DETERMINANTS OF ATTITUDE TOWARDS ISLAMIC FINANCING AMONG HALAL-CERTIFIED MICRO AND SMEs : A PROPOSED CONCEPTUAL FRAMEWORK

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Abstract

Islamic finance and Halal are *Shariah*-compliant business sectors that share similar values, market and principle. Despite similarities, there has been disconnection between Islamic finance and Halalsectors. In Malaysia, the disconnection is witnessed by low penetration of Islamic financing among Halal industry players.Being a true Halal operator, business must not only focus in Halal production but importantly finance the business in Islamic way of financing; however, this has not been achieved. The need to merge Islamic finance and Halal sectors by making Islamic financing part of the Halal production is essential.This study aims at investigating and determining factors that influence the attitude towards Islamic financing using Theory-of-Planned Behavior. The research findings will be a platform to unravel the belief factors that influence the formation of attitude of the Halal-certified product entrepreneurs towards Islamic financing and their intention to adopt Islamic financing in business.

Key words: Islamic banking, Islamic finance, Attitude, Small and medium enterprises, Halal.

1. Introduction

Halal industry evolved tremendously since its inception during the first Malaysian International Showcase (MIHAS) in 2004. Today, Halal has emerged as a new source of economic growth. The growing Muslim population totaling at 1.8 billion or 23% of the world population, the increasing awareness and demand for *Shariah*-compliant products among Muslims and the increasing acceptability of Halal products among non-Muslims have created massive possibility of growth in Halal business. The global Halal business market is estimated at USD2.3 trillion in 2012, excluding

Islamic banking, finance and insurance (Malaysia SME, 2012). While, the global Islamic banking and finance industry assets worth at over USD1.3 trillion in 2012 and expected to reach USD 2 trillion in next three to five years. If the Halal business market and Islamic finance were to combine, the potential size of the Halal industry is estimated at USD3.5 trillion. In the World Halal Forum 2011, Halal and Islamic finance sectors are reported to be the two fastest growing *Shariah*-compliant industries, which are growing at 15% to 20% per annum. Despite similarities and significant growth, the two *Shariah*-compliant business sectors are growing at different momentum and are developing independently. Islamic finance has become a global brand, sophisticated and organized industry in the past four decades, whilst Halal industry is seen more fragmented, less structured and only emerged in the global sphere for the past ten years (Halal Focus, 2011). In realizing the disconnection ofthe two business sectors, Malaysia's Prime Minister, Dato Seri Najib Tun Razak has addressed the need to merge the Halal industry with Islamic finance into an integrated Halal economy.Halal economy serves as a term to integrate the production of Halal products with the Islamic financial system for a new economic model (Irfan and Man, 2012).In other words, need to combine Islamic finance and Halal holistically by making Islamic finance part of Halal production.

In Malaysia, the issue of disconnection or lack of interaction between Halal and Islamic finance sectors is witnessed by the low penetration of Islamic finance among the Halal industry players. Although, Islamic banks have established in Malaysia for almost three decades, there are only 5% of Halal players use Islamic banking and finance productswhile the remaining 95% are non users of Islamic financing instruments (Badlyshah, 2011). Being a true Halal business operator, the business must not just focus in Halal production, but must also adopt an Islamic or *Shariah* way of financing. However, this has not been achieved. The low penetration of Islamic finance is likely due to the lack of awareness among the Halal industry players on Islamic financial system. The aversion to switch from well-established conventional financing has also constituted to the minimal usage of Islamic finance in Halal industry.

