Islamic Finance for SMEs in Jordan
1978-2014

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Submitted to the
Institute of Graduate Studies and Research
in partial fulfillment of the requirements for the Degree of

Master of Science
in
Banking and Finance

Eastern Mediterranean University
June 2014
Gazimağusa, North Cyprus

Approval of the Institute of Graduate Studies and Research

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ABSTRACT

Small and Medium Size enterprises (SMEs) are considered an essential yield for both social and economic development of countries around the world. The purpose of this study is to identify the role of Islamic banks and Islamic financial institutions in financing the development of SMEs in Jordan.

The study revealed that the Islamic finance for SMEs is sufficient. It is also concluded that Islamic banks focus on increasing investors' profits, eliminates society's inequalities and improve general standard of living and playing a significant role in social welfare.

In addition the study indicates that the Islamic bank's approval time for funding application does not take longer than the conventional financial institutions. Consequently, clients select Islamic banks and Islamic financial institutions for funding because of the simplicity and because they comply with Islamic laws.

Whether Islamic banks contribute a great deal to the economic and social development of the country or not, it is suggested that Islamic banks and Islamic financial institutions must focus more on the SMEs. The researcher also recommends more funding to SMEs which would lead to increase in production and will contribute in the development of the economy. Primary and secondary data is used to analyze the research question.

Key words: Islamic finance, SME finance, Jordan.

ÖZ

Tüm dünyada, küçük ve orta ölçekli işletmeler (KOBİ'ler) ülkelerin sosyal ve ekonomik olarak gelişmesinin temelini oluşturmaktadırlar. Bu çalışmanın amacı İslam Bankacılığının ve İslam finansal kurumların KOBİ finansmanında oynadığı önemli rolü araştırmaktır.

Bu çalışma İslam Bankacılığının KOBİ'ler için yeterli olduğunu göstermektedir. Ayrıca, İslam Bankacılığı yatırımcının karını artırmak, toplumdaki eşitsizlikleri azaltmak, hayat standardını artırmak ve toplumsal refahı artırmakta önemli bir rol oynamaktadır.

Ayrıca, bu çalışma İslam Banka'larının credi başvurularını değerlendirme süresinin geleneksel bankalara göre daha uzun olmadığını göstermektedir. Banka müşterilerinin Islam Bankalarını ve İslami finansal kurumları seçmelerinin nedeni ise bu kurumların çalışma yöntemlerinin basit olması ve İslami Kurallara uyarak çalışması olduğu anlaşılmıştırç.

Bu araştırma İslam Bankacılığının ve İslami finansal kurumlarının KOBİ'lere odaklanmaları gerektiğini ve KOBİ finansmanını artırarak ekonomik ve sosyal kalkınmaya katkı koymayı artırabileceklerini vurgular.

Anahtar kelimeler: İslam finans, KOBi finans, Ürdün.

ACKNOWLEDGMENTS

No one walks alone on the journey of life; I would like to thank everyone that joined me, and walked beside me in the bad and good days of my journey. My deepest thanks for all those helped me along the way.

My initial thanks go to Ms. Nihel Erulgen and Mr. Ahmet Simitcoglu from the Ministry of Foreign Affairs and Ministry of Higher Education for awarding me with a scholarship to finish my MA program.

I would like to express my sincere thanks and appreciation to my supervisor Prof. Dr. Hatice Jenkins for her expertise, guidance, and assistance in this study. Her encouragement motivated me to work hard. Without her knowledge and help, this study would not have been successful.

I wish to avail myself the opportunity to express a sense of gratitude and love to my parents for their support, strength, and help. A special thanks to my father and mother, Fayez Mumani and Majedah Momani, for their emotional and financial support along my MA program. I would to thank them for encouraging me in overpassing the many obstacles that I faced. I would to thank my brothers in law Muaatasim and Samar for their motivation and support. Moreover, my thanks go to my bothers Amer and Mohammad and my sisters Reem and Roan for their support during my education period. I would to thank them for their care, fare, and their worries for me night and day.

I am truly indebted and thankful to my friends Dr. Hosam Rjoub and Dr. Ahmed Abu- Rub in helping and encouraging me during this work. I would also like to thank my loyal friends Jehad, Abod and Abu-Ali for helping and support me in difficult days of my life. I would like to thank all of them for making me feel myself at home.

TABLE OF CONTENTS

LIST OF TABLES

Chapter 1

INTRODUCTION

It is widely accepted that the equal distribution of income and maximizing socio-economic benefits for the citizens are the primary goals of Islam. The majority of governments, administrative authorities, cooperatives and social organizations support programs that provide finance to the small and medium size enterprises (SMEs). These organizations have policies to eliminate poverty and unemployment in relatively less developed communities and societies of their respective countries.

Since the establishment of banks and other financial institutions, the primary objective is to provide support for the development of Large Scale Enterprises (LSEs) and the development of (SMEs). Unfortunately, initial efforts were unable to provide favorable results for SMEs. Despite the fact that SMEs account for a significant part of the country’s economy and provide employment opportunities for the majority of people.

Islam emphasizes ethical, moral, social, and religious factors to promote equality and justice for the good of the society as a whole. An Islamic financial system advocates entrepreneurship and risk sharing and believes poor people should take part in economic and business. Financial inclusion, entrepreneurship and risk-sharing through partnership finance are supported by the Islamic financial systems.

SMEs create the foundation of economic growth and social development in all countries around the world in general, and in developing countries in particular. They help to increase the production capacity, and contribute to eliminate the problems of poverty and unemployment. Those kinds of businesses became strategic goods in many countries.

The definition of SMEs is not standard and it is not universal as it changes from country to country. Multiple criteria used to define SMEs, such as the number of workers, asset size, annual sales, or annual production, and so on.

This research defines SMEs according to the number of workers employed by businesses. A business is defined as small if it employs 5 workers or less, medium if it employs 6-20 employees, and large if more than 20 employees are employed. The reason for the adoption of this definition is because it is easy to find the number of employees of businesses and it is more reliable than the annual sale data.

The lack of funding is one of the most important constraints faced by SMEs. Marketing and administrative barriers, the lack of an integrated accounting system, shortage of trained manpower, institutional constraints and government legislation are also limitations faced by the SMEs.

High interest rates and the lack of adequate collateral are the major barriers facing the SMEs where banks would usually finance large businesses and prefer to deal with them because of the low degree of risk and the ability of these businesses to provide the required guarantees.

Since the SMEs are important for the economy, the Islamic banks and Islamic financial institutions must play a significant role in financing these businesses. Supporting SMEs are one of the objectives of religious institutions, thus the most important goal of Islamic banks and Islamic financial institutions is to contribute to the economic and social development of the society. Accordingly, this study has identified the current practice of Islamic banks and Islamic financial institutions in financing SMEs.

1.1 Research Question

This study analyses the question whether Islamic Banks and Islamic Financial Institutions are more suitable to finance SMEs than conventional banks.

1.2 Hypothesis

H0: Islamic Banks and Islamic Financial Institutions have a significant role in financing SMEs.

1.3 The Objectives of the Study

This study aims to analyze the appropriateness of the Islamic financial system for SME finance.

1.4 The Importance of the Study

This applied study tries to find evidence through a survey study at SMEs in Jordan that the Islamic banks and Islamic financial institutions are important for SME finance.

1.5 Scope of the Study

The scope of this study is limited to the financing of SMEs by Islamic banks and financial institutions operating in Jordan. These financial institutions are Jordan Islamic Bank (JIB), Orphans Fund Development Corporation (OFDC), and Agricultural Lending Institutions (ALI).

1.6 Methodology and Data

A mixed methodology was adopted using both qualitative and quantitative methods to draw the strengths and minimize the weakness of each approach. Data collection was employed at qualitative research stage including reports issued by banks and financial institutions. The study will be addressed to adopt the statistical approach to test hypotheses concerning Islamic finance for SMEs. In this study, quantitative data was analyzed, employing the SPSS v18.0 package.

Chapter 2

LITERATURE REVIEW

There are many previous studies that dealt with SMEs in terms of their developmental role in the society.

Qasim (1999) classifies the SMEs sector in Jordan according to their number of employees, their sector of activities, sources of funding. Using sampling in small industrial, commercial and service in Amman, Irbid and Mafraq in 1998, pointed out that 42 percent of SMEs are engaged in industrial activity. 63% of these SMEs employ 4 migrant workers, and 74% of small business owners rely on self- financing sources (Statistic Department of Jordan, 2002).

It has been indicated that Jordanian banks offer a lot of small-scale lending, but this activity is not based on a systematic and organized basis to get to small borrowers, so the study has recommended Jordanian banks to allocate a proportion from the overall lending to the small enterprises sector (Mohammed, 1994).

A study by Asameerat, (2009) entitled “Administrative and Financial Problems Facing Small Enterprises in the Territory of the North Jordan”, focused on identifying the financial and administrative problems faced by the owners of small businesses in the territory of the North through a field study on a sample of 260 SMEs. The researcher found out the most important obstacle to SMEs is that the lack of capital, the lack of guarantees and lack of management, financial and marketing expertise were other main reasons for the failure of some of these businesses (Khan. M., et al, 2006). Accordingly, the researcher recommended organizing tailored training programs that will train the owners of these businesses (Khan. M., et al, 2006).

