

Strategies in Islamic Finance Affecting Malaysian Bumiputera SME Performance: A Conceptual Framework

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To Link this Article: <http://dx.doi.org/10.6007/IJAREMS/v11-i1/12161>

DOI:10.6007/IJAREMS/v11-i1/12161

Published Online: 15 March 2022

Abstract

Malaysia is emphasizing on developing SMEs as they are, among others, the main contributors to the country's GDP. Even though the government has invested in various programs and initiatives to enhance Bumiputera SMEs' business performance, it is still bearing poorly as opposed to that of other ethnic groups. In fulfilling the business requirements for capital financing, most of the SMEs in Malaysia are getting their financing from banking institutions, either in the form of Islamic or conventional financing. This paper intends to fill the gap between factors in Islamic finance and Bumiputera SME business performance by analysing and understanding comprehensive literatures on the subject in question. The aim of this study is to investigate the relationship between the strategies (networking, branding, financial assistance, and flexibility) in Islamic banks and Bumiputera SMEs' performance. For the research design in respect to conceptual papers, the present study adopts the type of Theory Synthesis. It seeks to achieve conceptual integration across Ibn Khaldun's Theory of Development, Resource-based View Theory and Stakeholder Theory. Hence, this paper provides an expanded perspective on Bumiputera SMEs' performance by bringing previously unconnected or incompatible elements together in a novel way. The literature reveals that there are positive relationships among strategies and Bumiputera SMEs' business performance. However, only a handful of studies are analysing these correlations. If empirically supported, the proposed framework may provide an effective alternative in assisting Bumiputera SMEs to delve into information pertaining to Islamic financing for a better decision making on their capital financing or bank-related business transaction activities. In essence, this study reveals that there is a need for further research to discover new insights on strategies and factors in Islamic finance and enhance business performance of Bumiputera SMEs in Malaysia.

Keywords: Malaysia, SME, Islamic Finance, Business Performance, Bumiputera

Introduction

Malaysia's pioneering role in the development of Islamic banking and finance has gained worldwide recognition, since the passing of the first legislation of Islamic finance in 1983 i.e., the Islamic Banking Act, 1983. Banking institutions are the main source of financing for small and medium enterprises (SMEs), providing more than 90% of their total financing (Chong & Balogun, 2017). In the mid-term Review of the 11th Malaysia Plan 2016-2020, the Malaysian government has recognised SMEs' function as catalysts to increase investment and transform the country into a developed nation by year 2024. SMEs are critical components of the Malaysian economy, contributing more than a third of her gross domestic product (GDP) and providing job opportunities to more than four million workers in Malaysia. Due to these vital roles of SMEs in the economy, studies on the factors affecting SME performances are widely conducted among researchers (Toh et al., 2021; Qalati et al., 2021; Shahzad et al., 2020; Hameed et al., 2018).

Realizing the profit opportunities, most of the Bumiputera households in Malaysia engaged in SMEs. Yet, business performance gap between Bumiputera and other races is on the rise. Bumiputera entrepreneurs are still small in numbers, and their sustainability is lower than that of entrepreneurs from other races. This is proven by the gradient of winners in the Malaysia Enterprise 50 Award 2004 - 2008 among the SMEs, in which only 27% of them were Bumiputera companies, whereas that of the non-Bumiputras were 72% (Hung et al., 2011). According to Hanifah et al (2019), Bumiputera SMEs' market sharing and ownership are relatively lower than that of other races. Pertaining to that issue, statistics show that though Bumiputera represents almost 70% of the total population in Malaysia (Izzwi et al., 2018) only 40% of the total business registered with Companies Commission of Malaysia are owned by Bumiputeras (Utusan, 2019). *What causes this underperformance among Bumiputera SMEs?* For a business to succeed and survive in the dynamic business environment, the management should focus on strategic manoeuvrability including organizational agility, flexibility, and responsiveness (Kornelius et al., 2021). Therefore, in order to compete in the market, SME needs to have proper marketing strategies such as brand advertisement and business network extension (Hanifah et al., 2019). To face the challenges, it is important to have flexibility features in the financing terms attained by SMEs (Baños-Caballero et al., 2016). SMEs commonly approach banks to obtain working capital requirements or asset financing, in which the types of financing can be divided into debt finance (asset based) and equity finance (asset backed). Each financing types has its own benefits; debt financing would allow the SME owners to retain full control of their business unlike equity financing. Equity financing is based on profit and loss sharing. In the interim, equity financing is riskier for the banks than a loan as the investment does not need to be paid back immediately, unlike debt financing that requires loan repayments to be commenced shortly after the loan approval (Fianto et al., 2018). In Islamic financing, some of the examples of equity financing are the products using *Musarakah* (partnership) and *Mudharabah* (investment) contracts, whereas the debt financing types are like *Murabahah* (profit plus mark-up) and *Tawarruq* (commodity Murabahah) contract (Thaker et al., 2021).

