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Partnership As an Approach to Finance SMEs

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ABSTRACT

Abstract— Financing SMEs is considered one of the most important tools in middle east. To support SMEs, and sustain their business, the existence of financial solutions that comply with the Islamic rules will provide more alternatives for SMEs to finance their short-term obligations represented in profit and loss sharing tools (Musharakah and Modaraba). This study is based on using partnership as an approach to finance SMEs. The study was conducted in Kingdom of Bahrain. Recently, many financial institutions started to adopt many Islamic financial tools. The purpose of this study is exploring how the partnership is different from the traditional financial solutions and the impact of it on nonbanking financial institutions and on the financial services. The study was conducted through a five-points Likert scale questionnaire as the research instrument. The respondents of the study are the employees in nonbanking financial service providers and SMEs in Bahrain. The statistical techniques used in the study are Correlation Analysis, General Linear Model Structural Equation Methods and Path Analysis. The results showed a strong positive and significant correlation between partnership, non-banking financial institutions, financial services and SMEs. The study provides suggestions and recommendations for SMEs in Kingdom of Bahrain to have more alternatives to finance their operations.

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Introduction

The Islamic financial approach plays an important role in providing financial solutions that comply with Islamic financial norms and values. These solutions can provide different business sectors an opportunity to finance their transactions and finding the appropriate financial tools to meet their financial obligations. The traditional financial solutions may no longer effective to response to large segments of customers who target the Islamic financial solutions to finance their obligations specially for those who belongs to SME sector that has gained a great attention by governments in nowadays. One of the main concepts in Islamic finance that can leverages the financial obligations is partnership. The concept can positively affect the cashflow cycle and provides an access to finance specially for small and medium enterprises. The small and medium enterprise sector has a major impact on job creation and contributes to the improvement of the economic growth. Due to the limited accessibility of SMEs to gain more funds from banks either to grow or even to meet their short run financial obligations, there is a need for different sources of funding that are not contain the same restrictions provided by the traditional banks. This study attempts to examine the effect of partnership on financing small and medium enterprises applied in non-banking financial institutions in Bahrain. The Importance of this study lies in providing deeper understanding of partnership concepts as a financial tool that could replace the traditional financial tools and provide Islamic financial solutions to a large segment of SMEs who are not able to access to banking finance.

Statement of the Problem

The use of partnership to finance SMEs is still controversial. Also, there is a need for further studies regarding the adaption and understanding how SMEs can access for more different Islamic financial tools. The main questions of the study are:

1.What is the impact of using partnership by SMEs in Kingdom of Bahrain to finance their operations?

2.What is the impact of partnership on non-banking financial institutions if considering different partnership concepts to finance SMEs in Bahrain?

3.What is the impact of using partnership on the financial services to finance SMEs in Bahrain?

Hypothesis

H01: There is a significant effect of partnership on SMEs.

H02: There is a significant effect of partnership on nonbanking institutions.

H03 There is a significant effect of partnership on financial services.

H04There is a significant effect of partnership on all dependent variables.

Conceptual Framework

The goal of conceptual framework is to provide more understanding for the relationship between the variables of the study. Also, the framework will assist in provide guidelines on methods of data collections, analysis and achieving research objectives. The following model provides the variables of the research and the relationship between these variables. In this study, four main variables exist: partnership as an independent variable, nonbanking financial sector, financial services and SMEs as dependent variables

Literature Review

Profit and Loss Sharing

Two prominent equity-based instruments are Musharaka (partnership) and Mudaraba (silent partnership) with defined profit-loss sharing (PLS) rules and values (Alghamdi ,2017). The rationale of the profit-loss sharing is that return on capital will be related to productivity, and the allocation of funds will be primarily linked to the soundness of the project (Kabir et al. 2012). Also, PLS could reduce the unjust distribution of wealth. In PLS, the supply of money is not allowed to overstep the supply of goods and would thus curb inflationary pressure in the economy (Zaher & Hassan 2001 as cited in Alghamdi ,2017). Profit-loss sharing is considered to better adjust to shocks and disruptions of payments mechanism. In a system where predetermined interest rate is prohibited and the nominal value of deposits (i.e., investment accounts) is not guaranteed, shocks are absorbed by changes in the nominal value of the deposits. (Alghamdi ,2017).