According to Mohamed (2003), in another study entitled “Small businesses: Nature and Challenges with a Particular Reference to its Role in Development in Jordan”, there is a need to distinguish between small developing businesses and small steady businesses, and that the main challenge for these businesses is lack of skills and administration capabilities, that should be developed. Furthermore it has focused on the role of government in overcoming the challenges of facing small businesses

In accordance to a study by Duwabh (2006), it was recommended to apply the Islamic system for financing SMEs, work on activating the role of the Arab Union for SMEs, and work to provide regulatory environment to achieve partnership among Arab countries. In addition, many Arabic researchers conducted different studies aiming to find ways and methods of Islamic finance for SMEs. One of the methods that may help alleviating the problems of financing SMEs, the study of Omar, (2004) methods of Islamic finance based on commercial credit for SMEs", and in the same study of Omar (2004), which proposed a model for financing SMEs using the system of participation ended by Tamleek (diminishing partnership) are some examples of the Arabic research in this field.

The financing of SMEs has been a subject matter of interest for both to policymakers and researchers because of the importance of SMEs for private sector development. According to Beck (2006) and Ayyagari (2007), SMEs account 60% of manufacturing employment on average across 76 developed and developing countries. According to Beck (2008) SMEs depend on financing from banks. It is also argued that foreign banks have a disadvantage in soft information acquisition compared to domestic banks. Foreign banks also have centralized and hierarchical organizational structures (see for example Mian, 2006, Gormley, 2007 and Sengupta 2007).

Islamic finance for the SMEs describes the financial services for low income populations in which the services provided match to Islamic principles. Accordingly, Islamic finance is simply ethical finance as its servicing the requirements of humankind. According to Banker (2010) Islamic finance is a flourishing market.

Regardless of the financial crisis which has disturbed the economies of industrialized and developing countries, the Islamic finance has been successful and has enjoyed a 29 percent growth in assets in 2009 and an 8.85% growth rate in 2010. These assets are presently worth $895 billion. In addition, the Global Head Islamic Finance of Thomson Reuters predicts that Islamic finance industry will be growing to $2 trillion volume in the next 5 years. Since Islam prohibits the receiving or paying interest which is the base of most conventional banking system, many Muslims feel hesitated to use their products and services.

Moral values have been in every part of religions and societies throughout human history. Koontz (1990) argues that a state religion can comprise a central source of power to control ethical practices; but in US, there are many cultures and religions that do not allow government, educational institutions or other private associations as the center of ethical tradition. Prince Charles expressed similar feelings about a need of values in the developed world Dunning (2003). While producing a generation of excellent corporate managers, business schools are failing to give their students ethical value-based system. After all, ethical values and a moral scope are surely essential for any society.

Lacking moral values, ethical principles tend to change by experience and 'feeling' for what is good enough at any certain time. Certainly, Webster's Business Dictionary, defines ethics as a conduct one may expect from a reasonable person under normal circumstances. What is 'reasonable' and 'normal' might be different from person to person, group to group, city to city and country to country.

The Islamic form [of corporate governance] exceeds national barriers, but the common bond comes from religious principles which lay down how trade and commerce supposed to be conducted with a believer to the faith (Lewis et al, 1994).

Islam puts the highest emphasis on ethical values in human life; these ethical values are definite and absolute. Prophet Muhammad (peace be upon Him – PBUH), regarded by Muslims as the last Messenger of Allah, said: "I have been sent for the purpose of perfecting good morals" Bukhara. Qur'an (The Holy Book of Islam), source of supervision including the message of Allah to mankind, states: 'O believers! Do not consume each other's wealth unjustly, but only [in lawful] business by mutual consent' (Qur'an, 4: 29). Islam is familiar with the attractiveness of engagement in business transactions, and it also supports fair trade, commerce and an entrepreneurial culture.

This philosophy involves that an entrepreneur who execute his/her business procedures according with the commands of Allah will also get in a superior reward in the life after. Business transactions can turn out to be a part of Ibadan (worship and obedience of Allah) if they are executed in accordance with the Islamic regulations of behavior. Pilgrims are permitted to undertake business transactions even during Hajj, the annual pilgrimage to Makah, the top form of worship in Islam (Qur'an, 2: 198). Islam state that the search for one's livelihood through fair business is like seeking the blessing of Allah (Qur'an, 62: 10).

Chapter 3

THE ECONOMIC IMPORTANCE OF SMEs

The SMEs play a very important role in economic and social development of countries. SMEs are important to almost every country in the world, but especially to developing countries, especially those who have major employment and income distribution challenges.

In this chapter we present an overview of:

1. Definition and characteristics of SMEs.
2. SMEs in the Arab world
3. The reality of SMEs in Jordan.
4. Constraints to SMEs in Jordan.

3.1 Definition and Characteristics of SMEs

To choose a specific definition for SMEs is something difficult and complicated. However there are some criteria that can be considered. These criteria could be quantitative criteria like the number of employment and volume of capital. There are also qualitative criteria like regulatory and technical ones, so it can be concluded that the definition of SMEs varies from country to country. In order to understand the definition of SMEs we have to know the nature of these criteria in more details.

3.1.1 Quantitative Standards

Employment

This criterion is used to distinguish between SMEs and large enterprises and is considered one of the basic criteria and the most widely used. According to United States International Trade Commission, SMEs are companies with up to 500 employees. In the EU, SMEs have between 11 to 200 employees and sales under $40 billion). In Japan, SMEs in industry have up to 300 employees whereas those in wholesale and retail have up to 150 and 50 employees, respectively. Developing countries use the World Bank benchmark of 11 to 150 employees and sales of under US $5 billion (Levine, 2006). In Taiwan, small companies are up to 20 employees and medium companies are below 200 employees. In Ireland, the SMEs employ 50 employees where in Yemen the small companies combine less than 4 employees. Medium it is considered when the number of employees is between 5-9 employees.

The SMEs definition varies from country to country according to the level of economic development. According to the Statistics Department of Jordan businesses are classified small if they have between 1-4 employees and medium if they have between 5-19 employees (Statistic Department of Jordan, 2008). Accordingly it seems that this standard varies from one country to another, depending on the size of the population in each country. For instance China is totally different from countries such as Bahrain or Jordan (Spencer, 1998).

Capital

Capital is one of basic commonly used standards to determine the size of the business, because it represents an important element in determining the production capacity of the Business. Also, it differs from country to country and from one sector to another. For example, in Indonesia and India , the SMEs are the ones who have less than $250,000 as a capital where in Saudi Arabia, the small businesses are who have a capital of 5 million riyals which is equivalent to $1.332 million and 25 million riyals for medium businesses which is equivalent to $6.665million. In Jordan, when the capital is less than $ 35,000 is considered as a small business and medium when the capital is $ 140,000. Accordingly, countries differ in the size of the capital prepared for the SMEs on the basis of the economic development from one country to another, for instance, a country like "Burkina Faso" cannot be similar to a developed country, such as Germany or Switzerland, so the economic development plays a significant role in determining capital of SMEs (Saudi, 1998).

Sales volume

The sales volume is another criterion for classification of businesses; it is an accurate measure to the activity level of the business and its competitiveness. This criterion is frequently used in the United States and Europe, where small businesses are classified as with their turnover around 1 million dollars a year or less, while in Arab world it is less common to use and some consider it more convenient for commercial businesses rather than industrial business.

Quantity and value of production

According to Muhammad (1998) some gives more importance to the value and the quantity of the output, and to the level of the quality to distinguish between small, medium and large businesses. According to this standard, SMEs are defined as those businesses that are small and they relate to small size markets of low- income consumers, on the other hand, large businesses are characterized by widespread production that go beyond their markets to local and regional markets.

Production capacity

This standard is effective in the comparison between businesses where the nature of the product like in manufacturing, sugar and cement, but in some businesses where the product forms are numerous such as textiles, the energy kind of equipment is not an accurate measure of the business size. It can be said: that every standard of quantitative criteria that have been mentioned differs from one country to another depending on the level of economic, productive, and population factors and what applies to a country may not be correct in another country (Saqr et al, 2004).

3.1.2 Quality Standards

Managing and organizing

It is assumed that the SMEs have been distinguished from large size businesses, in terms of the organization and management. SMEs are characterized by simplicity, and they often lack of technical to organization skills. With respect to management, SMEs are often controlled by their owner. The owners of SMEs are in charge of marketing, finance and technical aspects; hence the success of these firms depends heavily on the experience and competence of the owner (Asalmeye et al, 1999).

Technical Standard

SMEs mostly use the simple methods of production with low capital-intensive and high labor-intensive methods, therefore, high-tech methods are used in the large business in production, and according to this criterion businesses are classified to small, medium and large based on the degree mechanization. It is rare to find SMEs utilizing the same technology used by large firms (Tanch, 2003).

3.2 Characteristics and Advantages of SMEs and their Importance

SMEs are characterized by number of features as discussed in more detail below:

SMEs increase job opportunities

As compared to large businesses; studies indicate that a significant role has been played by small businesses in employment. In the United States, the companies with fewer than 100 employees provide about 80% of new jobs in the service sector companies. In the UK, small businesses (less than 20 workers) are representing 36% of the total number of employees. In Japan, SMEs (less than 500 employees) employ 74% of the total employment in industry sector (Saqr et al, 2004).

They are easy to set up

SMEs are characterized by the small size of its capital and ease of establishment, as well as the short time needed for the preparations including feasibility studies. They are easier to execute, setting up of production lines of machines and equipment, low-cost installation, lower administrative expenses, and effortlessness in design of organizational structures (Muhammad, 1998).

