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Islamic financing options for SMEs—role of Islamic banks

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Abstract

Small medium enterprises (SMEs) have significant role in employment creation and growth of gross domestic products of the developing country. Globally, SMEs make up over 95% of all firms, account for approximately 50% of GDP and 60%–70% of total employment. However, in order to grow and contribute more significantly to the economy, SMEs face some constraints. One of the main constraints faced by SMEs is the lack of finance. The Islamic participatory schemes, such as mudarabah and musyarakah, integrate assets of lender and borrowers; therefore, they allow Islamic banks to lend on a longer term basis to projects with higher risk-return profiles and thus, to support for economic growth. However, as Islamic banks try to avoid uncertainties, the mentioned schemes are not widely used. Therefore, support from government and academia needed to create innovation in the participatory financing scheme so that all related parties can share mutual benefits.

Keywords: Islamic finance, Islamic banks, small and medium enterprises.

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1. Introduction

1.1. SME definition

The term 'small medium enterprises (SME)' encompasses a broad spectrum of definitions. Different organisations and countries set their own guidelines for defining SMEs, often based on headcount, sales or assets. The World Bank defines SMEs as those enterprises with a maximum of 300 employees, $15 million in annual revenue, and $15 million in assets. The Inter-American Development Bank, meanwhile, describes SMEs as having a maximum of 100 employees and less than $3 million in revenue. While the European Union definition: 'The category of micro, small and medium-sized enterprises is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro'. Small and medium enterprises are thus defined as firms with 10–250 employees, and more than 10 million euro turnover or annual balance sheet total. This definition is more encompassing, and much larger, especially with regards to turnover, than some others.

Enterprise Category	*Headcount*	*Turnover*	*Balance sheet total*
medium-sized	*< 250*	*≤ € 50 million*	*≤ € 43 million*
Small	*< 50*	*≤ € 10 million*	*≤ € 10 million*

Figure 1. Definition of SME

[Source: European Commission, Enterprise and Industry (2011). 'Small and medium-sized enterprises (SMEs), SME Definition']

1.2. The impact access to finance on SMEs

Access to finance is necessary to create an economic environment that enables firms to grow and prosper. SMEs in developing countries, however, face significant barriers to finance. Financial constraints are higher in developing countries in general, but SMEs are particularly constrained by gaps in the financial system such as high administrative costs, high collateral requirements and lack of experience within financial intermediaries. Increased access to finance for SMEs can improve economic conditions in developing countries by fostering innovation, macro-economic resilience and GDP growth.

Small and medium enterprises (SMEs) and high-growth start-ups are the backbone of both developed economies and emerging markets and developing countries in terms of employment generation, opportunity and sustainability, as well as economic growth. Formal SMEs contribute up to 33% of GDP in developing countries (IFC 2010) and up to 51% in high-income countries (SME Corp 2015). Globally, SMEs contribute 43.5% to total employment and are responsible for 57.8% of total new jobs created (Ayyagari, Demirguc-Kunt & Maksimovic, 2011). The relevance of these figures must be considered against the need to create about 600 million jobs around the world by 2030 to keep up with the growth of the labour force (World Bank, 2014).

The major challenge faced by SMEs is access to finance. The total financing gap for micro, small, and medium enterprises (MSMEs) in developing countries is estimated to be $2.4 trillion; Gap database. The financing gap in EMDCs is even more severe, since financial institutions such as banks widely consider SMEs as being too risky due to such factors as lack of collateral and insufficient credit history. About 55%–68% of SMEs in developing countries are either financially underserved or not served at all, resulting in lost opportunities to develop their SMEs.

Islamic banking and finance has shown remarkable global success in terms of growth, expansion and institutional and product diversification. Over the past 5 years, the Islamic banking and finance industry has grown by a compound annual growth rate of about 17%, reaching more than $1.87 trillion in total assets by the first half of 2014. The Islamic banking sector grew by 16% in 2013, according to the IFSB, compared with the overall global banking growth (based on the assets of the top 1,000 global banks) of only 4.9% in 2012.