Thus, in applying some of the strategies, the first method of networking can raise understanding of potential markets, new business locations, innovations, sources of capital and potential investors, and it can positively influence the performance of small firms (Rafiki & Wahab, 2013). The second aspect of having a proper corporate brand as one of the marketing strategy is vital in ensuring SMEs' proper identification (of who they are and what they do) in the market (Fatimah et al., 2015). Furthermore, proper branding would create a

positive corporate image, resolving negative influence of competitors and enable Bumiputera SMEs to gain higher levels of profit competitively in the market by beckoning consumers on their product quality (Fombrun & Shanley, 1990). These two strategies will be further explained later in this paper.

Apart from the branding and networking strategies, financial assistance is also deemed to be the challenging factor that exploits the Bumiputera SME business performance. Notwithstanding the challenges to obtain financing among Bumiputera SMEs, Malaysia partakes one of the largest Islamic banking industries worldwide (Ishak, 2019). Bank Negara Malaysia, in its Financial Sector Blueprint 2011-2020 released in December 2011, said it expects financing based on Islamic principles to account for 40% of total financing in 2020, from 29% in 2010. Bank Negara Malaysia data also indicates that, in 2019, 28.5% of SME financing in the country was provided by Islamic banks. Accordingly, Islamic financing is a broad framework that has great potential for supporting Bumiputera SME businesses, given their fundamental criteria of generating positive societal impact (Haron & Ibrahim, 2016). Agreed by Trammell (2020), Islamic finance has played an important role in financing Bumiputera SMEs.

One of the characteristics of Islamic Financing that successful Bumiputera SME find useful is that the costs of loan administration and monitoring are low based on simple repayment schedule thus allowing for flexibility and customization based on clients' preferences (Obaidullah & Khan, 2011). Due to their low capital base, the availability of flexible-term financial resources is essential for the SMEs growth (Ali, 2013). Furthermore, Islamic finance differs from conventional finance in terms of late payment procedures which incur lower penalties (Elisabeth & Poppelwell, 2012), and in the aspect of flexibility is the treatment towards business owners who are in financial distress (*mu'sir*), who will be given extension of time with no additional charges via loan restructuring.

The purpose of this study is to investigate the relationship of the strategies and factors in Islamic finance (networking, branding and the financial assistance and flexibility provided by Islamic banks) on Bumiputera SME performance. This is a theory synthesis paper which adopts the type of Theory Synthesis highlighted by Jaakkola (2020) for the research design of conceptual papers. Based on the grounded theory technique, the conceptual framework analysis is conducted to provide a procedure for theorizing and developing a conceptual framework. Therefore, this paper develops a conceptual framework for explaining the concept of Islamic finance and analyze its effect on the performance success of Bumiputera SMEs. Several theories are used to investigate the influence of the elements in Islamic finance (flexibility and financial assistance) and the strategies (networking and branding) on Bumiputera SMEs' performance. Accordingly, literature revealed the relationships among these constructs. This paper contribution is in integrating those constructs into a comprehensive conceptual framework to enable a better understanding of the "what's" and "how's" in efforts for fostering Bumiputera SMEs development.

The remainder of this paper will be organised as follows. First, research problem and research objectives. Next, concise literature review of each construct will be introduced followed by relevant hypotheses. Four hypotheses on the relationships among the constructs will be generated. Then, a brief explanation of the theoretical development and proposed theoretical framework will be presented. Finally, implications for future research and concluding remarks will be put forward.

Research Problem

The Government of Malaysia is paying great attention to Bumiputera SMEs' performance through various constructive trainings and programs, but Bumiputera SMEs' contribution for the economy are still low. Various plans and policies following the New Economic Policy (NEP) which includes National Development Plan (1991-2000), the National Vision Policy (2001-2010) have been introduced to ensure Bumiputera SMEs are at par with those of other races. However, despite all these initiatives to improve Bumiputera SMEs, they are still underperformed.