They have uncomplicated management

SMEs are characterized by straightforwardness in management, leadership, guidance, and simplicity in defining goals. The manager can direct the efforts of workers toward the best ways to achieve the objectives. SMEs have the simplicity of the principles and policies that govern the work and they are easily convince employees and customers as the business is mostly directed by the owner where he/she undertake the technical financial, and the administrative responsibilities (Asalmeye et al, 2002). However, personal style management sometimes leads to an imbalance in the organizational structure.

High flexibility and adaptation to change in the environment

SMEs have the ability to adapt, changes in the external environment more than large businesses. They are flexible in production quantity and quality and in marketing programs, and they are flexible respond farther to the needs of the market.

The low level of used technology

SMEs use very simple technology compared to the large firms. This is more appropriate to the conditions of developing countries, where the used techniques in these businesses are simple, plus they require a very low cost of foreign exchange compared to sophisticated technology of the capital intensive. Besides this, the services associated with simple technologies are often available locally and the required skills are simple.

Relying on the domestic market

SMEs are often in contact with the local community, where they buy from the local community and sell to them. Also the owner and employees belonging to the same community, and this in turn leads to gaining experience in knowing the consumer behavior and tastes. Furthermore SMEs learn the ways to satisfy the needs of the local people as well as the size of the current and future demand for their products.

The production capacities of SMEs

SMEs are characterized by their productive capacity which able to control the elements of production, and producing more that simplify the production process, thereby raising production efficiency and achieving the highest possible profit; this, in turn, leads to working capital acceleration and shorten production cycle.

The low cost of labor

SMEs use less complex productivity techniques as well as less capital-intensive method of production. Therefore, the SMEs have the ability to absorb labor, especially since the technical complexity is low, labor training is more affordable.

SMEs complementary and supportive to the big firms

The SMEs typically achieve some of the benefits resulting from the separation of functions or stages of production. Some of them acquire specialization, in the Shoe manufacturers, for example, the large producer cannot produce all types of shoes with different colors, shapes, designs and sizes effectively or in appropriate quantities, and so the small factory resorts to produce specific types of shoes. So small firms rely on large firms' businesses that are working in the same field to meet their needs of basic services. Also in chemical, petroleum, and mineral industries big firms can contract with small businesses to manufacture some of the components for them. This corporation; is common in the engineering, metal, and electronic industries too (Saqr et al, 2004).

Different ownership patterns

SMEs are dominated by partnership or family ownership. These patterns can be established with small savings where their owners have organizational abilities and skills as well as excellent management.

3.3 The Definition of Small and Medium-Sized Enterprises:

3.3.1 The definition of SMEs internationally

Accordingly, it has been received several definitions of SMEs, including:

International Labor Organization (ILO) definition

According to ILO, the SMEs are the production and craftsmanship facilities which are not characterized by specialization in supervision and they are managed by the owner with up to 250 employees (Saad, J., et al 2004). This definition refers to the quantitative standard related to the number of employees and it seems similar what was taken by the European Union.

The definition of the United Nations Industrial Development Organization (UNIDO)

All small production units, which includes rural, handicrafts, and craftsmanship industries in addition to modern small factories, whether in the form of factories or those that do not (Ismail, M., 1992).

The definition of the Economic and Social Commission for Western Asia (ESCWA)

SMEs are any business that employs between 50-250 employees. This definition is similar to definition (ESCWA, 2002).

World Bank definition

The developing countries use the World Bank benchmark of 11-150 employees and sales of under US $5 billion and less than 500 employees in developed countries where this definition balances the situation of the developing countries and what they have with the developed countries and what it is provided for them (Ayyagari et al., 2005).

3.3.2 The Definition of SMEs in Jordan

In Jordan, we find the following definitions and classifications:

The Royal Scientific Society (Jordan)

According to (RSS), small businesses are those that employ from 1-19 employees, while the businesses that employ 20-99 employees are considered as medium-businesses, and more than that are considered as large businesses (RSS, 2005).

The Department of Statistics

The business is considered small if it employs 5 workers or less, and medium-sized enterprises that employ up to 20, and the business is treated as large if it employs more than 20 employees. Accordingly, this classification corresponds to the ranking of the Royal Scientific Society (Department of Statistics, 2003).

The Ministry of Industry and Trade of Jordan

Businesses that employ up to 3 employees are considered micro-businesses and between 5-19 employees are small businesses, where 29-99 are medium businesses however exceeding 100 employees are considered large businesses (Al-Saadi, 1998).

Amman Chamber of Industry

The business which employs less than 19 employees is considered a small business, and 20-100 is a medium business, where 100 employees and more is considered a large business (Al-Saadi, 1998).

It's been noted that all the definitions and classifications in Jordan adopted the standard as the number of people employed and the reason for this is due to the simplicity of this standard on one hand and focus on employment, on the other. However there are some differences in determining the maximum and minimum number of employees as the base for classification. This study adopts the definition of Department of Statistics for the SMEs which categorize the firms on the basis of number of employees, due to the ease of this standard and its simplicity, as we said earlier, in addition this standard is approved by the Department of Statistics which is the scientific reference in data collection, surveys, industrial and economical censuses in Jordan.

In total there are over 100 000 SMEs in Jordan, which represents approximately 97% of all businesses, according to the Department of Statistics. These companies are at the heart of the national economy, they contribute about 50% of GDP or more; providing employment to an estimated 60% of the Jordanian labor; create up to 70%

of new jobs in the economy; and account for 45% of exports, according to the Organization for Economic Cooperation and Development.

Table 3.1. Number of Businesses in Jordan, 2007.

Classification of Business	Number of Businesses 2007	Percentage of Businesses
Small	144036	97.9
Medium	2407	1.6
Large	730	.5
Total	**147173**	**100**

Source: Department of Statistics, the 2008 survey.

3.4 SMEs in the Arab world

The experiences of the Arab world in the field of SMEs are relatively new. In Egypt, it began in the early nineties through the government and the private sector, who founded the Alexandria Business Association by providing the lending programs for the poor, which later expanded to include suburbs and surrounding cities. As the Central Bank of Egypt launches a package of motivations to encourage banks to expand financing to SMEs by the end of this year, and this comes along with the need for financing small firms producing about 80% of the GDP. There was a company namely, Credit Guarantee Company (CGC) which has been established to ensure the risk of bank credit to small businesses in 1991, with the contribution of nine Egyptian banks with common ownership and insurance company (Mahrooqi et al., 2006).

In September 26-27.2006, 17 representatives from seven countries, Egypt, Jordan, Lebanon, Morocco, Palestine, Tunisia, and Yemen met to launch the first network to serve the microfinance institutions in the Arab countries, and in the end of 2006 the members have become 51 institutions. Consequently, increasing the awareness of SMEs in Syria, the authorities has issued a legislative ordinance No. 15 of 2007, which allows for Monetary and Credit Council to give license to introduce new financial institutions and banks that aims to provide necessary fund for SMEs (Kengo et al., 2007).

The awareness of Arab world in small and medium enterprises was aimed to reduce the problem of unemployment and its high rates in most Arab countries; (Table 3.1) shows the unemployment rate in the Arab world for the period 2000-2009 as follows:

Table 3.2. The Unemployment Rate in the Arab World for the Period 2000-2009.

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Unemployment rate	14%	16.4%	18%	%12.3	15%	14.4%	15%	%14.5	%14	13.2%

The unemployment concentrated in the Arab countries mainly in the youth sector, where the average youth unemployment rate about 53% of the total number of unemployment for all Arab countries, ranging from unemployment rates of 2% in Kuwait, 3% in each of the UAE, Bahrain, Qatar, where in Saudi Arabia And Oman is7% and the rate exceed 11% in Egypt, Syria and Lebanon, and about 13% in Jordan, 14% in Tunisia and Morocco also 17% in each of Sudan, Somalia Yemen, where it has been found in Iraq, Palestine and Algeria that the unemployment rate exceeded 30% (Othaim et al., 2007). At this point, the importance of SMEs comes where they present, on average, more than 90% of the businesses in the developed and developing countries. For example, the available statistics for some countries in the Arab world show that the number of industrial business that employ less than ten workers represent 95% in Egypt, 42% in Tunisia and 50% in Morocco (Gallina et al., 2001).

The SMEs in the Arab countries gain its importance from a group of considerations related to the characteristics of their economic and social structure, rate of the availability of production factors and the distribution of the population and activities. In Yemen, for example, SMEs contributed near to 96% of the GDP in 2005, and about 77%, 59%, and 25% in Algeria, Palestine and Saudi Arabia, respectively, during the same year. In addition, these businesses, in Jordan, represent 92.7% of the total number of businesses which contribute 28.7% of the GDP, which is low compared with other Arab countries. These businesses represent 86.1% of the total number of industrial businesses in the United Arab Emirates (UAE), and approximately represent more than 99% of private businesses in the Arab Republic of Egypt.

According to Chen (2006) the number of SMEs in China in 2001 reached to 4.2 million businesses, which represents 99% of the size of the businesses registered in China, which is equivalent 75% of the total industrial businesses output as it has helped to create 79% of the total of new jobs in the country as whole.

The number of small and medium-sized enterprises in the world have increased, however in the Arab world, the ratio varies from one country to another, for instance, in the Arab Gulf countries the small and medium-sized enterprises represent the pillar of the industrial sector by an estimated 85% of the total industrial businesses existed there. A recent study by The Gulf Organization for Industrial Consulting (GOIC) has indicated that the amount of small and medium factories have reached 94% of the total number of the factories of the United Arab Emirates and 92% of the factories of Qatar, Oman, and Bahrain along with 75% of the factories of Saudi Arabia, and 78% of the factories of Kuwait. However in Egypt and Syria SMEs compose about the same percentage, but they vary in the nature of the investment activities. Where in Jordan, the services sector taken up a big size of the SMEs, which compose 70% of the size of the businesses in Jordan (Farajat, 2009). SMEs represent 97% of the registered businesses of the private sector (Al-Rai Newspaper, 2008).