2. SMEs and access to finance

The major challenge faced by SMEs, however, is access to finance. According to the IFC Finance Gap Database, the total financing gap for MSMEs in developing countries is estimated to be $2.4 trillion: of this total, a gap of about $1.3 trillion exists in G20 countries covered within the IFC Finance Gap Database (see Table 1).

Table 1. MSME credit gap in selected G20 countries

Country	Number of enterprises (Thousands)	Total credit gap ($billion)	Access to finance as major/ severe barrier (percent of MSMEs)
Argentina	2,133	67	34
Brazil	16,030	237	42
China	103,548	338	18
India	49,634	140	23
Indonesia	41,116	28	15
Korea, Rep.	4,644	114	17
Russian Federation	3,605	50	44
Saudi Arabia	1,843	237	42
South Africa	2,213	13	15
Turkey	4,120	73	20
Total	228,886	1,297	

[Source: IFC Finance Gap Data base (2011)].

The financing gap in developing countries is even more severe, since financial institutions such as banks widely consider SMEs to be too risky due to such factors as lack of collateral and insufficient credit history. About 55%–68% of SMEs in developing countries are either financially underserved or not served at all, resulting in lost opportunities to realize their full potential.

Access to finance is, therefore, a global challenge for both developed and developing countries and needs to be addressed more thoroughly by policy makers, the private sector, researchers and development agencies.

In order to support these priorities, especially in terms of increasing and diversifying the sources of financing for SMEs, one possibility is to identify the strength and potential of participatory finance such as Islamic finance, which could provide asset-based and equity-based financing to SMEs in developing countries.

3. Islamic finance and banking sector

Since its modern emergence in the 1970s, Islamic banking and finance has shown unprecedented global success in terms of growth, expansion and institutional and product diversification (see Table 2). Over the last 5 years, the Islamic banking and finance industry has grown by a compound annual growth rate of about 17%, reaching more than $1.87 trillion in total assets in the first half of 2014 (IFSB, 2015). The Islamic banking sector grew by 16% in 2013, compared with the much slower overall global growth of the banking sector (based on the assets of the top 1,000 global banks, which grew by only 4.9% in 2012 and 0.6% in 2013) (IFSB, 2015).

Table 2. Islamic banking and finance assets, 2014 ($billion)

Region	Islamic Banking assets	Sukuk outstanding	Islamic funds assets	Takaful contributions	Total
Asia	203.8	188.4	23.2	3.9	419.3
GCC	564.2	95.5	33.5	9.0	702.2
MENA (excl. GCC)	633.7	0.1	0.3	7.7	641.8
Sub-Saharan Africa	20.1	1.3	1.8	0.6	23.8
Others	54.4	9.4	17.0	0.3	81.1
Total	1,476.2	294.7	75.8	21.4	1,868.1

[Source: IFSB (2015)]. GCC = Gulf Cooperation Council; MENA = Middle East and North Africa.

The Islamic banking and finance industry is backed by almost 400 Islamic financial institutions operating in more than 70 countries, including countries outside the Organisation of Islamic Cooperation such as Germany, Luxembourg, Mauritius, Singapore, the United Kingdom and the United States. In 2015, the first Islamic bank operating in Germany was launched. In addition, a large number of conventional financial service providers such as asset managers are active in the Islamic fund industry by managing Shari'ah-compliant discretionary portfolios on behalf of Shari'ah-sensitive institutions and individuals mainly residing in the Gulf Cooperation Council (GCC). Portfolio information is not made public, but is estimated to add another $67 billion to the estimated Islamic finance assets (Asutay & Marzban 2015).

Even though the Islamic banking and finance industry is still relatively small in terms of size compared with conventional finance, its growth rate and increasing global outreach is significant, and indicative of the potential, this industry can reach the long-term.