Exploratory interviews have been carried out to examine views and opinions from the Bumiputera SME entrepreneurs. Contributory factors for the decline of Bumiputera business performance are networking issues, branding inefficiencies, fund gap, product development and marketing (Nor et al., 2012). Previous studies also highlighted on strategies; such as proper branding and networking (Hachimi & Salahdine, 2019; Tawfiqi et al., 2018; Rafiki & Wahab, 2013) as the factors to enhance Bumiputera SME performance. Moreover, only a limited number of studies has been conducted to determine the relationship between the flexibility of Islamic Financing and having Islamic financing as the medium of financial assistance with Bumiputera SMEs' performance. This has consequently leaved a research gap that this study sought to fill by analysing the correlation of Islamic financing on SMEs in Malaysia, specifically among Bumiputera who are showing worrisome performances.

Although numerous researchers have taken an interest in exploring SME business performance and have identified a significant relationship between some of the business strategies and business financing and SME performance (Rahman & Sondoh, 2011; Salleh et al., 2017; Islam, 2016; Nasir et al., 2017; Latifi et al., 2021), studies on SME Bumiputera performance and its relationship with Islamic financing factors are limited. Thus, a research study needs to be conducted to gain a more comprehensive understanding of relationship between Islamic financing alongside with the selected strategies and Bumiputera SME performances.

Research Objectives

The research objectives can be summarized as follows

- i. To determine the relationship between branding and Bumiputera SME performance.
- ii. To identify the relationship between networking and Bumiputera SME performance.
- iii. To find the relationship between financial assistance and Bumiputera SME performance.
- iv. To determine the relationship between flexibility and Bumiputera SME performance.

Literature Review

Bumiputera SME Performance

Firm performance results from the implementation of a strategy supported by company resources, capabilities, and competencies to achieve long-term objectives, such as increased sales, profit, market share, workforce, business units, productivity, quality, delivery, competency, customer satisfaction, and customer loyalty (Aboramadan & Borgonovi, 2016; Dibrell et al., 2014; Ratnawati, 2020; Sariwulan et al., 2020). Kaplan and Norton (1992) introduce a measure of organizational performance called the balanced scorecard, a collection of measurements that consists of financial, customer, internal process, and continual improvement perspectives. The balanced scorecard provides a comprehensive view of organizational performance and can be used for central coordination

between management and employees, investors, customers, and stakeholders. In this study, firm performance is defined a company's success in achieving the goals it has set in terms of financial, customer, internal process, and learning and growth perspectives (Dibrell et al., 2014).

Branding

Fatimah et al (2015) found that all Bumiputera SMEs in the said business agreed that they need to use branding strategy to create a strong corporate branding in developing the distinct identity based on the internal and external strength. Muhonen et al (2017) said that brand positioning and brand vision have a direct positive effect on brand performance, which in turn, positively affects business performance of Bumiputera SMEs. Brand identity has a positive effect on performance among SMEs (Tajeddini & Ratten, 2020). Effective branding strategy will create brand awareness among the Bumiputera SME products' users besides enhancing the specific brand credibility in the market (Rehman et al., 2016). Given the wide range of alternatives that customers can choose from when making purchase decisions, brands play an important role in streamlining their decision making by sorting out services and products (Kemp et al., 2020). Building strong brands not only increases Bumiputera SME visibility and credibility, but also distinguishes them from competitors, and acquires more market share (Huang & Lai, 2011). Therefore, Partanen, (2021) orchestrate that branding should be perceived important by SME owners and inculcated as one of the core values of the business. Based on the insights, this study assumes that

H₁: There is positive relationship between branding and Bumiputera SME performance.

Networking

Networking is the ability to build professional relationship with other associates that would benefit the business performance (Tajeddini et al., 2020). In today's volatile environment especially, SMEs need to manage network resource by exploiting the ties of interfirm networks to access external assets and information (Liu & Yang, 2019). There is a significant stimulus between networking and growth, as well as, the effectiveness of Bumiputera SMEs' business performances (Rethwan & Mansor, 2020). However, Zin & Ashari (2020) stressed that SME entrepreneurs can enhance business performance by embedding Islamic work ethics in their networking with employees, customers, vendors, partners, and communities. In fact, the benefit of building relationships and linkages with members of the community is enduring (Gibson et al., 2021). Thus, this study assumes that

H₂: There is positive relationship between networking and Bumiputera SME performance.

