

# THE IMPACT OF ISLAMIC FINANCING ON THE OPERATIONS OF SMES IN OMAN



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## ABSTRACT

*The study investigates the relationship between the growth of Islamic banks & financial institutions and the operational performance of small and medium enterprises located in Oman. The study employs qualitative method for data gathering. An effective questionnaire was created to gather the opinions of participants through semi-structured interviews. The sample consist of 40 employees of SMEs, 20 managers, and 2 financial experts. Thematic and descriptive analysis was used for analyzing data. Research findings revealed that owners/managers of SMEs and employees have effective knowledge regarding Islamic financing principles. Although the Islamic financing strategy is new in Oman, most participants including financial experts showed positive interest regarding its adaption. Further, findings indicated that there is a positive correlation between operations of Omani SMEs and Islamic financing. It is found that Islamic financing has benefitted SME operations as well as could play a significant role in the growth of SMEs and their operations in the future. This study helps policymakers and banks in understanding the scope of the growth in future. Thus, these banks can attract more SMEs and improve their growth rate. Finally, a comprehensive perception regarding workers, SME owners, and financial experts clarify willingness of using Islamic financing to get potential benefits in operations.*

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## INTRODUCTION

Islamic banking like any other banking organization needs funds to run smoothly and efficiently in the long run. As per recent research carried out on the topic, it has been observed that the owners and workers of the small medium enterprises (SMEs) holds a perception that Islamic Financing has aided their business to obtain the funds needed for facilitating business operations (Abdinur & Ondes, 2022). This enables these organizations, specifically, the SMEs to expand and grow beyond the current markets. Also, numerous studies conducted in the past have highlighted the presence of a positive link between business performance and Islamic financing operations. Islamic finance can be defined as the financial service that is implemented primarily in order to facilitate adherence to the key tenets of Sharia, which can be defined as the Islamic law. The primary sources of the development of Sharia are Hadith, the Holy *Quran*, *Ijma*, *Sunna*, *Ijtihad*, and *Qiyas* (Erdem, 2017). Islamic finance, including the financial institutions and products under it are growing rapidly and can be considered as one of the segments out there that is experiencing a drastic growth in the contemporary times within the global finance industry. For instance, the Dubai Islamic Bank was established in 1975 and at the present times the number of Islamic banks worldwide is more than 300. Furthermore, their operations extend to about 75 countries and holds assets in excess that would be equivalent to approximately US\$ 400 billion. Initially, the principles of Islamic finance were focused on the Middle East as well as in the Southeast Asia, in certain regions of Malaysia, and is gradually spreading to other nations and regions across the globe. Countries like Oman and Malaysia have experienced a growth in Islamic financing recently (Karmani & Zia, 2017).

For instance, Islamic financing in Oman has increased by about 9.5 % in the year 2020 when compared to the growths of the conventional banks in the region that experienced a growth in loan of about 2.1 %. The rise in such growths have been due to a rise in demand for the Islamic services and products. Furthermore, the conventional banks also provide

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their support to the Islamic products and services and offers these products via Islamic windows. They are also responsible for supporting the causes and elements of Islamic finance. The banking sector of Oman is likely to be constant in terms of spacing in the year 2021-22 due to strong momentum experienced in the year 2020. Furthermore, the share of the market of Islamic windows and banking increased to about 14.3 % towards the end of the year 2020, which was 13.6 % a year ago in 2019 (Khmous & Besim, 2020). In the year 2020, the total assets of the Islamic windows and banking was approximately OMR 5.1 billion, which is equivalent to USD 13.5 billion. The figure can be relatively high considering the fact that Oman was the last Gulf Cooperation Council (GCC) nation to introduce the elements of Islamic banking in the year 2013. On the contrast, although the elements of Islamic banking in Turkey and Indonesia have been there for over 20 years, the shares of the market there have been less than 8 %. The global proliferation of Islamic financial institutions has been achieved in parallel to the developments in the field of Islamic products, especially the ones that are financial in nature. The products here usually put prohibition on investment in tobacco, usury, gambling, to alcohol and armaments. The Islamic services on the other hand can include allocation of assets, management of funds, exchange settlement services, payment, and management of risks, insurance, and reinsurance (Mohamed *et al.*, 2020).