3.5 SMEs in Jordan

The SMEs in Jordan are characterized by comprising more than 90% of the total institutions operating in various economic sectors, as they absorb about 60% of the workforce and contributes nearly 50% of GDP. This means that these institutions are very significant for the economy and they should be supported for economic growth and development (Alkhasyib, 2009).

Since the end of the last century, Jordan began to approach the economic reform and liberalization of markets where the first achievements of this approach was signing the free trade agreement with the European Union in 1997. Followed by the accession to the World Trade Organization in April, 2000, with the aim of improving the living standards of Jordanian citizens improved through an economic growth yearly up to 6-7 %, and by the reduction of unemployment by creating job opportunities. The opening of Jordanian market for industrial investments, trade and various services, and enhancing the competition in the Jordanian market, leads to a reduction of high prices and diversify of products in the domestic market (EJAB, 2007).

The funding of SMEs in Jordan through the Agricultural Credit Corporation mostly to farmers began in 1959. In 1965 the sector was strengthened through the establishment of the Industrial Development Bank (Nabulsi et al., 2009).

Jordan has begun to encourage small enterprises in the early seventies, through the Five-Year Economic Development Plan (1976-1980), which encouraged the social and economic development and the trend towards small businesses that produce substitute goods and imported products. In 1984 the Jordan Loan Guarantee Corporation has been established with a capital of 10 million dinars (Mahrrouk et al, 2006). Also, in 1986 Union of Charitable Societies (UCS) has been established, and the plan focused on the promotion of agro-industries and the development of handicrafts. Furthermore, in 1989 an economic program was initiated in order to achieve economic and fiscal stability. This included an economic and social plan aimed to provide employment opportunities for Jordanians in the small businesses (Nabulsi et al, 2009).

In order to alleviate poverty and unemployment, in 1998, the government launched the social security package program to improve the living conditions of the poor and to increase the economic and social productivity. In 2002 for the same goals, the government launched another program to enhance the previous one. Moreover, in 2003 it has been integrated of the two programs within one package as "productivity socio-economic program", which includes the development of small and medium enterprises, where it was spent about 17.14 million dinars until 2005 on the development of small enterprises (Ministry of planning and International Cooperation, 2005). Therefore, we can call the nineties as the revolution of microfinance institutions many was established during this period. Some of these microfinance institutions are Jordan's Micro fund for Women, Ahli Microfinance Company *(*AMC*)*, Tamweelcom and the Middle East microcredit company. In 2005, the National Microfinance Bank was established (Nabulsi et al, 2009). In March 27, 2006, this Bank has launched as the first Arabic bank for financing the SMEs.

Table 3.3. The Unemployment Rate in Jordan

Year	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Unemployment rate	**13.7%**	**14.7%**	**15.3%**	**14.5%**	**12.5%**	**14.8%**	**14%**	**13.1%**	**12.7%**	**12.7%**	**12.5%**

Source: Department of Statistics.

SMEs, is a measure source to increase productivity power on the one hand, and to contribute in alleviating the problems of poverty and unemployment on the other hand in many countries, including Jordan. Also, SMEs work to achieve integration and harmonization of the industrial structures and development because the use a simple production methods and quick returns. Moreover, these businesses contribute to attract small savings that characterized by high turnover of capital, making them the starting point for large businesses (Asameerat, 2009).

One of the most important challenges facing the Jordanian economy is the high population growth rate and the slowdown in economic growth rates over the past years. Which have several implications especially on the labor market (Alnswor, 2008).

There are many different financial institutions that provide support and funding for the development of small enterprises in Jordan such as the Development and Employment Fund, which was established as a government institution in 1989 and began its lending in 1991. Also there is Craftsmen Loan Fund, which is a subsidiary of the Industrial Development Bank, was established in 1975, with the aim to finance SMEs and crafts. One of the leading institutions in the financing of small businesses in Jordan, the Jordanian company to finance small businesses (Tamweelcom), was founded as a non-profit organization to support and develop small enterprises as a company owned by the Noor Al Hussein, where the volume of bank loans provided until 31/12/2009 amounted to 64,958,074 dinars ($91.6 million). The total number of loans was 139,286 of which 127,258 loans for females and 12,028 loans for males. The total number of clients since the beginning is 85, 286 clients where females are 91.14 %, and males are of the total 8.86% .

Moreover, there are many institutions dealing with the financing of SMEs directly and indirectly, such as Lending Fund Women, which was founded in 1999 as a private Jordanian-profit organization, in order to support the productive capacity of SMEs. Also, it works to empower woman and enhance her position as a productive individual in the community where in 2005 the Fund provided 114 thousand loans to about 40 thousand people, 99% of them were women.

3.6 Constraints Faced by SMEs in Jordan

Many of SMEs face constrains that block them achieving the economic and social objectives ahead. The nature of these constraints varies depending on the nature of the business and activity practicing with the state in which they operate.

The United Nations has announced that 2005 is the year of microfinance in order to provide the necessary funding for more than 20 million households in developing countries (Prasad et al, 2009). Additionally, the main problem for small businesses is the need for funding from a third party where it is difficult to rely on self-financing, and the high cost of financing compared with the rate of return on the business, which often leads to the loss or suspension of the business (Prasad et al, 2009). In Jordan the SMEs pay a higher interest rate than big businesses on the same type of loan by 2-4 percentage points (Kandah, 2009).

Generally, SMEs do not provide financial statements, (Alzerra et al, 2005). In China, the lack of information was the main reason that led to the failure of small businesses (Alattar et al, 2009). According to Lybaert (1998) it has been found that there is a positive relationship between the extent to which is the use of the available information and the performance of SMEs. The asymmetric information between financial institutions and small businesses, and to get the required funding is one of the main constrains for small and medium enterprises (Gebru, 2009). Gebru (2009) found that the lack of adequate collateral is a major problem for small businesses that do not have fixed and sufficient assets. This is because banks rely on the capital (collateral) not on the income (cash flow) of the business for granting or reject a loan.

During the last fifty years the Arab Economic Planning used to rely on the public sector, which funds small businesses where such businesses have a quick return such as real estate (Hawat, 2007).

Chapter 4

THE NATURE OF ISLAMIC FINANCE AND ITS APPROPRIATENESS FOR SMEs

Despite that SMEs are very significant for economic development; they still suffer from many problems. The major problem facing them is the lack of funding (Fathi et al, 1992), and this problem is getting worse in the third world countries, including Jordan. It has been observed that the owners of SMEs in Jordan rely on own savings or liquidate assets to fund their businesses. These funding sources are inadequate for SMEs therefore; they have to seek for alternative financing sources. In this regard, we find that SMEs borrow either from the usury surplus units or from Islamic banks surplus units for the substantive consideration and considered legitimate as well.

As SMEs help to reduce poverty through process of job creation and became the sub-sectors most dynamic export. Especially, being less capital and more employees demanding, SMEs, from a social perspective, are more efficient in the allocation of resources compared to large businesses.

As the growth of SMEs sector is vital importance to develop and progress of any economy, the style of Islamic finance is the best suited and more worthy alternative to finance SMEs. To understand this issue, we need to have background concerning the basics of Islamic banking.

Islamic Banking is banking system based on Islamic law (Sharia). It follows Sharia, or Fiqh Almuamalat (Islamic rules on transactions). Rules and practices of Fiqh Almuamalat are extracted from the Qur'an (Islamic Holy Book) and the Sunnah, and other secondary sources of Islamic law, such as ijma'a (collective agreements opinion among the scholars of Shariah) and ijtihad (individual reasoning).

Basically, the Islamic banking system is defined as a banking transaction that is consistent with Islamic law, and the main rule is to prohibit interest or Riba (usurious), because the Islamic Banking system is interest-free banking.

Islamic banks, as being prohibited from receiving or paying interest, do not give out loans; instead, they use other forms like "Murabaha, Musharkh, Modharbh, Istisnaa and Leasing" to make profit.

4.1 Islamic Finance for SMEs

SME sector are more likely to use products and services in accordance with Islamic law, they are attracted to Islamic finance because it integrates moral values and ethical. Islamic banking system seeks to maximize financial returns and socially responsible ethical manners, provided that necessary products are available with features and competitive prices.

The most important advantage to prefer Islamic financial system rather than conventional financial system is the elimination of risk of misuse of banks funds. Consequently, financing SMEs is a natural appropriate for Islamic finance, and the fact that Islamic financial system deals directly with the real economy, involves the dynamic usage of resources, particularly capital and finance and contributes to alleviate of unemployment and poverty.

4.2 The Efficiency of Islamic Finance

The diversity in the methods of Islamic financing achieves the intended target of funding, and it helps to increase the expansion in investment. The difference between Islamic finance and conventional finance is that Islamic financial system based on the profit sharing principle. The Islamic bank shares the risk of the profit sharing along with the customer. This creates a sense of fairness or justice with the customer. The ethnics of Islamic banking are also considered an advantage due to the morals the business shows.

Participatory financing is an exclusive feature of Islamic financial system, and can offer necessary funding to economic and social development businesses. Islamic banks offer this service over the traditional services provided by conventional financial system.

4.3 Prohibition of Interest

Islam considers money as a tool of exchanging value rather than a valuable commodity itself (Suhail, 1936). In Islamic ideology, the charging of interest is considered not only a form of zulm (exploitation) but also a big sin than even adultery and drinking of alcohol.

