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DETERMINANTS OF THE ADOPTION OF GOOD GOVERNANCE: EVIDENCES FROM ZAKAT INSTITUTIONS IN PADANG, INDONESIA

BY

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ABSTRACT

Zakat is one of the fundamental principles in Islam and central to develop an economic system by enhancing socio-economic development. It is an obligation for Muslims to give a specific amount of wealth to the beneficiaries of Zakat with the wide-ranging purposes of alleviating poverty. In Padang, Indonesia, many Zakat institutions are trusted bodies and are responsible for managing Zakat funds. The importance of proper management and governance are challenges for these institutions. Governance is defined as a decision-making process and how well institutions implement decisions. Good governance is critical to Zakat institutions for implementing good management practices that efficiently collect and distribute Zakat funds. This study examined the determinants of the adoption of good governance practices in Zakat institutions in Padang, Indonesia. A total of 51 questionnaires were analyzed out of 135 that had been distributed. The data was analyzed using the Statistical Package for The Social Science (SPSS) for descriptive statistics and the hypothesis testing. Four variables were used the determinants for the adoption of good governance, namely, number of employees, size, age and efficiency. Of the six hypotheses generated, only two hypotheses were significant. The results showed that only size of Zakat institutions were related positively and significantly to the adoption of good governance principles in Padang, Indonesia. The age of the Zakat institution also had a positive, significant relationship with performance. The study also found that the level of adoption of good governance practices in Zakat institutions in Padang was quite low. Overall, the study highlighted the urgency for the relevant authorities such as Badan *Amil* Zakat Nasional (BAZNAS) and local and national government to initiate governance improvements of Zakat institutions to ensure achievement of socio-economic justice.

ملخص البحث

الزكاة ركن من أركان الإسلام الأساسية، ولها دور عظيم في تنمية النظام الاقتصادي من خلال تعزيز التنمية الاجتماعية- الاقتصادية،وعلى كل المسلم إخراج قدر معين من مالهلمستحقي الزكاة من أجل علاج الفقر. في بادانج بإندونيسيا، هناك كثير من مؤسسات الزكاة الموثوقة والمسؤولة عن أموال الزكاة،وأصبحت ضرورة حسن تدبير أموال الزكاة وحكمها من أكبر التحديات التي تواجهها هذه المؤسسات. فالحكم هو عملية صنع القرار ومدى تنفيذ المؤسسات قراراتها،وكان الحكم الرشيد أمر مهم للغاية فيمؤسسات الزكاة من أجل تطبيق حسن تدبير أموال الزكاة في جمعها وتوزيعها. وكانت هذه الدراسة تبحث عن العوامل المتعلقة بممارسة مؤسسات الزكاة في بادانج بإندونيسيا الحكم الرشيد، فقامت الباحثة بتحليل 51 استبانة من مجموع 135 استبانة التي وزعتها، وتم التحليل باستخدام أساليب الإحصاء الوصفي واختبار الفرضيات في البرنامج (SPSS)، وتناولت أربع متغيرات من أجل التوصل إلى العوامل المتعلقة بممارسة المؤسسات الحكم الرشيد، وهي: عدد الموظفين، والحجم، والسن، والكفاءة. فمن ست الفرضيات التي وضعتها الباحثة، تظهر فرضيتين تأثير المتغيرات الملحوظة على ممارسة المؤسسات الحكم الرشيد.والنتيجة تشير إلى أنه حجم مؤسسات الزكاة فقط يظهر علاقته الإيجابية الملحوظة باعتماد المؤسسات على مبادئ الحكم الرشيد في بادانج بإندونيسيا. وكذلك، تظهر العلاقة الإيجابية الملحوظة بين أداء العمل في مؤسسات الزكاة وبين ممارسة المؤسسات الحكم الرشيد. وكذلك استنتجت الدراسة أنه كان مستوى ممارسة الحكم الرشيد في مؤسسات الزكاة في بادانج ضعيفًا، فأكدت الدراسة على الحاجة الملحة إلى مساعدة الهيئات المتعلقة بالقضية مثل مؤسسة الزكاة الوطنية (Badan *Amil* Zakat Nasional ((BAZNAS و الحكومة المحلية، والحكومة الاتحادية فيبدء تحسين إدارة مؤسسات الزكاة من أجل ضمان تحقيق العدالة الاجتماعية والاقتصادية.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as dissertation for the degree of Master of Science in Accounting.

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DECLARATION

I hereby declare that this dissertation is the result of my own investigation, expect 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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In the name of Allah most gracious and most merciful.

To my mother;

who taught me sincerity, compassion and patience.

To my father;

who taught me discipline, perseverance and moderation.