The aim of the research is to explore the impact of Islamic investment or financing activities on Omani SMEs. The following research questions have been formulated considering the shortcomings of the previous literature published relevant to the given research topic:

- Q1. Do Islamic financing offer better results to the SMEs of Oman as compared to the conventional banks and financing?
- Q2. How can the SMEs of Oman yield the maximum level of performance and productivity by seeking aid from Islamic financing?

The study here would focus specifically on answering these questions and would provide suggestions to the SMEs of Oman to enhance their financial performance and level of productivity by relying on the elements of Islamic financing.

### LITERATURE REVIEW

Islamic finance has a wide and profound effect on the operations and performance of SMEs in Oman as well as other countries out there. It has been observed that Islamic finance has the capability of aiding a business contribute to the improvement of their skill sets of financial management via the introduction of certain processes like training. This in turn enable these small and medium enterprises to have an upper hand in terms of competitive advantage as well as market share due to the provision of interest free loans. Also, Islamic financing offers these SMEs with the needed capital in addition of enhancing the accessibility of the given capital. Furthermore, with this aid such companies can have a competitive advantage in the market as mentioned earlier with a mean lying between 4.135 and 4.002 (Ramachandran & Al Yahmadi, 2019).

As per the beliefs held by the owners and workers of the SMEs in Oman, Islamic financing eventually improves the performance of their businesses by aiding them to grow with an average mean of about 3.75. As per previously performed correlational analyses, a positive relationship exists between business growth and Islamic financing with a reading of 0.488 along with a significance of 0.000. Such statistical readings validate that Islamic financing has a positive influence on Islamic financing. Furthermore, it has been observed that owners of certain SMEs seek Islamic financing from the banks with an aim of enhancing their capabilities to carry out the businesses successfully. Islamic banks of Oman usually have capital bases of smaller sizes as compared to their conventional counterparts, which can hinder their capability to actively participate in large and flexible government financing projects. At the end of the year 2020, the government and public enterprise projects represented a mere of 4.6 % of the financing mix of Islamic windows and banks. On the other hand, the same figure is about 15 % for the conventional banks (Bilal, et al.2020).

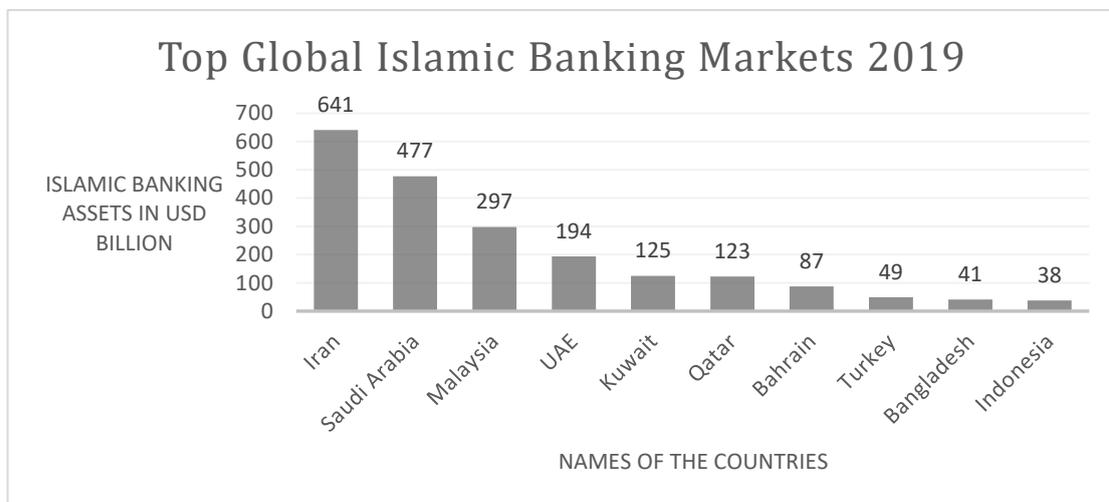


Figure 1. Top Global Islamic Banking Market 2019  
Source: Mohamed et al. (2020)

