

Risk Management Mechanism in Empowering Productive Waqf

A Conceptual Approach

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Abstract: Nowadays the development of Islamic social finance shows the significant role to increase the welfare of society. This paper emphasizes the productive Waqf, as one of the investment instruments in Islamic social finance. Productive Waqf faces the condition which has the opportunity to occur the risk and return in empowering productive Waqf. This paper investigates the risk management mechanism in empowering productive Waqf. Productive Waqf gives a long term benefit and added value to increase the welfare, to build the infrastructure to create civil society also to achieve welfare nation (*baldatun thayyibatun warabbun ghafur*). Productive waqf empowerment faces some challenges, especially the risks which occur along the productive Waqf empowerment. This paper uses literature review method to describe the risk management mechanism to increase the optimization of productive Waqf empowerment. The result of this paper can give a conceptual framework about the risk in empowering of productive Waqf and the mechanism to mitigate the inherent risk of productive Waqf to increase the productive Waqf management properly.

1 INTRODUCTION

High-profile non-profit failures and scandals have increased scrutiny of the non-profit sector in recent years. In late 2014, the largest social services agency in New York, the Federation Employment and Guidance Service, suddenly closed due to financial mismanagement. In January 2016, Goodwill Industries of Toronto declared bankruptcy, leading its CEO and board of directors to resign. And in March, the Wounded Warrior Project fired its CEO and COO after reports of wasteful spending. According to a 2013 investigative report from the Washington Post, between 2008 and 2012, more than 1,000 major US non-profits disclosed in federal filings that they had suffered a "significant diversion" of assets from internal wrongdoing (Bilich, 2016). It's no secret that non-profits are ill-equipped to address risk. In 2015, for example, the Utah Food Bank announced that a data breach exposing donor names, addresses, credit card information, and security codes may have impacted eight percent of its donors. Technology often requires significant capital, and non-profits do not have the same access to capital resources as their for-profit peers. As with the Sarbanes-Oxley Act of 2002, which ushered in regulations to enhance

corporate responsibility and combat fraud, leading organizations committed to non-profit advancement have begun to emphasize that non-profit risk management—a defined, routine commitment to gather, evaluate, and respond to threats and opportunities—is a non-profit duty (Bilich, 2016).

An effective risk management program can provide reasonable assurance that an organization remains agile and responsive in the face of uncertainties. It's unsurprising, therefore, that risk management is an emerging non-profit best practice. Indeed, as in the for-profit sector, where publicly traded organizations are increasingly held to account for their risks, an effective risk management program will soon become a minimal criterion for non-profit credibility in the marketplace (Bilich, 2016).

According Domanski (2016), a review of the latest writings on non-profit management and risk management reveals significant gap in research on risk in the third sector. There are many different kinds of research approaches to these issues, but it seems that a comprehensive theory about risk management in the third sector may be missing. Most of the studies have concentrated on testing fragmentary hypotheses on specific risk categories (Martínez, 2003; Clary, 1997) or on organizations operating in specific fields

and related risks (Fast, 2007; Sollis, 1995;) in Domanski (2016). The belief that there is research gap in this field is shared by researchers such as West and Sargeant and they propose applying existing risk management theory from the commercial sector to non-profit organizations (West and Sargeant, 2004) in Domanski (2016). This proposition may not be a correct one, however. Risk management in non-profit organizations is a more complex process because of factors such as a relatively high number of uninsurable risks (Head and Herman, 2002) in Domanski (2016). Most research papers concentrate on identifying ways how non-profits can minimize the risks that they face, rather than on how it can be managed by them. Research in this field is by all means a pioneering effort (Young, 2009) in Domanski (2016).

The research about risk management in waqf institution is very limited and limited conceptual research. Although, there are many research's about risk management in Non-Government Organization (NGO) or Non-Profit Organization both conceptual and empirical research. This paper adopt the risk management mechanism from Non Government Organization (NGO) or Non-Profit Organization to be implemented in conducting risk management in productive waqf institution and combine the theory and empirical research about waqf and risk management in waqf. The main goal of this paper is to solve the research gap by presenting the theory and practice of risk management of a study on risk management in productive waqf institution. The first research question is: What are the risk categories faced by productive Waqf institution? And the second research question is: How do the risk management mechanism will be implemented in productive Waqf institution?

