

## **A SOCIAL PERFORMANCE MANAGEMENT FRAMEWORK FOR ISLAMIC MICROFINANCE INSTITUTIONS**

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### **ABSTRACT**

The Islamic microfinance industry is in its infancy and it faces various challenges, including the lack of social performance management tools customised to the specific nature of the industry. Even though managing the performance of microfinance institutions has gained momentum with the development of several tools and techniques, the existing tools are inadequate for addressing the needs of IMFIs. Hence, this paper seeks to conceptualise a social performance management framework that is appropriate for IMFIs, to help them accomplish their financial, social and spiritual mission. It is argued that the spiritual dimensions and elements should be integrated into IMFIs' social performance management systems, specifically in their mission statement, governance structure, internal systems and activities, as well as in their measures of output and impact.

**Keywords:** Islamic microfinance, social performance management, spirituality

### **INTRODUCTION**

Microfinancing, through its provision of essential financial products and services to marginalised or low-income communities, has played a significant role in expanding economic opportunities and improving the livelihood of those who are financially excluded (Abu Seman & Mohd Ariffin, 2017; Ahmed, 2002; Khan, 2008). The Islamic Microfinance Institutions (IMFIs) were established to address Muslim needs through the provision of products and services that conform to Islamic financing principles (Karim et al., 2009; Khan, 2008; Rahman, 2010). IMFIs have similar goals and have faced the same challenges as conventional Microfinance Institutions (MFIs) as they strive for financial sustainability and empowerment of the poor. One of the challenges that is facing the industry relates to the assessment of MFIs' performance. The initial focus on financial performance did not reflect the industry's "double bottom line" of achieving both financial and social performance (Sinha, 2006). Consequently, the assessment approach has moved from a single dimension to a multi-dimensional approach (Roy & Goswami, 2013).

Besides the external assessment of MFIs, various authors have argued that there is a need for MFIs to also assess their performance internally, i.e. by managing their systems for measuring social performance (Ledgerwood et al., 2013). Social performance management for microfinance is conceptualised as the translation of the organisational mission into practice, relating to reaching the poorer and the excluded, improving the lives of clients, and widening the range of opportunities for communities (Ledgerwood et al., 2013; Hashemi, 2007). Managing social performance internally is vital to ensure the achievement of the social mission, leading to better ways of reconciling the tensions that arise from the pressure to attain the double bottom line, as well as enhancing the accountability and transparency of MFI social and financial performance (Siti Nabiha et al., 2018;

Ledgerwood et al., 2013). The measurement system is the locus of strategic planning and is linked to the key management processes of resource allocation, monitoring, reporting, evaluation and the reward system (Epstien & Yuthas, 2011). Moreover, the developmental goals of Islamic microfinance programmes will be better realised if the institution evaluates and manages its own social performance. One way of accomplishing this is for IMFIs to ensure that their internal processes, programmes and activities are structured and formulated for the achievement of their missions.

Even though the assessment of MFI social performance has gained momentum with the development of several tools and techniques, the existing tools and techniques are inadequate for addressing the needs of IMFIs as spiritual dimensions and elements are not integrated into these performance management systems. As Islamic microfinance is built on a different framework from the conventional view, it is imperative for IMFIs to consider spiritual and religious values in the management and development of programmes and clients' engagement, and to integrate these into their social performance management process. Besides the social and political aspects, financial inclusion and poverty eradication goals from the Islamic viewpoint have a moral and spiritual dimension (Abdul Rahman et al., 2015). Moreover, studies have shown the positive influence of religion/spirituality organisations. Spirituality has been shown to enhance workplace ethics, as it acts as a source of guidance, and plays a significant role in affecting judgement, and emotional and motivational qualities (Giacalone & Jurkiewicz, 2003; Fernando & Jackson, 2006, Pandey & Gupta, 2008). Due to the positive impact of the spirituality of individuals and organisations, research evidence has shown that even profit-oriented organisations attempt to inculcate and foster spirituality at work to shape the behaviour of their members (Cavanagh & Bandsuch, 2002; Giacalone & Jurkiewicz, 2003).

Despite the need to develop the social performance management of IMFIs and the empirical evidence supporting the influence of spirituality and religiosity in IMFIs (Rahman, 2010; Rulindo & Pramanik, 2013), literature discussing the role and integration of spirituality into the system of managing performance, especially for IMFIs, is still lacking. Hence, the purpose of this paper is to discuss the social performance management for IMFIs by integrating spirituality elements into the framework. The paper begins with a discussion of social performance management for microfinance institutions. The key significant differences of IMFIs, compared to conventional MFIs, are also elaborated in this section so as to justify the need for a specific IMFI social performance management framework. This is followed by a discussion of the importance of spirituality for IMFIs and their clients. Due to the lack of empirical literature on this issue in the context of IMFIs, the discussion in this section is broadened to include empirical evidence on the role of spirituality and its impact on organisations in general. In so doing, the question of the impact of spirituality on organisations, specifically IMFIs, is also addressed. Then, the next section explains the ways that spirituality can be integrated into the social performance framework of IMFIs. The paper ends with some concluding remarks.

