

THE PRODUCT RANGE CONCEPTUALIZATION FOR ISLAMIC SME FINANCING

Ahmad Aizuddin Hamzah^{a*}, Norhazlina Ibrahim^b, Amir Shaharuddin^c, Sumaiyah
Abd Aziz^d & Haneffa Muchlis Gazali^e

^{ae} Faculty of Labuan International Finance, Universiti Malaysia Sabah, Labuan International Campus,
^{bcd} Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia (USIM)

A PEER-REVIEWED ARTICLE

(RECEIVED – MAY 28, 2021; REVISED – SEPTEMBER 7, 2021; ACCEPTED – SEPTEMBER 30, 2021)

ABSTRACT

The SME sector is the most critical client for bank financing, particularly in commercial business banking. A dual banking system in which Islamic and conventional financial institutions coexist makes the financial market more competitive. To ensure that Islamic financial products and services can compete with the existing market, Islamic banking management must ensure that its services, particularly in the SME sector, have a place. Knowing the banking product preferences of those firms is one of the steps that should be taken. As a result, this study will develop a conceptual framework for the product range of Islamic banking products to investigate the SME owner's preference for Islamic SME financing. The product range of this range will be strengthened further with the theoretical support of planned behavior from the Managerial perspective among SMEs.

ABSTRAK

Sektor PKS adalah pelanggan terpenting untuk pembiayaan bank, terutamanya dalam perbankan perniagaan komersial. Sistem perbankan dwi, di mana institusi kewangan Islam dan konvensional wujud bersama, menjadikan pasaran kewangan lebih kompetitif. Untuk memastikan bahawa produk dan perkhidmatan kewangan Islam dapat bersaing dengan pasaran yang ada, pengurusan perbankan Islam harus memastikan bahawa perkhidmatannya, terutama di sektor PKS, memiliki tempat. Mengetahui pilihan produk perbankan firma tersebut adalah salah satu langkah yang mesti diambil. Hasilnya, kajian ini akan mengembangkan kerangka konsep untuk faktor rangkaian produk perbankan Islam untuk menyelidiki pilihan pemilik PKS untuk pembiayaan PKS Islam. Rangkaian produk dari julat ini akan diperkukuhkan lagi dengan sokongan teoritis tingkah laku terancang dari perspektif pengurusan di kalangan PKS.

Keywords: Islamic SME financing, Muslim entrepreneurs, TPB, product range, Malaysia

* Corresponding author; Ahmad Aizuddin Hamzah, PhD Candidate, Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia. Lecturer, Labuan Faculty of International Finance, Universiti Malaysia Sabah, Labuan International Campus. Malaysia. E-mail: aizuddin@ums.edu.my

1. Introduction

The life of a Muslim is not freedom. The law of *Shariah* binds every horn of deeds. This situation ensures that Muslims always know that they are only a servant to their Creator. The permissibility issue of *halal* products and the prohibition issue of *haram* products are among the issues, which are highly deliberated by them. *Halal* is an excerpt from Arabic that means something permissible, while this is the opposite of the word *Haram* that means things that need to be forbidden.

The rulings of *halal* and *haram* elements are expansive in the context of the daily life of Muslims. It is guarded against many angles. Among the aspects that are often highlighted are matters of worship such as prayer, fasting, and nutritional elements such as food and beverage that contain alcohol and animals forbidden from Islam such as swine and so on. However, the awareness and knowledge of Muslims on *halal* and *haram* is unbalanced. The Muslim community is more concerned about the *halal* ingredient in the aspect of food. At the one part, in the area of trading and business transaction, for example, the *Shariah* requirement, especially on financial matters, is still left behind. The halal business operator only ensures their products meet the halal standard procedure's requirement but not on their source of capital. For this reason, it makes challenges for Islamic banking to grow and at the same time extend their financial market share in Malaysia.

Although the existence of the Islamic Financial System in Malaysia reaches the age of 40, the awareness of the importance of this system is still low, especially to SME business entrepreneurs. More than half of the country's small and medium enterprises (SMEs) are not fully aware of the availability of Islamic business facilities (Edge, 2019). Due to that, most of the entrepreneur adopts conventional banking practice instead of Islamic financing. The ultimate goal of banking customers is to get financial resources. Issues in the formation of the product are less emphasized. This makes most of the clients in the financial market treat the Islamic economic system as conventional.

This matter is also one issue that is less emphasized in financial management for industrial enterprises in Malaysia, especially for businesses holding a Halal certificate. Halal ecosystems in the business chain in Malaysia are limited to the products and services provided. The financial resources owned by these firms are not made one of the processes in obtaining their *halal* certification. This situation causes these two industries to develop without the support of each other. Thus, Ishak and Man (2011) suggest that the government should create a new Halal policy. Ecosystem, which can strengthen the connection between both industries. Thus, it is crucial to ensure that 'halal' encompasses every aspect of the halal industry, including its financing, which must be entirely free of interest-based debt financing (Abdullah & Oseni, 2017). If financial resources are obtained from a *Shariah* non-compliant source, such as a traditional bank, the goods, and services provided by such financial resources are technically haram (IFN 2014).

