

## ISLAMIC FINANCING SELECTION AMONG SMALL AND MICRO-SCALE ENTREPRENEURS

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### Abstract

*The study attempts to investigate the probability of small and micro entrepreneurs who received financial assistance from microfinance program of Amanah Ikhtiar Malaysia (AIM) to select Islamic financing in business activities. A survey was conducted on the participants of AIM in Kelantan and Perak and data collected are analyzed using binary logistic regressions. The findings of the study show that the likelihood that Islamic financing is selected among small and micro entrepreneurs is likely to be determined by higher level of education, more asset value obtained and more understanding on the concept of 'riba'. Variables of age, amount of loan, household size, income obtained from AIM program, spending, understanding on concept of 'gharar', 'mudharabah', 'musyarakah', 'bai' bithamin ajil', 'istisna', 'salam', 'qard al-hasan' and 'al-inah' are not significantly influence the tendency to choose Islamic financing among small and micro entrepreneurs.*

**Keywords:** *Small and micro-enterprises, Amanah Ikhtiar Malaysia, Islamic financing, Malaysia.*

### INTRODUCTION

The pandemic of covid 19 has hit the economies of the world in unexpected ways. Businesses and firms are still struggling to cope with the pandemic and in the same time to revive back from the economic impact. Small Medium Enterprises (SME's) are not excluded from the economic turbulence. The fact that SME's are the backbone of the Malaysia economy is emphasize from the data where 98.5% business establishment in Malaysia are built up by the SME's. From this figure, majority of the SME's (76.5%) are from the micro enterprises and most of the businesses are focusing on the services sector

which constitutes of 89.2%. (SME Corporation Malaysia, 2021). Thus, looking at the progress of SME's are significant in terms of it leads to 38.9% contribution to Malaysia total Gross Domestic Product (GDP) and the SME's bring about 48.4% employment to the Malaysian.

Coming up with the National Entrepreneurship Policy 2030, the government aimed for SMEs to account for 50% of the nation's gross domestic product (GDP) by 2030. (Ministry of Entrepreneur Development and Cooperatives, 2019). The government is serious in promoting the development of SME's and hence, various strategies has been put to help the SME's that is highly affected by the storm of the pandemic Covid 19. For example, the government has allocated RM4.6 billion to empower Bumiputera entrepreneurs within the Budget 2021. This is given through various business boosting program such as the National Entrepreneur Group Economic Fund (Tekun) and Perbadanan Usahawan Nasional Bhd (PUNB). (The Star, December, 2020). Apart from that, the government has also established the Bantuan Prihatin Rakyat (BPR) and allowing for the withdrawal of i-Lestari and i-Sinar where it provides cash assistance to the people.

Being optimistic, the SME's are utilising the supports given by the government and taking proactive measures to ensure their stability. At the same time, the SME's are also getting ready for an unexpected economic turnaround which is in line with the new normal of "expecting the unexpected". Mastercard Impact Study for SMEs has conducted a survey towards SME's where the results shows that the issues on labour, financial and sales are three major concerns of the SME's survival during pandemic. (New Straits Times, March 2021). The Movement Control Order (MCO), the travel bans, closure of state and national border affect majors of SME's sector and in turn led to the contraction of the Malaysia GDP by 17.1% which is the second level lower after the economic crisis 1998. Adding to that, the SME Association of Malaysia found out that 57% of the SME's they surveyed reported no sales during the first MCO while 40% acknowledge that their revenues dropped by at least half. (Thomas, J. 2021).

Nevertheless, being resilient from fails most of the SME's now has ensure that they are crisis-proof through investing in the digital upgrades of their businesses, increasing the skills of the labour and not depending merely on the physical business transactions. Stepping in the year of 2021, most of the businesses have fully utilised the digital ways of transaction as to cope with the new normal of daily businesses activities. Extracting further the results of the survey from Mastercard Impact Study for SMEs, 85% of the respondent's belief in order to recover from the economic impact of the pandemic they need the assistance from the banking sector. This financial assistance from the bank has been rated as good or excellent by the respondents.