## **SOCIAL PERFORMANCE MANAGEMENT FOR MICROFINANCE**

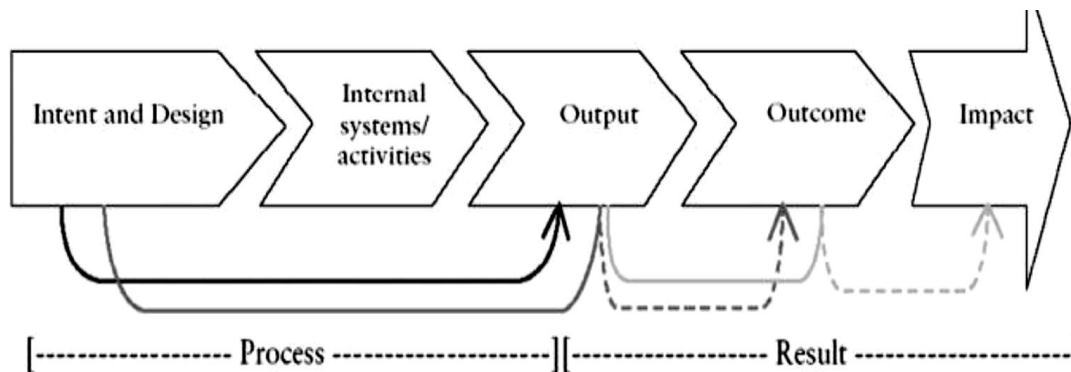
A performance measurement and management system (PMMS) is one of the management tools that enables the coherent translation of the organisation's mission and leads to the achievement of both its economic and social goals (Epstein & Yuthas, 2011). The basic idea underpinning social performance is for IMFIs themselves to assess and examine the process through which impact is created, determining whether the activities and systems in place enable them to achieve their mission. Even though serious reservations exist regarding undertaking social performance assessment, due in part to the difficulty in measuring and standardising social performance (Hashemi, 2007), social performance management is pertinent to ensure that IMFIs do not deviate

from their social mission. The pressure to be self-sustainable rather than relying on donors or governmental grants (Sinha, 2006) might lead to social missions being neglected, especially in situations where MFIs face funding pressures.

For MFIs, financial goals are not the ultimate priority, as financial performance is the means to achieve social goals. Nevertheless, it should be noted that financial sustainability is important as it ensures the sustainability of services to the marginalised group. Thus, social performance is viewed as both a social and economic impact that must be achieved, so as to achieve the double bottom line (Pawlak & Matul, 2004). As Pawlak & Matul (2004) argue, the focus on both financial and social performance could lead to improved financial performance, as the process of social performance management could lead to a better understanding of clients. The information from the system could be used to improve the organisation’s targeting tools, consequently increasing the efficiency of MFIs. Moreover, the achievement of the organisational mission requires the translation of that mission into strategic objectives with coherent programmes and activities.

Various social performance management tools and frameworks have been developed for conventional MFIs or for social enterprises, such as the Bagnoli & Megali (2011) multidimensional performance management framework incorporating economic performance, social effectiveness and legitimacy. Another model is the Social Enterprise Balance Scorecard of Somers (2005), which is an adaptation of the Norton and Kaplan balance scorecard. The SEBC consists of: (1) positioning social performance over financial performance; (2) broadening the financial perspective to include the outflow and inflow of funds; and 3) changing the customer perspective into a stakeholder perspective (including various stakeholders in addition to MFI clients) (Siti Nazariah et al., 2016).

Similarly, the *Imp-Act* programme and the CERISE Social Performance Indicators approach shift the concept of social performance, so that it is not seen only as a result, but also as the practices or processes required to achieve results (Sinha, 2006). Champion et al. (2008) proposed the common framework of social performance, relating to intent, processes and results as depicted in **Figure 1**.



**Figure 1:** Common framework for social performance assessment

**Source:** Champion, Linder & Knotts (2008)

As explained in CGAP Focus Note 41 (2007), social performance management, i.e. managing the process to achieve the organisational mission, consists of the following dimensions (on the dimensions of social performance management):

1. Intent – the MFI's stated commitment to its social mission, its target market and development objectives.

2. Internal Systems and Activities – the institution’s operational strategies, activities and systems implemented to achieve the mission and objectives.
3. Output – measure serving the targeted clients, i.e. the poor and the very poor, and their needs.
4. Outcome/Impact – the impact of its activities on the lives of the poor.

Even though both conventional microfinance and IMFIs have similar objectives of fighting poverty and improving the standard of living of their clients, conventional MFIs and IMFIs have significant differences. Hence, it is argued that the existing SPM models and frameworks of MFI need to be adapted to IMFIs due to distinct differences between them in terms of the intent, internal systems and activities as well as output and impact of microfinancing.