Besides purification on production, a *halal* assessment also evaluate the *Shariah*-compliant status of the firm business that claims to be *Shariah* compliant is not assessed based on the owner's region. It is much more on the character of the firm itself. One component that is the criteria of *Shariah*-compliant status for a firm is assessing their feature on the usage of their financial instrument. The financial resources component of the enterprise is also critical in ensuring that the business is *halal*-certified. A different approach is implemented by Malaysia's securities commission (SC) in their *Shariah* stock screening process. Apart from the goods and services provided by the business, determining the halal status of its stock also involves the company's financial resources. Financial management involving banking services such as deposit saving and financing must comply with the guidelines provided by the SC. Labeling as a *Shariah*-compliant stock to a company on Bursa Malaysia must ensure that services from conventional banking are limited to 33 per cent of the overall service. Although the government does not use such

policies to determine if business premises are Halal, they can assist industry players in choosing their business status. Indirectly, Islamic financing awareness among SME entrepreneurs can be increased. At the same time, the government also continues to play its role in supporting the growth of Islamic finance when it is made one of the key players in helping the policy of Halal Development Master Plan 2030.

The cooperation of all parties is necessary for strengthening this Islamic financial system, especially in Malaysia. Therefore, as a platform in the provision of Islamic financial services, institutional players need to formulate new strategies to strengthen their services' performance. In 2018, Bank Negara Malaysia (BNM) had activated a new development strategy for Islamic financial institutions in Malaysia. The central bank proposed a Value-Based Intermediation (VBI) for the Islamic financial institution to enhance its marketability. In addition to profit, the actual value of Islamic teachings is emphasized in the framework of this strategy model. The concept of mutual assistance is given full support in ensuring that the Islamic financial system remains supported by the local community, especially business entrepreneurs.

Banking consumers' viewpoints and support are essential to ensure that the government's strategy and framework plan for the growth of Malaysia's Islamic financial system run smoothly. This project aims to develop a framework to investigate the determinants of Islamic SME financing preferences among Malaysian Muslim Entrepreneurs. In this study, the authors have extended previous work, created some original ideas to the Theory of Planned Behaviour, and incorporated product range in explaining the Islamic SME financing preference among Muslim entrepreneurs in Malaysia. This paper is divided into five parts. The first part discusses the literature review. The second part elaborates on the methodology of the study. The following part discusses the analysis and findings of the study. The final part deliberates the discussion, implications, limitations, and future research.

2. Literature Review

Islamic Banking

The operation of the Islamic financial system is different from the existing financial system. There are three main pillars of business in Islamic financial institutions: emphasizing the aspects of the partnership, sale and purchase transactions, and the rental design (Hamzah & Gazali, 2015). These contracts will be developed to create an interest-free banking product based on the provisions outlined by *Shariah*. Ahmad (1994) argues that Islamic banking within an Islamic economic system must be based on zero-based interest, equity participation, joint ventures, and profit-sharing.

All these contracts are used in existing banking products such as deposits and financing and exist in investment banking services. Among the *Shariah* business contracts used in Islamic banking products are, *Musarakah* and *Mudarabah* (Partnership), *Ijarah* and *Ujr* (rental and wages), and sale and purchase contracts as *Murabahah*, *Salam*, *Istisna*, and *Bai Bithaman Ajil*.

Islamic banking is encouraged to use the principles of *mudarabah* and *musarakah* in their transactions. Products like this receive many requests from banking customers because they can help ease their financial burden, especially business capital assistance (Haron & Ibrahim, 2016). The concept of profit and loss sharing (PLS) in this contract is seen as fair to both parties and avoids a zero-win situation. Such a principle is also one of the differences that can be seen between the Islamic financial system and the existing banking. However, Islamic Banking nowadays is difficult to apply such a contract in their products and services. This is because Islamic banking will be at high risk due to the current uncertain situation. Besides, some studies (Siddiqi, 1985; Rosly and Bakar, 2003) consider PLS as the only strict principle of an Islamic banking system. Therefore, Islamic banking operations are now

more focused on sale and purchase and renting contracts in their banking products. It also makes the outcome of Islamic banking differ from the conventional approach where *Shariah* mode of the contract is adopting their entire banking operation (Amin, 2020).