For example, Maybank SME Digital Financing has served over 8,200 SME's with a total of RM1 billion financing. (Faridi, O. 2021). Bank Rakyat on the other hand assists to provide SME's with special financial package with shariah advisory services inclusive in the financing packages especially towards the halal SME's manufacturers and operators. (The Star, 2021). Given that various stimulus package and financial aids available for the recovery of the SME's, here comes the concern of this paper. Is Islamic Financial service will become a key feature in promoting SME's to recover? RAM Rating Services Bhd (RAM Ratings) indicate that local Islamic Banking sector able to grow at the rate of 8.1% in 2020 even though the pandemic Covid 19 strike. This has maintained the "stable look" rating by RAM ratings towards the Islamic Banking sector. The performance is far beyond the conventional banks with a growth rate of 1% in 2020. (Nur Haziqah, 2021). The major factor of stable performance of the Islamic Financial Sector is driven by the value of 'islamic first' agenda applied by major banking groups.

Islam as a way of life requires Muslim to practice shariah as comprehensive. This is inclusive in the daily business activities. Therefore, it is expected that Muslim entrepreneurs will tend to select Islamic Financial services rather than the conventional one. Alabbad, Divya, & Govindaraj (2020) highlighted that three major features for Islamic banks to attract depositors are depending on the religious, political and socio legal factors. They noted that Islamic shariah will governs the behavior of the depositors. Moreover, Azmat, Ali, Brown, & Skully (2019) use the term shariah consciousness referring to the Islamic banking customers whom aware and chose shariah as their priority in product selection. On the other hand, customers who is not shariah conscious will select products considering its arabic term and fatwas by renowned scholars to indicate the product is shariah compliance. This is supported by Jaara, Kadomi, et al (2021) which highlighted that religious is not the sole criteria for customers selection for Islamic financing. Apart from religious issue, Islamic banks should consider the product features and service quality in proposing the Islamic banking products.

Abdul Hadi, Noradilah & Muwazir, Mohd. (2020) looking at a slightly different angle, focusing on the impact of ethnicity. Malay ethnic group ranked religious and ethical as the main criteria for the selection of Islamic financial services. Chinese and Indian ethnic group consider religious factor as the least important for selection criteria. This is in line with the fact that majority of the Malay ethnic group is Muslim. Thus, religious factor is highly determining the selection criteria for the Islamic financing products. Khan, Udin, Majid & Anam. (2020) details the factor for customers to opt for Islamic financing is highly dependant on the level of knowledge, advertisement of the products and the shariah compliance level of the products. Fachrurazi, et al

(2020) focuses on 127 respondents of SME owners and learned that service quality, religiosity and fair schemes offered as the main factors for SME's owners' satisfaction and loyalty towards the Islamic financing services.

Centering on the case study of Pakistan, Bilal, Fatima, Ishtiaq, Muhammad & Hafiz (2020) conducted a study on 400 SME's owners using inferential statistic. The study found out that government support, subjective norms, perceived behavioral control and self-efficacy are among the significant factors for adoption of Islamic financial services among the SME's owners. In addition to that, a good corporate image of the Islamic banks is significant in increasing the numbers of consumer demand for the shariah compliance business transactions. Mohamed Shaban, Meryem Duygun, & John Fry (2016) compares the lending to SME's by Islamic banking with the conventional banking. The paper highlighted that with regards to price competition, Islamic banking will receive a greater market share for SME's lending due to its differentiated product nature. Yet, when it comes to the competition in loan output, the conventional banks receive a greater market share towards the SME's lenders.

Thus, the objective of this study attempts to investigate the probability of small and micro entrepreneurs who received financial assistance from microfinance program of Amanah Ikhtiar Malaysia (AIM) to select Islamic financing in their business activities. In particular, it attempts to identify significant factors contributing to likelihood of choosing Islamic financing among small and micro entrepreneurs.

## **DATA AND METHODS**

Data used in the study are collected through survey on participants of AIM program in Perak and Kelantan. The justification of selecting the two states is that these two states are having large number of participants of AIM among all states in Malaysia. Respondents are selected randomly at different AIM centres ('pusat') in each state. The questionnaires are prepared in Malay language in which respondents are asked on their socio-economic backgrounds, the amount of loan obtained from AIM, incomes after joining AIM program, value of assets after involve with AIM, expenditures or expenses, the awareness or understanding several concepts of Islamic financial products available in the financial market and their interest on Islamic financing. Questions are designed to be answered using several forms such as Likert scales, continuous numbers and categorical responses. The study is able to collect 1895 usable responses from the survey.