Given to the lack of supporting empirical evidence on the current issue, it is crucial and timely for the researcher to examine the Halal-certified product entrepreneurs' attitude towards Islamic financing in order to identify factors contribute to the problem. There have been substantial literatures on attitude towards Islamic finance among individual customers segment than business firms. In fact, to the researcher's knowledge no study to date has specifically examined the factors that influence attitude formation towards Islamic financing from the perspective of Halal-certified product entreprenuers. Furthermore, although previous studies contribute useful insights in examining individual customers' and business firms' attitude towards Islamic method of finance, none of studies have adopted Theory of Planned Behaviour (TPB) as the basis of investigation. Against this backdrop, it is imperative to understand the attitude of the entrepreneurs in Halal business towards Islamic financingby focusing at the antecedents of attitude. There has been substantial literatures that examined the relation between attitude and adoption intention, but minimal studies focused on the antecendents of attitude or the belief factors that influence the attitude formation. Hence, this study aims at identifyingthe salient beliefs factorsthat influence entreprenuers' attitude towards Islamic financing, and other key constructs of TPB that influence intention to adopt Islamic financing in business.

The remaining of the paper is organized as follows, section 2 presents the literature review, section 3 discusses TPB, conceptualization of constructs and hypothesis, followed by a conclusion.

2. Literature Review

2.1 The definition, principles and Islamic methods of financing

Islamic finance refers to a financial service or product that is consistent or principally implemented to comply with the principles of *Shariah* or Islamic law (Gait and Worthington, 2008). According to Lewis and Algaoud (2001), there are five religious features that form distinctive identity or basis of the Islamic finance i.e. *riba* (interest), *haram* (forbidden) *or halal* (permissible), *gharar* (speculative) *or maysir* (gambling), *zakat* (the prescribed purifying alms) and *Shariah* (Islamic) board. The concept of financing in Islam differs with conventional or "Western finance". The disctinction between Islamic financial system with the conventional system includes (Mirakhor and Iqbal, 2011) : Firstly, Islamic financial system strives for equitable, fair society and economic order. The prohibition of interest (riba) in the Islamic financial system is intended to avoid exploitation, to avoid profiteering through manipulation prices and to protect the poor (i.e. borrower). Secondly, Islamic financial system stresses the principle of cooperation and brotherhood. This is evident by the system of risk-taking, profit-and-loss-sharing that help the productivity of the business venture rather than creditworthiness of the entrepreneur of the conventional financial system. Thirdly, Islamic finance is grounded by the strict ethical criteria of Islamic law or Shariah.

Hanif and Iqbal (2010) have categorized Islamic modes of financing into two; (1) *Shariah*-compliant products and (2) *Shariah*-based transactions. *Shariah* compliant products are defined as Islamic mode of finance where the return of financier is predictable, predetermined and fixed within *Shariah* constraints, which includes *Murabahah* (cost plus profit sale or mark-up financing), *Bai Bithaman Ajil* (acquisition of assets and hire purchase financing or sale of goods on deferred payment), *Ijarah* (a leasing agreement), *Musharakah Mutanaqisah* (diminishing *Musharakah* or housing finance), *Bai Salam* (sale of goods where price is paid in advance, goods deliver in future), *Istina* (acquisition of goods by specification, where price is paid in advance, and goods deliver in the future)and *Quard Hassan (*benevolent or interest free loan). While, *Shariah*-based transactions are a mode of financing which based on the principles of risk and profit-sharing, where the return of financier is not fixed in advance, and it is dependable on the outcome of the project. *Mudarabah* (partial-equity partnership or profit sharing) and *musharakah* (full equity partnership or partnership financing) are the two profit-sharing arrangements or partnership contracts preferred under Islamic law.

2.2 Relevance of previous studies on attitude towards Islamic finance

There has been little empiricalwork done to examine the attitude towards Islamic banking and finance from the perspective of business firms. The few researchers who attempted to study business firms' segment were Edris and Almahmeed (1997), Jalaluddin (1999), Ahmad and Haron (2002), Osman and Ali (2008) and Gait and Worthington (2008, 2009).

