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ZAKAT-BASED MICROFINANCE: INSIGHTS FROM THE MELAKA ISLAMIC RELIGIOUS COUNCIL (MAIM)

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ABSTRACT

Islamic microfinance serves as a crucial tool for empowering marginalized and underserved populations by providing financial access for entrepreneurial activities, thereby contributing to poverty alleviation. Despite its recognized potential, the accessibility of Islamic microfinance remains limited due to funding constraints, prompting innovative approaches such as the use of zakat funds. Among the earliest institutions in Malaysia to implement zakat-based microfinance, the Melaka Islamic Religious Council (MAIM) adopted the qard al-hasan (interest-free loan) model to support small-scale entrepreneurs from the asnaf community. While this initiative showcased significant potential for enhancing financial inclusion and socio-economic development, its sustainability faced considerable challenges. This study utilizes qualitative methods, including semi-structured interviews and content analysis to examine MAIM's experience in implementing zakat-based microfinance. The findings identify critical barriers, such as community misconceptions, managerial shortcomings, and resource limitations, which contributed to the zakat-based microfinance program's discontinuation. By addressing these challenges, the study offers practical recommendations to strengthen the sustainability and impact of zakat-based microfinance initiatives. This research provides valuable insights into the integration of Islamic social finance principles within microfinance frameworks to achieve sustainable poverty alleviation and socio-economic development.

Keywords: *Islamic Microfinance, Zakat, MAIM, Micro-Entrepreneurs, Challenges.*

1. INTRODUCTION

The current reality indicates that many Muslim-majority countries appear to deviate from the concept of universal welfare (*maslahah*). Muslim communities are often associated with underdevelopment and poverty. According to data from the Human Development Index published by the United Nations Development Programme (UNDP, 2019), a significant number of Muslim-majority countries are classified as having 'poor' or 'extremely poor' populations. These nations also score poorly in areas such as balanced nutrition, healthcare, life expectancy, and education.

Islam teaches us that true righteousness extends beyond ritual practices to include tangible efforts in supporting those in need through acts of generosity and resource-sharing:

> *Righteousness is not that you turn your faces toward the east or the west, but [true] righteousness is [in] one who believes in Allah , the Last Day, the angels, the Book, and the prophets and gives wealth, in spite of love for it, to relatives, orphans, the needy, the traveler, those who ask [for help], and for freeing slaves; [and who] establishes prayer and gives zakah; [those who] fulfill their promise when they promise; and [those who] are patient in poverty and hardship and during battle. Those are the ones who have been true, and it is those who are the righteous. (Al-Baqarah 2:177)*

To address this pressing challenge of poverty, sustainable and long-term funding sources, alongside community development initiatives, are essential. Social finance has emerged as a crucial alternative to replace traditional government and donor funding for non-profit organizations engaged in community development, particularly in Indonesia and other predominantly Muslim nations. Among the various tools of Islamic finance, zakat—the third pillar of Islam and a mandatory act of almsgiving—holds significant potential. All Muslims meeting specified financial thresholds are obligated to contribute at least 2.5% of their accumulated wealth or income to benefit eligible recipients. Similarly, waqf, an Islamic endowment wherein assets are entrusted for charitable or religious purposes, and *sadaqah* (voluntary charity) have long been pivotal social finance mechanisms. These instruments have played a transformative role in combating poverty and fostering socio-economic development across Muslim communities for over 1,400 years.

Traditionally, zakat has been closely linked with providing direct financial assistance to address the immediate needs of impoverished individuals. Most zakat institutions commonly allocate funds in the form of cash or necessities, such as food. While these approaches offer temporary relief, they often fail to deliver sustainable, long-term benefits to the recipients. Studies indicate that such distribution methods have only a minimal effect on overall consumption patterns within the community. To enhance its effectiveness, zakat utilization should extend beyond meeting short-term consumption needs. Instead, it should encompass productive initiatives aimed at creating ongoing income streams for beneficiaries, thereby fostering lasting economic empowerment.

