

The Role of Islamic Finance in the Development of Small and Medium Enterprises in Jordan

Motasem Mohammad Al Dabbas
Balqa Applied University Jordan

Dr.mutasimdabbas@bau.edu.jo

Abstract. The study aimed to investigate the role of Islamic finance in the development of small and medium enterprises in Jordan. This study was conducted for the benefit of Islamic financial institutions on the one hand, and owners of small and medium enterprises on the other hand. The researchers used a descriptive analytical approach by analysis of (100) questionnaires filled out by owners of small and medium enterprises in Jordan. The study found that the degree of estimation of the study sample towards the extent where small and medium enterprises in Jordan dependent on Islamic finance are moderate. The study concludes that “Murabaha” financing formula is considered one of the main and popular financing methods among dealers in Islamic finance. The findings of this study have significant implications for policymakers in the financial sector to knowing the trends of SMEs which is necessary to enhance and increase this type of financing in general and Islamic finance in particular in order to development and support SMEs. The researchers recommend to increasing the financing of small and medium enterprises by Islamic banks and allocating funds allocated to this type of financing

Keywords: Islamic finance, small and medium enterprises

1. Introduction

The concept of Islamic finance has evolved in recent years, and there has been intense competition between Islamic banks and ordinary commercial banks, especially in financing small and medium enterprises and new and pioneering projects.

Small and Medium sized enterprises SMEs have a significant role in fostering economic growth, creating wealth and job opportunities, and industrialization. They have a significant role in terms of output expansion, utilization of local resources and adaptation to technology (Santoso, 2019). There is a need for the dissemination and development of small and medium enterprises, and their development, in the service of the overall economy, and there is a set of characteristics that distinguish small and medium enterprises, which require more care to support and finance them (Abu Shanab, 2015).

Raza et al (2017) reported that SMEs are the ones that are involved in originating things for meeting the demand of the local market. Those enterprises serve as a fundamental tool in the generation of income and creating job opportunities. Such opportunities support the economy.

Small and medium enterprises are defined based on a set of criteria, including the number of workers, the size of the capital, or a mixture of the two criteria together. There are other definitions based on the use of sales volume or other criteria. The World Bank, for example, defines small and medium enterprises using the criterion of the number of workers, which is considered a standard. In principle, an establishment is considered small if it employs less than 50 workers. There are many countries in the world that use this standard to define small and medium enterprises. In the United States of America, Italy and France, a firm is considered small and medium if it employs up to 500 workers, in Sweden up to 200 workers, in Canada and Australia up to 99 workers, while in Denmark it is the establishments that employs up to 50 workers (Al-Mahrouq and Muqabla, 2006).

Financing is a problem for existing SMEs, or projects to be established. Such as the complexities of guarantees, administrative and bureaucratic problems, the problems of the scarcity of specialized financial institutions willing to help those institutions looking for financing, and Islamic finance helps reduce such problems (Abu Shanab, 2015).

The establishment of specialized lending institutions such as Islamic banks in most countries of the world came as a reaction to some groups avoiding dealing with traditional commercial banks, in an attempt to contribute to the economic development process, at a time when their credit activity was focused on short-term loans, to obtain quick profits. Therefore, it was necessary to establish specialized financial institutions aiming to provide medium and long-term credit facilities to

various economic sectors, according to specific terms and methods that are distinct from those used in traditional banks (Al-Mahrouq and Muqabla, 2006).

The idea of micro and small loans goes back to Muhammad Yunus, a Bangladeshi who won the Nobel Peace Prize in 2006. Yunus, who was a professor at the Faculty of Economics at Chittagong University in Dhaka (the capital of Bangladesh), thought of helping poor farmers who mortgaged their land to banks in return for high loans. The benefits, he proposed the idea of "small loan", whereby loans are provided to dozens of farmers, without the need for guarantees that are usually required by commercial banks, and the experience of small loans in most Arab countries is recent, and dates back to the early nineties of the last century. The National Bank for Microfinance was established in Amman/Jordan, Al-Amal Bank in Yemen, Ebdaa Bank in Bahrain, Al-Amal Foundation in Egypt, and other contributions, as well as banks for the poor, and other official and private institutions (Abu Shanab, 2015).

Regarding the Islamic financial institutions, they have developed several financial products and instruments that fit with Islamic rules and provisions. Many instruments of those are based on equal participation, interest-free loans and deferred payment. Islamic financial institutions offer the same contribution to the financial system and the economy through combining ethical and moral values in its financing mode, motivating Muslim people to mobilize funds and offering external resources for venture capital (Santoso, 2019).