Several methods are applied on the collected data. Descriptive analysis provides a summary of the findings in general, such as frequencies and percentages for categorical data and minimum, maximum, mean and standard deviation for continuous data. The study also applies a nonlinear

regression model to analyze the tendency of small and micro entrepreneurs in AIM program to chose Islamic financing in their business activities. This model is designed explicitly for binary dependent variables (with value 1 or 0) to test the probability or likelihood that the respondents will choose Islamic financing. The population logit model of the binary dependent variable, with multiple regressors, could be written as:

$$L_i (Y) = b_0 + b_1(\text{income percapita after joining AIM}) + b_2(\text{total spending}) + b_3(\text{amount of loan}) + b_4(\text{value of assets}) + b_5(\text{education level}) + b_6(\text{age}) + b_7(\text{household size}) + b_8(\text{Dummy state}) \quad (1)$$

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where  $L_i$  is with a value of 0 or 1.  $L_i = 0$  if the respondent is not interested in Islamic financing and  $L_i = 1$  if the respondent is interested in Islamic financing. The independent variables in the model are age, household size, education level, income per capita after joining AIM program, value of assets, amount of loan, total spending from income, dummy state and understanding of respondent on several Islamic concepts such as riba, gharar, mudharabah, musyarakah, bai bithamin ajil, salam, istisna, qard al-hasan and al-inah. Definition of each of these islamic concepts is available at the Appendix.

Several variables or data are transformed into natural log in order to standardize the scale and to remove the skewness of the original data such as value of assets, amount of loan, total spending from income and income per capita after joining AIM program. As for the dummy state, the respondent from Kelantan is marked as 1 and 0, otherwise. If we take the antilog of the slope coefficients ( $b$ 's or  $c$ 's), subtract one from it, and multiply the result by 100, it will give us the percent change in the odds for a unit increase in the  $j$ th predictor. We could interpret the percentage change as the probability or likelihood that the respondents choose to opt for Islamic financing due to a unit increase in independent variables.

Normally, the  $R^2$  or adjusted  $R^2$  is used to evaluate the goodness-fit of the OLS model. However, the  $R^2$  is a poor measurement of goodness-fit for nonlinear probability model. For that reason, an alternative goodness-fit measurement for non-linear logit model, called "fraction correctly predicted", is used. Besides, we adopt Pearson  $\chi^2$ -type tests of goodness-of-fit, namely Hosmer-Lemeshow (1989) and Andrews (1988a, 1988b) to further strengthen good model selection.

## RESULTS AND DISCUSSION

Table 1 displays the descriptive statistics of data. The respondents in study are mainly female. From total number of respondents ie.1895, 97.1 percent (1692 respondents) are female and 2.9 percent (51) are male with the balance are missing data. 50.3 percent of total respondents are from Kelantan and 49.7 percent are from Perak. Majority of respondents in study are literate but from most of them obtains formal school education up to secondary level. Only 2.4 percent have education beyond school level or tertiary level. About 12.2 percent (210 respondents) do not have any formal education.

When respondents are asked on their understanding of several Islamic concepts, more than 80 percent have high and moderate understanding on the concept of 'riba'. Unfortunately, more than 75 percent not understand or less understand the concepts of 'ghharar', 'mudharabah', 'musyarakah', 'bai' bithamin ajil', 'istisna', 'qard al-hasan' and 'al-inah'. However, when the respondents are asked on their interest on Islamic financing, 98.7 percent is interested to use Islamic financing in their business activities.

**Table 1.** Descriptive analysis of data

Item/variable	Scale/category	Frequency	Valid Percent
Gender	Female	1692	97.1
	Male	51	2.9
	Total	1743	100.0
Education level	No formal education	210	12.2
	Primary	969	56.4
	Secondary	497	28.9
	Certificate/Diploma	40	2.3
	First degree/post-graduate	2	.1
	Total	1718	100.0
State	Perak	941	49.7
	Kelantan	954	50.3
	Total	1895	100.0
Interested in Islamic financing	Yes	1678	98.7
	No	22	1.3
	Total	1700	100.0