As per Al Balushi et al. (2019) the financial policies and capital structure of SMEs are crucial areas of concern for policy. Over the last few years, a limited number of studies have been conducted on capital structure of the SMEs. The given deficiency can be highlighted while conducting extensive investigation on the factors that are responsible for influencing funding related decisions revolving around Islamic finance. The given paper by Al Balushi et al. (2019) has been developed with an aim of investigating that whether the owners and managers of SMEs of Oman have an intention of adapting or embracing Islamic finance, and whether these beliefs are influenced by these individual's knowledge in the area along with the characteristics of the firm and that of themselves. The authors here have relied on a questionnaire survey that has been conducted via face-to-face interviews, in which about 385 owners of SMEs operating in Muscat, the capital city of Oman have been included. Furthermore, the collected data have been analyzed intricately using The Kruskal–Wallis one-way analysis of variance (ANOVA) non-parametric test. The findings obtained reveal that the Islamic knowledge of the owners and managers of the SMEs along with their personal characteristics are indeed responsible for shaping their intentions of adapting Islamic finance. However, the characteristics of their companies have no substantial influence of the decisions undertaken by these owners and managers of SMEs to accede Islamic financing.

On the other hand, the paper by Al Balushi (2019) focuses on the adoption of instruments of Islamic financing by small and medium enterprises (SMEs) in Oman. The given PhD thesis has been developed to conduct critical investigation on the intention of the owners and managers of the small and medium enterprises (SMEs) of Oman for embracing or adapting Islamic financing instruments (IFIs). Under normal circumstances when the owner or the managers of a SME when deciding how to finance the given business has to rely on the conventional instruments of financing that are commonly provided by the banking industry of Oman. However, recently due to the rise of Islamic finance and banking, the financial services industry of Oman has experienced a new offering, leading to the alteration of the usual situations. The owners and managers of SMEs in Oman at the contemporary times has the freedom to choose between non-Islamic and Islamic finance options when carrying out their financial decisions. Thereby, having an in-depth insight into the option would be ideal for fueling their financial condition by carrying out robust and flexible financial decisions. This is extremely important as the choices undertaken by these SMEs would lead to altercations in the financial structures of these businesses. Thus, the research carried out as a part of this paper is significant to the chosen research topic. This is also because the paper critically carries out investigations of the part that instruments of Islamic financing can play crucial roles in both encouraging a more equitable sharing of the growth in the SMEs of Oman and stimulating that growth prior to that. To check the relevancy of the hypotheses of the given study paper, statistical techniques and methods were relied upon. Also, hierarchical multiple regression along with factor analysis were used for the initial part of the research paper. Furthermore, one-way ANOVA nonparametric test of Kruskal Wallis as well as factor analysis were utilized for the second paper. Also, thematic, and descriptive analysis have been relied on in order to study the data sets for the third paper reviewed. The findings of the given research paper can aid the policymakers who usually targets small businesses as they are needed to know that the financial needs of small enterprises are not constant in nature, and thus can later with the characteristics of the owners and managers of these companies. Furthermore, these individuals and groups are needed to align their policies with the changing requirements of the owners and managers of these small and medium enterprises (SMEs). In the given research paper, a quality approach has been adhered to, and the primary data sets were gathered from around 385 owners and managers of SMEs in interviews that were conducted face-to-face.

On the contrary to the research papers mentioned above, Al-Balushi et al. (2018) sheds light on the Islamic financial decision making within the small and medium enterprises (SMEs) in the Sultanate of Oman. The paper here has relied on an approach of theory plan behavior. As per arguments put forward by the author, the non-financial factors such as the attitudes of the owners and managers of SMEs in addition of perceived behavioral control, subjective norms, and behavioral intentions are responsible for heavily altering the financial decisions of these SMEs at the end of the day. The researchers as the tool of analysis have relied on a hierarchical multiple regression in which data procured from a sample size of 385 SMEs is used to back up the behavioral approach of the given research with an aim of critically understanding the financial decisions. Although the factors mentioned earlier acted as catalysts for the decision-making processes as well as policies of the SMEs, it has been observed that religiosity affects the behavioral intention negatively for the adaptation of Islamic financial instruments (IFI). Also, the implications of the financial decisions, especially the ones that revolve around Islamic finance as well as the ideas for future research have been discussed as well.