In PLS-based finance, investment depends on the additional production that is reflected in the expected profitability of the project. (Alghamdi ,2017). There is substantial evidence in the literature that small and medium enterprises are more financially constrained than larger enterprises. (Alghamdi ,2017). However, SMEs owners usually face a higher cost in access to external funds in the form of interests and collateral requirement. (Alghamdi ,2017). They usually fail to meet the stringent credits requirements of conventional banks. A number of factors including information asymmetry, lack of trade

history and lack of collateral increase the risk of lending to SMEs, hindering banks' willingness to lend to SMEs. To alleviate the finance issue facing SMEs, diverse and innovative sources of finance can be examined; one possibility is to identify potentials and limitations of participatory models of Islamic finance. Profit-loss sharing (PLS) contracts, is a possible solution to finance SMEs by allowing the entrepreneurs to share, rather than to bear, (Alghamdi ,2017). It is argued that Islamic participatory approaches could have huge economic potentials for SMEs if genuinely undertaken. In partnership contracts, the Islamic financial intermediary (IFI) and the entrepreneur contribute capital into the business; thus, both parties share the risk and the rewards associated with entrepreneurial activity (Alghamdi ,2017). Moreover, considering the objectives of Islamic finance, IFIs are under religious and moral obligation to actively participate towards the nations' welfare and prosperity through the promotion of entrepreneurship and funding the creation of new enterprises (Alghamdi ,2017). The profits and losses shared in PLS are those of a business enterprise or person which/who has obtained capital from financial institution (the terms "debt", "borrow", "loan" and "lender" are not used). (Wikipedia,2015). The intention is to promote "the concept of participation in a transaction backed by real assets, utilizing the funds at risk on a profit and-loss-sharing basis". (Wikipedia,2015). It is stated that at least five times that Mudarabah and Musharakah are ideal mode of financing. (Shaikh,2014 as cited from Usmani 2004). Equity financing instruments for Islamic business contracts are based on the mudarabah (profit sharing) and musharakah (profit loss sharing) principles. (Sapuan,2016). These financing methods are an alternative to conventional debt financing that is based on rate of interest (riba). (Sapuan,2016). Equity financing involves mutual sharing of risks and profits, depending on the performance of the investment project. (Sapuan,2016).

Modaraba

In the case of mudarabah (profit sharing), the contracting parties i.e., the fund provider (rabbulmal)-who supplies the financial capital and the entrepreneur (mudarib)-who supplies the expertise and management, will collectively take part in profit sharing venture. Profits derived from the project will be shared according to the predetermined profit-sharing ratio such as 60:40 or 70:30 by both parties. (Sapuan, 2016). In the event of failure, all losses must be borne by the fund provider (rabbulmal), while the entrepreneur (mudarib) would have lost his time and effort. (Sapuan, 2016).

With regard to the application of mudarabah for SMEs development, specific/restricted mudarabah is more appropriate to take place as the conditions and stipulations laid down by the financier could safeguard their capital outlay. (Jalil and Sabri,2007). In Islamic jurisprudence discipline, the financier is termed as the sahib al-mal or rabb almal (capital provider) as he is the party who provides a specific amount of capital to the SMEs. (Jalil and Sabri,2007). SMEs provide entrepreneurship and management expertise for carrying out the specified business venture, trade, industry, or services. Profit will be divided between as pre-determined ratio. (Jalil and Sabri,2007).In the case of loss (without negligence or misconduct), the financial loss will be incurred by the financier and the entrepreneur will suffer a fruitless effort. The enterprise will have a bad track record which would lead to bad reputation of the company. This is indeed a fair division of profit and loss. (Jalil and Sabri,2007).