Therefore, the notion of zakat-based microfinance offers significant promise as an innovative mechanism for alleviating poverty within Muslim communities. By channelling zakat funds into interest-free loans and other financial services that adhere to Shariah principles, this model directly caters to the needs of marginalized populations often excluded from conventional banking systems. Unlike traditional microfinance, which often prioritizes profit, zakat-based approaches emphasize social welfare, aligning closely with the ethical and inclusive values of Islam. This framework not only enables small-scale entrepreneurs to attain financial independence but also nurtures a sense of self-reliance and dignity among beneficiaries. When effectively implemented, combining financial discipline, community participation, and capacity-building programs, zakat-based microfinance has the potential to bridge the gap between economic hardship and long-term development, generating widespread benefits that uplift entire communities.

This article aims to explore the implementation of zakat-based Islamic microfinance at the Melaka Islamic Religious Council (MAIM). It begins with a discussion on the concept of microfinance, followed by an overview of MAIM's background. Insights from interview data will shed light on the implementation process of zakat-based Islamic microfinance and the challenges that led to its discontinuation.

2. THE CONCEPT OF ISLAMIC MICROFINANCE

Conceptually, microfinance refers to small-scale financial services that may include credit, savings, insurance, and investment. It is termed "micro" because it targets marginalized, impoverished groups often excluded by mainstream banking systems, providing them with small-scale financial access for entrepreneurial purposes (Kiiru, 2007). The academic sphere offers varying definitions of microfinance, leading to a lack of uniformity. Otero (1999) defines microfinance as the provision of financial services to low-income, poor, and extremely poor individuals. However, this definition diverges slightly from practical applications, as microfinance institutions often avoid serving the extremely poor to minimize risks of misappropriation (moral hazard). Karlan

& Goldberg (2011) describe microfinance as the inclusive provision of small-scale financial services for those excluded from mainstream banking.

Despite the diverse definitions, the essence of microfinance remains consistent: it is a financial instrument characterized by its small scale, focus on financial inclusion, targeting the poor as its primary beneficiaries, and aiming to empower them through entrepreneurial activities. Microfinance differs fundamentally from commercial finance in two key aspects: implementation objectives and target clientele. Microfinance prioritizes impoverished and rural populations as its primary clients, with poverty alleviation as its main objective. Conversely, commercial finance targets middle- and upper-class groups, focusing on profit generation as its business orientation.

Microfinance is often associated with the establishment of the Grameen Bank in Bangladesh by Prof. Muhammad Yunus in 1983. The bank not only provides financial access to the poor but also supports their businesses through entrepreneurship training programs that enhance clients' knowledge and skills. Empirical studies have shown that the Grameen Bank initiative has had a positive impact on poverty alleviation efforts (Bhuiyan et al. 2017; Khandker 1996; Siwar dan Talib 2001; Wahid 1994). This remarkable success earned Prof. Yunus and the Grameen Bank the Nobel Peace Prize in 2006. However, the Grameen Bank operates as a conventional microfinance institution and is not Shariah-compliant, as it charges interest on its loans. A survey conducted by Karim, Tarazi, dan Reille (2008) found that most Muslims in impoverished countries are reluctant to engage in interest-based loans due to their inconsistency with Islamic principles and values. Recognizing this need, the implementation of Islamic microfinance must be intensified to address the financial needs of poor Muslim communities in a Shariah-compliant manner.

Islamic microfinance can be considered an adaptation of conventional microfinance, differentiated by its application and development of Islamic financial contracts in offering products and services. Key contracts used in Islamic microfinance include *murabahah* (cost-plus financing), *qard al-hasan* (benevolent loans), and *musharakah* (partnership). Rahman (2007) dan Ahmed (2002) highlight several fundamental differences between Islamic and conventional microfinance, as summarized in the following table:

Table 1 Comparison Between Islamic Microfinance and Conventional Microfinance

	Islamic Microfinance	**Conventional Microfinance**
Sources of funds	External sources, client savings, *zakat*, *waqf*, etc.	External sources, client savings
Financing Instruments	Diverse Islamic contracts such as *murabahah*, *qard al-hasan*, and *musharakah*.	Interest-based loans
Target Population	Extremely poor and moderately poor populations	Moderately poor populations only
Target Groups	Families and women.	Women only.
Debt Responsibility	Shared by clients and their spouses	Solely borne by the clients.
Default Management	Group and spousal guarantees, guided by Islamic ethics	Relies on group pressure
Operating Model	Emphasizes religious values and compliance with Shariah	Secular approach without adherence to Shariah)