Recent trends in the growth Islamic finance assets have led to widespread criticism that it is limiting its services to a great extent to high-net worth individuals and mimicking conventional debt financing, rather than significantly contributing to social and economic development via asset-based and equity-based transactions with risk-and-profit sharing nature (Marzban, Asutay & Boseli, 2014).

From a Shari'ah perspective, the foundational philosophy of Islamic finance relies heavily on the economic and social development factor, including financial inclusion in the form of servicing the unbankable of the society, such as SMEs (Asutay, 2012). As Haneef (2005) explains, Islamic economics is an 'approach to, and process of, interpreting and solving the economic problems of human beings based on the values, norms, laws and institutions found in, and derived from the sources of Islam'.

The concept of inclusive growth in Islam is underscored by Muslim theologian, jurist and philosopher Imam Al-Ghazzali:

> ***"The objective of the Shari'ah is to promote the well-being of all mankind, which lies in safeguarding their faith, their human self, their intellect, their posterity and their wealth. Whatever ensures the safeguard of these five serves public interest and is desirable".***

The core principles of Islam empasize social justice, inclusion and sharing of resources. In the case of SMEs, financial inclusion can be addressed by Islamic finance by promoting risk-sharing contracts as a viable alternative to conventional financing. The principles of Islamic finance are derived from a set of rules based on the Shari'ah and interpreted through the Quran, Sunnah and from ellaborative efforts of Shari'ah scholars. The basic principles of an Islamic financial system, five major principles of Shariah, are the following:

1. Ban on interest (riba): This refers to conventional forms of finance that differentiate between acceptable interest and usurious interest suac as excessive rates of interest (Ilias, 2010). Literally, the term interest it means usurious and is prohibited in Islamic law.
2. Ban on uncertainty: This refers to uncertainty in contractual terms and conditions are prohibited, unless the terms and conditions on risk factors are clearly understood of both parties in a financial transaction.
3. Risk-sharing and Profit-sharing: This refers to all parties involved in a financial transaction which is shared both the associated risks and profits. This means the earnings of profits or returns from assets are acceptable with the condition that the business risks are shared by the lender and borrower.
4. Ethical investments: This refers to investment in industries which are prohibited by the Qur'ān, like for instance: alcohol, pornography, gambling and other pork based products.
5. Asset-backing: This refers to financial transaction on 'tangible, identifiable underlying asset', like, real estate or commodities. In Shariah principle, the money is not considered an asset class because this is 'not tangible' and may 'not earn a return' (NBAR-IFO, 2008).

These principles of Shariah mentioned above is very much important to all employees working in Islamic banking, financial institutions, non-profit organisations, business professionals, educators of Islamic Finance System, students, general public (Muslim community) and future researchers. The standardisation of Islamic finance systems across the globe must be continuously and strictly implemented based on Islamic tradition or practices. However, it can be assumed that Shariah can be interpreted in many ways and some Islamic scholars are not completely agreed that constitutes Shariah-Compliant Financing. On the other hand, standardisation is very challenging since the maturity of Islamic finance markets varies across the countries in global markets is well-established.

4. Key instruments of Islamic finance

In Islamic finance, the term 'loan' refers only to a benevolent loan (qard al hasan), a form of financial assistance to the needy to be repaid free of charge. Other instruments of Islamic finance are not referred to as 'loans' but rather as financing modes falling under one of the three categories: Profit-and-loss sharing (PLS), non-PLS contracts and fee-based products.

PLS financing products: PLS financing is closest to the spirit of Islamic finance. Compared with non-PLS financing, its core principles of equity and participation, as well as its strong link to real economic activities, help promote a more equitable distribution of income, leading to a more efficient allocation of resources. There are two types of PLS financing: musharakah and mudarabah.

Non-PLS financing products: Non-PLS contracts are most common in practice. They are generally used to finance consumer and corporate credit, as well as asset rental and manufacturing. Non-PLS financing instruments include murabahah, ijarah, salam and istisna' (summarized below).