Past Study on SME with Islamic Banking

There are several previous studies investigate the relationship between the Islamic banking system and the SME sector. This relationship is seen in two different approaches, namely bank lending relationship dan adoption of SME owners. A study from Aysan, *et al.* (2016) reveal that Islamic banks (known as Participation banks in Turkey) are more inclined toward financing SMEs than conventional banks. Moreover, as all noticed, SME characters are opaque, but the SME quality for Islamic banks is comparable to that of conventional banks. Meanwhile, Shaban *et al.* 1.(2016) argue that Islamic finance controls the market as the nature of its products in the model of price competitiveness. While, different result finding by Masuduzzaman *et al.* (2018) which, effect of Islamic and conventional banking on SME firm efficiency is flow at the same way. Different financial resources do not affect the firm's performance unless any other factor includes size, the firm, sector, and business location.

On the aspect of the behavior approach, the adoption of SME owners towards Islamic banking reveals some different results. Shahrudin *et al.* (2005) investigate the perception of SME businesses on Islamic finance on their business financial instrument used. The factors determined such as knowledge, satisfaction, acceptance, and perception of the SME owner towards the reliability of the Islamic financial instrument. Based on that, the SME owner less prefers Islamic finance as the most desirable financial institution. Meanwhile, studies conducted by Jaffar & Musa (2014) take different approaches. They argue that there is a link between industry players gaining Halal certification status with the Islamic financial sector. Therefore, further investigations were conducted using the Theory of Planned Behaviour to look at the intentions of these SMEs on Islamic financial products. It shows that the factor of attitude, subjective norms, and perceived behavioral control is significant for SME owner's intention on Islamic financial products.

Besides, the rapid growth of the Islamic financial sector in Africa has led to further studies by (Badaj & Radi, 2018) to look at the perception of these SMEs on Islamic financial services. With the development of the theory by the previous researcher, this study uses the Decomposed Theory of Planned Behaviour and evaluated eleven dimensions to examine the SME financing system's actions against the profit and loss method. The 11 variables are Cost, Risk Sharing, Business support, Loss of control, Access to conventional Debt, stage of development, Financial suitability, religious beliefs, Normative beliefs, self-efficacy, and facility condition. Each of these variables is reacting differently. There is a connection between these factors, and some of them are opposed.

Considering the wide variety of previous studies on the use of Islamic finance instruments, further studies by Al Balushi *et al.* (2019) look at other aspects of lending, especially among SMEs. Among the items used to view this relationship are SME manager knowledge, size, and firm characteristics. Using Oman Muscat as a research site shows that specific knowledge and attributes are related to Islamic financing but not to firm characteristics. The entrepreneur's understanding of Islamic finance with the familiar Islamic finance contract is closely linked to their decision to choose Islamic financial instruments. However, knowledge of the agreement of *ijarah* has no relation whatsoever to the years of contracting *Musyarakah*, *Murabahah*, and *Mudarabah*. This implies that their understanding of experience depends only on contracts that they understand. In addition, the backbone of SME entrepreneurs reflects some different factors in influencing them to use these Islamic financial services. Gender differences and educational background support this relationship but not to differences in marital status and age of entrepreneurs. However, for the firm factors, it is found that the relationship between the features of the prime and the

use of Islamic finance instruments does not exist. Due to the limited size of the study area, this decision has yet to represent the entire SME community in general and needs to be applied further to developing countries.

Theory of Planned Behaviour

Theory of Planned Behaviour (TPB) is the extension of Theory of Reason Action (TRA) (Fishbein & Ajzen, 1975). TPB has been applied to understand a user's adoption behavior (Ajzen, 1991). Under TPB, there are three antecedence variables as Attitude (ATT), Subjective Norm (SN), and Perceived Behavioural Control (PBC). Attitude refers to how a person has favorable or unfavorable evaluation towards the particular behavior in question (Ndubisi & Sinti, 2006). The second antecedence is SN refers to the individual's perception of the societal norm for the behavior (Yang & Devaney, 2012). If the individual believes the action is in line with cultural norms, the intention to perform it is thought to be stronger. PBC is seen as a critical predictor of actual behavior (Ajzen, 1991).

Many studies have employed TRA to understand a person's behavioral intention towards particular behavior in action. The application of TRA has been diversified in halal food purchasing (Lada et al., 2009), zakat compliance (Bidin et al., 2009), and depositors' withdrawal intention (Abdul-Razak and Abduh, 2012), to mention but a few. Besides, TRA has been revealed to be a robust and parsimonious model for predicting user adoption behavior. Ajzen (1991) incorporated perceived behavioral control and extended TRA to predict individuals' behavioral intention better. Past studies utilized TPB to investigate a wide range of behavior. For example, Bonne et al. (2007) attempted to examine the application of TPB in predicting the intention to eat halal meat among Muslims. The study was conducted in France with a total of 576 valid responses. Results showed that halal meat consumption was determined by a positive personal attitude, social influence among peers, and perceived behavioral control. The study used multiple regression analysis. Using the same analysis but in a different setting, Alam and Mohamed-Sayuti (2011) investigated factors influencing people to purchase halal food in Malaysia. The authors confirmed that attitude, subjective norm, and perceived behavioral control consisted of 68.9 percent variation in the dependent variable (i.e., halal food purchasing intention). Given the arguments, it can be seen that the Islamic paradigm accepts the application of TPB, although it has been drawn from a Western world.

