

## Chapter 61

# Blockchain for Islamic Social Responsibility Institutions

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### ABSTRACT

*Blockchain and smart contracts are forming new systems to record and manage businesses with less need for intermediaries. The new systems are expected to offer high level of governance with lower cost as compared to the traditional technologies. While there is a continuous effort to apply this innovative technology in several businesses, Islamic finance in general—and Islamic social finance in particular—are facing few challenges that could be solved by such innovations. Islamic social finance institutions such as waqf are facing some challenges in enhancing its governance structure to ensure Shariah compliance as well as economic efficiency. This chapter explains how blockchain and smart contract technologies can help these institutions for better governance, lower transaction cost, more transparency, and higher trust, hence enhancing the business flexibility and market accessibility. It also presents some related cases that are currently under development as an evidence for the practicality of these technologies in the Islamic social finance arena.*

### INTRODUCTION

There are mainly two main trends that can be observed in the post financial crisis in 2007-2008. First, there is an outcry from various parts of the world to introduce social and ethical values to the financial system and institutions (Benedikter, 2012). The introduction of the Sustainable Development Goals (SDGs) and the Principles for Responsible Investment by the United Nations are some of the evidences. Second, due to various advancements in the technology including blockchain, there is a shift in the focus of innovation from merely digitalization of financial products and services to changing fundamental

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business models, products and services (Gomber, Koch & Siering, 2017). The current trend is towards more customer-centric approach and greater customization.

Islamic finance is another dimension of doing finance in compliant manner to Sharī'ah (Islamic law). Since the inception of Islamic finance almost four decades ago, it has not been able to demonstrate substantial divergence from the conventional finance (Khan, 2010). Due to adherence to Sharī'ah, it is claimed that Islamic finance is more refined form of ethical and social finance. However, in practice, the ethical and social aspect of Islamic finance is overshadowed by its commercial aspect (Sairally, 2007). The development achieved so far in the area of Islamic finance was focusing on the contractual forms of the financial transactions only. This approach, though, avoids elements prohibited by the Islamic law, but it results in the similar effect and outcome of conventional finance. Therefore, it fails to reflect Islamic social and ethical values. This study derives its motivation from such practices of Islamic finance and attempts to suggest development of Islamic social finance institutions through blockchain and smart contracts to support sustainable economic development. Moreover, currently, the Islamic social finance institutions are facing an array of challenges and issues which will be discussed throughout the chapter.

This chapter applies qualitative technique of literature review and tries to develop relevant concepts and ideas. This chapter is discursive in nature covering a technical subject of blockchain and smart contracts and link those concepts with Islamic social finance products. Furthermore, while there is an array of issues and challenges facing the implementation of these products in the contemporary world, this chapter explains how blockchain and smart contract technologies can help the social finance institutions for better governance, lower transaction cost, more transparency and higher trust; hence, enhancing the business flexibility and market accessibility. It also presents some related cases that are currently under development as an evidence for the practicality of these technologies in the Islamic social finance arena.

## **BACKGROUND**

There are various Islamic social finance institutions proposed by the Islamic law which always played a pivotal role of sustainable economic development in a Muslim society throughout the history of Islam. The whole social ecosystem was an integral element of the financial empowerment program of the people which actively contributed in the financial inclusion, poverty alleviation and fruitful mutual community initiatives. However, recently, such important institutions have been generally failed to produce substantial impact within the Muslim society. Part of this problem is due to the challenges and issues faced by such institutions. Whereas another part of the problem lies in the fact that the commercial aspect of Islamic finance has captured most of the academic and professional attention at the expense of the Islamic social finance. One can easily notice the dearth need of quality academic literature in the topic from technology perspective.

The Islamic social finance institutions comprise of *zakat*, *sadaqat*, *waqf* and *qardh hasan* proposed by the Islamic law. A brief description of each of these institutions is given for a better understanding of the readership.

### ***Zakat***

*Zakat* is the transfer of ownership of a specific amount of money (or property) from someone who meets the certain criteria for the *zakat* to be obligated up on him/her to someone who deserves it by fulfilling

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