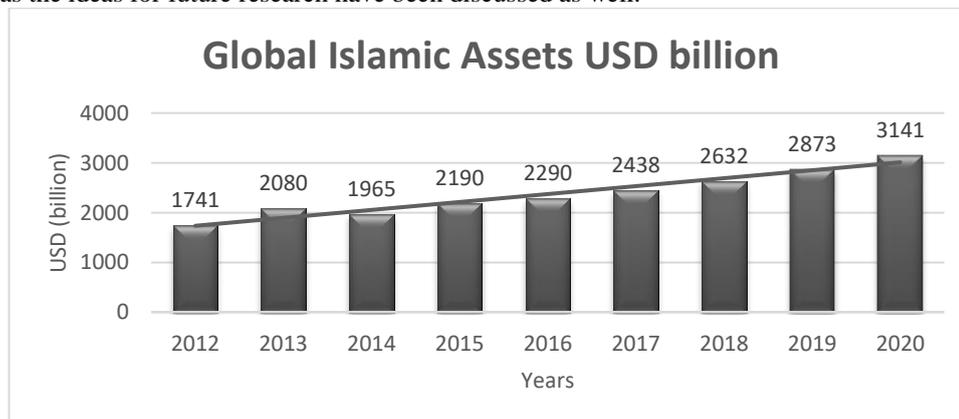


Figure 2. Rise of Islamic financing and banking even during the Covid-19 pandemic  
Source: Rabbani et al. (2021)

The paper by Khiernnas (2021) has been developed with an aim of examining the relationship between the development of small and medium enterprises in Oman and the growth in Islamic windows and banks. To obtain the desired objective, the banks have relied on the method of total financing as well as evaluating its total assets as the indexes that are used for measuring the development and growth of these banks along with the SMEs that are registered under the General Authority for the Development of Small Enterprises (Riyada). The latter is carried out with an aim of setting them as an index for the development of the institutions mentioned earlier. The findings were formed after critically comparing the graphs and tables that present the statues of Islamic windows and banks and certain SMEs in the regions of Oman. A conclusion was arrived here that that there is strong positive link between development of Small and Medium Enterprises and the growth of Islamic windows and banks in Oman. Further recommendations were made to fill the research loopholes.

Table 1. Summary of the studies reviewed and analyzed

Author	Year & Plan	Methods	Findings
Al Balushi et al.	2019 (Oman)	The authors here have relied on a questionnaire survey that has been conducted via face-to-face interviews, in which about 385 owners of SMEs operating in Muscat, the capital city of Oman have been included. Furthermore, the collected data have been analysed intricately by using The Kruskal–Wallis one-way analysis of variance (ANOVA) non-parametric test.	The Islamic knowledge of the owners and managers of the SMEs along with their personal characteristics are indeed responsible for shaping their intentions of adapting Islamic finance. However, the characteristics of their companies have no substantial influence of the decisions undertaken by these owners and managers of SMEs to accede Islamic financing.
Al Balushi	2019 (Oman)	In the given research paper, a quality approach has been adhered to, and the primary data sets were gathered from around 385 owners and managers of SMEs in interviews that were conducted face-to-face. As analytical tools, statistical techniques and methods were relied upon. Also, hierarchical multiple regression along with factor analysis were used for the initial part of the research paper. Furthermore, one-way ANOVA nonparametric test of Kruskal Wallis as well as factor analysis were utilized for the second paper. Also, thematic, and descriptive analysis have been relied on in order to study the data sets for the third paper reviewed.	The findings of the given research paper can aid the policymakers who usually targets small businesses as they are needed to know that the financial needs of small enterprises are not constant in nature, and thus can later with the characteristics of the owners and managers of these companies. Furthermore, these individuals and groups are needed to align their policies with the changing requirements of the owners and managers of these small and medium enterprises (SMEs).
Balushi et al.	2018 (Oman)	A hierarchical multiple regression analysis tool has been used in which data procured from a sample size of 385 SMEs is used to back up the behavioural approach of the given research with an aim of critically understanding the financial decisions.	Although the factors mentioned earlier acted as catalysts for the decision-making processes as well as policies of the SMEs, it has been observed that religiosity affects the behavioural intention negatively for the adaptation of Islamic financial instruments (IFI).
Khiernnas,	2021(Oman)	The graphs and tables that present the statues of Islamic windows and banks and certain SMEs in the regions of Oman have been critically examined and evaluated to form the findings.	A conclusion was arrived here that that there is strong positive link between development of Small and Medium Enterprises and the growth of Islamic windows and banks in Oman. Further recommendations were made to fill the research loopholes.