Financial Assistance

Financial assistance gives benefit to Bumiputera SMEs in many ways; support acquisition of machinery, tools and equipment and firms' learning activities; and are targeted towards loosening capital constraints of smaller firms (Ayub et al., 2020; Rahim et al., 2021). Hove Sibanda & Poe (2014) reveal that Islamic banking has a positive impact on both entrepreneurial motivation and firm competitiveness and firm competitiveness, besides, having a highly significant and strongly positive impact on business performance of SMEs. Ismail, Rosland and Mohamad (2015) believed that Islamic financial Institutions in Malaysia can further boost the economy of overall regional Muslims, including Bumiputera SME

business, by following provision of Islamic law. The entrepreneurs' Islamic product selections are affected by the nature of Shariah-compliant financing, simple, and quick process that the Islamic banks provided (Rasheed et al., 2019). Real Islamic Shariah banking and innovations affect positively the Bumiputera SMEs' environment, such as 'Murabaha' 'Mudarabah', 'Musharakah' and 'service Ijara' which are unique to Islamic banking (Yussuf, 2017). Therefore, the following is hypothesised:

H₃: There is positive relationship between financial assistance and Bumiputera SME performance.

Flexibility

The flexibility and shariah-compliant features in Islamic finance may have some effects on Bumiputera SME business performance. Unlike in conventional financing, in the case of compounding profit on a restructured and rescheduled Islamic financing facility, the Shariah Advisory Council (SAC) ruled that Islamic Financial Institutions (IFIs) are not allowed to impose compounding profit to ease the burden of customers who are impacted by any crisis and this have a huge impact on society. This ruling is premised on the principle of 'ihsan' (beneficence) (BNM, 2020).

The flexibility of Islamic Financing differs from conventional banking in two ways. i.e; i) late repayments, in which profit is calculated based on the outstanding principal only, hence, late repayments should incur lower penalties (Elisabeth & Poppelwell, 2012; Yaakub et al., 2014). Whereas in conventional banks, as interest is calculated on a compounding scale, late repayments can incur comparatively higher penalties (Rogoff, 1990). ii) early settlement; in Islamic financing, SME owners can exit the contract at any time without penalty, if they fairly settle their outstanding obligations (Yaakub et al., 2014; Abdul-Rahman, 2014), whilst in conventional banks, due to a lock-in period, SME owners could incur a hefty exit penalty if they opt for an early settlement (Reifner, 2019). In addition to that, flexibility in Islamic financing can be seen in the case when the business owners who are in financial distress (*mu'sir*) will be given the extension of time, but no additional charge will be incurred via restructuring. Whereas in conventional bank, the usual practice of restructuring is by giving time extension, but additional interest charge will be incurred by business owners (except for the recent moratorium, where no extra charges are allowed for all banks) (Nor, Pitchay, & Usman, 2020). Dowla & Barua (2006) further explained that a borrower in Islamic bank can opt out basic loan in favour of a flexible loan (reducing the loans instalment size and thus extend the loan period during crisis). Hence, use of Islamic financing products has given entrepreneurs much flexibility in managing their businesses as they could easily rearrange the terms of loan, given the nature of the contract signed for Islamic financing (Abdullah, Awang, & Rahman 2016). For instance, contracts such as *salam* (a forward sale with spot payment) and *Istisna* (manufacturing with forward delivery) allow for flexible payments by the customers. Hence, the following hypothesis is derived

H₄: There is positive relationship between flexibility and Bumiputera SME performance.

Research Methodology

For the research design in respect to conceptual papers, the present study adopts the type of Theory Synthesis as proposed by (Jaakkola, 2020). Table 1 explicates sections on methodological aspects of this conceptual paper.

Table 1

Research Design Elements in the Conceptual Paper

Empirical research	Conceptual paper equivalent
Theoretical framing	Choice of theories and concepts used to generate novel insights
Data (source, sample, method of collection)	Choice of theories and concepts analysed
Unit of analysis	Perspective; level(s) of analysis /aggregation
Variables studied (independent/dependent)	Key concepts to be analysed/explained or used to analyse/explain
Operationalization, scales, measures	Translation of target phenomenon in conceptual language; definitions of key concepts
Approach to data analysis	Approach to integrating concepts; quality of argumentation

Source: Jaakkola (2020)

The goal of this theory synthesis paper is to achieve conceptual integration across numerous theories or streams of literature. This paper helps by summarizing and synthesizing existing knowledge about a concept or phenomenon. In other words, this study enhances the body of knowledge by remodelling the connection of the strategies and factors in Islamic finance and Bumiputera SMEs' performance by applying several underpinning theories. In particular, this research contributed to enable a better understanding of the strategies and elements in Islamic finance for fostering Bumiputera SMEs growth and how Ibn Khaldun's Theory of Development, Resource-based View Theory and Stakeholder Theory might be utilized in such endeavours.