Item/variable	Highly understand	Moderately Understand	Less Understand	Not Understand	Not Highly Understand
Understand the concept of 'riba'	250 (14.4)	1144 (65.7)	44 (2.5)	285 (16.4)	18 (1.1)
Understand the concept of 'gharar'	11 (0.6)	147 (8.4)	87 (5.0)	1357 (77.9)	139 (8.0)
Understand the concept of 'mudharabah'	20 (1.1)	346 (19.9)	93 (5.3)	1168 (67.1)	113 (6.5)
Understand the concept of 'musyarakah'	23 (1.3)	288 (16.5)	83 (4.8)	1241 (71.3)	106 (6.1)
Understand the concept of 'bai' bithaminajil'	16 (0.9)	182 (10.5)	76 (4.4)	1329 (76.3)	138 (8.0)
Understand the concept of 'salam'	99 (5.7)	468 (26.9)	61 (3.5)	1014 (58.2)	100 (5.8)
Understand the concept of 'istisna'	12 (0.7)	109 (6.3)	90 (5.2)	1395 (80.1)	135 (7.8)
Understand the concept of 'qard al-hasan'	20 (1.1)	234 (13.4)	66 (3.8)	1294 (74.3)	127 (7.3)
Understand the concept of 'al-inah'	27 (1.5)	187 (10.7)	72 (4.1)	1329 (76.3)	127 (7.3)

Note: Total frequency excludes missing value/data. Total number of respondents, n=1895.

\*figure in bracket (xx) represent the percentage of the frequencies

**Table 2.** Descriptive statistics on continuous data

Variable	N	Min	Max	Mean	Standard deviation	Skewness	Kurtosis
Age	1742	19.00	85.00	45.6625	11.40683	.271	-.191
Household size	1890	1.00	18.00	5.9926	2.47699	.573	.693
Yearly Per capita	1885	.00	7600.00	344.9572	581.76398	4.925	42.421

income (RM)							
Yearly spending (RM)	187 1	.00	151580. 00	1389.103 1	6434.4091 7	20.874	477.251
Value of asset (RM)	171 3	.00	420000. 00	13552.58 03	25998.600 45	5.606	58.674
Amount of loan (RM)	189 2	200.0 0	22000.0 0	3561.786 5	2722.4459 4	2.908	12.403

Notes: N is total responses excludes missing data.

As for the continuous data/variables, Table 2 shows the descriptive statistics on minimum, maximum, mean, standard deviation, skewness and kurtosis. As for the age of respondents, the minimum age is 19 years old and the maximum age is 85 years old. The average age among respondents is more or less 46 years-old. The minimum household size of respondents is one member and the maximum household size is 18 members. On average, the household of respondents is about 5.9 or 6 members. The respondents are also asked about the approximate yearly per capita income that they received after joining the AIM program. It could be extracted that the minimum yearly income received by them is none while the maximum of yearly per capita income is RM76,000.00. The mean per capita income per year received by respondents is approximately RM345.00.

Besides, the maximum yearly spending of respondents is RM151,580.00, with a mean of RM1,389 while the maximum value of asset they have is RM420,000.00 with the mean of 13,553.00. The amount of loan made by respondents from the program is RM3,562.00 on average with minimum of RM200.00 and the maximum of RM22,000.00. Skewness is a measure of symmetry. A distribution, or data set, is symmetric if it looks the same to the left and right of the centre point. Kurtosis is a measure of whether the data are heavy-tailed or light-tailed relative to a normal distribution. For skewness, if the number is greater than +1 or lower than -1, this is an indication of a substantially skewed distribution. All variables displayed on Table 2 have skewness more than +1 which indicate that data are skewed distribution. For kurtosis, the general guideline is that if the number is greater than +1, the distribution is too peaked. This peaked distribution is found in all data except data on age and household size.