Some philosophers have commented about interest like:

- "To take usury for money lent is unjust in itself, because this is to sell what does not exist, and this evidently leads to inequality which is contrary to justice" Thomas Aquinas.
- "You cannot make money just with money." Martin Luther.

4.4 Venture Capital and Islamic Finance

In the past, Venture Capital ("VC") idea came from the Islamic concept of "Mudaraba", which was used beforehand Islam by Arab dealers. Far along, this concept remained registered by shariaa (Islamic law), and it is well known as Fiqh Almuamalat (Islamic transaction) (Welsch et al, 1982).

When Islamic culture was spreading over the world, the concept of Mudaraba developed and has sustained on the way to remain practiced in Islamic transaction. In the 10th period century, Mudharabah concept was taken by Italy and spread in Europe. In Europe, the numbers of entrepreneurs who were financed by Mudaraba were increasing, and consequently businesses becoming larger and larger.

The comprehensive Islamic finance (almost exclusively Islamic banking) is roughly three decades old, and it is worth at over US$150bn (Iqbal et al, 2005). However, Islamic finance has not been related to economic development to the same scope as SMEs, and there have been very few innovations in Islamic financial tools. Over 65 percent of Islamic funds are now invested through murabaha, an Islamic debt tool that is used to obtain real assets for advance sale at a fixed gain rate. In setting out a structure for Islamic SMEs, there are mainly two reasons to justify this type of finance. First, the state of economic development in the Muslim world has remained at the lower end of the scale for more than a century (Ahmed, 2004). Second, it is believed by Islamic economists that SMEs finance has its original roots in the Islamic world, mainly in the concept of Mudaraba. These funding instruments provide support to those with entrepreneurial skills but lacking financial resources.

The entrepreneur or the receiver of capital is termed the midrib while the provider of capital, the venture fund, is known as Rabb al-mal.

The essential academic form of an Islamic financial institution, with accordance to Iqbal et al (2005), has been developed along the outlines of the Two-Tier Mudaraba Method (TTMM).

The first tire is an agreement between the depositor and the Islamic bank. Savers or depositors (rab al mal) deposit their money in the bank (mudarib) and agrees to share the profits. In this instance, the depositors are the suppliers of the capital and the bank manages funds.

The second tire is agreement between the entrepreneurs and the Islamic bank, where the entrepreneurs (mudarib) pursue funding for their businesses based on that the profits generating from their business will be shared with the bank (rab al mal) according to a predetermined proportion. In this case, the bank functions as the provider of capital and the entrepreneur functions as the manager.

Mudaraba is the main Profit and Loss Sharing (PLS) instrument of asset and liability formation in Islamic financial system. The bank’s yield is consequently defined by a part of the return for the parties of the TTMM; banks share earnings with their investors and also with their recipients. If a business venture fails, the money source (bank) loses its money and the entrepreneur loses time and efforts.

One more major type of Islamic financial system is Musharaka; where partners with a given sum of money come together to start a venture. They share profit in a determined proportion. Entrepreneurs are allowed to pay to the total funds commitment, but it is only in Musharaka that the partners might experience a financial loss, strictly in amount to their money contribution.

Mudaraba and Musharaka are equity-based, profit sharing structures, even though there are certain crucial variances between the two forms of finance. The main variance is that the businessperson offers no money involvement in Mudaraba, and thus they are not likely to suffer any loss apart from losing effort (cost of labor) if the venture fails. Besides, the bank is not authorized to contribute in the supervision of a Mudaraba business therefore this form of funding takes a higher amount of risk.

In a business funded by Musharaka, the bank has right to take part in supervision apart from it intentionally waives the right to do so.

The vital question is where the current practice of SMEs funding fits within the PLS (profit-loss sharing) methods of Islamic financial system. Two option methods that might be useful for Islamic SMEs are now discovered deeply. The first option explains how the TTMM could be used to change conventional techniques of Islamic finance within an official Islamic SMEs structure. However, the current operation of TTMM has been basically unable to accomplish the PLS objectives of Islamic finance. The principal/agent problem, and the associated concerns of information asymmetry, moral hazard and adverse selection, has restricted the use of 'profit-sharing' finance. The existing Islamic banking portfolio is therefore loaded heavily in favor of fixed return arrangements such as murabaha, ijara, istisnaa and other debt generating tools (Iqbal et al, 2001).

The more dominant Islamic PLS structure, Mudaraba, is especially liable to the risks of adverse selection and information asymmetry because it relies on trust between the capital recipient and provider. By contrast, Musharaka gives investors the option to engage (directly or indirectly) in the management of investee companies. In reality, however, the banks' right to participate in the management of firms funded by Musharaka deals is almost invariably waived, mainly because this degree of involvement would be prohibitively costly. The fairly ironic outcome is that SMEs (often ideal candidates for equity finance) approaching Islamic banks face very similar barriers to those put up by conventional banks (Masood, 1983). The problems associated with the use of Mudaraba and Musharaka provide some justification for the current predominance of debt-based instruments within Islamic banking assets. There is also a degree of inertia, in that Islamic banking emerged in the 1970s while SMEs in its contemporary form has edged its way into the Islamic world over the 1990s. Bankers are resistant to change (Ahmad, K, 2000).

In order to overcome the disputes mentioned above, Mudaraba has been joined with additional financial structure, wakalah, whereby customers allow a bank or financial manager to invest money on their behalf, in return for a determined fee. This structure is commonly used by Islamic mutual funds (Iqbal et al, 2005) and a joined TTMM-Wakalah structure possibly will offer an appropriate model for an Islamic SMEs.

4.5 Profitability in Islamic Banks

The conventional banks make profit through providing people cash and charge interest on this loan. And they provide different services and charges money too. Again they take money from others and make them pay interest, with a lower rate.

Islamic banks give loans to people. But there is an agreement between the bank and the borrower. The borrower will manage the business while bank look over. The benefit of this activity will be shared between the bank and the borrower at a predetermined proportion. When people deposit their money in an Islamic bank, they become kind shareholders in the bank. And share of profits in a predetermined rate. (Ibrahim A.H, 2008).

The difference between the Islamic Bank and others lies in the banking system and its mechanisms. The Islamic banks work in accordance with the Shariah to receive the money and reinvest it unlike conventional banks (Monzer, 2001). As for asking collaterals (guarantees) the Islamic banks do not require less collateral than conventional banks. They can sometimes even be tougher in requiring the guarantees. This is to protect their depositors. In case of delays in the payment of funds by the borrower banks do not impose additional compensatory fines on the borrowers. (Abdussamad, 2004).

4.6 Islamic Finance Forms

4.6.1 Musharaka (Diminishing Partnership)

A combined venture or partnership structure with profit/loss sharing implications that is used in Islamic finance instead of interest-bearing loans. Musharaka permits both party involved in a business to share in the profits and risks. Instead of charging interest as a creditor, the supporter or the bank will achieve the return in the form of a portion of the real profits received, with accordance to a predetermined ratio. However, unlike a traditional creditor, the financier will also share in any losses (Rosly et al, 2003).

Musharaka plays a very vital role in financing business operations based on Islamic law, which prohibit making a profit on interest from loans. For example, suppose that an individual (X) would like to begin a business but has limited funds. Individual (Y) has surplus funds and wishes to be the financier in Musharaka with (X). The both persons would come to an agreement to the terms and begin a business in which both share a portion of the profits and losses. These cancel out the need for (X) to get a loan from (Y).

Practical steps for Musharaka:

The customer should apply for funding to an Islamic Bank on the basis of Musharaka (Diminishing Partnership), and attached a feasibility study of the business, and the necessary documents by supporting the ownership of land and other documents.

The bank will revise the subject for verification if it got approved by the bank to participate, the following things should be determined:

- The value of financing provided by the bank and how to pay and conditions.
- Determine the required collaterals such as mortgage or other for the benefit of the bank
- Write a contract and sign it
- The company should open a special account in the bank.
- Distribute the profits according to the predetermine agreement and the loss as much as the percentage of contribution in capital.

The bank accepts to waive its shares of the business to the partner partially or totally through several techniques, one of these techniques is:
Doing an agreement with the parties in order to replace the partner with the bank after the end of the partnership contract. (Abusulayman et al 1992).

The parties agree to divide the profit into three sections by predetermine agreement, proportion to the bank as a return on Musharaka , proportion to the other partner as a return to what has paid and worked and proportion to buy his/her shares.

The parties agree to divide the capital into shares and each has a specific value, and one will get a share in each year, so the shares of the bank diminishing, and in return the share of the partner will increase until it reaches the possession of all the shares of the bank.

Banks and Islamic financial institutions have invented Musharaka (Diminishing Partnership) to help artisans, owners of SMEs, professionals farmers to own the tools, machines, carpentry and blacksmith shops, as well as taxi drivers to own taxis and others (Sanusi, 2006).

4.6.2 Mudaraba

"Mudaraba" is a unique type of partnership where the bank gives money to the partner to invest it in a business. The money comes from the first partner is called "rabb-ul-mal", while the supervision and effort is an exclusive responsibility of the partner, who is called "mudarib.

The Islamic Bank and customer debate business plan; the bank grants the necessary funds to the customer then customer establishes the business and control its operation after that business makes either positive or negative profits if it is positive the profit will be shared between the customer and the bank on the base of predetermined ratio however if negative the loss will be absorbed by the bank; so the assets will be decreased from the value of the asset (al-Dabbo et al, 1997).