Among the key significant differences is that first, Islamic microfinance aims to support the poverty alleviation and socio-economic development of its clients through the provision of products and services that conform to the Shariah concept and principles. Hence, IMFIs must operate within the ambit of Islamic laws and principles, as contained within the Qur’an and in accordance with the Sunnah of Prophet Muhammad and these should be reflected in the way they conduct their business. This includes the application of the concepts associated with microfinance – to alleviate poverty and foster socio-economic development (Farook, 2008; Ahmed, 2002; Dusuki, 2008; Obaidullah, 2007). The Islamic financial principle of risk sharing means that IMFIs eliminate interest as the basis of their financing (World Bank & Islamic Development Bank, 2016; Wardiwiyono, 2012), The mission and operations of IMFIs, irrespective of their business models and different target market segments; should be guided by Islamic laws and principles, including the principles of equity, participation and ownership (Hussain, Shahmoradi & Turk, 2016). Second, the key objective of IMFIs is to transform their clients from being recipients of *zakat* (tithe) to becoming a *zakat* contributor within a specific time period (IRTI Islamic Social Finance Report, 2014). Third, IMFIs’ social development programmes are centred on Islamic teachings in order to build social capital and characters and enhance behaviours, i.e. instil solidarity among beneficiaries and generate a moral obligation to repay debt, in addition to skill empowerment training such as those pertaining to business knowledge and mentoring. The social development programme includes spiritual development, especially in internalising Islamic spiritual values to build character and instil good behaviour (Hadisumarto & Ismail, 2010).

The role of IMFIs is that of a financial provider that acts as an intermediary between providers of funds and fund users while at the same time fulfilling collective religious obligations (*yard kifayah*) by improving the socio-economic situation of the poor (Farook, 2008). The distinct differences between Islamic and conventional microfinance are reflected in the Islamic financial products, focusing on families as the target group and integrating religious work incentives. Work is considered as part of *ibadah* or worship and social developmental programmes are based on Islamic teachings (Ahmed, 2002; Abdul Rahman, 2007). Thus, spirituality is one component of IMFIs as their scope covers the religious and socio-economic perspectives. As such, building a social performance management framework of IMFIs requires the integration of spirituality elements and values. The next section discusses the importance of spirituality for IMFIs and their clients, as well the empirical findings on the impact of spirituality on organisations in general and specifically on IMFIs.

## **THE IMPORTANCE OF SPIRITUALITY FOR IMFIS AND THEIR CLIENTS**

### **Definition of Spirituality**

There is lack of agreement of the conceptualisation of spirituality (Pandey & Gupta 2008) as it is a broad concept and is usually defined based on the affiliation of religion and moral values (Ashta & De Selva, 2012; Giacalone & Jurkiewicz, 2003; Karakas, 2010). The common Western view of

spirituality is disconnected from religion as it involves philosophy about life and its meaning. Hence, not all of those who seek self-actualisation or self-empowerment follow a religion (Rassool, 2000). In contrast, there is no distinction between spirituality and religion in Islam as Islamic spirituality is connected to the values from Al-Quran and Sunnah. According to Nasr (1997), Bonad et al. (2013) conceptualised spirituality from the Islamic viewpoint as “the presence of relationship with Allah that affects individual’s self-worth, sense of meaning, and connectedness with others and nature”. This follows the Islamic worldview of there being no distinction between the secular and the sacred as all human activities should be bounded by Islamic principles and submission to Allah in all aspects, whether this be in economic, political or social activities. As Basri et al. (2016) state: “Clearly, in Islam there is no separation between the sacred and the profane in human activities as all activities are bounded by Islamic principles. Muslims cannot become good Muslims if they compartmentalised their behaviour into sacred and secular dimension, as all their activities are bound by the shariah.” Hence, in this paper, the term spirituality with regard to IMFIs is related to the Islamic perspective of spirituality.

### **The Impact of Spirituality**

As mentioned, limited research has been undertaken on spirituality’s impact on IMFIs. Hence, both empirical and conceptual papers are used to provide the arguments for the impact of spirituality on IMFIs and other religion-based IMFIs. Much of the empirical research on spirituality and ethics is from the Western perspective, (Rizk, 2008) and scant attention is paid to the impact of spirituality in microfinance settings, especially IMFIs. Thus, literature from a Western perspective was examined to gain insights into the impact of spirituality on employees and organisations. The empirical literature has shown a positive impact of spirituality, as noted by Moberg (2010):

*“The results of studies relating to spirituality to measures of health, well-being and personality and other concerns are so exceptionally consistent in one direction that many researchers are surprised by their discoveries.”*

One of the most prominent successful examples of the positive impact of spirituality on organisation is the Mondragon cooperatives in Spain that was established under the guiding principles of a Catholic priest. The humanist principles that governed their activities are open admission, democratic organisation, the prominence of labour over capital, self-management, wages are set based on solidarity principles, group cooperation, social transformation, focusing on peace, justice and development (Gibson-Graham, 2003). Gibson-Graham (2003) further notes that these innovative principles transform the way economic decisions are made.

