثيراً في قصد أصحاب المصلحة للاستثمار، متبوعاً بـ "المعايير الشخصية" و "المعايير الأخلاقية"، مع وجود 67.1% من التباين بينهم. ومع ذلك، فقد وجد أن "التحكم السلوكي المدرك" ليس له تأثير إحصائي. تشير نتائج الاختبارات إلى أن لهذه العوامل تأثيراً أكبر على المطورين مقارنةً بالمستثمرين. أما فيما يتعلق بعوامل النجاح الأساسية CSFs، فقد كانت أهم خمس عوامل: "إطار الحوكمة الرشيدة"، "الالتزام بالمعايير الأخلاقية"، "عمليات الشراء الشفافة"، "النطاق المحدد جيداً"، و "دراسة جدوى قابلة للتطبيق". في حين كانت العوامل الأقل أهمية: "البرامج الاجتماعية المعتمدة"، "ضمان سندات التأثير الاجتماعي"، و "الإرادة السياسية". من المهم النظر في هذه العوامل الهامة لتطوير سندات التأثير الاجتماعي المتوافقة مع الشريعة الإسلامية. وأظهرت نتائج الاختبارات أن المستثمرين والمطورين يختلفون في ترتيب عوامل النجاح الأساسية. حيث صنفت مجالات "التعليم" و "الرعاية الصحية" و "الأطفال" على أنها المجالات ذات الأهمية الأكبر، في حين كان "التفاوت الاجتماعي والاقتصادي" و "تكرار المخالفة" و "العوامل الأقل أهمية". تعتبر نتائج البحث هامة جداً لأنها تشير إلى المجالات الاجتماعية التي ينبغي تحديد أولويتها لضمان

سلامة واستدامة سندات التأثير الاجتماعي المتوافقة مع الشريعة الإسلامية في ماليزيا. في حين أن نقص فهم أصحاب المصلحة لسندات التأثير الاجتماعي يعني ضمناً أنه يجب زيادة مشاركة أصحاب المصلحة في هذه السندات. مع وجود اختلافات للرأي بين المستثمرين والمطورين، فإنه يجب استخدام استراتيجيات مختلفة عند التعامل مع مختلف المجموعات من أصحاب المصلحة. بالإضافة إلى ذلك، فإن ما يعتبره أصحاب المصلحة من اختلافات بين سندات التأثير الاجتماعي و السندات التقليدية CBS و صكوك SRI يشكك في إمكانية تطبيق الأطر الحالية للسندات التقليدية و صكوك SRI على سندات التأثير الاجتماعي المتوافقة مع الشريعة الإسلامية. وبشكل عام، فقد وجد البحث أن اهتمام أصحاب المصلحة بالاستثمار في سندات التأثير الاجتماعي المتوافقة مع الشريعة الإسلامية في ماليزيا أمر مشجع ولكن يجب التغلب على العديد من التحديات من أجل تطويره.

APPROVAL PAGE

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DECLARATION

I hereby declare that this thesis is the result of my own investigations, 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.

Syed Marwan Mujahid bin Syed Azman

Signature

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This thesis is dedicated to:
my late mother, Allahyarhamah Dr Che Noraini Hashim;
my father, Dr Syed Azman Syed Ahmad Nawawi;
“Lord, have mercy on them, just as they cared for me when I was little” (17:24);
my wife, Nor Syahirah;
my children, Sharifah Maryam and Sharifah Hannah;
and my family.
*“Our Lord, give us joy in our spouses and offspring. Make us good examples to those
who are aware of You” (25:74).*

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“Our Lord, give us good in this world and in the Hereafter, and protect us from the torment of the Fire.” (2:201)