2 LITERATURE REVIEW

2.1 The History and Significance of Waqf

Muslims are encouraged to create sadaqah that keeps producing benefits/revenues to its targeted objectives. Waqf is also termed "sadaqah jariyah" or "continuous sadaqah". The waqf created by giving away an asset that have feature of perpetuity on a permanent basis. These sadaqah can be religious like establishing a mosque, or for social purposes like building a house for the wayfarer or digging of river/canal or a sadaqah gave during his/her life that continues (giving its benefits) after his/her death (Ahmed,

2007). An important characteristic of waqf relates to its objective, that is, the idea of *birr* (doing charity out of goodness). The objective of waqf may be for the society at large, including the provision of religious services, socio-economic relief to the needy segment, the poor, education, environmental, scientific, and other purposes. Many scholars term the ownership of awqaf assets/properties "as if it were owned by God." The founder (*waqif*) determines the objectives for which the property made into waqf can be used and the way its fruits, services and revenues can be distributed. The founder also determines the waqf management and process of succession of managers. The founder can impose any restrictions or qualifications he/she likes on his/her waqf, etc. Most awqaf are perpetual and very often this is emphasized in the waqf deeds (Ahmed, 2007).

The history of awqaf is very rich with prominent achievements in serving the poor in particular and enhancing the welfare in general. Various kinds of awqaf were established including those for public utilities, education and research, and health care. Educational awqaf also covered scientific research that was not restricted to Islamic studies. There were awqaf assigned specifically for research in science, physiology, pharmacology, mathematics, astronomy, etc. Hospitals and medicines are one of the most famous sub-sectors of awqaf. Muslims continued to establish awqaf hospitals and health care centers until the first part of the 20th century when the Waqf Children Hospital of Istanbul was founded (Ahmed, 2007).

The significance of the awqaf in Muslim societies of the past is evident from information available on the size of these institutions. In certain Muslim countries awqaf reached one third or more of total of cultivable land and other properties. The first land survey in Egypt conducted during Muhammad 'Ali's rule indicated that 600,000 were awqaf out of a total of 2.5 million feddan (acre) of cultivable land; most of these awqaf were for mosques and education and a great chunk was for al-Azhar itself. The large investments in the social sector succeeded in transforming the society and empowering the poor segments of it. Education, offered almost only by awqaf, enabled the poor move up the economic ladder and obtain high levels of economic and political power (Ahmed, 2007).

While most of waqf created are real estate, the cash waqf dates back to as early as the turn of first century of Hijrah. Cash waqf had two forms. First, cash was made into waqf to be used for free lending to the beneficiaries and second, cash was invested and

its net return is assigned to the beneficiaries of the waqf (Ahmed, 2007).

2.2 Risk Categories

According to Domanski (2016), there is no comprehensive description in international research literature of risks faced by nongovernmental organizations. Authors have mostly alluded to the risk of partnership, cooperation, or alliance (Martínez, 2003; Sollis, 1995); reputation risk (Clary, 1997); and financial risk (Bowman, Keating, Hager, 2007; Young, 2007). Other less explored risk categories faced by non-profit organizations include asset risk (Duncan, 2008; Pike, Roos, Marr, 2005); legal risk, including risk of loss, litigation risk, risk of inadequate legal interpretation, compliance risk, reputation risk (Zapadka, 2007); grant risk (Tyrakowski, 2007); risk of mission drift in a high-income scenario (Christensen, Clerkin, Nesbit, Paarlberg, 2009); risk of staff death, especially if the organization operate in armed conflict zones (Fast, 2007); organization, personal, and time (Mitchell, 1995); and advertising risk (West, Sargeant, 2004) in Domanski (2016),

According to Domanski (2016), risks associated with partnerships and alliances are an important area of research. Martínez (2003) in Domanski (2016) analyzed such forms of collaboration between non-governmental organizations, and he pointed to risks that occur before, during, and after alliances. He stressed that alliances with the commercial sector may create certain risks for non-profit organizations such as that of losing sight of the core mission. A significant risk emerges when a partner of the non-profit organization engages in unethical activities and has been stigmatized by the public (Wymer Jr., Samu, 2003) in Domanski (2016).