The fostering of spirituality does have positive impact even in cases whereby organisations are established based on capitalistic value as Karakas (2010), in his review of 140 empirical papers on spirituality at work, found that spirituality has a positive impact on employees and on their organisation. Based on a systematic analysis of the literature, Karakas (2010) categorised the impact of spirituality at work (such as from an organisation’s spirituality programmes, fostering or allowing free expression of spirituality and value, supporting employees to incorporate spirituality and values into their work, etc.) on individuals and organisations by integrating three perspectives:

- Human Resource Perspective – spirituality enhances employees’ well-being and quality of life
- Philosophical Perspective – spirituality provides employees with a sense of purpose and meaning at work
- Interpersonal Perspective – spirituality provides employees with a sense of interconnectedness, community and consideration for others

As shown in **Table 1**, Karakas (2010) notes that spirituality enhances employees' well-being by increasing their morale, commitment and productivity, providing them with a sense of meaning and purpose at work and increasing their attachments, loyalty and sense of community in the organisation. This consequently leads to an increase in productivity and performance. Thus, the positive impact of spirituality at work is emotionally, spiritually and socially abundant workplaces (Karakas, 2010).

**Table 1:** Three perspectives on benefits of spirituality for employees and organisations

Focus on developing employees	<b>Well being</b>	<b>Purpose and Meaning</b>	<b>Community &amp; Connectedness</b>
Positive outcomes of incorporating spirituality	Emotionally abundant workplaces <ul style="list-style-type: none"> <li>• Increased moral and commitment</li> <li>• Increased employee well-being</li> <li>• Increased employee productivity</li> </ul>	Spiritually abundant workplaces. <ul style="list-style-type: none"> <li>• Increased sense of meaning &amp; purpose</li> <li>• Increased fulfilment &amp; job satisfaction</li> <li>• Increased hope &amp; creativity</li> <li>• Increased reflection</li> </ul>	Socially abundant workplaces <ul style="list-style-type: none"> <li>• Increased sense of connectedness &amp; community</li> <li>• Increased attachment, loyalty and belonging</li> <li>• High-quality connections</li> </ul>
Ideal benefits for employees. Spirited workplaces of the 21 <sup>st</sup> century	<ul style="list-style-type: none"> <li>• Empowered, committed, passionate employees</li> <li>• Engaged with passion</li> </ul>	<ul style="list-style-type: none"> <li>• Highly aware, self-reflective, creative employees</li> <li>• Alive with meaning</li> </ul>	<ul style="list-style-type: none"> <li>• Compassionate, benevolent employees</li> <li>• Connected with compassion</li> </ul>

**Source:** Karakas (2010)

The analytical concepts used by Karakas are used in this paper as they are aligned with the Islamic view of spirituality. As stated previously, Islamic spirituality relates to the relationship with Allah, which affects the individual's self-worth (well-being), sense of meaning (purpose of meaning) and relationship with others and nature (interpersonal perspective). However, Karakas' (2010) analytical concept is broadened to include the importance of spirituality for IMFIs' employees and also their clients, as the focus of IMFIs is on the development of their clients and the impact of spirituality on the performance of MFIs and micro-entrepreneurs.

The importance of spirituality for IMFIs and micro-entrepreneurs arises from the following:

**(i) Spirituality enhances employees' and clients' well-being**

The impact of the internalisation of Islamic spiritual values on organisations with regard to the development of employees' well-being has been noted by researchers (Rokhman, 2010).

The internalisation of Islamic ethical principles and Islamic work ethics helps to strengthen individual moral reasoning, (Rizk, 2008; Hadisumarto & Ismail, 2010) and organisational commitment and continuity (Ali & Al-Owaihan, 2008; Rokhman, 2010). A study by Rokhman (2010) showed a positive relationship between the Islamic work ethics and job satisfaction and organisational commitment in microfinance institutions.

**(ii) Spirituality provides employees and clients with a sense of purpose and meaning at work**

Developing and fostering the view that work is considered part of *ibadah*, i.e. a religious practice, would contribute to the sense of purpose and direction of both employees and clients. The inculcation of spirituality at work for IMFIs' employees and clients would further emphasise their sense of purpose and meaning. It has been argued that the Islamic teachings, in terms of viewing work as a part of worship, are an additional incentive for IMFIs' employees to better serve their clients and contribute to the better performance of their organisations (Ahmed, 2002).

**(iii) Spirituality enhances sense of community (interconnectedness with others and nature)**

In Islam, the spirit of brotherhood is the primary objective of transacting parties and an important foundation for micro-entrepreneurs' development as it is expected to give mutual benefits, especially to those involved (Hadisumarto & Ismail, 2010). The common feature of successful microfinance is group-based financing and guarantees (Obaidullah & Khan, 2008). Hence, actions to foster the spirit of brotherhood in IMFIs' social development could enhance the clients' and employees' social well-being, and their sense of belonging and social inclusion in society (Quraisy et al., 2017; Hassan, 2014). Such action could strengthen the clients' social capital, which could offset their lack of physical collateral. Social capital, i.e. as groups and individual access to resources through their social network, resulted in mutual benefits not only for the economic aspect but also other social aspects such as ability of the group to have a collective action (Villalonga Olives & Kawachim, 2015; Wahyudi, 2014). Thus, social capital is a tool for effective social development program that can be harnessed and fostered by IMFIs.