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LIST OF ABBREVIATION

BAZ	Badan Amil Zakat
BAZDA	Badan Amil Zakat Daerah
BAZNAS	Badan Amil Zakat Nasional
CEO	Chief Executive Officer
CFO	Chief Fundraising Officer
COO	Chief Operational Officer
CPO	Chief Program Officer
CRO	Chief Relationship Officer
DEA	Data Envelopment Analysis
e.g.	(exampligratia): for example
et al.	(et alia): and others
i.e.	(id est): that is
IFI	Islamic Financial Institution
IOG	Institute on Governance
LAZ	Lembaga Amil Zakat
LAZDA	Lembaga Amil Zakat Daerah
LAZNAS	Lembaga Amil Zakat Nasional
NGO	Non- Governmental Organization
OECD	Organization for Economic Co-operation and Development
P.B.U. H	Peace Be upon Him
PLS	Partial Least Squares
PPP	Public- Private Partnership
SEM	Structural Equation Modeling
SPSS	Statistical Package for the Social Science
S.W.T	Subhanahu Wa Ta'ala (Praise be to Allah and the Most High)
TQM	Total Quality Management
UNDP	United Nations Development Programme
UPZ	Unit Pengumpulan Zakat
ZIS	Zakat, Infak and Shodaqoh

CHAPTER ONE

INTRODUCTION

1.0 INTRODUCTION

The images of "bad governance and lack of accountability" have often been presumed to be characteristic of public services organizations. Zakat institutions are no exception. As a trusted body in managing and administrating Zakat, they receive much attention from the public. Maintaining a high level of transparency and good governance practices are challenges for Zakat institutions in order to achieve efficiency and good governance. Hence, this study examines the current practices of good governance in Zakat institutions in Padang, Indonesia. To achieve this objective, this study examines the determinants and level of adoption of good governance practices in Zakat institutions in Padang. This chapter begins with the background of study, followed by problem statements and further explains the research objectives and research questions. The last section discusses the motivation and organization of the study.

1.1 BACKGROUND OF THE STUDY

Governance is a process through which societies or organizations make important decisions (Institute of Governance [IOG], 2003). Essentially, governance is concerned with how an organization conducts its activities, giving direction and setting strategies in compliance with norms, regulations, and social expectations. In other words, governance is necessarily about making organizational rules and procedures to ensure the effectiveness of an organization's activities. Zakat institutions are trusted bodies

responsible for managing Zakat activities in Muslims countries. Governance is also considered as an indicator to measure the effectiveness of Zakat institutions. A possible reason for this is that governance is a process guiding and restraining the decision-making process of Zakat managers. Proper governance through appropriate directions and strategies for certain activities are necessarily important for enhancing socio-economic justice. Therefore, evaluation of governance is crucial for Zakat institutions to function effectively. In Indonesia and especially in Padang, no official statistical reports exist on the adoption of good governance principles in Zakat institutions. This is despite the fact that the potential for Zakat collection in Indonesia is almost 217 trillion rupiah or equal to 3.4 per cent of Indonesia's 2010 GDP (Firdaus, Beik, Irawan & Juanda, 2012). Hence, this study focuses on the issue of the adoption of good governance in Padang, Indonesia.

Demographically, Padang city has a strategic position as a capital city of West Sumatera Island. Sumatera is one of the biggest islands in Indonesia. Around 803,706 people or 96 per cent of Padang's citizens are Muslims (Statistics of Indonesia, 2010), and many Zakat institutions have been established in Padang, including those from government, Non-Governmental Organizations (NGOs), Islamic Co-operative, corporate bodies and *Mosque*s. Because of their wide reach, Zakat institutions have great potential to address Padang's poverty problem by distributing charitable funds to poor and needy people.

Unfortunately, a number of Zakat institutions have not adopted good management practices, and thus a lack of proper management still can be found. For example, media reports have said that one of the large government Zakat institutions have put its Zakat collection in the local bank instead of dispensing the funds

(Posmetro Padang, 2013)[1]. The impact of this situation is related to the issue of transparency and accountability that managers should practice in handling Zakat funds. Zakat managers could handle these issues properly if they adopted good governance standards. According to Vinten (1997), governance enhances transparency, efficiency and accountability in delivering public needs. Further, governance supports the effectiveness of an institution's performance (Taylor, 2000; Graham, Amos & Plumptre, 2003; Abdul Wahab & Abdul Rahman, 2011). Therefore, to resolve all these potential issues, Zakat institutions in Padang should either adopt or adapt these principles to ensure accountability and good performance.