Thaker et al (2020) add that Islamic banking and finance is a broad framework which has great potential in terms of fostering development and finance in small enterprises. That's attributed to their fundamental criteria that emphasize generating positive societal impact.

As SMEs represent a large size in the economy. It constitute more than 90% of the size of the economy, and they contribute to reducing poverty and unemployment. appropriate means of financing. At same time Islamic banks play a major role in financing SMEs. They are eager to achieve and are characterized by their characteristics, as one of their most important goals is their contribution to comprehensive economic and social development, and it is worth noting that small and medium enterprises require Flexibility and diversity in financing methods (Abu Diab, 2003). Accordingly, some questions arose about the role of Islamic finance in the development of small and medium enterprises in Jordan.

2. Literature Review

There are a large number of methods that Islamic banks and financial institutions can use in financing operations, and they are of two basic types: financing methods based on participation in the return on investment, and financing methods based on debt. In the financing methods based on participation in a return on investment,

speculation stands out, which is one of the most common and practical methods of financing in Islamic banks (Al-Shawarbi, 2002).

Cherqaoui (2022) adds that combining the principles of Islamic finance, the advancements in technology, and Fintech represents an opportunity to contribute significantly to the improvement of the entrepreneurial ecosystem in the Islamic countries and the promotion of MSMEs segment development.

Sojoodi & Jalili (2022) added that (SMEs) play a major role in the economy. In developing countries, these companies play an important role in creating employment, especially for women. Investing in the development of SMEs requires having a long-term and effective strategy with returns that are sustainable.

The owners of SMEs and the workers in them believe that Islamic financing has helped their businesses to acquire the funds required for their businesses to develop and expand beyond existing markets (Abdinur & Ondes, 2022). Benbekhti et al (2021) added that Islamic finance is a golden opportunity and a sufficient alternative financial source for SMEs. Furthermore, SMEs contribute to reducing the rate of unemployment through contributing to the labor market.

Kiran (2022) added that owners/managers of SMEs and employees have effective knowledge on the principles of Islamic finance. Although the Islamic financing strategy is deemed new in Oman, most of the participants (including financial experts) have positive attitudes towards its adaption. The study findings also show that there is a positive relationship between operations of Omani SMEs and Islamic financing. It was concluded that Islamic financing has benefitted SME operations as well as could play a major role in the growth of SMEs and their operations in the future.

Mkadmi & Ahmadi (2022) show that, the tax optimization of Islamic financing in the case of SMEs needs an adapted approach from the Tunisian tax administration. Using Islamic finance products is important since more than half of the entrepreneurs have used such products. Most of the entrepreneurs who used Islamic financing (80 %) chose the Murabaha type of financing. Most of the entrepreneurs (56 %) are satisfied with the products that are offered by Islamic institutions (56%).

Adelekan (2021) reported that Islamic finance is a significant driver of SMEs' competitiveness. It was found that Islamic finance plays a critical role in driving product price, customer experience, and quality of products. It was found that Islamic finance may reduce its operational cost since it comes at a no-interest rate while giving room for more innovative prices and customer-centric products at competitive prices. It was found that SMEs are expected to leverage the opportunities provided by Islamic finance in order to carry out sustainable business practices.

Santoso (2019) found that IFIs support MSMEs towards SDGs achievement in terms of industrial innovation, poverty alleviation, infrastructure, financial stability, and income distribution and economic growth. Currently, from demand side, the intention to use and access MSMEs to IFIs is still very low, but in the future may be better, if strategy is implemented such financial literacy which improve MSMEs understand the advantages and features of Islamic financial products. Raza et al (2017) found that investment arrangement in the country has been significantly increasing recently. The Islamic investment is one of the swiftest sub-segments in the financial sector. Islamic deposits increased by 42%. In terms of the State Bank of Pakistan (SBP), it enhances the five year design of the Islamic investment industry, with focusing on the SME sector. It was found that spiritual belief is one of the major reasons that prevent the entrepreneurs to opt for a proper finance. There are more than 25% of these entrepreneurs who don't opt any type of financing, and 20% restrict themselves to a necessary level. Most of the SMEs rely mainly on informal origins in terms of funding.

Abu Shanab (2015) concluded that a number of Islamic financing formulas provide effective solutions; To enhance the economic role of small and medium enterprises, and to confront the problems of poverty and unemployment in Jordan, in particular.