Source: Created by the researcher

## METHODOLOGY

A methodology is an essential element for any research study and is usually used to demonstrate the use of tools and methods to develop the given research paper. It has been observed that implementing an efficient and proper methodology in a study paper enables the researcher to go through a well-guided and scientific pathway. Furthermore, going for a sound set of methods and tools that is considered right for the research paper would provide the researcher with the needed sets of guidelines to make the projects smooth, manageable, and effective at the end of the day. In the given research paper, a qualitative methodology has been relied on to gather the data sets and the needed information for shaping and developing the research paper (Kooli et al., 2022).

As mentioned earlier, the aim of the research is to explore the impact of Islamic investment or financing activities on Omani SMEs. Semi-structured interviews were relied on to in which about 40 employees of different SMEs of Muscat and nearby areas in Oman were selected. In addition to 40 employees, the participants would also include 2 financial experts, and 20 managers from the chosen SMEs, thereby having a total study participant of 62. Questionnaires primarily comprising of open-ended questions have been provided to the 62 participants. Due to the presence of the open-ended questions the respondents have been able to answer each of the questions in multiple ways, thereby giving them the needed freedom while responding to the questionnaire and thus add to the flexibility of the data obtained by the researcher at the end. Furthermore, the acquired data sets were analyzed by descriptive and thematic tools of analysis, thereby providing effective findings and conclusions drawn at the end.

### **Sample**

As mentioned earlier, a qualitative data collection approach has been adhered to here in which semi-structured interviews have been used to procure the needed sets of data from about 62 staff members of multiple SMEs spread across Muscat and the nearby areas in Oman. Out of the 62 staff members procured, 40 of them are employees, 20 of them are managers, and 2 are financial experts working in these SMEs of Oman. As a part of the semi-structured interviews, questionnaires primarily containing open-ended questions were present here.

### **Measurement Technique**

Descriptive and thematic analyses were used to critically study the obtained data sets from the semi-structured interviews. The interview transcripts obtained have been studied to form preliminary codes, which in turn is used to develop the final sets of codes. Furthermore, certain codes formed at the end have been combined to form the study themes, comprising of specific phrases as well as words. The themes that have been developed here are as follows: Perceptions of the owners and managers of SMEs on Islamic banking, Difference between Islamic and conventional financing, and the relationship between operations of Omani SMEs and Islamic financing (Mascarenhas, 2021).

## **EMPIRICAL FINDINGS AND DISCUSSION**

As mentioned earlier, three themes have been generated by conducting thematic analysis on the obtained data sets from the semi-structured interviews carried out. Each of these themes have been further connected with one another to form realistic and useful findings that have helped the researcher to understand the impact of Islamic financing comprehensively and extensively on the operations of the small and medium enterprises (SMEs) in Oman. Each of the themes obtained have been further elaborated below.

### **Perceptions of the Owners and Managers of SMEs on Islamic Banking**

The responses from the interviews backed up by the existing literature on the subject reflected that the owners of the SMEs are highly aware of the principles of Islamic banking and possess the needed knowledge regarding Islamic financial instruments. This statement has been verified and thus can be regarded as accurate in spite of the fact that the element of Islamic finance is comparatively new in Oman. The positive perception of Islamic financing methods held by these individuals and groups alike could play a crucial role in facilitating the development of the Islamic banking industry and aid numerous SMEs in improving their business operations.

### **Difference between Islamic and Conventional Financing**

There are multiple elements that differ between Islamic financing and conventional financing systems as well as methods. For instance, in terms of savings accounts, the sharing of profit is only permissible under Islamic finance. On the other hand, the depositors are paid the interests as a part of conventional financing. Also, account of investment under Islamic financing can be considered as a copy of the fixed deposit account in conventional financing. In addition to these factors, it is important to note that Islamic financing is relatively new as compared to its conventional counterparts, and thus, the former usually have significantly less resources and capital at its disposal (Al-Abri et al., 2018). However, drawbacks like these are being minimized by forming mutual collaborations between the two systems of financing.

### **The Relationship between Operations of Omani SMEs and Islamic Financing**

A positive and strong relationship between the two variables, namely Islamic financing and operations of Omani SMEs exists. The statement here has been supported by the majority of the participants interviewed and is further supported by the existing literature on the subject that have been reviewed previously in the second chapter. Furthermore, it has been found that Islamic financing has been responsible for promoting SME operations and leading to their growth, as well as has played a crucial role in their growth in the long run. The same can be said for the operations of these SMEs in the near future. Mutual benefits of Islamic financing and Omani SMEs can reinforce Oman's national development. As per the responses obtained, it has also been found that better regulators and policies could increase popularity of Islamic finance among the people of Oman.