Although Islamic microfinance has not been widely explored in Islamic finance academia, it is an essential and foundational component of the Islamic financial ecosystem. It complements the existing Islamic financial system by serving as a mechanism for financial inclusion. The mainstream Islamic commercial financial system has often been criticized for being exclusive, focusing primarily on profit maximization and targeting middle- and upper-class segments. In contrast, Islamic microfinance, with its social orientation, broadens the scope of Islamic finance by targeting the lower-income population.

This approach contributes to a more comprehensive Islamic financial system, aligning it more closely with its original purpose: creating a meaningful social impact. By integrating lower-income groups into the system, Islamic finance can effectively fulfill its ethical mandate, reinforcing its role as a socially inclusive and impactful financial model (Chapra 1979; Lone 2016; Mohammad dan Shahwan 2013).

3. METHODOLOGY

This study employed a semi-structured interview method to collect primary data. This approach offers several advantages, including providing detailed and nuanced insights into the research phenomenon (Sekaran dan Bougie 2016) while allowing greater flexibility for interviewers to ask questions and for informants to share their views without being influenced by external factors (Berg, 2001). A set of interview questions was provided to the informants one week before data collection to ensure they had ample time to prepare their responses comfortably. The interviews were conducted face-to-face and involved two officers at the Zakat Management Centre (PZM) office. In addition to interviews, content analysis was employed to examine articles, reports, and other documents related to zakat and microfinance to gather supplementary data. For data analysis, inductive, deductive, and analytical methods were applied consistently to ensure robust and reliable findings.

4. BACKGROUND OF MAIM

MAIM was established on September 28, 1960, with the primary purpose of managing Islamic affairs in the state of Melaka, including the distribution of zakat (Sani et al., 2019). Its formation was under the provisions of the Administration of the Religion of Islam (State of Melaka) Enactment 2002, which states:

> *"There shall be a body known as the 'Melaka Islamic Religious Council' to assist and advise the Yang di-Pertuan Agong on matters related to Islam."*

MAIM's operations are guided by its objectives, vision, and mission. Its vision is to become a leading institution in managing *Baitulmal* efficiently, professionally, and innovatively, thereby enhancing the economic development of Muslims in Melaka by 2022 in line with technological advancements and current needs, while adhering to Shariah principles. To achieve this, MAIM's mission focuses on advancing zakat management, Baitulmal property development, and socio-economic initiatives through systematic governance and the preservation of *maqasid shariah*, executed transparently and efficiently. Below is the objective of MAIM:

i. To motivate and guide the Muslim community toward the pursuit of knowledge and exemplary practices, fostering a progressive, virtuous, and ambitious society aligned with Islamic principles.
ii. To position MAIM as a unifying institution and a point of reference for

resolving issues within the Muslim community.

iii. To promote harmony among diverse racial, ethnic, and cultural groups through effective and impactful *dakwah* efforts.
iv. To develop and enhance *Baitulmal* for economic stability through well-planned investments, construction, and Shariah-compliant business ventures.
v. To advance and expand zakat institutions for the benefit of the Muslim community.

The Baitulmal department within MAIM is tasked with overseeing zakat-related affairs, particularly the distribution of zakat funds and addressing zakat-related issues. It consistently manages, plans, and regulates the welfare of zakat recipients across all *asnaf* categories. Additionally, it coordinates and investigates applications from those in need, ensuring proper assessment and provision of aid. To ensure systematic and efficient zakat management, Baitulmal has established several objectives (MAIM, 2020):

i. To distribute zakat collections to the eight *asnaf* groups through programs, schemes, and projects outlined in the zakat budget, ensuring efficiency, effectiveness, and compliance with Shariah principles.
ii. To identify the poor and needy who require assistance, thoroughly investigating and processing applications to verify their eligibility based on established guidelines.
iii. To foster a sense of acceptance and patience among those eligible for aid.
iv. To collaborate with various stakeholders to support eligible individuals through zakat funds.