1.2 PROBLEM STATEMENT

The development of Zakat institutions in Indonesia has evolved since Zakat Management enactment No. 38/1999 that protects, regulates and services *Mustahiq* and *Amil* Zakat (Mujiyati, 2010). The growth of Zakat institutions in Padang has attracted huge attention from the public. Despite being regarded with respect as trusted bodies responsible for managing and administrating the Zakat, many issues exist with respect to the management performance of Padang Zakat institutions. First among these issues are transparency and accountability. The lack of accountability is evidenced in Indonesian Zakat institutions by difficulties in obtaining financial reports. This difficulty could be because Zakat institutions still perceive themselves as institutions similar to charity institutions that do not really need to be fully responsible or transparent to the public. Many of these institutions would argue that most of their

[1]Redaction of Postmetro Padang, "Baznas Kerjasama dengan Bank Nagari, Tabungan Dana Zakat Diberi Bunga", *Postmetro Padang*, 19 February, 2013, <http://posmetropadang.com>

work deals with issues pertaining to the soul that are not easily measured or reported (Afifuddin & Nabiha, 2010).

Zakat managers of Badan *Amil* Zakat Nasional (BAZNAS) do not announce to the public where they save the Zakat funds, and the public is suddenly surprised when they learn that Zakat funds have been deposited in a local bank rather than being distributed to the poor and needy (Postmetro Padang, 2013)[2]. Such practices have raised serious concerns for Muslims in Padang, but shown the reported case represents only a tiny fraction of the number of such cases that have occurred in Padang Zakat institutions. Over time, the lack of accountability for such practices will erode public confidence on Zakat institutions. Muslims will begin to assume their money will be not distributed to the rightful recipients, and will prefer to give Zakat directly to them (Lessy, 2009).

Table 1.1 Number and Percentage of Poor in Padang

Years	**Poverty Line**	**Poor People**	
		Total (000)	**Percentage (per cent)**
2011	326,705	51	6
2010	306,108	53	6
2009	272,329	47	6
2008	237,999	52	5
2007	197,554	40	5
2006	289,273	42	4

Source: Statistics of Indonesia (2013)

The second issue is related to the efficiency of Zakat institutions in Padang, as no evidence exists that they have achieved their goal of eradicating socio-economy

[2] Redaction of Postmetro Padang, "Baznas Kerjasama dengan Bank Nagari, Tabungan Dana Zakat Diberi Bunga", *Postmetro Padang*, 19 February, 2013, <http://posmetropadang.com>

problems. In spite of the fact that Badan *Amil* Zakat Daerah (BAZDA) collected Zakat in the amount of Rp 15 billion (USD=1,251,000) in 2011 and Rp 18.5 billion (USD= 1,542,900) in 2012 (Padang Ekspres, 2013)[3], these funds were not effectively distributed to protect the social-economic interests of the rightful beneficiaries. As presented in the Table 1.1, Statistics of Indonesia (2013) recorded that the number of poor people in Padang increased from 47,000 in 2009 to 51,000 in 2011.

The huge gap between actual Zakat collection and effective Zakat distribution indicates that the performance of Zakat institutions in Padang remains low. The demand for accountability by the public is quite challenging for Zakat institutions because satisfying those demands is more than just collecting and distributing Zakat in accordance with *Shariah* principles. The expectations are that Zakat institutions will be managed professionally and efficiently (Ismail Ibrahim, 2006). As a result, Zakat institutions in Padang must improve management and governance practices. For the purposes of this study, the implementation of good governance is assumed to help Zakat managers in exercising power and control over institutional activities. Good governance is concerned with the responsibility of Zakat managers for governing their institutions with full integrity for stakeholders. The concept of good governance is a set of dynamic processes in an organization that determine the organization's structures and functions, giving directions and setting strategies (Shipley & Kovacs, 2008; Graham et al., 2003).

Good governance is a key element for institutions to conduct its activities in a manner that promotes good values, norms and ethics. Further, good governance also ensures that organizational activities and operations meet public needs and

[3] Zulkarnaini, "Zakat Disimpan Bank Nagari, DPRD Pertanyakan Bunga Dana Zakat", *Padang Ekspres*, 20 February, 2013, <http://padangekspres.co.id/?news=berita&id=40708>

expectations. The need for accountability in Zakat institutions is crucial because Islamic institutions such as Zakat are required by Islam to be fully accountable, fair, and honest and serve justice. Past empirical studies have focused mainly on proposing a framework for good governance and efficiency of Zakat institutions (e.g., Abdul Wahab & Abdul Rahman, 2011).

Thus, research examining the level of adoption of good governance in Zakat institutions is lacking, and taken together with poor accountability and performance this need is the major motivation for this research. Even though the main focus of this study is to examine the determinants for the adoption of good governance in Zakat institutions in Padang, Indonesia, an investigation of performance is also conducted. Therefore, this study examines the determinants for the adoption of good governance and performance in Zakat institutions in Padang, Indonesia.