Al-Asraj (2012) argue that their high importance of Islamic finance formulas in their ability to Achieving justice between the two parties to the transaction, so that each party obtains its right, instead of the interest-based lending system that guarantees the right of the loan holder usually at the expense of the borrower. Ahmad (2003) concluded that there are a number of usurious banks that started to follow the formulas of Islamic financing in their financing of small projects. Small enterprises achieve higher profits by financing them from Islamic banks.

3. Methodology

The researchers adopted a descriptive analytical approach in order to achieve study objectives. This study was applied to a sample of owners of small and medium enterprises dealing with Islamic banks in Jordan. This study aimed to investigate the role of Islamic finance in the development of small and medium enterprises in Jordan. The study questions are the following:

Q.1: To what extent are small and medium enterprises in Jordan dependent on Islamic finance??

Q.2: What is the role of Islamic financing formulas in developing small and medium enterprises in Jordan?

The researcher used questionnaire as study's instrument. The questionnaire consists of two parts, the first containing statements related to the extent to which small and medium enterprises depend on Islamic finance. The second part relates to

Islamic financing formulas and their role in the development of small and medium enterprises. The study's variables are listed below:

- The independent variables: Islamic financing.
- The dependent variable: developing small and medium enterprises in Jordan.

The validity of the questionnaire was tested by sending the tool to three experts, in order to express their opinion regarding the language, clarity and relevance to the objectives of the study. The questionnaire, its language integrity, and its relevance to the objectives of the study, and their recommendations were taken into consideration.

The questionnaire was distributed to the study sample consisting of (100) of owners of small and medium enterprises dealing with Islamic banks in Jordan. To measure the reliability of the tool, the values of the Cronbach alpha coefficient have been calculated, and the total value of this coefficient is (0.809), and this value indicates that the reliability of the tool is high.

The researcher used SPSS program was used, and a set of statistical methods were used. These methods are as follows: Frequencies and percentages, Means and standard deviations, Cronbach's Alpha. The following criteria were used to classify averages:

- Low level from 1.00 to 2.33
- Intermediate level from 2.34 to 3.67
- High level from 3.68 to 5.00

Mean and standard deviation were extracted. The answers were arranged according to the mean standard (Low level, Intermediate level, High level) to judge the attitude of the study sample related to the first question that answers the extent to which small and medium enterprises depend on Islamic financing. The same mean and standard deviation were used for the second question to find out the attitude of the study sample for the most important Islamic financing formulas (Murabaha, Lease to Own "Leasing", Musharaka, Mudaraba, Istisna'a).

4. Results and Discussion

First Question: To what extent are small and medium enterprises in Jordan dependent on Islamic finance?

To answer this question, averages and standard deviations were calculated as shown in Table (1).

Based on Table (1), it was found that the degree of estimation of the study sample towards the extent where small and medium enterprises in Jordan dependent on Islamic finance came in a moderate degree, because the total mean was (3.59) and the total standard deviation value was (0.93). It was found that the statement No (9) where stated: " Islamic banks require many and difficult guarantees from small

and medium enterprises" achieved the first rank, as it achieved an mean of (3.66) and a standard deviation of (0.78) with a moderate degree.

It was found that the statement No (7) where stated: " Islamic finance ranks first in terms of financing options for small and medium enterprises" achieved the last rank, as it achieved an mean of (3.49) and a standard deviation of (0.88) with a moderate degree.

We conclude from these results that there is a demand from the owners of small and medium enterprises to finance their projects from Islamic banks, but at an average rate. This indicates that financing small and medium projects through Islamic financial institutions may find competition with commercial banks, especially since the study sample believes that there is difficulty in obtaining financing from Islamic banks due to the large number of guarantees required by Islamic banks.

These results show the importance of Islamic financial institutions, especially accredited banks, in increasing the financing of small and medium enterprises in order to develop them and increase their size. Financing small and medium projects contributes to encouraging members of society to establish projects, thus increasing job creation in the economy and reducing unemployment rates.