5. IMPLEMENTATION OF ZAKAT-BASED ISLAMIC MICROFINANCE AT MAIM

MAIM was among the earliest zakat institutions to offer Islamic microfinance using zakat funds. This initiative was introduced in Melaka in 2014 through the *qard al-hasan* model, which refers to interest-free loans. In this zakat-based microfinance program, MAIM functions as the creditor, while asnaf entrepreneurs take on the role of debtors. MAIM provides financial assistance in the form of loans to supply the necessary capital for the entrepreneurial ventures of asnaf beneficiaries. These loans are typically disbursed as cash, recognizing that not all asnaf entrepreneurs require equipment—some may only need additional funds to expand their businesses. The contract's duration is determined through mutual agreement between both parties, with MAIM setting the monthly repayment amount in accordance with the agreed terms. Recipients of this facility were required to repay the financing they received, as the compulsory repayment element was crucial to encouraging small-scale entrepreneurs to work diligently to generate income and fulfil their repayment obligations.

This facility targeted low-income individuals who already had existing businesses or enterprises. The Baitulmal conducted a screening process to ensure that only those with specific types of enterprises qualified for this financing. Eligible applicants could borrow a maximum of RM5,000, with the funds sourced from the allocation for the *asnaf al-gharimin*. This *asnaf* category refers to individuals burdened with debt permitted by Shariah—such as debts for personal welfare or communal benefit—who are unable to repay their obligations (MAIM 2014; Md Yusof dan Tahir 2015). However, the scope of implementation was expanded to include individuals who may not necessarily be in debt but required financial support to sustain their existing enterprises.

The zakat-based microfinance facility was offered to small-scale entrepreneurs, not limited to those classified as *faqir* (destitute) or *miskin* (poor). Its primary objective was to empower small-scale business owners, thereby contributing to the socio-economic development of the local community. Such microfinance initiatives are crucial as tools for financial inclusion, providing underprivileged populations with access to financial resources and enabling their participation in economic activities (Hassan, 2015). Despite its significance, MAIM's zakat-based microfinance program lasted only two years, ending in 2016 due to sustainability challenges. This short-lived initiative underscores the complexities of integrating social objectives with financial sustainability in Islamic microfinance operations.

6. ISSUES AND CHALLENGES

Although zakat-based Islamic microfinance holds considerable promise for uplifting low-income groups, its long-term sustainability remains uncertain in practice. The experience of MAIN reveals several critical challenges and obstacles that hinder its effective implementation:

6.1 *Community Attitudes and Understanding*

MAIM’s microfinance program was founded on the *qard al-hasan* contract, it is compulsory for the recipients to repay the amounts borrowed. When funds are disbursed without the expectation of repayment, recipients may perceive them as unrestricted charity. This perception can lead to the funds being directed toward immediate consumption rather than investments that generate sustainable income. For example, a recipient might choose to use the money for daily household expenses rather than as capital to start or expand a business.

While this provides short-term relief, it does little to address the root causes of poverty or to create lasting financial stability.

The repayment requirement shifts this dynamic. Knowing they must repay the funds encourages recipients to allocate them toward income-generating activities, such as purchasing inventory, tools, or equipment for a small business. A repayment obligation also reduces the likelihood of misuse of funds. Without this rule, there is little accountability for how the money is spent, which could lead to waste or mismanagement. In contrast, when recipients are aware that repayment is expected, they are more likely to plan carefully and use the funds effectively. This productive use of the funds aligns with the objectives of zakat-based microfinance, which aims to transform beneficiaries into economically active contributors to society.

This initiative is not without its challenges, particularly when it comes to addressing recipients' reluctance to repay loans. A significant barrier stems from two pervasive misconceptions. First, many recipients perceive the zakat fund as their right, a divine provision meant to be given unconditionally. Second, zakat's traditional characterization as a form of charity reinforces the belief that repayment is unnecessary, creating resistance to the idea of returning the funds. These deeply ingrained views undermine the repayment framework, which is crucial for ensuring the sustainability of zakat-based microfinance initiatives. Beyond these misconceptions, some *asnaf* exhibit a complacent attitude. They become overly reliant on aid, viewing financial assistance as a continuous lifeline rather than a stepping stone toward self-sufficiency. This dependency mentality not only hampers the effectiveness of microfinance but also conflicts with the Islamic principle of empowering individuals to achieve financial independence. Such attitudes can lead to misuse of funds, as recipients may prioritize immediate consumption over investments in income-generating activities.