TABLE OF CONTENTS

| | |
|---|-----------|
| Abstract | ii |
| Approval Page..... | v |
| Declaration | vi |
| Copyright Page..... | vii |
| Acknowledgements..... | ix |
| List of Tables | xvi |
| List of Figures | xviii |
| List of Abbreviations | xix |
| CHAPTER ONE: INTRODUCTION | 1 |
| 1.1 Background of Study | 1 |
| 1.2 Problem Statement..... | 6 |
| 1.3 Research Objectives..... | 9 |
| 1.4 Research Questions..... | 9 |
| 1.5 Scope of the Study and Respondents..... | 10 |
| 1.6 Significance and Contributions of the Study | 11 |
| 1.6.1 Theoretical Contribution | 11 |
| 1.6.2 Empirical Evidence in the Context of Malaysia | 12 |
| 1.6.3 Methodological Contribution | 13 |
| 1.6.4 Practical Contribution | 13 |
| 1.7 Organisation of the Study | 14 |
| CHAPTER TWO: SOCIAL IMPACT BONDS, SHARI’AH-COMPLIANT SIB, SRI, AND SOCIAL SECTOR IN MALAYSIA | 17 |
| 2.1 Introduction..... | 17 |
| 2.2 Social Impact Bonds | 18 |
| 2.2.1 Definition of Social Impact Bond | 18 |
| 2.2.1.1 Public Private Partnership | 19 |
| 2.2.1.2 Payment by Results | 20 |
| 2.2.2 Main Social Impact Bond Stakeholders..... | 22 |
| 2.2.3 The General Social Impact Bond Structure | 26 |
| 2.2.4 Potential Benefits from Social Impact Bonds | 28 |
| 2.2.5 Limitations of the Social Impact Bond Model..... | 31 |
| 2.2.6 Potential Risks from Social Impact Bonds | 32 |
| 2.2.6.1 Intervention Area Risk | 32 |
| 2.2.6.2 Execution Risk..... | 33 |
| 2.2.6.3 Intermediary Risk | 34 |
| 2.2.6.4 Political Risk | 34 |
| 2.2.6.5 Financial Risk..... | 35 |
| 2.2.6.6 Reputational Risk | 35 |
| 2.2.7 Social Impact Bond Development and Areas of Implementation.... | 36 |
| 2.2.8 The World’s First SIB | 40 |
| 2.3 Shari’ah-Compliant SIB (SC SIB)..... | 43 |
| 2.3.1 <i>Shari’ah</i> Compliance Standards in Malaysia..... | 44 |
| 2.3.1.1 Development of SC SIB | 48 |

| | |
|---|-----------|
| 2.3.2 Social Finance, SRI, and Islamic Finance..... | 49 |
| 2.3.3 Malaysia’s SRI <i>Sukuk</i> Framework..... | 52 |
| 2.3.4 The World’s First-Ringgit Denominated SRI <i>Sukuk</i> | 57 |
| 2.3.4.1 Is SRI <i>Sukuk</i> an SIB? | 60 |
| 2.3.5 Possible <i>Shari’ah</i> -Compliant SIB Structures..... | 62 |
| 2.3.5.1 Potential of Waqf in SIB | 64 |
| 2.4 Social Service Sector in Malaysia | 66 |
| 2.5 Conclusion | 73 |
| CHAPTER THREE: THEORETICAL FRAMEWORK | 75 |
| 3.1 Introduction..... | 75 |
| 3.2 Maqasid al-Shari’ah..... | 75 |
| 3.2.1 Maqasid al-Shari’ah Definition | 76 |
| 3.2.2 Maqasid al-Shari’ah in the Context of Islamic Finance..... | 80 |
| 3.2.3 Maqasid al-Shari’ah in the Context of this Study | 81 |
| 3.3 The Stakeholder Theory | 84 |
| 3.3.1 Definition | 84 |
| 3.3.2 Aspects of the Stakeholder Theory | 87 |
| 3.3.2.1 Descriptive Stakeholder Theory | 87 |
| 3.3.2.2 Instrumental Stakeholder Theory | 88 |
| 3.3.2.3 Normative Stakeholder Theory | 88 |
| 3.3.3 Significance of Stakeholder Theory to the Study | 90 |
| 3.4 The Theory of Reasoned Action..... | 91 |
| 3.5 The Theory of Planned Behaviour..... | 93 |
| 3.5.1 Significance of TPB for the Study | 95 |
| 3.6 Theoretical Framework Figure | 95 |
| 3.7 Conclusion | 97 |
| CHAPTER FOUR: RESEARCH METHODS AND PROCESS..... | 99 |
| 4.1 Introduction..... | 99 |
| 4.2 Research Methodology and Paradigm | 99 |
| 4.3 Quantitative Research Methods..... | 103 |
| 4.3.1 Population and Sampling | 104 |
| 4.3.1.1 Sampling Method | 105 |
| 4.3.1.2 Sample Composition | 107 |
| 4.3.1.3 Sample Size | 108 |
| 4.4 Research Instrumentation | 110 |
| 4.4.1 Sections of the Questionnaire..... | 110 |
| 4.4.1.1 Questionnaire Measurement Scale | 112 |
| 4.5 Data Analyses Techniques..... | 112 |
| 4.5.1 Normality Test | 113 |
| 4.5.2 Multicollinearity Test..... | 113 |
| 4.5.3 Multiple Regression Analysis Test | 114 |
| 4.5.4 Mann-Whitney U Test..... | 114 |
| 4.5.5 Wilcoxon Signed-Rank test..... | 114 |
| 4.5.6 Kaiser-Meyer-Olkin (KMO) and Bartlett’s Test of Sphericity..... | 114 |
| 4.5.7 Reliability Analysis: Cronbach’s Alpha..... | 115 |
| 4.5.8 Factor Analysis | 115 |
| 4.6 Pilot Study | 115 |