Musharaka

Musharaka is another potential model for SMEs development. (Jalil and Sabri,2007). Perhaps, it is more practicable and realistic compared to modaraba where total financial capital is contributed by only one party. In Musharaka model, both financier and SMEs contribute to the capital of the joint venture and participates in work. (Jalil and Sabri,2007). The relationship between the financier and SMEs in a contract of Musharaka from the Fiqh viewpoint is a partner-to partner relationship (Jalil and Sabri,2007).

In a real situation, the financier could contribute e.g., 90% of the total capital outlay while the rest is contributed by the enterprise. (Jalil and Sabri,2007). However, the enterprise may carry out 90% of the labor and management aspects in the joint venture. (Jalil and Sabri,2007). In other words, the financier contributes most of the financial capital while the enterprise contributes most of the human capital. (Jalil and Sabri,2007). According to Hanafis and Hanbalis, profit can be divided in proportion to capital contribution; or equally divided even the capital contributions are different; and unequally divided even the capital contributions are equal. (Jalil and Sabri,2007). However, Malikis and Shafi'is state that profit should be in proportionate to the size of capital contribution. In the case of loss (without negligence or misconduct), the scholars agree that the loss should be divided in proportion to their respective shares in the capital. (Jalil and Sabri,2007). This is based on principle of "Profit should be according to what they (partners) stipulated, and the loss should be proportionate to both funds (Jalil and Sabri,2007 as cited from AAOIFI, 1998).

SMEs Sector in Kingdom of Bahrain.

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According to Kasi, (2016), Bahrain is an island with a total land of 765.3 square kilometers, located in the western shores of the Arabian Gulf. Bahrain is characterized as a "high income" economy with a gross national income per capita of US$ 28,272.

Today, Kingdom of Bahrain is ranked 39th in the 2015 GCI rankings and 65th in the

World Bank's 2016 "Ease of Doing Business" rankings. (Kasi, 2016 as cited from World Bank, 2016).

According to the Ministry of Industry, Commerce & Tourism, Bahrain, SMEs or MSMEs (micro, small and medium enterprises) represent 99 percent of all commercial establishments registered in Bahrain. (Kasi, 2016 as cited from Bahrain News Agency, 2015) .The SME sector represent 28% to Bahrain's (GDP) and gives direct and indirect employment to over 400,000 employees (Kasi, 2016).

Plans are designed to raise the share of the SME sector to the GDP to 35% by 2018 (Kasi, 2016) .The sector also represents 8% of the total exports (Kasi, 2016 as cited from Ministry of Industry, Commerce & Tourism 2016) .Bahrain was one of the first country in the Gulf countries to have come up with a formal policy statement and a definition of micro, small and medium enterprises. (Kasi, 2016 as cited from Ministry of Industry, Commerce & Tourism 2016).

Micro projects are defined as those projects that have up to 10 workers and have assets up to 20,000 Bahraini Dinars for the industrial segment, and yearly turnover of up to 100,000 Bahraini Dinars for all other segments (Kasi, 2016) .Small projects, defined as those with 11 to 50 workers (and up to 100 for the real-estate sector) and have assets between 20,001 Bahraini Dinars and 500,000 Bahraini Dinars for the industrial segment, or a yearly turnover between 100,001 Bahraini Dinars and 1 million Bahraini Dinars for all other segments (Kasi, 2016)..Medium-sized companies are those with 51 and 250 workers (and up to 400 for the real-estate sector) and have assets between 500,001 Bahraini Dinars and 3 million for the industrial segment, or a yearly turnover between 1,000,001 Bahraini Dinars and 5 million for all other segments (Kasi, 2016) .