Types of Mudaraba:

There are several forms of Mudaraba in terms of its conditions and its division and in terms of turnover of capital, and it has been discussed types as following:

- Limited Mudaraba: where the owner of the money restricting the partner, who is called ‘’Mudarib’’ in a certain type of work or a particular place or constrained by a certain time during a year.

- Absolute Mudaraba: where the owner of the money does not restrict the partner, who is called ‘’mudarib’’ in any condition in terms of time, place or nature of the activity so he/she has the freedom.

Types of Mudaraba in Islamic banks and Islamic financial institutions

- Partnership Mudaraba:

It has three parties, namely, the owner of the money, the investor (speculator/Mudareb), and the Islamic bank, where all of them earn profits.

Based on the continuity of the partnership; it take at least one year, where some take more than an a year as well as the capital is secured.

- Individual Mudaraba:

It has two parties, namely: the owner of the money and investor (speculator/Mudareb), where it ends as soon as the business ends, however the capital is not secured.

- Mudaraba ended by ownership:

It arises between the Islamic bank and speculator, where the bank give money and the speculator invest, and the bank give the speculator the right to take the bank's shares at once, or in installments, as agreed terms.

It is similar to the steps involved in the Musharaka ended by ownership, but the partner in partnership speculation does not contribute in the capital, however he/she participates in the work, and trying to buy the share of the bank gradually.

If we assume that the bank bought a taxi for $ (9000) dinars, and then gives it to someone who would like to work on it under the following conditions:

The bank will get 20% of the net profits obtained as a result of working on the car where the one who work on the care will get 50% of the profits. The remaining of the 30% of the profits will pass up in a special account until it reach (9000) dinars, and then the bank will concede its ownership of the car to the favor of the worker or speculator.

If we assume that the profits derived monthly equal to 600 dinars, so the share of the bank is (120) dinars per month, worker (300) dinars, and the passed up amount in the account is (180) dinars, and at the end, we find that it needs to fifty months to own the car $180 \times 50 = 9000$ dinars.

Practical steps for Mudaraba

- The owners of capital deposit their savings individually in Islamic Bank; in order to invest their money in an appropriate field.
- The bank pays out to investors separately, and thus a contract will be held between the bank and the investor.
- Profits are calculated every year based on the return on the assets of the company after deducting expenses.
- Profits are distributed among the three parties, the owner of capital, the bank, and an investor (speculator/Mudareb).

4.6.3 Murabaha

Murabaha is a specific type of trade and not a financing in its origin. While Murabaha is a trade business deal, regulations of Shariah on the subject of trade must be understood. Where the deal would complete on a “cost plus profit” basis i.e. the seller reveals the cost to the buyer and includes a certain profit to it to pull in at the last selling price.

Since it is a sort of sale, it is necessity to involve a seller and buyer and something that is bought and sold. The Islamic bank or Islamic financial institution is the seller and the customer is buyer. It is impossible to be used as a substitute for running finance facility, which afford case for satisfying a variety of needs of the customers and it is a fixed price Sale and in general is completed for short term. The deal can be used in order to meet up the working capital requirements of the customer (Abaidullah, 2005).

The distinctive characteristic of Murabaha from normal sale is that the seller reveals the cost to the buyer and a known profit is added. However the essential system for Murabaha financing consider asset to be sold have to exist and sale price should be determined as well as sale must be unconditional. And with accordance to the assets to be sold they should not be used for non-Islamic intention and should be in ownership of the seller at the time of sale; physical or constructive where renegotiation of price and discounting of Murabaha instrument are not permitted.

Practical steps of Murabaha

- Customer and Islamic bank sign a contract to go into Murabaha.
- Customer selected as agent to obtain goods on behalf of the bank.
- Bank provides the necessary cash to agent/supplier for buying the goods.
- The agent gets ownership of goods on behalf of the bank.
- Customer offers to buy the goods from bank throughout a declaration and bank agrees to sale.
- Customer pays the predetermined price to bank with accordance to an agreement. Typically on a delayed payment basis (Bai Muajjal).

4.6.4 Istisna’a

Istisna’a is an agreement where one part accept to produce a particular product which is likely to be completed with accordance to a specific contract conditions at a predetermined price and for a specified date of delivery This acceptance of production contain some procedures of manufacturing, building, gathering or packaging (Ershaid, 2010). In Istisna’a, the mission is not contingent to be done by the first part and the work can be completed by others under his/her supervision. Istisna’a, is a tool of pre-shipment financing and it is an agreement that the contract can be mentioned to something which is unavailable at the time of finishing the deal, whereas Murabaha is an arrangement to purchase commodities that are available or easy to be reached in the marketplace. Funding under this form would persuade and support the full use of the capacity and technological ability in developing and developed countries (Hnwon et al, 2005).

Types of istisna'a

- Classical istisna'a: Is the normal istisna'a agreement that include two parties of transaction, almustasni (buyer) and al-sani (vendor).
- Parallel istisna'a: parallel istisna'a agreement can be defined as the action where the almustasni (manufacture or buyer) doesn't put a condition on the agreement obliging the al-sani (vendor) to accept making something (goods, asset, item, etc.) by him. In this case, the vendor is officially or contractually permitted to accomplish his contractual obligations by involving into a second istisna'a agreement with a third party vendor, where he will become the buyer. The second contract is the parallel istisna'a. The paralleling is similar to offsetting in conventional finance transactions (Elyès, 2009).

Practical steps of funding Istisna'a:

- The client applies to the Islamic bank, for instance, for a building loan, and attach with the application a statement supported by fees and maps from a consulting engineer for the nature and specifications of the building, copy of the property deed, The planned land area and its location, feasibility study, and a brief report of the engineer who designed the building so that it includes the cost of construction.
- The bank analyzes the feasibility study of the business conducted by high quality experts in order to identify the feasibility of financing the business.
- In the case of the approval of the bank on request from the client, the bank asks over to submit the final documents for the financing and provide the necessary collaterals.
- After the final agreement, the bank signed a contract with the client where all the rights and obligations of each party are determined, and the most important terms in the contract include, the sale price of the building to the customer, delivery date, the repayment period, the amount of installments, and the amount of the down payment in the case of its existence.
- After signing a contract, the bank will sign an implementation contract with the contractor "parallel Istisna'a contract", and the client will be connected with bank directly and nothing to do with his contractor, also it is possible that the client suggests to the bank a particular company for the implementation.

4.6.5 Closed-End Leasing

Closed-end leasing: it is the action where the bank rents, for instance, a car to someone for a certain period and for a predetermined payment in return over priced and transfer its ownership to them after the end of the period and payment of all installments in a new contract.

Closed-end leasing differs from the installment sale in terms of composition, where it consists from two independent contracts:

The first: leasing contract and are starting to take all the provisions of the leasing in that period.

The second: contract titling that after the end of the period, either through donation or sale at a nominal price as predetermined in the leasing contract.
And its reality- in all its forms-Leasing and buy together, whatever the form taken by the contractual transfer of ownership, whether it's at the end of the lease period, or estimating shares during the period of the contract.

It came in a query of Islamic Development Bank directed to the Islamic Fish Academy describe closed-end leasing contract as a contract leasing includes a commitment from the lesser to donate of the leased premises after the fulfillment of all installments of leasing.

And according to the Accounting and Auditing organization of Islamic financial institutions have influenced the definition of closed-end leasing through its process, namely:

- Closed-end leasing by selling in a price specified in the contract.

- Closed-end leasing by selling before the expiry of the leasing contract in a price equivalent to the remaining installments.
- Closed-end leasing by selling gradually.

Chapter 5

THE REALITY OF ISLAMIC FINANCE FOR SMEs

It has been observed already that the SMEs have great contribution and role in increasing of employment, social integration and reforming a country. It would not be wrong to call SMEs as key-drivers of a country's economy. Due to the SMEs vital role in economic productivity, this sector deserves an adequate funding. However, this funding should be facilitated and supported through the different legitimate financing forms.

5.1 Financing of SMEs by Islamic Banks and Islamic Financial Institutions in Jordan

Funding is the most important factor in the development of SMEs. It has positive effect to both the investors and the economy of a country; if it is done in terms of the proportion funded and if interest charges are eliminated. This way SMEs can grow rapidly. Therefore, Islamic Bank and Islamic Financial Institution should take this SMEs funding issue into account. Additionally, banks supporting SMEs by financing them must be promoted globally where possible.

The Islamic International Arab Bank was excluded from the study, because it does not have any SMEs financing program.

5.2 Jordan Islamic Bank

5.2.1 Jordan Islamic Bank Foundation and Objectives

Jordan Islamic Bank was founded in 28th Oct 1978 (JIB, 1978). It formally started its banking and commenced operations in September 1979 and right after its operations it's been ranked as the third largest bank of Jordan in terms of its assets, deposits and financial investments (JIB, 2000). By 2004 Jordan bank has been expanded with fifty two branches, 14 offices and 1 million customer accounts across the whole country (JIB, 2004).

The Jordan Islamic Bank's goals and objectives are as follows:

1. To expand the scope of the public dealing with banking sector through non-usurious banking services, and introducing a purposeful service that aims to recover the social solidarity on the basis of mutual benefits.
2. Develop strategies to acquire funds and savings and direct them towards participation in investment via non-usurious.

3. To provide the necessary funding to meet the needs of the various sectors, particularly those are faraway and incapable to avail banking facilities associated with interests (JIB, 1985).

Hence, it shows that these goals are clear and comprehensive by way of they cover the needs of the deficit units as per Islamic law.