| | |
|---|-----|
| 4.6.1 Implementation of Pilot Study | 117 |
| 4.6.1.1 Respondents of the Pilot Study..... | 118 |
| 4.6.2 Improvements to the Questionnaire Based on the Pilot Study..... | 119 |
| 4.7 Full Questionnaire Distribution | 121 |
| 4.7.1 Administration Methods | 121 |
| 4.7.2 Questionnaire Administration | 122 |
| 4.8 Profile of Respondents..... | 123 |
| 4.8.1 Response Rate | 123 |
| 4.8.2 Respondents' Profession | 124 |
| 4.8.3 Respondents' Work and Financial Instrument Experience..... | 125 |
| 4.8.4 Respondents' Income | 127 |
| 4.8.5 Respondents' Gender, Age, Race, Religion, and Education..... | 128 |
| 4.8.6 Summary of Profile Analysis | 131 |
| 4.9 Conclusion | 131 |

CHAPTER FIVE: STAKEHOLDERS' PERCEPTION OF SOCIAL IMPACT BOND, CONVENTIONAL BONDS, AND SUSTAINABLE & RESPONSIBLE INVESTMENT (SRI) SUKUK

| | |
|---|------------|
| 133 | 133 |
| 5.1 Introduction..... | 133 |
| 5.1.1 Related Research Objective and Research Questions..... | 133 |
| 5.2 Literature Review | 134 |
| 5.2.1 Literature Explaining the Concept of SIB..... | 135 |
| 5.2.2 Comparing SIB with Other Financial Mechanisms | 136 |
| 5.2.3 Literature with Empirical Information Gathered | 138 |
| 5.2.4 Literature on Investor Behaviour and Motivation..... | 141 |
| 5.3 Research Gap | 142 |
| 5.4 Variables and Hypotheses Development..... | 143 |
| 5.4.1 Comparison of SIBs with Conventional Bonds | 144 |
| 5.4.2 Comparison of SIBs with SRI <i>sukuk</i> | 146 |
| 5.4.2.1 Guarantee of Capital..... | 146 |
| 5.4.2.2 Financial Risk..... | 147 |
| 5.4.2.3 Return Mechanism..... | 148 |
| 5.4.2.4 Shari'ah Compliance | 149 |
| 5.4.2.5 Shari'ah Base..... | 149 |
| 5.4.2.6 Rating Requirements | 150 |
| 5.4.2.7 Transferability and Tradability..... | 150 |
| 5.4.3 Variables and Hypotheses Developed..... | 150 |
| 5.5 Data Analyses and Discussions | 153 |
| 5.5.1 Stakeholders' General Perception of the Financial Instruments ... | 153 |
| 5.5.1.1 Stakeholders' Perceptions of Social Impact Bonds..... | 154 |
| 5.5.1.2 Stakeholders' Perceptions of Conventional Bond..... | 162 |
| 5.5.1.3 Stakeholders' Perceptions of SRI Sukuk..... | 168 |
| 5.5.1.4 Stakeholders' Motivation and SIB Categorisation | 174 |
| 5.5.2 Comparative Analyses of the Financial Instruments | 176 |
| 5.5.2.1 Test for Normality | 177 |
| 5.5.2.2 Comparison Between Financial Instruments..... | 177 |
| 5.5.3 Comparative Analyses Between Stakeholder Groups..... | 180 |
| 5.6 Summary of Chapter | 182 |