Micro enterprises represent 92% of total SMEs registered in Kingdom of Bahrain (Kasi, 2016) . The structure of micro, small and medium projects more or less follow structure models elsewhere in the developed countries (Kasi, 2016) .There is a high density of business enterprise per inhabitant (Kasi, 2016). Conservative forecasts of the true number of SME's are said to be around 49,000, providing vacancies to 447,780 workers (Kasi, 2016) .Bahrain's small and medium enterprises are often concentrated in three essential segments – commerce (43%), Industry (14%) and property (12%).(Kasi, 2016)

Research design

In order to achieve the objective of the study, the researcher will collect quantitative data and adopt a mixed inductive and deductive approach. The Bahrain financial sector represent the population of the study. It includes all types of financial institutions in the public and the private sector. The reason behind choosing the financial sector is the extensive use of different financial instruments, particularly, to some other sectors. The implementation of the Islamic financial tools plays a vital role as a financial instrument for different institutions that finance SMEs sector that rely employ to some extent traditional financial instruments as their backbone infrastructure for financing their business operations. Stratified random sample will be drawn from the financial sector institutions. The reason behind selecting this sampling techniques is to address the decision makers who can provide funds to SMEs. The sample will be drawn from the managers who approve the provision of fund to SMEs. Sample members have been divided demographically into different groups according to their age, gender, level of education, functional level and years of experience. The samples size will be calculated according to the number of institutions already provide the fund. The questionnaires will be distributed in different locations in Bahrain including Bahrain Financial Harbor, Ministry of Finance, Bahrain bay and other governates in Bahrain. The questionnaires use structured questions where the sample members should select their answers from a five-point Likert scale. The questionnaires have been distributed through different methods: Direct interaction with sample members and online questionnaire. The statistical tool that will be applied is the statistical package for social sciences (SPSS). The statistical techniques used in the study are Correlation Analysis, General Linear Model Structural Equation Methods and Path Analysis

Analysis of Data

In the following section, we discuss the results of the statistical analysis. We first provide statistical summary measure to the research variables, the partnership, the partner _F (Financial Services), the partner_ SME (Small and Medium enterprise), and the partner_ NB (Non-banking financial institutions). As indicated in Table (1), the average response of the participants regarding the partnership is 4.05 on 5-likert scale (p-value =0.000) which

insure positive attitude of respondents to the role of the partnership the model.

It is also clear that a 95% confidence interval for the average mean of the partnership is in between (3.85, 4.26). It is also evident that the respondents are significantly positive in their attitude towards partnership _F (mean = 3.94, p-value =0.000), with 95% confidence interval (3.74, 4.15). The conclusion holds for both partnership NB (mean 3.82, p-value =0.000), and 95% confidence internal (3.65, 4.10), and partnership SME, (mean = 4.05, p-value=0.000), and 95% confidence interval (3.6, 4.03).

Correlation Analysis

In this section we discuss the pairwise correlation between the research variable. The correlation is a measure of linear association between the research variables. It describes the strength and direction of the linear relationship between pairs of research variables. As illustrated in Table (2), there is strong positive and significant correlation between partnership and partnership _F (r =0.586, p-value =0.000), strong positive and significant correlation between the partnership and partnership NB (r = 0.622, p-value 0.000). Strong positive correlation between the partnership and partnership SME (0.668, p-value = 0.000). Meanwhile, there is strong positive and significant correlation between partnership _F and partnership NB (r=0.735, p-value =0.000), and partnership _F and partnership SME (r= 0.874, p-value =0.000). Finally, there is strong positive and strong positive and significant correlation between partnership NB and partnership SME (r =0.811, p-value =0.000).

The casual Effect of Partnership on Partnership _F, Partnership NB, and Partnership SME

The multivariate analysis of variance statistical technique is implemented to study the effect of partnership on partnership _F, Partnership NB, and Partnership SME. Table (2) exhibits the results of MANOVA. Partnership has a significant effect on partnership _F (p-value = 0.000), has significant effect on partnership NB (p-value =0.000), and has significant effect on SME (p-value =0.000).

General Linear Model

Structural Equation Methods is used to fit the data to many alternatives, the following are the direct effects on each of dependent variables.

Path Analysis

As shown in the Table (5), partnership has 53% significant positive effect on partnership _F, which justifies hypothesis H1. Partnership has 51% significant positive effect on partnership NB, which verifies hypothesis H2. Partnership has 58% significant positive effect on partnership which asserts hypothesis H3.

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