Another challenge is the lack of financial literacy and entrepreneurial skills among *asnaf*. Many asnaf lack the necessary knowledge to manage the funds effectively, which can result in poor financial decisions. For instance, funds intended to support business ventures might instead be spent on non-productive items, such as daily household needs. While these expenditures address short-term challenges, they fail to contribute to the long-term economic productivity of recipients or the broader objectives of zakat-based microfinance. Additionally, the enforcement of repayment adds a layer of complexity. Unlike conventional loans, where legal measures can be taken against defaulters, zakat-based microfinance operates within an ethical and religious framework. Institutions face challenges in balancing compassion with accountability, as aggressive enforcement could contradict the principles of

Shariah and potentially alienate beneficiaries. This delicate balance often leaves zakat institutions with limited recourse to ensure repayments.

6.2 *Lack of Expertise in Microfinance Management*

One of the critical challenges in implementing zakat-based microfinance is the evident lack of expertise in microfinance management within many zakat institutions. Unlike conventional microfinance, which is built on decades of experience and structured methodologies, zakat-based programs often struggle to adopt best practices that ensure both sustainability and effectiveness. This gap in expertise can limit the potential of zakat-based microfinance to uplift *asnaf* communities.

Microfinance management extends beyond simply disbursing loans; it involves creating a comprehensive system with structured methods and regulations to ensure that funds are utilized productively. Institutions such as Amanah Ikhtiar Malaysia (AIM) exemplify this with their group-based lending model. By requiring loans to be distributed to groups of five members, AIM introduces a system of collective responsibility, where if one member defaults, the others are obligated to cover the repayment. This system promotes accountability, peer support, and discipline among borrowers. Additionally, AIM's practice of weekly repayments alleviates the financial strain of larger monthly sums, making it easier for participants to manage their obligations incrementally. Successful microfinance programs also integrate crucial supplementary initiatives, such as entrepreneurship training and business management courses. These programs equip recipients with the skills needed to maximize the impact of the financing they receive, reducing the likelihood of financial losses in small-scale ventures. Furthermore, robust monitoring mechanisms are essential to track the use of funds, ensuring that they are directed toward productive purposes rather than immediate consumption or non-essential expenditures.

Unfortunately, zakat institutions like MAIM often lack the capacity to implement these sophisticated systems. This lack of expertise results in several shortcomings. For instance, without proper monitoring, recipients may use the funds for non-productive needs, such as covering daily expenses, which undermines the program's long-term objectives. Moreover, the absence of structured repayment systems, like AIM's group-based model, leaves zakat-based microfinance vulnerable to high default rates, as there is little to no mechanism to enforce accountability among borrowers. The lack of training programs and business development support is another significant weakness. Many *asnaf* lack entrepreneurial experience or financial literacy, which are critical for managing microfinance effectively. Without these skills, recipients are more likely to mismanage their funds or face difficulties in sustaining their ventures. This not only jeopardizes their ability to repay the loans but also diminishes the overall impact of the program in fostering self-reliance and economic empowerment.

In addition, zakat institutions often operate with limited manpower and resources. Staff members may already be overburdened with existing zakat management duties, leaving little room for the intensive fieldwork required in microfinance programs. Tasks such as assessing the creditworthiness of applicants, monitoring loan usage, and providing continuous support to recipients demand dedicated personnel with specialized expertise, which many zakat institutions currently lack. The absence of a clear operational framework for zakat-based microfinance hinders scalability and consistency. While institutions like AIM have developed well-defined systems over the years, zakat-based programs sometimes operate without consistent strategic planning or the adoption of proven microfinance methodologies. This may result in inefficiencies and missed opportunities to leverage zakat as a powerful tool for poverty alleviation.