CHAPTER SIX: FACTORS INFLUENCING STAKEHOLDERS' INTENTION TO INVEST IN SHARI'AH-COMPLIANT SOCIAL IMPACT BONDS..... 185

| | |
|--|-----|
| 6.1 Introduction..... | 185 |
| 6.1.1 Related Research Objective and Research Questions..... | 185 |
| 6.2 Literature Review | 186 |
| 6.2.1 Theory of Planned Behaviour | 186 |
| 6.2.2 Application of TPB in Business Related Behavioural Studies | 187 |
| 6.2.3 Application of TRA and TPB Studies in the Malaysian Context .. | 188 |
| 6.2.4 The Role of Moral Norm in TPB | 189 |
| 6.2.5 Research Gap | 191 |
| 6.3 Variables and Hypotheses Development..... | 192 |
| 6.3.1 Behavioural Intention..... | 192 |
| 6.3.2 Attitude..... | 193 |
| 6.3.3 Subjective Norm..... | 194 |
| 6.3.4 Perceived Behavioural Control | 195 |
| 6.3.5 Moral Norm..... | 196 |
| 6.4 Data Analysis and Discussion | 198 |
| 6.4.1 Factor Analysis | 198 |
| 6.4.1.1 Kaiser-Meyer-Olkin (KMO) and Bartlett's Test..... | 198 |
| 6.4.1.2 Confirmatory Factor Analysis | 199 |
| 6.4.2 Multiple Regression Analysis | 201 |
| 6.4.2.1 Reliability Analysis | 201 |
| 6.4.2.2 Normality Test..... | 202 |
| 6.4.2.3 Multicollinearity Analysis | 202 |
| 6.4.2.4 Multiple Regression Tests | 203 |
| 6.4.3 Comparison Between Investors and Developers..... | 205 |
| 6.5 Summary of Chapter..... | 207 |

CHAPTER SEVEN: CRITICAL SUCCESS FACTORS OF IMPLEMENTING SHARI'AH -COMPLIANT SOCIAL IMPACT BONDS..... 210

| | |
|--|-----|
| 7.1 Introduction..... | 210 |
| 7.1.1 Related Research Objective and Research Questions..... | 210 |
| 7.2 Literature Review | 211 |
| 7.2.1 Critical Success Factors Studies | 211 |
| 7.2.2 Social Impact Bond Critical Success Factors Studies..... | 215 |
| 7.2.2.1 SIB Preconditions by Social Finance | 216 |
| 7.2.2.2 Critical Issues for SIB in Canada | 217 |
| 7.2.2.3 SIB Success Criteria by Center for American Progress | 217 |
| 7.2.2.4 Essential Criteria for SIB by the Young Foundation..... | 218 |
| 7.2.2.5 Feasibility Study and Issues for SIB in Australia..... | 219 |
| 7.2.2.6 SIB Feasibility Criteria by KPMG | 220 |
| 7.2.2.7 SIB Feasibility Assessment Framework..... | 222 |
| 7.2.2.8 Feasibility of SIB in Hawaii | 223 |
| 7.2.2.9 SIB Study in Canada | 224 |
| 7.2.2.10 Housing First SIB Feasibility Study..... | 226 |
| 7.2.2.11 Study on Social Financing and SIB in Malaysia..... | 227 |
| 7.2.3 Research Gap | 229 |
| 7.3 Variables and Hypothesis Development..... | 230 |
| 7.4 Data Analysis and Discussion | 232 |