As IMFIs rely on clients' networks for the outreach and recovery of their loans, they can leverage on this social capital. Besides improving outreach, relying on their clients' networks could reduce the cost of this outreach, as shown from evidence that potential clients might be willing to apply for loans as other households in their social network do so (Hassan, 2014; Hermes & Lensik, 2011). Moreover, the benefits of spirituality for building up social capital can help to mitigate the negative consequences of group lending and joint liability leverage on social pressure and punishment, consequently leading microfinance clients to use loans for short-term returns (Hermes & Lensik, 2011). Social well-being builds on a sense of community and consideration for others and trust can become the group habit and culture. Furthermore, research has also shown an improvement in clients' social well-being from IMFIs' social development programmes (Quraisy et al., 2017).

**(iv) Spirituality enhances organisational and client performance**

A study conducted by Rulindo & Pramanik (2013), which examined the impact of spiritual and religious capacity building by IMFIs on their clients, found that higher spirituality levels can have a positive effect on income. In another study, Rulindo & Mardhatillah (2008) found that micro-entrepreneurs with a higher level of spirituality tended to have a higher income, and to have improved their poverty status. For IMFIs, inculcating Islamic spirituality may help reduce their clients' defaulting on loans, as in Islam, not paying loans is considered to

be sinful. Thus, providing spiritual and religious enhancement programmes can build character and help the IMFIs to solve moral hazard problems (Abdul Rahman & Dean, 2013). In their empirical research based on four microfinance providers, Tsafe & Abdul Rahman (2014) found that spirituality influences and contributes to a more effective performance by the IMFI board and may positively influence the microfinance institutions' achievement of their dual objectives.

Moreover, literature that has examined the differences in performance between conventional MFIs and the mainly non-Islamic religion-based MFIs have provided evidence that MFIs with religious affiliation display a stronger social performance (Casselmann et al., 2015; Mersland et al., 2013; Rulindo & Pramanik, 2013). Casselman et al. (2015) examined the relationship between the religious affiliation of microfinance institutions and social performance and found evidence that religiously affiliated microfinance institutions exhibited stronger social performance (in terms of mission statement, client service delivery and the breadth and depth of outreach). On the other hand, Mersland et al. (2013) studied differences in performances between Christian-based MFIs and secular MFIs, and found that Christian MFIs had lower operating costs and financial profits, but that there were no differences between the secular and faith-based MFIs in terms of their efficiency of assuring loan repayments and loan sizes.

## **INTEGRATING SPIRITUALITY ELEMENTS INTO SOCIAL PERFORMANCE MANAGEMENT FRAMEWORK**

The IMFI social performance framework should incorporate elements of spirituality, which are one of their key characteristics. For this reason, the spirituality dimension needs to be considered in IMFIs' social performance management. Even though control mechanisms including control over performance and the employment of tools such as performance measurement systems are important to ensure that organisational objectives are achieved, it is argued that control systems alone are not sufficient to ensure improvements. A higher inner consciousness needs to be inculcated, so that this leads to respect for laws and society (Basri et al., 2016).

The importance of spirituality in managing IMFIs is significant due to the fact that in some countries, the microfinance industry is weakly regulated or unregulated (Mersland et al., 2013). Thus, a tool to assist IMFIs to self-regulate themselves might be needed. Through the use of a holistic social performance management system, IMFIs also need to set targets based on information from the measurement system, and use these to improve the organisational internal process and support decision making (Bhimani & Willcocks, 2014; Otley, 1999). In addition, if the system is integrated with organisational processes – such as the reporting and monitoring system, and reward and resource allocation – it can be used for improvement purposes, in terms of determining which areas, programmes and/or activities need to be improved or realigned to achieve their social mission (Pawlak & Matul, 2004).

The role of the spirituality element in Islamic microfinance in this paper will be framed based on the framework in **Figure 1**, i.e. in terms of internalising Islamic spirituality in social performance in the coherent mission statement, in the internal systems and activities, and also as reflected in the output measure used.

### **Mission Statement (Intent and Design)**

As IMFIs' activities and values are shaped by their intent (mission), integrating spirituality into the social performance framework would require the intent and design of IMFIs to consider the triple bottom line – economic, social and spiritual objectives. Thus, this means that IMFIs' focus would be on the spiritual, social and economic development of their clients and the recipients of their services. The mission statement serves as a guide to the employees and represents the core values or belief



systems of the organisation. The belief system is the “explicit set of organisational definitions that senior managers communicate formally and reinforce systematically to provide basic values, purpose and direction for the organisation” (Simons, 1995). These core values would guide IMFIs, as they inform the board, management, employees and clients of what the IMFI stands for, and shows what employees can or cannot do, thus acting as a control mechanism.