Edris and Almahmeed (1997) have pioneered the study on business firms' determinants of bank selection in Kuwait. This study considered 304 business firms of the dual-banking system. The findings revealed that the majority of business firms in Kuwait prefer to deal with commercial banks than Islamic banks. Furthermore, the business firms ranked the size of banks asset as the primary motivating factor for bank patronage while Islamic banking practices were ranked fifth among the bank patronage factors. This study indicates that although Islam being the dominated religion in Kuwait, and the religion factor drives the individual customers' interest towards Islamic banking (Al-Sultan, 1999; Metwally, 1996), religion factor is not the only bank selection determinant for the business firms.

Jalaluddin (1999) examined the attitudes of 385 small business firms towards the profit or loss sharing method of finance in Australia revealed that the motivation for their interest towards profit/loss sharing method includes business support, level of risk sharing with between lenders and borrowers, risk default in the traditional system such as interest rates, the profitability linkages to the cost of borrowing and the expected rate of return. The deterrents to apply profit/loss sharing method include the terms and conditions of borrowing, the extent of management intervention and the cost of borrowing.

In Malaysia, Ahmad and Haron (2002) studied the perception among 45 corporate customers towards Islamic banking system. The findings found that there has been low usage of Islamic banking products. In fact, most of the respondents were late comers whereby started patronizing Islamic banking less than 5 years ago, despite 15 years of establishment. 65% who are majority Non Muslims had low knowledge on Islamic banking principles and Islamic financial system especially in understanding on the nature of profit-sharing concept.

Gait and Worthington (2008) who reviewed the attitudes towards Islamic financial products and services of the business firms concluded that the predisposition to Islamic methods of finance is subsumed to the criteria taken in selecting a conventional bank. Gait and Worthington (2009) also surveyed 296 Libyan business firms on attitude towards Islamic methods of finance. The study revealed the majority of the Libyan business firms (72.3%) are interested to use Islamic finance, despite informal practice of Islamic financial institution in the country.The motivating factors for business firms to potentially use Islamic finance are religion, followed by profitability, business support and unique services.

Osman and Ali (2008) who focused on Muslim entrepreneurs in Malaysia found that 80% of the total sample intent to use Islamic financing because of religion obligation or Shariah-based system. Other important reasons were certainty of capital and return. Among the users of Islamic financing (58%), the motivating factors to use Islamic financing are the sense of belief that Islamic finance brings justice to people and more profitable than conventional financing. While, the non users of Islamic financing felt that Islamic finance and conventional products are of no difference, in fact Islamic financing is perceived more expensive than conventional financing.