Theoretical Development

Ibn Khaldun's Theory of Development

Ibn Khaldun's insight on economic philosophy and principles were very profound that a number of theories have been promoted by him (Chapra, 1999). Ibn Khaldun's economic philosophy, elaborated in *Muqaddimah*, focuses on the relationship between religious factors and economic issues as compared to the wealth of nation (Agil, 2008). This study argues that Ibn Khaldun's theory of development emphasizes on the multidisciplinary factors (including strategies and factors in Islamic finance) that could increase firm's sustainable competitive advantage and business performance. Ibn Khaldun's theory of development proposes that high performance will be determined by the interaction of all socio-economic and political variables. This denotes that a firm's sustainable competitive advantage results from a tight strategic fit among an integrated set of factors. Therefore, this study proposes that strategies (networking, branding) and factors in Islamic finance (the financial assistance and flexibility provided by Islamic banks) contribute towards a firm's strategic advantage and business performance.

The key issue of Ibn Khaldun's theory of development is to bring to light the importance of effort in business compared to other jobs (Tunggak & Salamon, 2011) and reveal the key success factors creating the valuable nations and determining its competitive advantage. Firms shall obtain sustainable competitive advantages by implementing strategies that exploit their internal strengths. Internal resources can be regarded as a success factor that decides

socio-economic development (Marcin, 2013). These strategic assets have also been highlighted in the Resource-based View (RBV) Theory.

Resource-based View (RBV) Theory

The basic principle of RBV is that distinctive resources are the sources of long-term competitive advantage (Barney, 1991). All assets, capacities, organizational processes, firm qualities, information, knowledge, and other assets possessed by a firm that enable it to conceive of and implement strategies that improve efficiency and effectiveness are included in the concept of resources. (Barney, 1991; Daft, 1983). The resource-based view of the firm emerged as a prominent framework in strategic management throughout the 1980s, and it redirects our attention from the industry to the firm level as a primary predictor of firms' profitability (Brahma & Chakraborty, 2011). The RBV asserts that whether firms will make higher profits and have a competitive advantage over others is determined by who owns and controls strategic assets.

Nevertheless, having strategic assets alone cannot provide a business with a competitive advantage, it is how the organization deploys its scarce resources, makes full use of its dynamic capabilities, invests in, and complements its existing capabilities, can provide a competitive advantage. The RBV concept helps to improve the performance of SMEs. Dynamic capabilities which are part of the management process, also help stimulate RBV to improve the performance and competitive advantage of SMEs. (Sharma, 2021; Chumphong et al., 2020). Though RBV has become a leading paradigm in the business management field, it is argued that in its current form, RBV is yet incomplete. Freeman et al (2021) suggest the reconciliation of Stakeholder Theory and RBV which offers a more promising path to advancing and understanding of management. Moreover, the stakeholders are the ones who bind resources to organizations, neither the RBV nor the new stakeholder view is complete without the other (McGahan, 2021).

Stakeholders Theory

Stakeholder theory advocates that any party affected by the organization or its workings is considered as a stakeholder. Therefore, firms should strive to do right by all these stakeholders in order to achieve sustainable success. Traditionally, the shareholder view stresses that the stockholders are the owners of the company, and the firm has a binding financial obligation to put their needs first, to increase value for them. But stakeholder theory argues that there are other parties involved, including governmental bodies, political groups, trade associations, trade unions, communities, financiers, suppliers, employees, and customers. Even competitors are counted as stakeholders; built on their capacity to affect the firm and other stakeholders (Freeman, 2015).