Therefore, in addition to the social and economic objectives, the spiritual objective should be considered in the mission statement of IMFIs and reflected in their policies, procedures, guidelines and organisational processes and activities. With this, the development, fostering and inculcation of Islamic spiritual values should permeate the whole governance structure, the internal processes, the design of products and services offered and capacity building strategies for IMFI employees and clients.

Incorporating spirituality into the intent and design of the organisation could be undertaken by formally stating the spiritual objectives that form part of the IMFIs’ guiding statement as a holistic description of intent, i.e., a coherent mission statement. Hence, IMFIs can formally incorporate spiritual objectives into their mission, vision or statement of values. This statement constitutes the moral and emotional logic of an organisation. It gives meaning to employees and clients and makes them proud to contribute to its achievement (Khalifa, 2012). Moreover, the integration of spirituality as part of the coherent mission statement of IMFIs could assist IMFI to balance the trade-off between social and financial objectives. The financial objective is needed for achievement of social objectives and both objectives should ultimately lead to the fulfilment of the religious obligation.

### **Integrating Spirituality into the Governance Structure**

The concept of Islamic social responsibility must be in accordance with the objective of Shariah: “to promote good (justice) and forbid evil (injustice), and which is manifested in the concept of protecting the faith, life, intellect, posterity and wealth of mankind” (Farook, 2008). In Islam, having effective governance is considered an act of worship (*ibadat*) and not just a role in itself as a means of livelihood (Tsafie & Abd Rahman, 2014). Moreover, the expectations of IMFIs should not be any different from those of any other member of society, as IMFIs’ organisational members should be subjected to the same ethical and moral values (World Bank & IDB Report, 2016).

The absence of SSB in some IMFIs has resulted in doubts over the conformance of their products and services to Islamic principles (Wardiwiyo, 2012). The establishment of the Shariah Supervisory Board is crucial to inculcate trust in the products and services, and in its activities and processes. Thus, having an independent and effective SSB is part of the mechanisms that ensure that the products, processes and services are Shariah compliant (Hasan, 2009; Shibani & De Fuentes, 2017). Members of the SSB should be well versed in shariah and finance or should be a mixture of experts in the relevant areas so that proper advisory and monitoring roles can be carried out. In doing so, the SSB should be empowered and given the authority not only to determine shariah-compliant products but also to oversee and monitor the overall processes and activities of IMFIs.

Integrating spirituality objectives and fostering spiritual values may enhance accountability and help IMFI boards to have sound governance; consequently, this may improve both the social and financial performance of IMFIs. Good governance is an essential element in promoting the principles of fairness, accountability and transparency, which are required of IMFIs (Hasan, 2009). Given that internal governance involves control mechanisms, the board has a crucial role in IMFIs, especially with regard to its impact on the performance measures used (Hartarska & Mersland, 2012), signalling to the employees and other stakeholders what is deemed to be important in the organisation.

### **Integrating Spirituality into the Internal System – Capacity Building Strategies**

Spiritual practices in IMFIs constitute two forms of activity in accordance with Islamic principles: first, the daily moral and ethical commitment of employees of Islamic microfinance providers, and second, the practices of the organisation with reference to Shariah compliance (Wediawati & Setiawati, 2016). One important internal process to ensure spiritual practice and to translate IMFIs' mission into outcomes is human capital management for IMFIs' board members, management, employees and clients. Spirituality should be integrated into the internal process through a spiritual enhancement programme, which should lead to the character development of both clients and IMFIs' organisational members. Investment in human capital is necessary not only to enhance individuals' skills and talents for economic purposes (Hashi & Bashiir, 2009), but also for the social and moral development of employees. In IMFIs, training employees is an important part of the capacity building strategies and policies. Moral values and principles should be emphasised to improve skills and spiritual practices (Wediawati & Setiawati, 2016). Internalising spiritual principles in IMFIs may help to establish good work ethics among the employees of IMFIs.

Besides training for organisational members, IMFIs should incorporate ethical values into the education and training for clients, not only to develop their skill sets but also to enhance their conformity to ethical and moral values. As mentioned, one key characteristic of IMFIs should be the transparency in financial performance, recording and accountability over resources used and their business transactions. IMFIs have a duty to disclose their operations, including the compliance to Islamic laws and principles (Shariah) of all their stakeholders. This disclosure should also extend to their clients' performance. However, one crucial problematic issue for micro-entrepreneurs is the lack of recording of financial transactions. As Muslims are required to record their business transactions (Basri et al., 2016), financial training and the enhancement of business knowledge to ensure business and financial literacy of clients also fulfils a spiritual and religious obligation.

Client capacity building also constitutes a form of promoting loan repayments and supporting borrowers to create human and economic capital (Abdul Hadi & Kamaluddin, 2015). The focus on training and development programmes enhances the technical know-how of microfinance clients, based on the argument that they may not have financial and business abilities. The provision of funds without proper training in important skills might not make the poor to be productive.