According to Domanski (2016), another important risk category listed by researchers as a relevant one for non-profit organizations is the reputation risk. According to www.iiibf.com unique risk factors faced by awqaf and waqf-based organizations cover Credit risk, Market risk/ Rate-of-return risk: Reputation risk: Shariah-legal risk: Risk of waqf-corporus depletion: Risk of improper benefit sharing: Operational risk.

2.3 Strategic Risk Management Process

The present section serves the verification of the strategic risk management model which is being recommended for the non-profit organization and

spread by the American association The Non-profit Risk Management Center. The risk management process can be defined as a systematic and purposeful sequence of activities including “Identifying the context,” that is, profiling the organization in risk management and setting risk management objectives; “Risk assessment,” that is, risk identification and prioritization; “Taking and communicating appropriate decisions;” “Acting on decisions taken;” and “Monitoring and adjustment” (Head, Herman, 2002, pp. 47) in Domanski (2016).

3 METHODOLOGY

This paper uses literature review method to describe the risk management mechanism to increase the optimization of productive Waqf empowerment. Literature review in this paper based on the literature from:

- Habib Ahmed (2007).
- Mohamad Yusri bin Yusof (2014)
- Jarosław Domanski (2016).
- Norhanizah Johari, Nazifah Mustaffha, Latifa Bibi Musafar Hameed (2016).
- Nur Atikah Atan and Fuadah Johari (2017).

Habib Ahmed (2007) studies the economics of micro financing and discusses the sustainability and operational issues of a waqf-based MFI in details. The paper presents a case for introducing waqf-based Islamic MFI that can provide micro financing and facilitate wealth creation of the poor. The paper provides the theoretical basis and operational framework for alternative waqf-based Islamic MFI. It discusses the operations of conventional MFIs and examines their strengths and weaknesses.

Mohamad Yusri bin Yusof (2014) introduces waqf, zakāh and ṣadaqah, which are currently being mobilized by the non-Financial Institutions (non-FIs) such as charitable organizations and Non-Governmental Organizations (NGOs) as additional components of Islamic finance industry, to complement the efforts of financial intermediaries as contributor to key socio-economic development. Towards the end of the paper, some recommendations are presented to push the activities of non-FIs in promoting waqf, zakāh and ṣadaqah via trust funds into the mainstream economy in a more coordinated, integrated and efficient manner at national and international levels.

Jarosław Domański (2016) addresses risk management in non-profit organizations. This topical issue appears not to have been adequately studied by

researchers to date. There are several questions the author of this paper attempts to answer: What are the risk categories faced by non-profit organizations in their daily operations? Do Polish non-profit organizations take any measures in the area of strategic risk management? A contribution is made to the theory of management of non-profit organizations by making an overview of existing literature on the subject, identifying a research gap, proposing concepts that attempt to fill the gap, and recommending areas for future study. A comprehensive list of risks faced by non-profit organizations in their daily operations has been developed and validated for further application. The empirical material comes from a study based on a national random sample of 235 non-profit organizations.

Norhanizah Johari, Nazifah Mustaffha, Latifa Bibi Musafar Hameed (2016) explain that Internal controls establish a process on how an organization handles in receiving and reporting money and, administrative and management tasks. An effective internal control involves the control environment, risk assessment, control activities, information and communication and the monitoring activities.

Nur Atikah Atan and Fuadah Johari (2017) analyze the related literatures on Waqf for poverty alleviation and social well-being between 2006 until 2016. The methodology of this article is through descriptive research based on document analysis on previous articles and literatures on Waqf between 2006 until 2016. From 365 citation found under 'Waqf' keywords which including journal articles, books and conference paper, only 289 articles that are published under journals publications consists of national and international journals were selected and had been analyzed using the Statistical Product and Service Solution (SPSS) software.. Findings- The general finding of this article shows that among the Waqf issues or subject that have the highest interest among the researcher for the current 10 years are related to the issues of cash Waqf (19.4%), Waqf property (13.8%) and Waqf concept (12.5%). However issues that related to poverty and poverty alleviation (14 articles), microfinance (17 articles) and corporate Waqf (13 articles) have also gained a popularity among the researcher.