The Jordan Islamic Bank has also began SMEs funding program while introducing a special program of funding professionals, craftsmen and small and medium industries. Bank has also commenced its work in this program in 1994.

The Bank's policy of financing SMEs consists on the following two categories:

1. Small investors and small business owners to grow their businesses.

2. Financing artisans to enable them to find jobs and income.

Thus, according to this program the targeted sectors such as college and university graduates, craftsmen, professionals and technicians having hands on experience in all economic activities. It has also included sharia law approval, doesn't matter if the business is new or existing, and an upper limit of financing must be 20,000 JD or more, if the business proved its success.

5.2.2 Conditions of Applying for Funding

1. Applicant must comply with good citizen reputation.
2. Must have enough experience in the field of desired business.
3. The business should be economically feasible and must be within the Kingdom.
4. Business is not supposed to be incompatible with the provisions of Islamic Sharia law.
5. The investor should contribute in the capital whether by cash or any mean and should be approved by the Bank.
6. The applicant should obtain the necessary licenses and legal documents.
7. The applicant must be ready for full-time administration and operation of business.

8. Provides an optimum level of security to the bank and correspond with his capabilities.

5.2.3 Jordan Islamic Bank's Role in Financing SMEs

In 1994, the Jordan Islamic Bank (JIB) began the scope of the developmental role and social in order to reduce unemployment rate. Though, a new policy had been applied to help craftsman, professionals and jobless by providing sufficient funds through Musharaka. In addition, funding that had been submitted to this category by Murabaha and allocated sum of money from the bank must also be invested in this area too. However, in 2001 the funding “Musharaka ended with ownership” remain a sole program called (finance craftsmen, professionals and SMEs in accordance with the form of Musharaka ended with ownership), and this includes the following features:

1. The borrower is partner with the bank in the profit and loss.
2. The Bank provides the necessary administrative and financial skills and experiences for free of charge to the borrower.
3. The borrower is not obligated to pay a monthly installment.
4. Distributes the net return into three shares:
    - A share to the entrepreneur for effort.
    - A share to the bank for its money that are invested in the business.
    - A share allocated to the business owner to buy the bank's shares.
5. The Bank provides service for the owners of small and medium enterprises through the bank's branches that cover most parts of the kingdom.

Hence, the following table shows the amounts awarded and the number of SMEs funded through this program:

Due to decreasing the funds amount granted as diminishing Musharaka, many businesses have been declined. The total value of funding in 1995 was 100,000 dinars which is 1.3% of the total credit that given as Musharaka. In 1996, it increased by 70,000 dinars where the rate of Musharaka increased to 1.6% of the total Musharaka, while the large number of businesses were still been decreasing. Whereas the minimum 5 businesses were funded that time, while the decline in the amount of funding led to 43000 dinars in 2000 and only .4% of the total Musharaka. In 2001 increased in Dinars reached to 86000, while just 4 businesses were funded that account for .7% of total credit as Musharaka. Year 2002 was not even so different, as just 3 businesses got funded and rest other declined.

In 2004, 16 businesses were funded with a total of 375,000 dinars and 3% of the total credit of Musharaka, while the numbers of businesses that have been benefited from the program till the end of 2004 were just 56 with average of .9% of the total credit given as Musharaka. As for financing businesses through the Murabaha form, they have had the largest amounts ranging between 1, 90,000 to 2, 32,000 dinars with. It is to be noticed that the granted amount was continuously decreasing in most of the years.

In 2001, there was no any single SME succeed in getting funds, unless by Musharaka only which is away from the form of Murabaha. The financing granted by Musharaka form represented 0.9% in average of the total Musharaka. So, the bank started financing using Murabaha form 1999 to 2000 and recorded a rate of 0.3 average percentage of Murabaha in the bank and overall ratios were very low.

So far, it has been analyzed that the role of Jordan Islamic Bank in financing SMEs was not satisfactory.

5.3 The Orphans Fund Development Foundation of Jordan

Before establishment of this institution, orphans' money was deposited in Sharia courts. This money was supervised by the judge either directly, through trustees or by guardians to preserve and develop it. This was the only solution in Ottoman Empire to preserve Orphans' money.

However, the only source to develop Orphans' money was to lend and charge interest, that was a subject of complaint and criticism, and main issue with this was the Sharia judiciary which was responsible to handle it. In 1953 according to Orphans law, this was an interim until the establishment of an institution for the purpose of developing orphans funds (OFDF, 1998).

5.3.1 The Object of the OFDF

In the provision no.4, foundation law no.20 for the year 1972, the purpose of this foundation was to develop and invest orphans money in all types of legitimate investments. Although, this investments were not supposed to be conflicted with the provisions of Islamic Sharia law, and the law states that the orphan is minor civil. Investors, who deposited their money in cash in the account of the foundation or did not have a legitimate representative, must have foundation and its subsidiaries in order to achieve this objective.

The money transferred into accounts from the Islamic courts or invested through different ways but is consistent with sharia law and hey grants funds to orphans, students and other deserving Muslims. This has been done by allocating a percentage from the profits and this decision must be made by the board of directors of the Foundation (OFDF, 1972).

Table 5.1. SMEs Funded by the Jordan Islamic Bank from 1995-2004 (Jordanian Dinars).

Year	Total Musharkah given to SMEs (J.Dinars)	Total Murabaha given to SMEs (J. Dinars)	Number of SMEs funded by J. Islamic Bank	Musharaka given to SMEs as % of the total Musharaka*	Murabaha given to SMEs as % of the total Muabaha**
1995	100000	1700000	8	1.3%	.6%
1996	170000	1900000	5	1.6%	.6%
1997	81000	704000	6	.8%	.3%
1998	57000	275000	3	.5%	.1%
1999	74000	232000	4	.7%	.1%
2000	43000	284000	4	.4%	.1%
2001	86000	-----	2	.7%	-----
2002	20000	-----	2	.2%	-----
2003	81500	-----	6	06%	-----
2004	375000	-----	16	3%	-----
Average			56	.9%	.3%

Source: Jordan Islamic Bank annual report for the years 1995-2004, 2005, PP.126-131.

1 U.S. dollar = 0.709 Jordanian dinar most of the time.

Moreover, according to the provision No.4 in 2002, foundations must seek the above targets and goals; they can only invest their financial resources in different ways of investment which are not inconsistent with the provisions of Islamic law (OFDF, 1999-2002).

For example:

- Using the forms of Islamic investment like Musharaka, Murabaha, Istesnaa, Mudaraba and others.
- Contributing to the companies where shareholder has limited contribution.
- Establish and participate in developing businesses.
- Finance the economic and social businesses weather individually or collectively.
- Construction of buildings and purchasing of real estate such as, land and buildings for sale or lease.
- Deposit in investment accounts in Islamic banks.

5.3.2 Evaluating the Role of the OFDF in Supporting SMEs

The foundation began in 1988 with funding SMEs by using the form of Murabaha, where it began investing with 931 JD and has expanded in funding for SMEs under a number of criteria such as:

- ✓ Businesses that are funded by 20,000 dinars or less are small businesses.
- ✓ Businesses that are funded by 20,000 to 40,000 dinars are medium businesses.
- ✓ Businesses that are funded by more than 40,000 dinars are large businesses.

The following table shows the number of transactions and value of Murabaha already given to small and medium-sized enterprises in Jordanian dinar in 1994-2004.

It is clear from Table (5.2) that the number of small businesses were on the rise since 1994, however, in 1995 the number of businesses start decreasing. In 1889 SMEs decreased to 1559 with a net amount of JD 4,993,877. Where the rise in the number of businesses kept persisted till the 1999. Although, the number of businesses have reached in 2003 to 5768 businesses and funding amount of JD 26,915,813 which means 39% and it was the highest percentage.

Table 5.2. The Number Of Transactions and Value of Murabaha Given To SMEs by Orphans Fund Development Foundation 1994-2004 (Jordanian Dinar)

Year	Total Funds given to all businesses in Jordan	Number of SMEs received funding from OFDF	Total Funding Given to SMEs by OFDF	Percentage of SME funding as a % of total funding of OFDF
1994	37,368,585	1,889	6,490,888	17.4%
1995	39,958,831	1,559	4,993,877	12.5%
1996	42,947,713	2,198	8,105,920	18.8%
1997	44,384,939	3,060	10,087,947	22,7%
1998	47,113,105	4,122	13,273,194	28.1%
1999	48,959,310	4,739	13,948,280	28.4%
2000	54,011,172	4,904	13,452,096	25%
2001	54,771,899	1,354	3842661	7%
2002	61,690,754	3,459	13,681,403	22.1%
2003	69,000,800	5,768	26,,915,813	39%
2004	79,000,300	5,519	24,670,114	31%
Average				52.2%

Source: The orphans fund development foundation of Jordan, Yearly book.1994-2004. Table is constructed by the researcher.

1 U.S. dollar = 0.709 Jordanian dinar most of the time.

In the year of 2001, a rapid decrease in the number of businesses has been observed and in the total fund where the numbers of businesses were 1,354 decreased significantly in amount. It shown that there is a big gap in the number of businesses in this year and it's been found that the reason behind this is a change in the top level management and prevention of SMEs funding. Therefore the rate of funding on average was 25.2 % as it's shown on the table.

As for the geographical distribution of small businesses funded by the orphans fund development foundation, it's been noticed that the business was covering most of the governorates of the Kingdom. Whereas, the capital city Amman was on top of 25424 businesses, and Irbid was the second among 8278 businesses, and Alfalfa was ranked as the third in which the number of businesses reached to 6897 businesses (OFDF, 1994-2004).