6.3 *Human Resource Constraints*

Human resource constraints are a significant challenge in implementing zakat-based microfinance effectively. These programs demand extensive manpower for crucial tasks such as identifying eligible recipients, conducting financial assessments, monitoring fund usage, collecting repayments and providing ongoing support to participants. However, institutions like the MAIM often operate with limited staff, which restricts their ability to deliver impactful services. For instance, in each district, only two to three staff members are responsible for managing all zakat-related activities, including microfinance programs. This overstretched workforce leads to insufficient attention to essential tasks, such as regular client monitoring and field surveys, compromising the overall effectiveness of the program. Moreover, staff in zakat institutions typically lack specialized training in microfinance management, as their expertise is often confined to zakat distribution. The absence of skills in areas like financial planning, risk assessment, repayment system and entrepreneurship support hamper their ability to implement and oversee programs effectively.

Another critical issue is the lack of consistent monitoring and support for beneficiaries. Effective microfinance programs require regular engagement with participants to ensure productive fund utilization and to provide guidance for overcoming challenges. However, with an understaffed team, such follow-ups become sporadic, increasing the risk of fund mismanagement and business failures. Additionally, the integration of microfinance programs within broader zakat operations creates inefficiencies, as staff are burdened with overlapping duties that dilute their focus and effectiveness. This structural limitation is further compounded in rural areas, where the need for financial inclusion is greater but access to resources and manpower is most constrained. Limited staff availability makes it challenging to reach these communities, leaving them underserved and disconnected from the benefits of microfinance.

7. RECOMMENDATIONS

7.1 *Transforming Asnaf Perceptions and Practices*

Addressing the challenges related to community attitudes and understanding in zakat-based microfinance requires a practical and empathetic approach that directly engages recipients and reshapes their perceptions. One of the most effective strategies is educating recipients about the dual role of zakat in microfinance. While zakat traditionally serves as a charitable tool, its application in microfinance aims to foster development and self-sufficiency. Awareness campaigns can be designed to highlight this purpose, using real-life success stories of *asnaf* who have transitioned from dependency to self-reliance. These campaigns should emphasize that repayment is not merely a requirement but a means to ensure that others in the community can benefit from similar opportunities, creating a ripple effect of empowerment.

A lack of financial literacy and entrepreneurial skills is another major barrier to the productive use of funds. Zakat institutions should address this by providing mandatory training for recipients before disbursing funds. These programs can teach essential skills such as budgeting, saving, and basic business management. Tailored workshops for recipients planning small businesses, covering topics like inventory management and marketing, can further equip them to use the funds effectively. Pairing recipients with experienced mentors within the community can also provide practical guidance and inspire confidence. To ensure that funds are directed toward income-generating activities, structured loan utilization plans can be introduced. Recipients should work with microfinance officers to develop detailed business plans before receiving funds, outlining how the money will be used and the expected outcomes. These plans can include specific milestones and repayment schedules, fostering accountability and helping recipients focus on long-term goals. For recipients new to repayment obligations, a phased approach can ease the transition. Offering smaller initial repayment amounts or grace periods allows recipients to stabilize their income streams before beginning repayments, reducing financial pressure and increasing their willingness to comply.

Engaging the broader community is another impactful way to address misconceptions and resistance. Peer support groups can be established where recipients meet regularly to share experiences, challenges, and successes. These groups act as informal accountability networks, promoting a sense of solidarity and mutual encouragement. Collaboration with religious leaders can further strengthen these efforts. Trusted figures such as ustaz's, imams and scholars can use their influence to emphasize the principles and objectives of zakat-based microfinance, reinforcing the importance of repayment as a collective responsibility aligned with Islamic values. Balancing compassion with accountability is essential in maintaining the ethical framework of zakat-based microfinance. Instead of punitive measures, institutions can implement incentives, such as rewarding timely repayments or granting access to larger loans for consistent payers. Positive reinforcement motivates recipients while preserving the program's ethical integrity. Technology can also play a key role in enhancing transparency and support. Mobile applications or online platforms can provide recipients with real-time updates on repayments, reminders for due dates, and educational resources. These tools can also serve as channels for recipients to seek advice or report challenges, ensuring they feel supported throughout the loan cycle.