4 RESULTS AND DISCUSSION

Risk Management for Awqaf is very important to develop to prevent and mitigate the occurrence of risk

in managing productive waqf. Risk management was started by identifying the risk faced in managing the productive waqf. Domanski (2016), in his research found that a comprehensive classification of risks faced by non-profit organizations is proposed and it includes risks related to management, operation, finance, external environment, regulatory environment, partnership, grants, and staff/volunteers. According to www.iiibf.com, unique risk factors faced by awqaf and waqf-based organizations cover Credit risk, Market risk/ Rate-of-return risk, Reputation risk, Shariah-legal risk, Risk of waqf-corpus depletion, Risk of improper benefit sharing, Operational risk.

The awqaf ecosystem displays considerable variation across countries and regions. While awqaf is originally meant to be in the voluntary sector, the current situation shows diverse roles for stakeholders in the public, private and voluntary sectors. Notwithstanding this diversity, the fact remains that the sector must be regulated, though the regulatory principles should be flexible enough to be relevant for alternative structures. Further, regulators should have a good understanding of the unique risk factors faced by awqaf and waqf-based organizations (www.iiibf.com).

4.1 Credit Risk

Some experts cite credit risk as a major risk factor for a waqf, similar to other Islamic financial institutions. This is, perhaps, an example of faulty analysis. Credit risk for a financial institution arises in the face of recurring loan transactions. It should be fairly obvious that a waqf has many distinct features making it different from lending-type financial institutions.

4.2 Market Risk/ Rate-of-Return Risk

Investment function in case of waqf is compulsory. All awqaf assets must be invested. They must be invested in a prudent manner. Nevertheless, the awqaf portfolios are vulnerable to adverse market movements or volatility in the rates of returns. There is a divergence of views among fuqaha on the degree of market risk or business risk that a waqf portfolio should be exposed to.

4.3 Reputation Risk

Awqaf face reputation risk, which becomes significant when they repeatedly seek to raise additional waqf resources and create new awqaf.

4.4 Shariah-Legal Risk

This risk contributes to reputation risk, though it may be less severe in case of waqf-funded operations than zakat-funded ones, given the inviolable position of Shariah regarding the nature of beneficiaries with the latter. Zakat laws are understandably, more demanding than waqf laws.

Related to Shariah-legal risk is the possibility of commingling of all forms of charity funds including zakat and waqf. Given the need to adhere to conform to the Quranic prescription regarding eight classes of eligible beneficiaries of zakat funds, some experts advocate in favor of disallowing zakat organizations completely from engaging in waqf mobilization and management.

4.5 Risk of Waqf-Corpus Depletion

This is a unique risk with awqaf that contributes significantly to Shariah-noncompliance and reputation risk. Such risk may arise, when the management in the face of fixed commitments towards beneficiaries (or high costs of its operations) and inadequate returns from its investment routinely borrows (as qard-al-hasan) from waqf-corpus. It is a major risk factor, justified by the fact that some known global players are widely known to engage in such behavior.

4.6 Risk of Improper Benefit Sharing

The risk of inadequate or improper sharing of waqf benefits among beneficiaries needs to be put sharply under focus instead of being clubbed together with Shariah-noncompliance or reputation risk. The so-called "business face" of awqaf often dilutes its ultimate objective of passing on benefits to designated beneficiaries by focusing too much on the generation of returns (and consequent flows to providers of private capital used for development of waqf assets).

4.7 Operational Risk

It is a Shariah-legal requirement that the waqf management (nadzir/ mutawalli) must take adequate care of the waqf assets, invest/utilize them properly and do everything as expected from a trustee-manager, e.g. refrain from sale, mortgage, willful negligence causing destruction or diminution of value. The possibility of such events may be captured as operational risk. Such risk may be mitigated by having an incentive structure that aligns the interests

of nadzir/ mutawalli with that of the beneficiaries in carrying out management of the waqf assets. A proportional sharing of surplus with the permissible proportion being known to all parties, may be considered a good mechanism. A related risk factor affecting operational efficiency of awqaf is about volunteerism. Awqaf organizations are usually characterized by heavy dependence on volunteers. Another kind of operational risk factor is typical of off-shore awqaf. Some experts advocate denial of permissibility to such awqaf on the basis of apprehensions regarding shell-organizations.