1-Profit sharing financing products:

Musharakah	Equity participation, investment and management from all partners; profits are shared according to a pre-agreed ratio, losses according to equity contributions
Mudarabah	A profit-sharing partnership to which one contributes the capital and the other the entrepreneurship; or the bank provides the capital, the customer manages the project. Profit is shared according to a pre-agreed ratio
Qard Hasan	Charitable loans free of interest and profit-sharing margins, repayment by instalments. A modest service charge is permissible
Wakalah	An 114uthorization to the bank to conduct some business on the customer's behalf
Hawalah	An agreement by the bank to undertake some of the liabilities of the customer for which the bank receives a fee. When the liabilities mature the customer pays back the bank

2.Advance purchase financing products:

Murabahah	A sales contract between a bank and its customers, mostly for trade financing. The bank purchases goods ordered by the customer; the customer pays the original price plus a profit margin agreed upon by the two parties. Repayment by instalments within a specified period
Istithna'	A sales contract between bank and customer where the customer specifies goods to be made or shipped, which the bank then sells to the customer according to a pre-agreed arrangement. Prices and instalment schedules are mutually agreed upon in advance.
Mu'ajjal Bai al Salam	Purchase with deferred delivery: A sales contract where the price is paid in advance by the bank and the goods are delivered later by the customer to a designee
Ajaar	Lease and Hire Purchase:
Ijarah Ijarah Mutahia Bittamlik	A contract under which the bank leases equipment to a customer for a rental fee; at the end of the lease period the customer will buy the equipment at an agreed price minus the rental fees already paid.

5. Islamic financing options for SMEs

Islamic finance, as an alternative and ethical financing method, directs funding to impact-oriented real economic activities; it thus utilizes economic and financial resources to satisfy the material and social needs of all members of the community—including SMEs.

The main foundations of Islamic financial products are its asset-based transaction nature, together with its equity-based nature of sharing risk and profits. Asset-based financing, according to Askari, Iqbal and Mirakhor (2014), fulfils a core requirement of Islamic financial transaction by ensuring that the financial transaction is part of a real economic activity with a close financial linkage to the financed assets. This ensures less 'financilisation' compared with interest-based transactions, where assets are generally not part of the financial transaction and serve solely as collateral. Equity-based financing, on the other hand, promotes profit and loss sharing between financiers and entrepreneurs. This increases the alignment of their interests, increases risk sharing and foster entrepreneurship—especially of seed and early-stage start-ups, which rely purely on equity financing for their ventures.

The Islamic financing options for SMEs identified can be divided into two broad categories: asset-based and equity-based financing options (Figure 2).

Islamic financing options for SMEs					
Asset Based			Equity Based		
Murabaha	Ijara	Salam	Musharaka	Diminishing Musharaka	Mudharaba

Figure 2. Islamic financing options for SMEs

[Source: ZAMIR IQB A L Islamic Financial Systems, Leveraging Islamic Finance for SMEs, World Bank (October 2015)]

Each of these financing categories has a fundamental role to play in increasing the financial inclusion of SMEs, as well attracting potential capital from Islamic capital providers and sources. Other Islamic financing models exist, such as fee-based models like Wakala and Kafala.

Kafala, for instance, means guarantee, and can be and is utilised in the context of Islamic financial SME transactions.

5.1. Asset-based SME financing instruments

Asset-based financing is the most commonly used financing option by Islamic banks—especially sale-based financing in terms of Murabaha—followed by Ijara. Islamic banks favour Murabaha because it is relatively easy to implement, utilises the same credit criteria for entrepreneurs as other customers—as compared with conventional financing—and is utilised to mimic the return and risk characteristics of conventional loans. In the MENA region, for instance, the proportion of Murabaha financing to total Islamic financing was about 75% in 2008 (Ali, 2011).

5.1.1. Murabaha

Murabaha is defined as 'a contract between a financier and a client through which the financier purchases assets required by the client and then sells them to the client at a cost that includes a disclosed profit margin to be paid'.