7.2 *Structured Operational Frameworks*

To address the lack of expertise in microfinance management within zakat institutions, a series of targeted and practical recommendations must be implemented, tailored to the specific challenges these institutions face. By focusing on capacity building, strategic partnerships, and operational refinement, zakat-based microfinance programs can become more effective and sustainable.

The first step is investing in specialized training for zakat institution staff. Employees responsible for managing microfinance programs need a solid foundation in essential areas such as financial planning, risk management, repayment systems and entrepreneurship development (Rozi, 2024). This training should not only focus on theoretical knowledge but also include practical workshops and case studies. For example, staff could learn how to design group lending models like those used by Amanah Ikhtiar Malaysia (AIM) or TEKUN Nasional, where collective responsibility among borrowers promotes accountability and reduces default rates. These workshops can also cover the design of weekly repayment schedules, which alleviate financial strain on recipients and encourage consistent repayment behaviour. Beyond individual training, institutions should establish dedicated divisions solely focused on zakat-based microfinance. Currently, many zakat institutions manage microfinance as an extension of their broader zakat operations, which dilutes focus and effectiveness. A specialized division would allow teams to concentrate on developing and executing robust microfinance strategies. This division could also be tasked with creating structured operational frameworks, ensuring consistency across all programs. These frameworks should include clear policies for loan disbursement, monitoring mechanisms, and repayment enforcement, tailored to the unique needs of *asnaf* communities.

Collaboration with established microfinance organizations is another key recommendation. Partnering with entities like AIM, TEKUN or even international microfinance networks could provide access to proven methodologies, technical expertise, and best practices. For example, these partnerships could introduce zakat institutions to advanced monitoring tools that track loan utilization and measure impact. Such tools help ensure that funds are used productively, reducing the likelihood of misuse or mismanagement. To strengthen recipient capacity, institutions should embed entrepreneurship training and financial literacy programs into the microfinance process. Before receiving funds, asnaf recipients should undergo mandatory training that covers basic business skills such as inventory management, marketing, and budgeting. Providing post-disbursement support, such as mentorship programs where recipients are paired with successful entrepreneurs, can further enhance their ability to sustain and grow their ventures. These initiatives reduce the risk of business failures and empower recipients to maximize the impact of the funds.

Leveraging technology can also help overcome the limitations of traditional systems. Mobile apps or web-based platforms can streamline processes such as loan applications, repayment tracking, and progress reporting. These tools reduce the administrative burden on staff and provide recipients with user-friendly ways to manage their loans and seek support (Thaidi, 2023). For example, a mobile app could send reminders for repayment due dates and offer financial management tips tailored to the recipient's business type. Finally, zakat institutions must adopt a phased approach to implementing advanced microfinance methodologies. Rather than attempting to overhaul systems entirely, incremental changes can be introduced to test their feasibility and effectiveness. For instance, a pilot program could be launched in one region to trial group-based lending or new monitoring mechanisms before scaling these practices institution-wide. This gradual approach minimizes risks and allows for adjustments based on real-world outcomes.

7.3 *Comprehensive Staff Training Programs*

To overcome human resource constraints in zakat-based microfinance, zakat institutions must implement targeted and practical strategies tailored to their operational realities. These recommendations focus on workforce development, structural enhancements, and innovative solutions to ensure that human resource limitations do not hinder the effectiveness and sustainability of microfinance programs. One immediate solution is to establish a dedicated microfinance division within zakat institutions. Specialising microfinance operations from broader zakat management duties allows institutions to ensure that staff members focus exclusively on tasks critical to the success of microfinance programs, such as recipient assessment, loan monitoring, and support for business development. This structural change allows for greater specialization and improved program delivery.

Equally important is providing comprehensive training for staff. Employees managing microfinance programs must acquire skills beyond traditional zakat distribution, including financial planning, risk assessment, repayment collection and community engagement (Jimoh, 2024). For instance, training modules can simulate real-life scenarios where staff learn to evaluate business proposals, assess creditworthiness, and design repayment plans tailored to individual recipients' needs. These programs should also incorporate case studies from successful microfinance initiatives, such as those by Amanah Ikhtiar Malaysia (AIM), to illustrate effective practices like group lending models and frequent repayment schedules. Recruiting additional personnel is crucial, particularly for roles that require fieldwork, such as conducting rural outreach or monitoring fund utilization. To ensure effective coverage in underserved areas, institutions should hire field officers dedicated to engaging with beneficiaries, assessing their progress, and providing guidance. These officers can act as a bridge between recipients and the institution, offering localized support that enhances program outcomes.