| | |
|--|------------|
| 7.4.1 Ranking of Critical Success Factors | 232 |
| 7.4.1.1 Overall Perception of Respondents | 233 |
| 7.4.1.2 Perception of Investors and Developers | 237 |
| 7.4.2 Comparison Between Investors and Developers..... | 239 |
| 7.4.2.1 Normality Test..... | 239 |
| 7.4.2.2 Mann-Whitney U Test: Critical Success Factors | 240 |
| 7.5 Summary of Chapter..... | 241 |
| | |
| CHAPTER EIGHT: SOCIAL AREAS FOR SOCIAL IMPACT BOND | |
| IMPLEMENTATION | 243 |
| 8.1 Introduction..... | 243 |
| 8.1.1 Related Research Objective and Research Questions..... | 243 |
| 8.2 Literature Review | 244 |
| 8.2.1 Research Gap | 247 |
| 8.3 Variables and Hypothesis Tested | 247 |
| 8.4 Data Analysis and Discussions..... | 249 |
| 8.4.1 Ranking of Social Areas..... | 249 |
| 8.4.2 Comparison Between Stakeholder Groups | 257 |
| 8.4.2.1 Normality Test: Sum Score of Social Area | 258 |
| 8.4.2.2 Mann-Whitney U Test: Priority Social Areas | 258 |
| 8.5 Summary of Chapter..... | 259 |
| | |
| CHAPTER NINE: DISCUSSION AND CONCLUSION | 261 |
| 9.1 Introduction..... | 261 |
| 9.2 Summary of Study | 261 |
| 9.3 Major Findings and Implications..... | 265 |
| 9.3.1 Stakeholders' Perception of SIB, CB, and SRI <i>sukuk</i> | 265 |
| 9.3.1.1 Implications | 266 |
| 9.3.2 Factors Affecting Intention to Invest in SC SIB | 269 |
| 9.3.2.1 Implications | 269 |
| 9.3.3 Critical Success Factors of Implementing SC SIB in Malaysia..... | 271 |
| 9.3.3.1 Implications | 272 |
| 9.3.4 Social Areas of Priority for SC SIB Implementation..... | 272 |
| 9.3.4.1 Implications | 273 |
| 9.4 Prospect of Developing SC SIB in Malaysia..... | 276 |
| 9.5 Limitations of Study and Suggestions for Future Research | 280 |
| 9.6 Conclusion | 282 |
| | |
| REFERENCES..... | 284 |
| | |
| APPENDICES | 302 |
| Appendix I: SIB Database | 302 |
| Appendix II: Questionnaires..... | 304 |
| a. Pilot Questionnaire | 304 |
| b. Final Questionnaire | 321 |
| Appendix III: Support Letters..... | 332 |
| a. Application Support Letter to SIDC from Supervisor..... | 332 |
| b. Application Support Letter to SIDC from the University | 333 |
| Appendix IV: SPSS Output for Chapter 5 | 334 |
| Appendix V: SPSS Output for Chapter 6 | 338 |

| | |
|---|-----|
| Appendix VI: SPSS Output for Chapter 7 | 350 |
| Appendix VII: SPSS Output for Chapter 8 | 354 |

LIST OF TABLES

| | | |
|------------|--|-----|
| Table 2.1 | SIB Database According to Country and Social Areas | 39 |
| Table 2.2 | Ihsan SRI <i>Sukuk</i> Key Transaction Details | 60 |
| Table 3.1 | Summary of <i>Maqasid al-Shari'ah</i> Items | 79 |
| Table 3.2 | SIB Characteristics and Parallels to <i>Maqasid al-Shari'ah</i> | 83 |
| Table 4.1 | Pilot Study Respondents' Profile | 118 |
| Table 4.2 | Questionnaire Distribution and Response Rates | 123 |
| Table 4.3 | Distribution of Respondents by Profession | 125 |
| Table 4.4 | Distribution of Respondents by Work Experience in Current Vocation | 126 |
| Table 4.5 | Respondents' Involvement in Financial Instruments | 127 |
| Table 4.6 | Distribution of Respondents' Average Income per Month | 128 |
| Table 4.7 | Respondents' Gender | 129 |
| Table 4.8 | Sample Breakdown by Race | 129 |
| Table 4.9 | Respondents' Religion | 130 |
| Table 4.10 | Respondents' Level of Education | 130 |
| Table 5.1 | Conventional Bonds vs. Social Impact Bonds | 145 |
| Table 5.2 | Distribution of Responses to SIB Items (N=260) | 154 |
| Table 5.3 | Distribution of Responses to CB Items (N=260) | 163 |
| Table 5.4 | Distribution of Responses to SRI <i>Sukuk</i> Items (N=260) | 169 |
| Table 5.5 | Distribution of Responses to Remaining Items (N=260) | 174 |
| Table 5.6 | Test for Normality of Composite Score Data | 177 |
| Table 5.7 | Wilcoxon Signed Ranks Test Statistics | 178 |
| Table 5.8 | Mann-Whitney U Test and Descriptive Stats | 181 |
| Table 6.1 | KMO and Bartlett's Test for 21 Items Combined | 198 |
| Table 6.2 | Factor Loadings and Communalities | 199 |