From an access to finance perspective for SMEs, Murabaha is expected to partly fill the Shari'ah consciousness gap, but not to contribute significantly to closing the financing gap of SMEs that lack access to funding because of their specific needs or their lack of collateral or credit history—which Islamic banks usually request, as in a conventional debt transaction.

Therefore, Islamic banks should be encouraged to move from mainly providing Murabaha to other asset-based and equity-based financing instruments to meet the actual demands and characteristics of SMEs.

At the same time, the reluctance of Islamic banks to do so opens opportunities for a wide range of non-banking financial services providers to compete with banks in providing adequate offerings to SMEs and thus to enhance financial inclusion.

5.1.2. Ijara

Ijara or Islamic Leasing is defined 'as a transaction through which one party leases an asset such as equipment to be used by a client for an agreed upon rental fee. Another form of Ijara—Ijara Wa Iqtina—is a lease to own, a financier lease assets to clients for an agreed rental fee, while only one of the parties unilaterally buys or sells the asset at the end of the lease period'.

Ijara (Islamic leasing), on the other hand, is a Shari'ah-compliant financing product that can benefit SMEs , since the main criterion for eligibility for financing is the ability to generate cash flows serving the lease, rather than providing collateral and credit history.

Ijara is widely used to finance SMEs, as it reduces start-up costs and provides additional security to lessors.

The core challenges that need to be addressed are the lack of regulation for the leasing industry in general, especially in developing countries, and the need to create funding channels for Islamic leasing transactions through banks and leasing companies. These financial institutions are mainly financed through equity, and thus present an excellent opportunity for Shari'ah-conscious investors to diversify their investment portfolios.

5.1.3. Salam

Salam is defined as 'A forward sale contract in which an advance payment is made for commodities (mainly agricultural crops) to be delivered at a future date. A Salam can thus be utilised to provide working capital to the SME'.

Even though Salam is an excellent mode of financing to provide working capital, it is almost never utilised because implementation is so complex. The financier must act as a commodity reseller and expertise is lacking in the market among Islamic finance practitioners. Salam should be further explored and supported as a mode of financing for farmers, especially for MSMEs in countries such as Sudan and Pakistan.

5.2. Equity-based SME financing instruments

Equity finance is a key for companies that seek long-term corporate investment, to sustain innovation, value creation and growth, as the OECD has noted, 'Equity financing is especially relevant for companies that have a high risk-return profile, such as new, innovative and high growth firms. Seed and early stage equity finance can boost firm creation and development, whereas other equity instruments, such as specialized platforms for SME public listing, can provide financial resources for growth-oriented and innovative SMEs' (OECD, 2015).

5.2.1. Musharaka

Musharaka is defined as 'a partnership agreement established by two or more parties in which all partners provide capital to a joint venture to share its profits and losses. Profits are distributed among partners proportionate to their capital contribution'.

Musharaka a straightforward partnership model, is a favourable option for SME financing that is almost never used because of the perceived risk of entering into a profit and loss sharing relation with SMEs and start-ups. But Musharaka—if defined based on healthy and balanced capital contributions from the entrepreneurs and the financier—can result in appropriate mitigation of risk.

Musharaka and conventional venture capital/private equity funds share many commonalities in terms of the formal relationship and structure of the vehicle. Therefore, Musharaka could be easily adopted by conventional vehicles to attract capital from Shari'ah-conscious investors.

The Islamic Development Bank and the World Bank have both helped to introduce and implement Musharaka for SME refinancing through different lines of credits and financing provided to developing countries such as Egypt and Jordan.

The key challenges of implementing Musharaka, in addition to the high capital charges for Islamic banks, are similar to conventional challenges faced by venture capital funds in developing countries, primarily to identify appropriate exit venues and secondary markets to exit the partnership within the specified investment horizon.

5.2.2. Diminishing Musharaka

Diminishing Musharaka is defined as 'a Musharaka agreement where the entrepreneur promises to buy the investment shares of the other partner(s) over time until the entrepreneur owns 100% of the venture'.