Collaboration with experienced microfinance organizations offers another practical avenue to address knowledge and resource gaps. Partnering with such organizations can provide zakat institutions with access to proven methodologies, tools, and best practices. For instance, partnerships can help introduce advanced monitoring systems that track loan usage and measure impact, ensuring that funds are utilized productively. Collaborative initiatives can also include joint training sessions or secondments, where zakat institution staff work alongside experienced microfinance practitioners to gain hands-on experience. Leveraging technology is an essential component of addressing human resource constraints, as it not only reduces the workload on staff but also provides recipients with easy-to-use interfaces to manage their loans, track deadlines, and access financial advice.

To address challenges specific to rural areas, where staff shortages are most acute, zakat institutions can adopt a community-based approach. This involves identifying and training local volunteers or community leaders to assist in program implementation. These individuals can serve as intermediaries, helping to identify eligible recipients, monitor fund usage, and facilitate communication between beneficiaries and the institution. This approach not only expands the institution's reach but also fosters trust and collaboration within the community. Finally, implementing a phased approach to scaling microfinance operations can help alleviate pressure on limited human resources. By piloting new initiatives in select areas before expanding them institution-wide, zakat institutions can test their feasibility, refine processes, and address challenges incrementally. This reduces the risk of overburdening staff while ensuring that programs are rolled out effectively.

8. CONCLUSION

Islamic microfinance has demonstrated substantial potential as a transformative tool for alleviating poverty and fostering socio-economic empowerment, particularly among marginalized populations. The Baitulmal of MAIM stood out as one of the early adopters of zakat-based microfinance in Malaysia, using zakat funds to offer interest-free business loans to low-income individuals. This initiative aimed to enable small-scale entrepreneurs to access much-needed capital, providing a pathway for economic self-reliance and community development. Despite its promising vision, the program was short-lived, running for just two years (2014–2016). This abrupt discontinuation highlights significant challenges that require critical attention to enhance the viability and impact of similar programs.

Among the primary issues were misconceptions surrounding zakat's nature, with some recipients perceiving the funds as a right or a one-time charitable gift, undermining the repayment structure critical for program sustainability. Additionally, MAIM's lack of specialized expertise in microfinance management further constrained its ability to design and implement an effective system. Compounding these issues was a severe shortage of human resources, with limited staff unable to provide the comprehensive support and monitoring required for such initiatives to thrive. Together, these challenges reveal systemic gaps that need addressing to fully realize the potential of zakat-based microfinance.

Addressing the multifarious challenges of zakat-based microfinance requires a blend of targeted interventions and strategic reforms. Educating recipients about the dual role of zakat through community engagement and awareness campaigns can shift perceptions, highlighting the developmental purpose of microfinance and the necessity of repayment. Equipping recipients with essential skills through mandatory financial literacy and entrepreneurship training ensures productive use of funds, complemented by structured loan plans to foster accountability. Internally, zakat institutions must establish dedicated microfinance divisions, invest in comprehensive staff training, and collaborate with experienced microfinance organizations to adopt proven practices. Leveraging technology for streamlined operations and employing phased implementation strategies further enhances program sustainability, particularly in underserved rural areas. By integrating these practical measures, zakat institutions can empower recipients to achieve lasting economic self-reliance while ensuring the sustainable growth of microfinance programs.

The findings of this study not only illuminate the complexities of implementing zakat-based microfinance but also serve as a strategic guide for future initiatives. Addressing these challenges head-on enables zakat institutions to leverage microfinance as a sustainable mechanism to break the cycle of poverty, empower communities, and create long-term socio-economic impact. Ultimately, the integration of zakat-based microfinance within Islamic social finance holds the potential to align financial systems with the maqasid al-shariah, achieving both social equity and economic justice. This study thus contributes meaningfully to the discourse on Islamic finance, offering actionable recommendations to enhance the effectiveness and resilience of zakat-based microfinance programs.

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