| | | |
|-----------|--|-----|
| Table 6.3 | Grouping of Factors and Significant Variables | 200 |
| Table 6.4 | Reliability, Mean, and Standard Deviation of Factors | 201 |
| Table 6.5 | Test for Normality | 202 |
| Table 6.6 | Intercorrelations of Variables | 203 |
| Table 6.7 | Multiple Regression Analysis of the Extended TPB model | 204 |
| Table 6.8 | Mann-Whitney U Test Statistics | 206 |
| Table 7.1 | Summary and Implications of Study of Investors in Canada | 225 |
| Table 7.2 | Critical Success Factors | 230 |
| Table 7.3 | Critical Success Factors Mean Scores and Rankings | 232 |
| Table 7.4 | Tests of Normality | 239 |
| Table 7.5 | Mann-Whitney U-Test between Investors and Developers | 240 |
| Table 8.1 | SIB Social Areas, Examples, and Sources | 248 |
| Table 8.2 | Social Areas Mean Scores and Rankings | 250 |
| Table 8.3 | Normality Test Results: Social Areas | 258 |
| Table 8.4 | Mann-Whitney U-Test Between Investors and Developers | 258 |
| Table 9.1 | Summary of Findings and Implications | 274 |

LIST OF FIGURES

| | | |
|------------|--|-----|
| Figure 2.1 | PPP, PbR and SIB | 22 |
| Figure 2.2 | Generalised SIB Organisational Structure | 26 |
| Figure 2.3 | General SIB Structure | 27 |
| Figure 2.4 | SIB Value for Money | 30 |
| Figure 2.5 | Value of SIB Market and Social Areas (CAD mn) | 39 |
| Figure 2.6 | HMP Peterborough SIB Structure | 41 |
| Figure 2.7 | Ihsan SRI Sukuk Structure | 58 |
| Figure 2.8 | The SRI Ecosystem | 62 |
| Figure 2.9 | Example of Musharakah SIB Structure | 64 |
| Figure 3.1 | Hierarchy of Purposes of the Islamic Law | 77 |
| Figure 3.2 | Theory of Planned Behaviour | 94 |
| Figure 3.3 | Theoretical Framework Diagram | 96 |
| Figure 6.1 | Model Construct for Extended TPB | 197 |
| Figure 8.1 | Budget Allocation for Operations and Development of MOHE | 251 |
| Figure 9.1 | Major Themes of the Study | 264 |

LIST OF ABBREVIATIONS

| | |
|--------|--|
| CBs | Conventional Bonds |
| CSFs | Critical Success Factors |
| CSR | Corporate Social Responsibility |
| ESG | Environmental, Social and Governance |
| EFW | Enterprise Waqf Fund |
| GLCs | Government-Linked Companies |
| IFIs | Islamic Financial Institutions |
| ITI | Industry Transformation Initiative |
| KPIs | Key Performance Indications |
| MRA | Multiple Regression Analysis |
| NGO | Non-Government Organisations |
| NPO | Non-Profit Organisations |
| PbR | Payment by Results |
| PCA | Principal Component Analysis |
| PPP | Public-Private Partnership |
| REITS | Real Estate Investment Trusts |
| SAC | <i>Shari'ah</i> Advisory Council |
| SC | Securities Commission |
| SC SIB | <i>Shari'ah</i> -compliant Social Impact Bonds |
| SIB | Social Impact Bonds |
| SIDC | Securities Industry Development Corporation |
| SIMT | Social Impact Measurement Tool |
| SPSS | Statistical Package for the Social Science |
| SPV | Special Purpose Vehicle |
| SRI | Sustainable and Responsible Investment |
| TPB | Theory of Planned Behaviour |
| TRA | Theory of Reasoned Action |