In addition to the normal financial and business literacy skills, IMFIs could integrate ethical and spiritual teachings into their client training programmes in order to enhance their clients' knowledge and to build character and social capital. Moreover, previous studies indicate the need for training and educational programmes that emphasise good moral values (Rokhman, 2010). Religious orientation has a positive influence on entrepreneurial activity and economic growth (Galbraith & Galbraith, 2007; Mardhatillah & Rulindo, 2007; Rulindo & Mardhatillah, 2008). Aligning spiritual values with the building of characteristics such as sincerity (*ikhlas*), trustworthiness (*amanah*), diligence and perseverance (*istiqamah*), contentment and patience (*redha* and *sabr*), and other moral attitudes will help to develop entrepreneurs. Besides building entrepreneurs' self-esteem and self-reliance, fostering positive group values, trust and supportive cultural habits for the group could lead to greater cohesiveness and socially abundant workplaces, and consequently social capital for the clients.

As training and capacity building are crucial to the social performance of IMFIs, it is recommended that the participation of other Islamic organisations, in the form of waqf and zakat funds and religious expertise for capacity building, is provided to strengthen the IMFIs' development programmes (Abdul Rahman & Dean, 2013; Wediawati & Setiawati, 2016). This is because some IMFIs do not conduct spiritual training due to a lack of funding, expertise and networks (Wediawati & Setiawati, 2016).

### **Products and Services**

Islamic economics promotes risk sharing among the providers and users of funds through prohibition of interest, asset-backed and equity financing (World Bank & IDB Report, 2016)

IMFI objectives are similar to those of conventional microfinance in terms of poverty alleviation and improving the lives of marginalised groups; however, their financial products and services should be consistent with Islamic financial principles (Shariah-compliant products). It is important for the providers of Islamic microfinance to attract their customers with products and services that align with Islamic values (Rokhman, 2010). Thus, the spiritual objective of Islamic microfinance makes it an effective instrument for enhancing financial inclusion and providing benefits to all members of society.

Therefore, having knowledge of the market they serve will help IMFIs to align their operational strategies in a more effective manner. This may include the financial services processes of application procedures, and processing and managing repayments. As posited by Farook (2008), Islamic financial institutions have two interrelated reasons to be socially responsible: their role as a financial institution means that they need to fulfil a collective religious obligation, and as a financial intermediary they need to set an exemplary stance. IMFIs' spiritual mission can be intensified by providing Islamic financing schemes that aim to eradicate poverty and socially uplift poor communities. However, some authors have argued that there is a lack of certain types of financing such as Mudharaba and Musharakah in IMFIs and a lack of urgency in offering takaful and other microsavings products (see for example Goud, 2013). Thus, a variety of financial services offered at an affordable price is one of the measurements of IMFIs products and services as this is extremely important to fulfil the life cycle events of IMFI customers (Noipom, 2013). To demonstrate this, IMFIs should have an understanding of the market they aim to serve, and fulfil the diversified requirements of clients through a range of financial products (Khaleequzzaman, 2007). This may lead Islamic microfinance to be more inclusive and viable.

### **Output Measures**

In addition to the financial performance of MFIs (such as financial and operational self-sufficiency) and social performance measures (such as breadth, depth, scope and length of outreach, the appropriateness of service, etc), the spirituality component of output and outcome measures needs to be considered. In contrast to financial reporting, which may be well established with key indicators and measures, social and spiritual measures are not so straightforward (Sinha, 2006). Social performance evaluation is problematic, since it is difficult to quantify the social impact of microfinance, due to the subjective nature of social measures (Siti Nabiha et al., 2018). Moreover, the social goals developed for specific IMFIs would be influenced by their context and mission statement. Similarly, the outcome of spirituality is difficult to measure directly, hence the proxy measure of the outcome of spirituality could be used, in terms of better performance for clients and IMFIs, as shown in the empirical research in the previous section. Hence, it is suggested that the spiritual outcome of training and capacity building is demonstrated through improvements in the character and business performance of micro-entrepreneurs in the following dimensions/indicators:

### **Financial Capital**

As the key aim of Islamic microfinance is to transfer the poor from being a person entitled to receive *zakat* (*Mustabiq*) to a person who is required to pay *zakat* (*Muzakki*) within a specific time period (IRTI Islamic Social Finance Report, 2014), the most significant outcome of the IMFI programme should be the development of successful entrepreneurs, who have graduated from poverty to become a member of society who contributes *zakat*. In Islam, *zakat*, *qard* and *waqf* are recognised as important tools of wealth redistribution to bridge the gap between the rich and the

poor (Obaidullah, 2007). Including spiritual development in a financial support and capacity-building programme will improve the economic condition of the marginalised groups, and prepare them to be part of the formal financial system (Hassan, 2014).