To sum up, risk factors associated with awqaf or waqf-based organizations are unique. A waqf is very different from a bank or financial institution that buys (borrows) and sells (lends) funds. Its unique risk factors must be understood and articulated accurately before we rush to bring in the much needed regulatory reforms that are of course, overdue (www.iiibf.com).

Risk management mechanism to increase the optimization of productive Waqf empowerment in this paper adopt the risk management process according to (Head, Herman, 2002, pp. 47) which was implemented in the research of Domanski (2016) with a title Risk Categories And Risk Management Processes In Non-profit Organizations. According to (Head, Herman, 2002, pp. 47) in Domanski (2016), the risk management process including "Identifying the context," "Risk assessment," "Taking and communicating appropriate decisions," "Acting on decisions taken," and "Monitoring and adjustment" as explained below:

- **Defining the Context**

Non-profit organizations should start a risk management process by engaging in a detailed review of their history, culture, and past activities in order to increase the chances of success and to identify adequate funds for future activities. Defining the context or contextualization means analyzing the environment and identifying the normal or routine state of the organization and the target position it wants to achieve in the future. The context is the baseline for the goals and objectives of the organization, the implementation of which will be hindered by unexpected future events that will be subject to the strategic management process (Head, Herman, 2002, pp.48-49) in Domanski (2016).

- **Risk Assessment**

Risk assessment is a step where a portfolio of risks is identified and then each of them is assessed in terms of value or importance. First, it makes sense to appoint a Risk Management

Committee within the organization. Such a team should be made up not only of executive board members but also of individuals directly involved in tasks and projects (Domanski 2016).

▪ **Making and Communicating the Decision and Action**

There are many effective risk management techniques that can be applied to address specific identified risks. A number of non-profit organizations use those techniques often now knowing that what they do is part and parcel of strategic risk management. Head and Herman (2002, pp.55–63) in Domanski (2016), provided an exhaustive list of such techniques which includes provision of training, securing OHS tools and equipment, staff appraisals, volunteer and participant assessment, adequate supervision, maintenance and repair planning, contingency planning and testing, clearly defining expectations and issuing clear instructions, use of external experts, stocktaking of assets, regulatory compliance, internal audit procedures, readiness to cover financial losses, and regular stakeholder communication. The stage of the risk management processes called “Action” covers the implementation of actions defined earlier in line with the logical sequence as defined in the strategic risk management plan (Domanski, 2016).

▪ **Monitoring and Course Correcting**

This step is designed to monitor the strategic risk management process and to implement necessary corrections. It is critical that a developed action plan should not be seen a static, once-for-all document. (Domanski, 2016).

5 CONCLUSIONS

Non Government Organization (NGO) or not-for-profit organization is an institution which have responsibility to public, so the prudent management is needed to develop the sustainability of NGO operational. Waqf as instrument in Islamic economic and included Islamic social finance have the same characteristic like as the NGO which have purpose to serve the society and social solidarity. This paper emphasizes the risk management mechanism in managing the productive waqf. Productive waqf institution should emphasizes to face the possibility the occurrence of risk in managing productive waqf by conducting risk identification, risk assessment,

risk prevention, risk mitigation and monitoring risk management process. In this study to response the research question, classification of risk faced by Non Government Organization (NGO) or not-for-profit organization covers risks related to management, operation, finance, external environment, regulatory environment, partnership, grants, and staff/volunteers, while the unique risk factors faced by awqaf and waqf-based organizations cover Credit risk, Market risk/ Rate-of-return risk, Reputation risk, Shariah-legal risk, Risk of waqf-corpus depletion, Risk of improper benefit sharing, Operational risk.

The risk management mechanism which was implemented in productive Waqf institution in this paper adopt the risk management process according to (Head, Herman, 2002, pp. 47) which was implemented in the research of Domanski (2016) including “Identifying the context,”; “Risk assessment,”; “Taking and communicating appropriate decisions,” “Acting on decisions taken,” and “Monitoring and adjustment.

The implementation of risk management in productive waqf institution can give explanation about the mechanism of risk management in productive waqf to conduct productive waqf properly and increase the trust of public and society and can reach the welfare of ummah and welfare state.

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