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF STUDY

Social service programmes are integral to a nation. They provide care and welfare to people through various types of assistance in areas such as healthcare, education, and social security. Providing these social services is the executive responsibility of the government as the caretaker of the people and the nation's public funds. However, growing public debt and economic hardship reduce the ability of the government to continuously fund social services and cover all the social areas that need attention (Fox & Albertson, 2012). There is also a growing acknowledgement that existing social programmes, especially those that are funded by the government, are not being managed well enough to reach their full potential (Liebman, 2011). As a result, Non-Government Organisations (NGOs) and Non-Profit Organisations (NPOs) have come into the sector to offer their services and fill the gaps which the public services have failed to address. However, despite their efforts to help the public, the social services provided by NPOs often do not have a stable long-term funding, and lack the ability and resources to scale up their operations (Liebman, 2011).

NPOs that offer social services typically have substantial knowledge, understanding and experience in the social issues that they address and engage in (Department for Communities and Local Government, 2014; Goering et al., 2014; Nahar & Aslam, 2016; Social Finance & The Young Foundation, 2012). Often, these NPOs have innovative ideas that can potentially help solve the issues at hand. At times, they may even outperform the government in providing the social services as they are

more targeted since they are established by people who are closer to the grassroots and have genuine concerns about the issues at hand (Nahar & Aslam, 2016).

Yet, past experiences show that their ideas are often implemented at a small scale or are held back due to limited funds and restricted experience on how to obtain additional and stable funding (Liebman, 2011; Nathan et al., 2014; Patel, 2014). Additionally, unnecessary bureaucracy and red tape results in a lot of time and energy being expended on efforts to obtain government funding (Nahar & Aslam, 2016; Nathan et al., 2014; Patel, 2014). Although some programmes run by NPOs do receive monetary assistance from the government for their operations, most of the time the funding-streams are not consistent in the long term, and the amount is usually not enough for them to scale up their operations to cover more affected people (Liebman, 2011). This over-reliance on government funding also raises the question of NPOs compromising their independence and objectives to pursue the goals dictated by the government (Aslam et al., 2013).

Furthermore, in the current system, very few government-funded social service programmes focus on the outcomes of the services provided. Rather, the focus has been on the delivery of services which are usually limited to a very specific activity. Outcomes of these programmes may not be rigorously assessed, thus allowing public funds to be wasted for years on ineffective programmes that have no indication of providing adequate impact (Liebman, 2011).

In response to these challenges inherent in current social services, new strategies have been proposed to create avenues for partnership between the public sector and private organisations in social service delivery and funding. These strategies look towards social financing, evidence-based policymaking or “social-impact” financing in the form of Payment by Results (PbR), as well as cross-sector collaborations in the form

of financing mechanisms such as Social Impact Bonds (SIBs) (Böhler, 2014; HM Government, 2011; ICF GHK & BMG Research, 2013; Ministry of Foreign Affairs of the Netherlands, 2013; NSW Government, 2013; Social Finance & Center for Global Development, 2013). It is argued that mechanisms such as SIBs may lessen the government's financial burden as the initial funding of social programmes is provided by the private sector (Liebman, 2011). SIBs could also solve the problem of the government spending money on inefficient programmes as repayment is made only if a programme is successful in achieving the impact or outcome targeted. Additionally, SIBs take away a significant amount of the financial risk from the public sector, as both the public and private sectors now share the overall risk.