Table 1: Means and standard deviations of Islamic finance

No	Statement	M	S.D	Rank	Degree
9	Islamic banks require many and difficult guarantees from small and medium enterprises	3.66	0.78	1	Moderate
1	The enterprises relies mainly on Islamic finance	3.61	0.86	2	Moderate
3	Islamic banks attract small and medium enterprises	3.60	0.97	3	Moderate
8	The enterprises is trying to obtain the trust of Islamic financial enterprises	3.59	0.85	4	Moderate
10	It is easy to deal with Islamic banks	3.58	0.93	5	Moderate
6	There are different Islamic financial enterprises	3.54	0.91	6	Moderate
4	There is high confidence in Islamic banks by society	3.53	0.86	7	Moderate
2	Islamic banks have proven their ability to develop small and medium enterprises	3.51	0.86	8	Moderate
5	Islamic banks have departments specialized in dealing with small and medium enterprises	3.50	0.87	9	Moderate
7	Islamic finance ranks first in terms of financing options for small and medium enterprises	3.49	0.88	10	Moderate
	Total	3.59	0.93		Moderate

The results of the study are consistent with previous literature and research. Abdinur & Ondes (2022) reported that Small Medium Enterprises owners and workers believe that Islamic financing has helped their businesses to obtain the funds needed for their businesses to grow and expand beyond existing markets . Benbekhti et al (2021) found that Islamic finance is a golden opportunity and a sufficient alternative financial source for SMEs. Kiran (2022) found that SMEs owners have effective knowledge regarding Islamic financing principles. Adelekan (2021) reported that Islamic finance is a significant driver of SMEs' competitiveness.

Second Question: What is the role of Islamic financing formulas in developing small and medium enterprises in Jordan?

To answer this question, averages and standard deviations were calculated as shown in Table (2).

Table 2: Means and standard deviations of Islamic financing formulas

Variables	M	S.D	Rank	Degree
Murabaha	4.02	0.91	1	High
Lease to Own "Leasing"	4.00	0.93	2	High
Musharaka	3.98	0.87	3	High
Mudaraba	3.96	0.79	4	High
Istisna'a	3.91	0.92	5	High
Total	3.95	0.94		High

Based on Table (2), it was found that the degree of estimation of the study sample towards the role of Islamic financing formulas in developing small and medium enterprises in Jordan came in a high degree, because the total mean was (3.95) and the total standard deviation value was (0.94). It was found that

The Islamic finance formula "Murabaha" achieved the first rank in financing small and medium enterprises with a mean of (4.02) and a standard deviation of (0.91). The Islamic finance formula "Lease to Own "Leasing"" achieved the second rank in financing small and medium enterprises with a mean of (4.00) and a standard deviation of (0.93). The Islamic finance formula "Musharaka" ranked third in financing small and medium enterprises, with a mean of (3.98) and a standard deviation of (0.87). The Islamic finance formula "Mudaraba" achieved the fourth rank in financing small and medium enterprises with a mean of (3.96) and a standard deviation of (0.79). The Islamic finance formula "Istisna'a" ranked fifth in financing small and medium enterprises with a mean of (3.91) and a standard deviation of (0.92).

It can be concluded that the "Murabaha" financing formula is considered one of the main and popular financing methods among dealers in Islamic finance. It turns out that Murabaha is considered one of the Islamic transactions that contribute to the development of small and medium enterprises, and this may be due to the fact

that these projects do not need huge sums like large companies, but rather simple sums that can be borrowed directly through Murabaha by purchasing production machines or raw materials, distribution vehicles and others. Panama Other funding streams such as Lease to Own "Leasing", Musharaka, Mudaraba, Istisna'a come in other preferences for SMEs and possibly because they are related to somewhat larger financings.

According to the presented results, they are consistent with previous studies. Sojoodi & Jalili (2022) reported that Small and medium enterprises (SMEs) play a vital role in the economy and creating employment. Kiran (2022) indicated that there is a positive correlation between operations of SMEs and Islamic financing. Mkadmi & Ahmadi (2022) reported that most of the entrepreneurs who have used Islamic financing have chosen the Murabaha type of financing. Ahmad (2003) reported that there are a number of usurious banks that started to follow the formulas of Islamic financing in their financing of small projects.

5. Conclusion

The concept of Islamic finance has evolved in recent years, and there has been intense competition between Islamic banks and ordinary commercial banks, especially in financing small and medium enterprises and new and pioneering projects. The research investigates the role of Islamic finance in the development of small and medium enterprises in Jordan. We conclude that financing small and medium projects through Islamic financial institutions may find competition with commercial banks, especially since the study sample believes that there is difficulty in obtaining financing from Islamic banks due to the large number of guarantees required by Islamic banks. The research reported that "Murabaha" financing formula is considered one of the main and popular financing methods among dealers in Islamic finance. The findings of this study have significant implications for policymakers in the financial sector to knowing the trends of small and medium enterprises which is necessary to enhance and increase this type of financing in general and Islamic finance in particular in order to development and support SMEs. The researchers recommend to increasing the financing of small and medium enterprises by Islamic banks and allocating funds allocated to this type of financing.

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