1.3 OBJECTIVES OF THE STUDY

The main focus of this study examines the determinants for the adoption of good governance. It also examines the determinants for performance of Zakat institutions in Padang, Indonesia. The study also aims to undertake an in-depth examination on the level adoption of good governance principles of Zakat institutions in Padang. The analysis of good governance principles is carried out based on five principles, namely, legitimacy and voice, direction, performance, accountability and fairness that the IOG's good governance principles adopted from United Nations Development Programme (UNDP) developed in 1997.

The research objectives of this study are:

1. To examine the level of adoption of good governance in Zakat institutions in Padang, Indonesia;

2. To investigate the determinants for the adoption of good governance in Zakat institutions in Padang, Indonesia; and
3. To explore issues concerning the governance of Zakat collection and distribution in Padang, Indonesia.

In seeking answers to the above research objectives, the study examines the adoption of good governance and the performance in Zakat institution in Padang, Indonesia. The study selected 135 Zakat institutions including government-based, NGOs, Islamic Co-operative, corporations and *Mosque*s. These institutions were selected due to their function as trusted intermediaries for Muslims to donate their Zakat and then distribute the Zakat funds to the rightful Zakat recipients. Every Zakat institution was provided questionnaire, which was addressed to institutional managers who were in charge of the collection and distribution of Zakat. Thus, these managers should provide good insight into the adoption of good governance principles in Zakat institutions in Padang, Indonesia.

1.4 RESEARCH QUESTIONS

Based on the limited literature and lack of past studies, the question of whether Zakat institutions in Padang have adopted good governance principles has been largely undetermined. The criticism of poor performance, lack of accountability and transparency in managing Zakat funds can be associated with the level of adoption of good governance.

Thus, the research questions of this study were as follows:

1. What is the level of adoption of good governance principles in Zakat institutions in Padang, Indonesia?

2. To what extent do institutional characteristics influence the adoption of good governance principles in Padang, Indonesia?
3. What are the issues of governance on Zakat collection and distribution in Padang, Indonesia?

1.5 MOTIVATIONS FOR THE STUDY

The motivation for this study largely stems from the important role of Zakat institutions for Muslim society at large. Most past studies in this area such as Shehata (1994), Shariff, Jusoh, Mansor and Jussoff (2011), Abu Bakar (2011), Abdul Wahab and Abdul Rahman (2012), Abdul Rahman, Haji Alias and Omar (2012) have explained that the payment of Zakat is not only to fulfil the religious aspects, but also to contribute towards poverty alleviation and socio-economic development. On the basis of social and economics, performing Zakat plays a prominent role in creating balanced human development to eradicate poverty and enhance socio-economic justice. Paying and distributing a Zakat encourages the Muslims to take care of the poor and needy. Ensuring fellows Muslim are well protected socially and economically is a responsibility for Muslims. The following are justifications for this study.

First, Zakat institutions are expected to play a key role in promoting the socio-economic objectives of Zakat in Indonesia. Despite having a number of Zakat institutions in Indonesia, Zakat management has not achieved effectiveness that meets public expectations. The chairman of BAZNAS and The Minister of Social Affairs of Republic of Indonesia, for instance, have said that the Zakat funds have not been

distributed effectively to the rightful beneficiaries **(**Tribunnews, 2013)[4]. In fact, this issue provides sufficient impetus for understanding the governance current practices of Zakat institutions in Padang, Indonesia.

Second, previous studies such as Taylor (2000), Graham et al. (2003) and Abdul Wahab and Abdul Rahman (2011) have found that good governance is important in supporting effective organizational performance. Governance has been defined as a process of decision-making and a process by which these decisions are implemented. Good governance in Zakat institutions is also in linked to the requirements of Islam for fairness, justice and accountability. These principles are important for ensuring the achievement of the goals and objectives of Zakat institutions. Therefore, investigating the level adoption of governance in Zakat institutions in Padang, Indonesia is necessary.

Third, a lack of study on good governance in Zakat institutions exists in Indonesia generally and Padang in particular. Fadilah (2013) conducted a preliminary study of good governance in the Institute *Amil* Zakat throughout Indonesia consisting of 41 Lembaga *Amil* Zakat Nasional (LAZNAS) and Lembaga *Amil* Zakat Daerah (LAZDA). However, the study only focused on to the implementation of Total Quality Management (TQM) and internal control that significantly influenced the implementation of good governance indirectly. Similarly, Abdul Wahab and Abdul Rahman (2011) proposed a framework for good governance and efficiency of Zakat institutions in Malaysia. Thus, although a few studies have highlighted the importance of good governance in Zakat institutions, an examination of the determinants for the adoption of good governance in Zakat institutions has yet to be thoroughly

[4] Redaction of Tribunnews, "Koordinasi Lembaga Zakat Masih Belum Efektif", Tribunnews, 12 July, 2013,<http://www.tribunnews.com/nasional/2013/07/12/koordinasi-lembaga-Zakat-masih-belum-efektif>