Given the arguments on the significance of SIBs, it is not surprising to see an increase in global interest in innovative social service programmes. According to the "Social Impact Bond Tracker" by Finance For Good (2017), as of February 2017, there are approximately 58 SIB programmes being implemented globally. Initial pilot SIBs have shown results that may establish the effectiveness of the concepts of "payment by results" and "social impact investing," and thus SIB models, which promises its further development around the world (Disley et al., 2011).

Additionally, over the past two decades there has been some significant innovation in the financial markets related to social finance and social impact financial tools (Mendell & Barbosa, 2013). For example, change in the strategies of responsible investing has been progressive, shifting from negative screening to a positive screening and a proactive processes that take into account environmental, social and governance (ESG) factors considerations, as well as social impact considerations (Eurosif, 2016; US SIF, 2016b). The "Socially Responsible Investment" concept, also referred to as "Sustainable and Responsible Investment" (SRI) has been in existence for quite some

time but has only been gaining prominence over the past 25 years (US SIF, 2016a). SRI and impact investing models, such as SIBs, are encouraging new approaches to financial investments and considerations of the effect on the society. The positive appraisal of SRI and SIB is also encouraging the formation of public private partnerships (PPP) aimed at tackling social issues in ways that have not been attempted before. Some countries and institutions have even introduced concepts such as Social Private Partnerships framework (PricewaterhouseCoopers, 2009) and Social PPP (Agensi Inovasi Malaysia, 2015) to further this agenda.

From the perspective of Islamic economics and finance, SRI shares similar values as Islamic ethics in aspects such as social responsibility considerations and ethical investing practices. The roots of SRI practices, argued to have stemmed from Christian ethical beliefs, are also similar to the practices of Islamic economics borne out of the philosophies of the *Shari'ah* - a set of Islamic laws and principles which provides a gambit for responsible behaviour, ethics, and accountability (CIWM, 2015). These shared values and practices are especially prominent with *Shari'ah*-compliant investment practices in the market where Islamic investment screening criteria have become a standard approach. The SRI concept is not alien to the philosophy underlying Islamic economics and finance. In fact, it is in line with the *maqasid al-Shari'ah* (objectives of *Shari'ah*) and *maslahah* (public good) - two fundamental concepts embodying the philosophical foundation and *raison d'etre* of Islamic economics and finance (Laldin & Furqani, 2013).

The Islamic finance industry has shown tremendous growth since the early 1970s where it started progressively with institutions that merely managed *hajj* (Islamic pilgrimage) funds, and has since developed comprehensively with Islamic banking, Islamic capital market, and takaful segments. Assets of the industry are approximated

at USD2 trillion as of 2015 (IFSB, 2016). However, despite the promising progress of the Islamic finance industry, there are tensions between its theory and practice. Although the industry has facilitated legitimate legally-compliant financial services, it is argued that it has not fully fulfilled its *maqasid al-Shari'ah* through social development and social impact (Mohammad & Shahwan, 2013). Among others, there is a severe lack of innovative financial tools that can help fulfil these objectives, while at the same time also obtaining the financial returns needed to ensure its sustainability (Ng et al., 2015). This is also the case for the SRI sector where there are still vast areas for exploration and implementation of financial tools that can bring impact on the society. Although there is a shift from negative to positive screening approaches in investing, there is still a lack of financial product development based on the positive screening and social impact. While the demand for Islamic and SRI driven financial products is high, there is not enough innovation to provide adequate supply of such products. Innovative financial tools, such as SIB and SRI *sukuk*, gives an opportunity for Islamic economics and finance to fulfil its objectives and value proposition, while also providing growth opportunities and sustainability in the long run.

As a leading country in Islamic economics and finance, the discourse on SRI and SIB is very relevant to Malaysia. SRI financing models or financial instruments like SIBs may provide an opportunity to improve Malaysia's social financing structure and efficiency, while at the same time provide an avenue for further growth and innovation in its Islamic finance industry. Thus, in this context, there is a need to explore an SIB model that is *Shari'ah*-compliant and hence operational within the Islamic economics and finance industry. Various factors may influence the development of *Shari'ah*-compliant SIB (SC SIB), hence also the need for further research in this aspect to ensure its feasibility and sustainability. Therefore, this study is an attempt to explore the