Parmar, et. al (2010) support the positive relationship between stakeholder-oriented management and company performance, which is always measured in terms of financial returns (Choi & Wang, 2009; Hillman & Keim, 2001). Thus, in most stakeholder-oriented empirical studies, stakeholder performance is an independent variable rather than a dependent variable. Consequently, the stakeholders' empirical literature reinforces the view that financial performance is the most relevant indicator of the value created by a company. Based on stakeholder theory, this study uses the measurement of stakeholder performance

as an independent variable and a certain measurement of business performance as a dependent variable (Choi & Wang, 2009; Hillman & Keim, 2001).

The Proposed Theoretical Framework

This study has constructed a conceptual framework based on three underpinning theories: Ibn Khaldun's Theory of Development, Resource-based View Theory and Stakeholder Theory. Figure 1 depicts the conceptual framework of business strategies (Umadia, & Kasztelnik, 2020; Blackburn et al., 2013; Pushpakumari & Watanabe, 2009) and business financing (Srhoj et al., 2020; Vos, Yeh, Carter & Tagg, 2007); then and links them to SME business performance (Park et al., 2020; Baños-Caballero et al., 2016). The dependent variable (DV) implies to Bumiputera SMEs' performance while the independent variables (IVs) indicate the strategies (networking, branding) and factors in Islamic finance (the financial assistance and flexibility provided by Islamic banks).

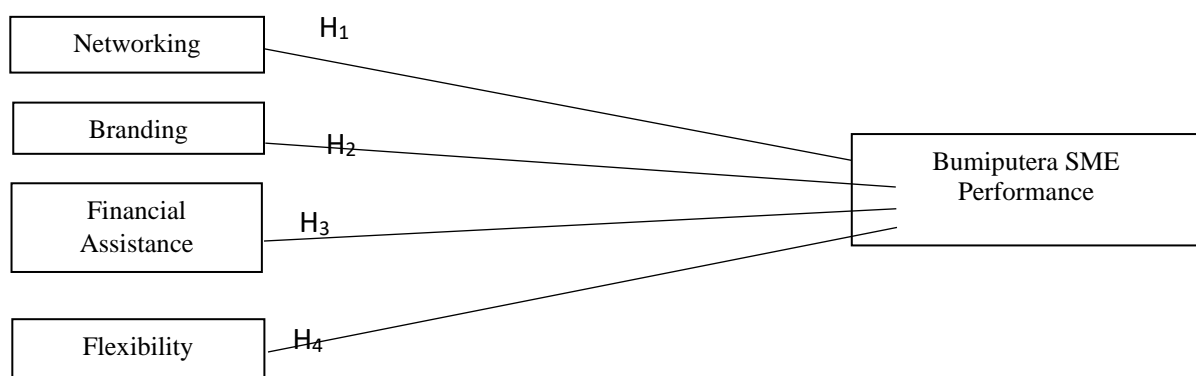


Figure 1: Conceptualization of the Relationships Between Business Strategies and SME Business Performance

The following hypotheses are made:

- H₁: There is a positive relationship between branding and Bumiputera SME performance
 H₂: There is a positive relationship between networking and Bumiputera SME performance.
 H₃: There is a positive relationship between financial assistance and Bumiputera SME performance.
 H₄: There is a positive relationship between flexibility and Bumiputera SME performance.

Implications for Future Research

The study offers novel outlook of strategies and factors in Islamic finance in the context of Bumiputera entrepreneurship. Being the first study that focuses on developing Bumiputera entrepreneurs' Islamic financing, a major contribution of this study is the implementation of strategies in Islamic finance among Bumiputera SMEs. Therefore, the research findings may be taken as input for future research, to assist as a standard to generate testable hypotheses.

Moreover, the analysis in this study will fill the literature gap by investigating the link between Islamic finance and performance of Bumiputera SMEs, as it serves as a guide for the academicians, researchers and decision makers who want to enhance SME business performance through stimulating Islamic finance in the banking sector. However, this study

may uncover a need for further research to determine new insights of factors in Islamic finance and to increase Bumiputera SME business performance in Malaysia.

Conclusion and Recommendation

In brief, this paper has come up with the proposition that Islamic finance may have a positive effect on Bumiputera SME business performance. As such, exploring this matter is crucial as this would signal to the policymakers to encourage and support the use of Islamic banks. Additionally, more banking institutions should develop using Islamic banking interest-free loans to fund SMEs that are uncompetitive due to the scarcity of financial resources and high cost of capital. This would be beneficial to many Bumiputera SMEs in Malaysia, as prior literature has shown that strategies in Islamic finance can increase Bumiputera SME business performance.

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