In addition, for the IMFIs, specific capacity-building programmes should be formulated with the aim of improving the behavioural, ethical, social and economic aspects of micro-entrepreneurs. As debt repayment is emphasised in the Islamic teachings, and as not paying back debt is considered sinful in Islam (Ahmed, 2002; Hadisumarto & Ismail, 2010; Rulindo & Pramanik, 2013), the outcome of the IMFI character-building programmes with spirituality values should improve the repayment commitment of micro-entrepreneurs, as paying back debt is a part of religious obligations.

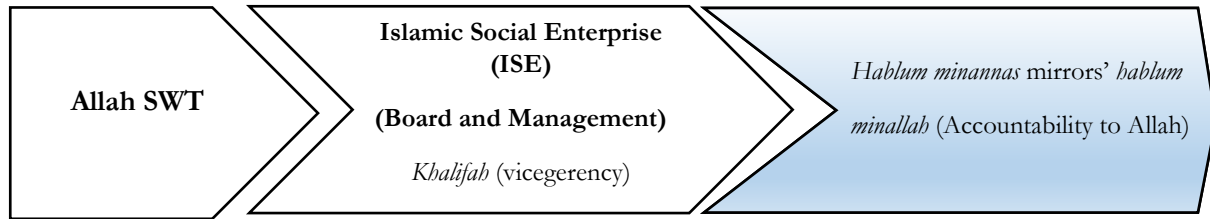
### **Social Capital and Well Being**

Another outcome of integrating spirituality into the training programmes of IMFIs is an improvement or creation of clients' social capital. As mentioned, spirituality training should also build on sense of community, trust and group solidarity among members. Inculcation of sense of community is crucial as most of IMFI financing models are based on the concept of the group-based lending approach, which involves joint liability for individuals within a group, with the shared responsibility also including repayment of the financing by the group's members (Obaidullah & Khan, 2008). The concept of group solidarity and cohesiveness may be reinforced through systematic training programmes and regular group meetings. Furthermore, these initiatives will allow for the opportunity to share knowledge, best practices and network among members (Hassan, 2014).

### **Spiritual Capital**

The impact of the IMFI programme on clients should also include the improvement of spiritual capital and enrich religious obligations among its Muslim clients or as noted by Aydin (2015) the measure of human development is ultimately is the "spiritual, moral and intellectual excellence through *tawqa* and *amal saleh*". This spiritual capital can be demonstrated through increased religious awareness (Rahman, 2010; Rulindo & Mardhatillah, 2008). As mentioned in Grine, Fares and Meguellati (2015), Al-Gazzali (2004) stated that religious rituals (*Ibadah*) should improve a person's relationship with Allah and the society, otherwise these would merely become empty rituals with no value. Therefore, these practices have a significant influence on the business experience of Muslim entrepreneurs (Rulindo & Pramanik, 2013; Grine et al., 2015), as they strengthen their motivation to succeed not only for the dunya (the world) purposes, but also for the akhirah (the hereafter) purposes, both of which form the Islamic world view (Al-Attas, 1995).

Therefore, in addition to the inclusion of the financial and social objectives of IMFIs, the integration of the spirituality dimension into the intent, process and output of social performance is presented in **Figure 2**. The assessment of spirituality within IMFIs is an important step to identify gaps that must be addressed to improve the performance of IMFIs. However, more work is required to identify and develop potential instruments to investigate the spiritual dimension in general, and specifically to identify outcome measures for the social performance management of IMFIs.



**Figure 2:** Proposed social performance management framework for IMFIs

## CONCLUSION

The paper suggests ways to integrate the spirituality dimension into the social performance management framework of IMFIs, as there is a distinction between the approaches of Islamic and conventional microfinance. In doing so, the impact of spirituality on IMFIs, their employees and clients, and the IMFIs' performance are also discussed. It is proposed that the spirituality element should be considered in the intent of the microfinance, i.e. in the mission statement and the process measures of managing social performance, in order to ensure that the IMFIs achieve their financial, social and spiritual missions. The IMFIs' development and poverty alleviation programmes should be multi-dimensional and promote Islamic moral values to develop entrepreneurs' consciousness (*akblaq*) (Hadisumarto & Ismail, 2010).

The spirituality dimension in social performance management has reference to the mission of IMFIs, as financial institutions with a social purpose fulfil their collective religious obligation. Internalising Islamic spiritual values within the IMFIs is necessary for the development of microfinance providers and their clients. Value-based education and training is one approach that supports the development of employees and clients. By providing financial products and investing in nurturing human development, IMFIs should be able to contribute to poverty alleviation and provide opportunities for the economic, social and spiritual development of the community and the wider society. IMFIs need to accentuate their microfinance programmes based on Islamic values and adopt a performance-minded culture to sustain their operations and achieve their triple mission – a financial, social and spiritual mission. To conclude, this paper presents a conceptual analysis of the Islamic perspective, measures and commitment to social and religious responsibilities as part of IMFI social performance management. The proposed framework in this paper may be of importance to regulators and IMFIs when formulating appropriate measures and programmes. They may enable them to incorporate spiritual values in order to ensure positive financial, social and spiritual outcomes of programmes at organisational and client levels.

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