Diminishing Musharaka is an innovative Islamic financial product, capable of overcoming shortcomings of financing instruments like Murabaha and Musharaka.

For financial institutions, the main advantage of the diminishing Musharaka model is that it is an equity-based partnership model that provides a clear exit and liquidation mechanism for the financier. This should not only encourage Islamic financial institutions and Shari'ah-compliant SME funds, but should also motivate conventional funds to offer the product.

Diminishing Musharaka is a perfect fit for SMEs, especially family businesses reluctant to give up ownership of the firm.

The diminishing Musharaka model might also be interesting for SME funds, but is not likely to offer added value to venture capital funds. Venture capital funds are not interested in the share buy-back from the founders and are in for multiples of returns, which can be achieved only through mergers and acquisitions or an initial public offering (IPO). Therefore, this financing model is more applicable if perceived as a time-limited equity participation, with the upside of receiving returns through dividends and an increase in the valuation of the business over time.

5.2.3. Mudaraba

Mudaraba is defined as 'a partnership between a capital provider (Rab- ul-Mal) and an entrepreneur who is acting as fund manager (Mudarib). Profits may be distributed at any pre-agrees ratio, whereas losses are borne by the capital provider.

Mudaraba is a model similar to conventional asset management, where asset managers invest on behalf of capital providers and receive a percentage of the realized return for services rendered. A main difference between the Islamic and conventional model in the case of the Mudaraba is that through a Mudaraba, the Mudarib (manager) is not to be compensated through a management fee and thus his only return would be generated in the case profitability is achieved A core difference between Mudaraba and Musharaka is that in a Musharaka, all partners are entitled to participate in managing the Musharaka venture, while in the Mudaraba there is a clear separation between the capital provider and the Mudarib, who is the one solely entitled to manage the Mudaraba business based on the agreed upon restricted or unrestricted Mudaraba agreement.

Mudaraba is a favourable financing option for start-ups and SMEs: first, because the entrepreneur on his/her own can manage the funds; and second, because the risk shifts towards the financier.

In general, Islamic banks are not providing Mudaraba financing to SMEs and start-ups because they consider the risk too high. Venture capital funds, both conventional and Islamic, are or can be based on Mudaraba by providing capital to start-ups and carrying the full risk; this generally needs to be mitigated through a restricted Mudaraba agreement and by enforcing corporate governance and board representation for monitoring and evaluation.

6. Islamic financing challenges

Like conventional banking, Islamic banking does not significantly contribute to financial inclusion in its respective markets of operation.

The potential of Islamic banks for financial inclusion within developing and developed countries is hampered by a set of specific challenges, which need to be addressed by their respective stakeholders. Topics such as improving regulatory insight managing liquidity and the impact of Basel III

on Islamic banks are challenges impacting Islamic banks in general, but are not specific to Islamic SME financing.

6.1. Product offerings

Product offerings for SMEs from Islamic banks (except in some countries such as Indonesia or Pakistan) are significantly limited to debt-based financing such as Murabaha, although products such as Ijara, Musharaka, Mudaraba and diminishing Musharaka are more appealing for specific financing needs and strongly promote the profit and loss sharing foundations of Islamic finance. The lack of diverse offerings for SMEs can be attributed to the risk perception of the Islamic banks as well as the limited exposure and know-how of their employees in structuring and managing such products.

6.2. Standardisation of contracts

This is crucial for the evolution of the industry. Standard-setting bodies such as the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) play a vital role in advancing the Islamic finance industry. Since the Shari'ah compliance of Islamic banks is generally determined by a Shari'ah board, financial transactions and Shari'ah guidelines are often approved that are not fully in line with AAOIFI requirements. Increased standardisation would improve the comparability of offerings between different Islamic banks and help build a common Shari'ah understanding and knowledge base for less experienced practitioners and SME end-clients. Organisations like AAOIFI can lower entry barriers and could encourage conventional banks to utilize their existing networks in offering Shari'ah-compliant products.