Moreover, research on Islamic mortgage adoption from the Islamic perspective is still scarce, and the concept has not been well explained (Bonne *et al.*, 2007; Alam and Mohamed-Sayuti, 2011). This gap demands a need for a better understanding of Islamic mortgage adoption from the TPB context. Hence, TPB deems appropriate. Furthermore, TPB is more relevant than other theories owing to its parsimonious and control components. Thrifty means that TPB only has the most straightforward research framework accompanied by a small set of factors instead of a cumbersome number of factors (Sekaran and Bougie, 2016). This is essential to meet a strong prediction of behavioral intention (Rhodes *et al.*, 2002). Besides that, TPB contains "control" elements as it is regarded as "planned." Purchasing a house using Islamic home financing involves a considerable cost which means that an individual should control what they adopt. Thus, TPB suits the current context.

Product Range

Products and services are one of the factors that motivate customers to buy and use the goods. Different tastes and desires cause the customer to weigh before making any purchase decision. In business matters, owners will look into many things, including the needs of their company. If a product and service supply a large chain of products, they tend to own such goods and services. This is acknowledged when the findings of a study from Abdul-Hamid et al. (2011) and Amin (2008) found that product type is an incentive for customers to use Islamic home financing products. Amin (2008) also argues that the question of *Shariah* compliance causes Islamic home financing products to provide a wide range of

products according to consumers' needs.

Meanwhile, in price competition, the diversification of Islamic financing products, especially the SME sector, causes Islamic banking to be in high demand compared to conventional banking (Shaban et al., 2016). The product range is an element that was not considered by previous researchers in looking at the relationship of Islamic financing adopting among SME owners. Enterprises of SME firms that provide halal goods and services are polluted if their financial resources come from usury sources (Abdullah & Oseni, 2017).

3. Conceptual framework

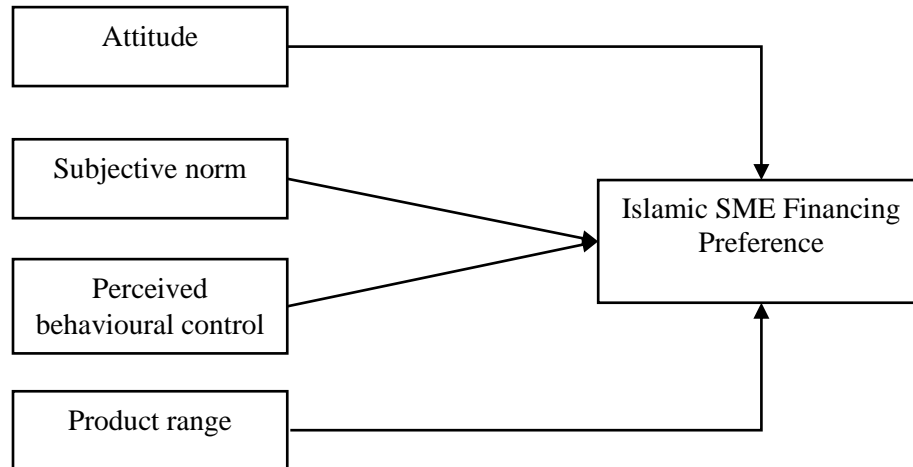


Figure 1: The Conceptual Framework

4. Conclusion

Financing is a necessity for all. For the business sector, especially those SME firm categories, capital injection is vital for their business growth. As a financial services provider, Islamic banking must play an essential role in ensuring that every SME enterprise is not left behind in enjoying *Shariah*-compliant financial facilities. This also coincides with Islamic banking's primary goal to prioritize social relations rather than profit. The importance of *Shariah*-compliant financial resources is paramount, especially to entrepreneurs who supply halal products and services. This will make the flow of the halal ecosystem perfect by considering all the factors. Therefore, research looking at the factors that motivate SME entrepreneurs to decide their financing capital from resources that follow *Shariah* methodology should be refined to get a more robust relationship framework.

This study aims to develop a framework to investigate the determinants of Islamic SME financing preferences among Malaysian Muslim Entrepreneurs. TPB has been enhanced with a product range in this study to explain Islamic SME finance preferences better. An implication of this study is for the policymaker and financial institutions to understand their customers better. This study could be used as a starting point for additional investigation by the researchers. Despite the conceptual work in nature, this study shed some light on the Islamic SME financing preference. Further research could validate the suggested framework and include more variables to explain the desire for Islamic

SME financing better.

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