**Table 3:** Results of Binary Logistic regressions

Independent variables	Binary logistic			
	Dependent variables: Interested in Islamic financing			
	(1)		(2)	
	B	Exp(B)	B	Exp(B)
Constant	0.686 (5.690)	1.985	4.976 (6.704)	144.9
Household size	-0.67 (0.160)	0.935	-0.152 (0.194)	0.859
Education level	1.507** (0.594)	4.511	1.441** (0.690)	4.225
Age	-0.008 (0.030)	0.992	-0.013 (0.034)	0.987
Dummy Kelantan	17.77 (1891.2)	52429384	18.175 (1791.9)	78244674
Value of assets (RM)	0.600*** (0.198)	1.822	0.499** (0.200)	1.647
Amount of loan (RM)	-0.200 (0.549)	0.819	-0.004 (0.594)	0.996
Yearly Per capita income (RM)	-0.552 (0.550)	0.576	-0.707 (0.669)	0.493
Yearly spending (RM)	0.202 (0.518)	1.224	0.455 (0.610)	1.576
Understand the concept of 'riba'			-0.605** (0.293)	0.546
Understand the concept of 'gharar'			1.901 (0.789)	2.976
Understand the concept of 'mudharabah'			-0.233 (0.571)	0.792
Understand the concept of 'musyarakah'			-0.720 (0.878)	0.487
Understand the concept of 'bai' bithamin ajil'			-0.617 (0.967)	0.539
Understand the concept of 'salam'			-0.682 (0.621)	0.506
Understand the concept of 'istisna'			-0.141 (1.125)	0.869
Understand the concept of 'qard al-hasan'			0.167 (0.507)	1.182
Understand the concept of 'al-inah'			0.339 (0.432)	1.403
<b>Diagnostic tests:</b>				
% correct classification	98.4		98.4	

Omnibus Chi-square stat.	34.898***	50.614***
Hosmer&LemeshowTest stat.	4.695	1.818
Cox &Snell R-square	0.042	0.06
Negelkerke R-square	0.277	0.399

Notes: 1. Standard errors are in parentheses;

2. \*\*\*statistically significant at the 1% level; \*\*5% level; \*10% level

The study also attempts to evaluate the factors that might contribute to the likelihood of choosing Islamic financing for business activities among a sample of respondents who receive financial assistance from the AIM program. The model developed in this study is Binary Logistic, where the dependent variable has only two categories, one and zero. One is coded to the responses of 'yes' for the survey question of 'Are you interested in Islamic financing for your business activities?' and zero is coded to the response of 'no' on similar question. The independent variables or regressors are variables such as age, state, education level, household size, income level after joining the AIM program, total spending, value of assets, amount of loan and understanding on nine Islamic financing concepts ('riba', 'gharar', mudharabah', 'musyarakah', 'bai' bithamin ajil', 'istisna', 'salam', 'qard al-hasan' and 'al-inah')

In some cases, the independent variables are dummy variable such as state (1=Kelantan, 0=Perak) and continuous variables such as age, household size, educational level, and yearly per capita income level, spending, value of assets, amount of loan and understading of Islamic financing concepts. There are two regressions (Model 1 and Model 2) formed with the first one is the regression with no variables on the understanding of Islamic financing concepts and the second one is when these variables are included. Table 3 presents the findings.

From Table 4, the regression results of Model 1 show that the significant predictors are 'education level' and 'value of assets'. Coefficients of both variables are positive and significant at 5% and 1%, respectively. The positive value of beta ( $\beta$ ) for education level that is 1.507, indicates that an increase in an independent variable score, that is the higher the education level, results in an increase probability of the case recording a score of 1 in the dependent variable (i.e., choose Islamic financing). The odd ratio (Exp ( $\beta$ )) for this variable is 4.511. We could interpret that the odds of a person opt for Islamic financing increases by a factor of 4.511, all other factors being equal. A positive sign of value of asset coefficient implies that for respondents with higher assets' value, the odds of selecting Islamic financing increases by a factor of 1.822, other things constant. Other independent variables do not contribute significantly to the probability of selecting Islamic financing among small and micro entrepreneurs.

In Model 2, while adding more regressors on the understanding of several Islamic financing concepts, the results are consistent to Model 1 on the two significant variables. Both variables, education level and value of assets, are having positive and significant coefficients. In this Model 2, however, one more variable is found to be significant at 5% level, that is, the understanding of concept of 'riba'. Data on understand concept of 'riba' and other Islamic financing concepts are arranged in such a way that the 'lower values' (scores 1 and 2) reflects more understand on the concept and 'higher values' (scores 3, 4 and 5) reflects low understanding on the concept (refer to Table 1). Thus, the significant and negative sign of coefficient of understand concept of 'riba' implies that the likelihood to choose Islamic financing among respondents is contributed by high understanding of respondents on the concept of 'riba'. This result is consistent to Lunn et al. (2001) who agreed with the effect of a person religious belief on his/her action. It was noted by Lunn et al., (2001) that there is a positive correlation between religious inclusion and religious participation. The belief that 'riba' is unacceptable in Islam due to its negative implications leads to the respondents' tendency to choose Islamic financing in their business activities.