6.3. Movable collateral

One of the key challenges with respect to access to finance faced by SMEs is the lack of or unsuitability of existing collateral. Seventy-eight percent of assets of businesses in developing countries are movable assets in the form of machinery, equipment and vehicles. Banks are reluctant to utilize movable assets of SMEs as collateral due to the lack of reliable legal frameworks and collateral registries.

A legal framework that allows for the use of moveable collateral could significantly enable SMEs to leverage and maximize the economic potential of their movable assets. This would facilitate their access to finance, and at the same time increase the offering of asset-based lending products for SMEs.

6.4. Information sharing

The lack of knowledge of Islamic finance among both practitioners and clients is a major drawback to the enhancement of Islamic finance. While larger financial institutions such as Islamic banks can hire internal and external human resources to provide the essential expertise to structure innovative financial products, smaller nonbank financial institutions are not able to hire a Shari'ah board and Islamic finance professionals. Therefore, information sharing is essential to expand Islamic SME financing. Educational material is needed, along with case studies, and most importantly contractual templates and operations manuals that smaller financial institutions willing to offer Islamic finance products can follow. Information and knowledge sharing would also contribute to the exchange of experiences across borders and trigger innovation through discussions and elaborations.

6.5. Human resources

Banks aiming to offer Islamic financial products to SMEs lack both Shari'ah personnel and Islamic finance professionals. Shari'ah personnel with knowledge in both Shari'ah and banking/finance operations are scarce because of the multidisciplinary knowledge required to determine the compliance of modern financial transactions and financial engineering to Shari'ah rules. Similarly, banking professionals interacting with SMEs often do not have any experience with respect to Islamic finance and are thus offering products that they either do not understand or do not believe in, in terms of the value proposition.

The shortage of expertise emerged as a major factor in a survey conducted by the Economist Intelligence Unit, and commissioned by Kuwait Finance House (2012). About 400 managers and executives from the banking and finance industry were interviewed to determine factors that have an impact on the demand of Shari'ah-compliant products and services. Forty-four percent of respondents cited the lack of professional management and awareness as the strongest farriers to growth in markets for Shari'ah-compliant products and services. Overall, 35% cited the shortage of expertise in the industry as the main reason holding back growth of Islamic financial institutions.

6.6. Islamic finance literacy

There is a general lack of understanding regarding Islamic finance as compared to conventional finance. Perceptions range from considering it as targeted social gifting, to simply rebranding conventional financial products, and to being more expensive than conventional products because of the operational Shari'ah requirements.

Even in the case of profit and loss sharing models such as Musharaka and Mudaraba, a deeper understanding of the benefits, responsibilities and duties attached to these models of financing must be communicated.

The Islamic finance industry is a key factor in perpetuating misperceptions due to the excessive use of debt-like instruments such as Murabaha, the high transaction costs attached to the financing, and the lack of Islamic finance literacy among the financial institutions staff members who interact with the public.

6.7. Branding

The labelling of Islamic banking could be a concern for both Muslims and non-Muslims; it might be perceived as being reserved for Muslims and could result in exclusion of non-Muslims. The lack of Islamic finance literacy among Muslims could result in their considering Islamic banks just rebranded conventional banks.

Therefore, the branding of Islamic finance must focus on its ethical value proposition—the concept of including all people—as well as on solid Islamic financial instruments based on profit and loss sharing.

7. Conclusion and recommendations

Finally, it can be said that Islamic finance is considered one of the best and most stable forms of finance available, as it provides the suitable environment for the creation and growth of small and medium enterprises, which is the best solution to the problems of unemployment and poverty in the Arab and Islamic countries.

The application of Islamic financing forms presents multiple images of the use of capital with labour, such as speculation, participation, Murabaha, Istisna'a, Salam, etc. This opens the way for the employment of a large number of skilled labour (university graduates and professionals).

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