3. TPB, conceptualization of constructs and hypothesis.

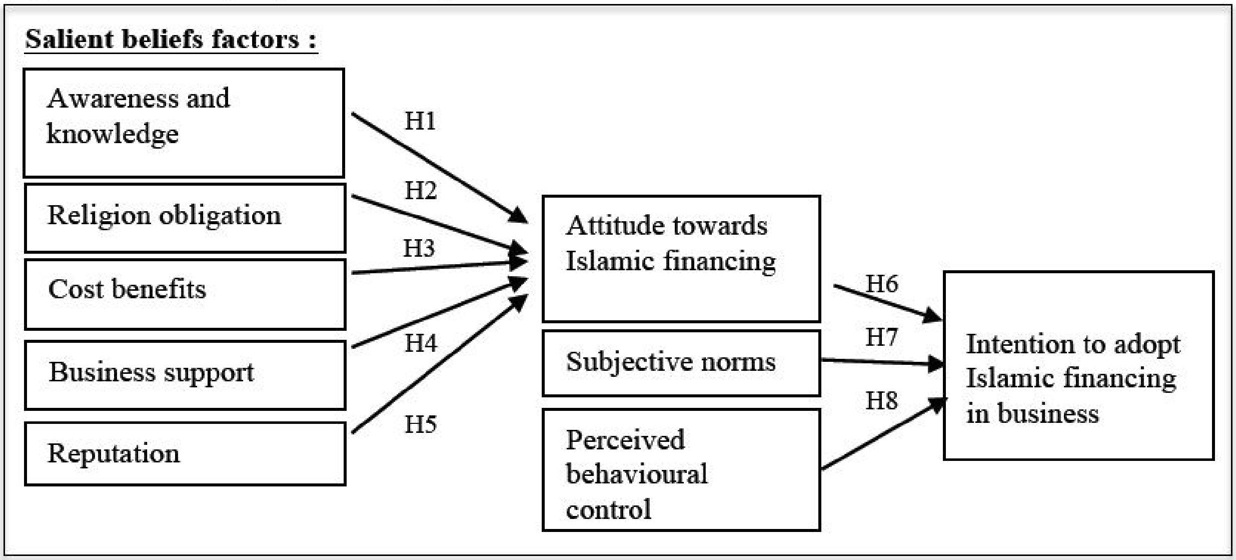
3.1 Theory of Planned Behaviour

Theory of Planned Behavior (TPB) was developed by Ajzen (1991) to study the linkages between beliefs, attitude, subjective norms, perceived behavioural control, intention and behavior. TPB model is one of the most influential and popular framework in studies concerning prediction of behavior from attitude variables. Although TPB is widely used in predicting an individual's behavioural intention, TPB is also appropriate in small business or organizational context. Business owners are usually the primary decision maker, whereby their perception is a significant determinant in adoption intention. Therefore, TPB can be directly used to postulate firm-level behavioral intention (Jin et al, 2012). Since this study focuses on attitude of Micro and SMEs towards Islamic financing, TPB is still relevant to be applied as the conceptual framework. TPB proposes three key determinants in influencing behavioral intention; attitude towards the behavior, subjective norms and perceived behavior control.

3.2 Conceptualization of constructs and hypothesis

The proposed conceptual framework (Figure 1) is adapted from the Theory of Planned Behavior by Ajzen (1991). This model explains that the adoption intention in Islamic financing is resulted from the attitude towards Islamic methods of finance, subjective norms and perceived behavioural control. It is hypothesized that salient belief factors is positively related to attitude towards Islamic financing and consequently influence adoption intention. Since this study is emphasizing on attitude towards Islamic financing, hence it is important to understand what are the belief factors that influence the formation of attitude before an attitude being formed. Thus, the proposed conceptual framework integrates salient beliefs factors i.e. awareness and knowledge, religion obligation, cost benefits, business support and reputation in TPB model, as a new approach in assessing consumers' attitude within the context of Shariah-compliant or Islamic financing.

Figure 1 : The proposed conceptual framework



3.2.1 Salient belief factors

Salient beliefs are identified by examining an individual's or groups' belief hierarchy that is the most frequently elicited beliefs (Fishbein and Ajzen, 1975). In this study, five salient belief factors i.e. awareness and knowledge, religion obligation, cost benefits, reputation and business support were hypothesized to influence attitude towards Islamic financing.

i. Awareness and knowledge

Awareness is having or showing realization, perception or knowledge of a situation or fact. While, knowledge is defined as the fact or condition of knowing something with familiarity gained through experience or education (Writz and Matilla, 2003). In this study, degree of consumer awareness and knowledge about Islamic financing in terms of existence, differences with conventional financing will influence attitude towards Islamic financing. This study hypothesizes :

H1 : There is a positive relationship between awareness and knowledge with attitude.

ii. Religion obligation

Religion obligation refers to the role of religion in affecting an individual's choice or activities (Amin et al., 2011). Several reviews on attitude towards Islamic banking have confirmed the importance of religious or Shariah-compliancy in customers' bank selection. The measures of religion obligation involve perception to comply with the underlying Islamic principles i.e. riba-free, investment in Halal business and equal distribution of wealth (Butt et al, 2011). This study suggests that the greater adherence to Shariah principle, the more favourable attitude is formed. Hence, the following hypothesis is proposed :