In both models, Model 1 and Model 2, based on the classification tables, when a set of predictor variables is entered, it improves the accuracy of prediction to 98.4% for both Model 1 and Model 2. Since the Omnibus tests of Model coefficients in Block 1 are significant ( $p$ -value  $< 0.05$ ) in both cases, the models with a set of variables used as predictors are better than the original guess shown in Block 0 without regressor. The Chi-square values in this test are 34.898 and 50.614 with 8 and 20 degrees of freedom, respectively. The Hosmer&Lemeshow test also supports the 'goodness of fit' of the models with the Chi-square statistics of 4.695 and 1.818, respectively, with  $p$ -values more than 0.05. The pseudo-R-square statistics, such as Cox & Snell R-square and Nagelkerke R-square, show that between 4.2% and 27.7% of the variability of the dependent variable is explained by the set of predictor variables in Model 1 and between 6% and 39.9% of the variability of the dependent variable is explained by the set of predictor variables in Model 2.

## CONCLUSION

The objective of this research is to investigate the tendency of small and micro entrepreneurs who are receiving financial assistance from the microfinance program by AIM to opt for Islamic financing. In this study, convenience sampling method is employed in selecting respondents who are participating in AIM program from Perak and Kelantan. Using data of 1895 respondents from a survey, the analysis is conducted. Descriptive measures are used to provide a general summary of data. This study also adopts a nonlinear

regression model designed explicitly for binary dependent variables in testing the probability that the respondents opt for Islamic financing.

The results show that more than 95% of the respondents are female. Most of them has education at primary and secondary levels. Majority of respondents not familiar or understand several concepts of Islamic finance except the concept of 'riba'. From binary logistic regression, it is found that the likelihood that respondents opt for Islamic financing is significantly contributed by higher education level, high value of assets and better understanding on the concept of 'riba'. Thus, it is necessary to increase awareness and provide knowledge on Islamic financing products and concepts to these small and micro entrepreneurs particularly to the participants of AIM. The role of society, banking industry players and the government is very crucial to encourage small and micro-entrepreneurs, particularly Muslim entrepreneurs, using the Islamic financing in their business activities which is in line with syariah.

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## APPENDIX

### Definition of Islamic financing concept

Concept	Definition
<i>riba</i>	All gains from loans and debts that exceed the principal of loans and debts.
<i>gharar</i>	Uncertainty or hazard caused by lack of transparency with regards to the commodity, subject matter or the price in a contract or exchange.
<i>mudharabah</i>	Profit and loss sharing contract whereby an investor/s provides capital and an agent or manager carries out a business project. The profit from the project is shared according to the pre-agreed proportion, whereas the loss is borne by the investor/s.
<i>musyarakah</i>	A partnership contract whereby all parties provide funds, not necessarily in equal amount, and have the right to work for the business project
<i>bai bithamin ajil</i>	The sale of goods on a deferred payment basis. Bank purchases equipment or goods requested by the client and subsequently sells the goods to the client for an agreed price, including a profit margin for the bank. The client will pay by installments within a certain pre-agreed period, or in a lump sum at the end of the contract period.
<i>salam</i>	Sale of goods where the price is paid in advance, before delivery or manufacture of the goods.
<i>istisna</i>	Similar to <i>bai al salam</i> where the sale of a commodity is transacted before the commodity is manufactured, assembled, or constructed.

<i>qard al-hasan</i>	A loan meant to help someone in need, a form of sadaqa for which no profit is allowed to the lender.
<i>al-inah</i>	A contract which involves sale and buy-back transaction of assets by a seller. A seller sells an asset to a buyer on a cash basis and later purchases it back on a deferred payment basis where the price is higher than the cash price. It is also applicable when a seller sells an asset to a buyer on a deferred basis and later purchases it back on a cash basis, at a price which is lower than the deferred price.

**Penafian**

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