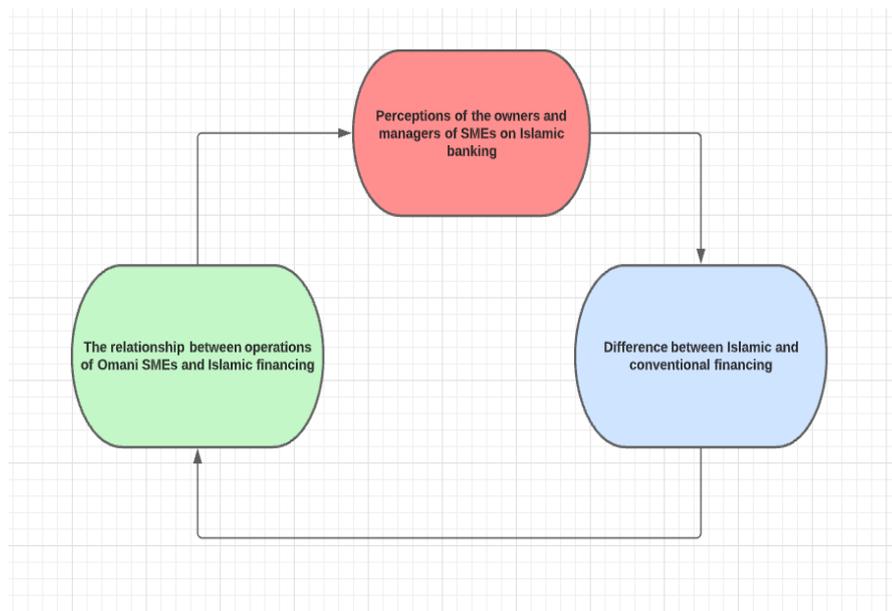


Figure 3. Interconnections between the themes generated

Source: Created by the researcher

### CONCLUSION

It can be concluded that although Islamic financing are less efficient as compared to their conventional; counterparts, they usually possess higher intermediation ratios as well as a higher level of quality of asset, and thus are better capitalized. During the financial crisis of Covid-19 these two factors have been primarily responsible for sustaining Islamic financing. Thus, a business can move towards betterment over time by seeking the aid of the elements of Islamic financing and aligning their goals and objectives with the policies of Islamic financing. Also, the owners and managers of SMEs have sufficient knowledge of the principles of Islamic financing. Although the system of financing here is relatively newer the users, primarily from the SMEs of Oman are increasingly relying on it to promote business operations and growth in the long run. This statement can be further supported by the fact that there is a strong and positive relationship between the operations of SMEs in Oman and Islamic financing systems. In terms of limitations, it can be stated that the given research lacked a touch of comprehensiveness and thus in the future this research can be further elaborated and lengthened, and further variables and research themes can be included to further add to its quality. Furthermore, as the data collection phase is solely focused on a qualitative approach, the use of any statistical data was excluded, which otherwise could have increased the accuracy of the research findings formed. This specific loophole can be filled up in the future by adapting a mixed data collection and analysis approach.

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**Data Availability Statement:** The data presented in this study are available on request from the corresponding author. The data are not publicly available due to restrictions.

**Conflicts of Interest:** The authors declare no conflict of interest.

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## APPENDICES

### Appendix A: Semi-Structured Interview Questions

1. Do you work in a small and medium enterprise (SME) based in Oman. Please describe your company's primary operations and activities.
2. Are you aware of the ideas and concepts of Islamic financing? If so, please describe it and its effect on the operations of the SMEs. Feel free to have multiple approaches in answering the question here.
3. Does Islamic financing influence the activities or performances of your organisation? Please elaborate your answer if possible.
4. Does Islamic financing promote sustainable performances of businesses? Describe the case of your organisation here as well to support your statements.
5. Which, as per your own opinion, has more potential for aiding SMEs like your company, the conventional or Islamic banks and windows? Please state the reason for your answer.
6. Does the present sets of Islamic financing policies of Oman align themselves with the interest of your company?

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