H2 : There is a positive relationship between religion obligation and attitude

iii. Cost benefits

Cost benefits are measured by cost of products and rate-of-return, availability of credit with favourable terms, lower service charge, lower interest charge on loan, high interest payment on deposits and lower monthly payment (Al-Ajmi et al. 2009). Gait and Worthington (2008) posit that business firms will consider cost benefits factor in bank selection regardless Islamic bank or conventional bank. Hamid and Masood (2011) revealed that lower monthly payment and service charges influence customers' selection for Islamic home financing. The perceived cost benefits may be positively related to attitude towards Islamic methods of finance. Thus, the study hypothesizes :

H3 : There is a positive relationship between cost benefits and attitude

iv. Business Support

Business support can be divided into two sections. 1. Financial support such as property loan, working capital and grant. 2. Non-financial support such as courses, advisory, management, distribution, research and development (Yusoff and Yacob, 2010). The variables for business support were measured in terms of the extent of Islamic financial institutions support business management, encourage business innovation and expansion, improve business efficiency (Gait and Worthington, 2009).This study hypothesizes that business support of financial institutions and agencies that provide Islamic methods of finance will influence business firms' attitude towards Islamic methods of financing.

H4 : There is a positive relationship between business support and attitude.

v.Reputation

Reputation is based on perceptions of the reliability, credibility, social responsibility and trustworthiness of the organizations (Fombrun, 1996). Previous studies showed "social welfare responsibility" factor appeared significant in consumers bank's selection (Al-Ajmi et al, 2009; Dusuki and Abdullah, 2007) this includes respects for the rights of employees, involved in community (e.g. giving donations or sponsorship) and environmental practice and impact. Islamic banks should uphold social objectives and promote Islamic values to the customer (Dusuki, 2008). In this study, reputation refers to social responsibility and social objectives of Islamic financial institutions. Thus, this study hypothesizes :

H5 : There is a positive relationship between reputation and attitude

3.2.2Attitude towards Islamicfinancing

Attitude towards the behavior refers to the individual's favourable or unfavourable evaluations of the behavior (Ajzen and Fishbein, 1980). Amin *et al.* (2011) found that attitude is positively related with the intention to use Islamic personal financing.This study measures attitude towards Islamic methods of finance from 5 determinants of attitude i.e. awareness and knowledge, religion obligation, cost benefits, business support and reputation which may influence entrepreneurs' behavioural intention to adopt Islamic methods of finance in business. Thus, the study hypothesizes :

H6 : There is a positive relationship between attitude and intention to adopt Islamic financing in business.

3.2.3 Subjective norms

Subjective norms refer to the perceived social pressures which influence an individual's behavioural intention (Ajzen, 1991). In the context of Islamic finance, previous studies show that subjective norms have a direct impact to the intention to use Islamic personal financing (Amin et al., 2011).

H7 : There is a positive relationship between subjective norm and intention to adoptIslamic financing in business.

3.2.4 Perceived Behavioural Control

Perceived behavioural control refers to the perception of ease or difficulty to perform the behavior of interest (Ajzen, 1991). The perceived behavioural control in this study suggests that entrepreneurs are likely to adopt Islamic methods of finance in business if they feel they have control over the behavior, or are prevented to adopt Islamic finance in which they have no control.

H8 : There is a positive relationship between perceived behavioural control and intention to adopt Islamic financing in business.

4. Conclusion

The significance of the study lies on its attempt to add new insights by bridging the two main Shariah-compliant business sectors, that is the Micro and SMEs' in Halal production and their attitude towards Islamic financing. This study integrates the salient beliefs factors in the TPB as a systematic approach in examining attitude and predicting adoption intention towards Islamic financing in business. The research findings could be a platform to understand factors that inhibit adoption of Islamic financing. Thus, to assist relevant government agencies in policies and strategies development for the growth of Halal market and Halal economy, which are essential for the job and wealth creation of the nation. Importantly, to strengthen the Islamic financial capabilities and regulatory framework which is the key driver for Halal SMEs and economic growth.

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