In addition, it has also been analyzed that the medium enterprises are covered most of the governorates of the Kingdom but in a very small number. The capital city, Amman was ranked at first by reaching to 103 businesses since 1998 to 2004, Irbid was ranked the second, and for example, Madaba, Mafraq, Karak, Tafila were not funded but only one business and the number of businesses in rest of the regions were ranging between 4-7 businesses.

5.4 The Agricultural Credit Development of Jordan

5.4.1 Summary of ACD of Jordan

The process of ACD begun when the Ottoman State was ruling that area; the Ottoman Agriculture bank in Jordan had three local offices by that period; namely Kerak, Salt, and Irbid.

After the local government's law had been declared in 1920, every office turned out to be an independent unit. In this situation until April in 1921, these offices were moved to work for an impermanent time under the Ministry of Finance. The directorate of the Agricultural Bank was founded in April 1922 and these offices were moved to work under its supervision (ACD Annual Report, 2003). Consequently, agricultural credits were delivered by offices or by the executive committee.

A proportion of 1% of agricultural yields used to be charged by taxes as a part of "farmers' benefits". Therefore, the Jordan Government decided at that time to locate this portion at JD 3500 to be paid by the agricultural bank on an annually basis. After that, this share was increased up to 15000 JD with an addition of JD 7500 chosen for the West bank as from 1953.

In order to renew the situation of the agricultural bank at that period, the government in 1953 assigned JD 50000 annually to be paid to the agricultural bank for five years. This was decided wit to increase the bank's capital and permit it to operate on an adequate level. Gradually, that capital reached JD 970,415 by the ending of 1959/1960.

On behalf of the Jordanian government, the Construction Council had begun its operation in 1952 as the agricultural loan business. Credits delivered by the business were JD 1,742,379 at the end of 1959-1960. The business hence, made contribution to the execution of numerous agricultural businesses mainly in the villages and the West Bank of the Kingdom. In 1952, the government also launched the Cooperative

Construction Department which delivered agricultural funding to rural lending people that they managed their business. Those loans were afforded by the distributions that the Council of Construction used to afford for this reason. Loans delivered to agricultural cooperatives totaled about JD 357,845 by the ending of 1961(Maith, 2000).

There was multiple credit sources with no obvious credit rule but with obvious purposes and goals were available. Those credit entities required the particular technical staff to organize the business. To combine the agricultural credit sources and locate a credit law according to technical, economic and practical foundation and protecting an effective monitor of the credits expenditure for their reasons and goals, the government decided to combine these three organizations in one called "Agricultural Credit Corporation" [ACC]. The Law of ACC No. 50 Issued in 1959, has canceled out the entire former credit corporation and moved their assets and money obligations to ACC. It has begun its real transactions on 1st Aug, 1960. This corporation is the main official source expert in agricultural funding (ACD, 1998).

5.4.2 The Purpose of the Loans

- To buy agricultural inputs (agronomy and animal).
- To improve the agricultural land in the rain-fed and irrigated areas.
- To develop and improve the livestock and poultry.
- Agricultural industrialization.
- Establish rural and farm infrastructure.

5.4.3 Criteria of the Distribution of Businesses

According to the size of agricultural holdings:

- The agricultural holdings that do not exceed 30 acres are considered as small

- The agricultural holdings ranging from 31-100 acres are considered as medium
- Agricultural holdings in excess of 100 acres are considered as large.

According to the categories of the loan sizes:

- Loans that are equal to or less than 10000 JD are considered as small.
- Loans that range between 10000-20000 JD are considered as medium.
- Loans that range between 20000 to 30000 JD are considered as large.

5.4.4 Agricultural Credit Development in Jordan in Financing SMEs

The regulatory tendency of modern agricultural system pays a special attention to SMEs holdings. The one way to stimulate the movement of the agricultural sector is through establishing small production units in owned holdings. It has been analyzed that those holdings characterized in permanency and continuity, although investment requirements in terms of working capital and cost of labor. In the light of the fragmentation and dispersion of agricultural holdings in Jordan, the corporation has worked to reconsider the terms of the applicable lending and instruction in order to guide these loans towards SMEs sector. As the corporation pay attention to deliver services and support for all farmers working in the agricultural sector, and due to the reluctance of some farmers the corporation has begun applying a program of Islamic finance within the form of Murabaha. It happened after the issuance of by law No. 6 of 1998 and was named as (financing system contracts without interest) of Article 24 of the Corporation Law, where the system aims to:

- Expanding the scope of dealing with the agricultural sector through providing the financial and investment services.
- Take advantage of financing and investment agricultural tools based on non-interest basis.

- To contribute in funding that is necessary to help meet the needs of the agricultural sector.

Notice that the percentage of Islamic finance granted to the owners of SMEs (farmers) was minimal to some extent where it reached in 2001 to 150 businesses for financing 832 063 JD from the total funding of $ 13,376,951. This year was the beginning of the Islamic finance where it was representing 6% of total funding compared to 94% with interest. In 2002 it increased, while the number of businesses reached to 553 businesses by a financing size amounted by 2.1 JD million from the total funding of 17,199,522 JD. Also it represents 12% of the total funding compared to 88% with interest. After increased in businesses in 2003 but the amount of funding dropped to 11%, and in 2004 the number of businesses have increased by 4% which represent 16%, however by comparing with the interest financing, these ratios are considered somehow low (Aldrabsh, 1998).

As it has been shown that about 95.8% of farmers prefer to deal with the institution in accordance with the system of Islamic finance, compared to only 4.2 % of the farmers prefer the interest funding system, but in fact it is not the case, we find that the ratios of Islamic finance were very few, and can be explained by several reasons:

First: The behavior of people of the region. And the extent of acceptance this type of funding, and their commitment to the Sharia.

Second: The nature of the promotion of Islamic finance either by the institution or by dealers.

Third: The presence of a third party (Contractor in Murabaha form and this means additional cost to the client).

Fourth: The system of Islamic finance system in the enterprise requires the presence of direct Debit unlike interest as it is through a system of interest, the creditor will be compensated for delayed payment.

Chapter 6

METHODOLOGY AND DATA

6.1 Research Methodology

This chapter describes the research methodology by using descriptive technique. It also gives information on the sample and interviews such as the gender, the business owner's location, occupation, estimated investment amount and other related information and activities.

6.2 Questionnaire Design

The questionnaire was designed to collect direct information and not to give audience chance to express their subjective experiences and views. Therefore the questionnaire was based on unbiased questions to picture the realistic situation. Thus, the aim of designing a questionnaire was to find out about the investors who benefited from Islamic finance and their in-progress businesses in various cities of Jordan. Beside this, the questionnaire (see Appendix A) was also aimed to analyze whether Islamic Banks and Islamic Financial Institutions or Conventional Banks are more supportive for SMEs.

A questionnaire was based on two parts. The first part was aimed to collect demographic information about the respondents. In this respect, investors were asked to specify their gender, city, business establishment year, the invested capital size, education level and activity of the business while, the second part consists of 20 statements that the study aimed to investigate about Islamic financial institutions support for SMEs. For each statement, the respondents were asked to provide their opinions about Islamic finance provided from Islamic financial institutions and Islamic banks. The questionnaire was in Arabic language for audience ease and was based on a 5-point Likert scale. The statements were graded based on a Likert scale as strongly agree (1) to strongly disagree (5).

6.3 Sampling Method and the Sample

Qualitative research approaches has been used in order to present accurate and verified results. The research approach was based on a detailed review of existing literature, including articles and research papers as well as primary research where a questionnaire was designed to collect current data to justify this research.

The sample of the target population (the SMEs owners benefited from Islamic finance forms) for the research was chosen randomly according to various business activities. A total of 600 questionnaires were distributed across eight different cities of Jordan namely, Amman, Irbid, Alzarka, Alsalt, Altafila, Almafraq, Jarash and Ajloun. Of 600 questionnaires 528 of them were qualified for analysis. Targeted audiences from those cities were varied in terms of age, gender, city, business establishment year, the invested capital size, their education level, and business activity.

As shown in the table 6.1, 88.6% of the respondents were males while the remaining 11.4% were females, and the reason behind this unbalanced ratio was the Jordanian cultural perception regarding to gender differences. In Jordan, a very height ratio of males is involved in financial sector than women. Around 61% of the respondents' education level was primary school and the next majority of respondents were in the illiterate category, which was approximately 16.1%. 22.9% of them were high school and others. However, The ratio of all respondents from different cities were ranged liked Amman (capital city) 58.5%, Irbid 18.9%, Alzarka 9.7%, Alsalt 2.5%, Altafila 1.9%, Almafraq 4.2%, Jarash 2.7% and Ajloun1.7%.

Additionally, almost 60% (58.3%) of the sample was established from 2000 on indicating this was a flourish period of SMEs in Jordan. On the other hand, 65% of the activities of businesses are in the trader sector that shows that skills and education are not necessary for such businesses. Finally, the rest distributed among craftsmen, livestock, construction, agricultural business, medicine and pharmacist with invested capital size ranged from 6001-1000 JD was approximately 65%. The following table shows the distribution of investors, according to these variables:

Table 6.1. Summary of Demographic Structure of the Sample

No			Frequency	Percentage of total sample	N	Mean	St.Dev.
1.	Gender	Male Female	468 60	88.6 11.4	528	1.11	.318
2.	City	Amman Irbid Alzarka Alsalt Altafila Almafraq Jarash Ajloun	309 100 51 13 10 22 14 9	58.5 18.9 9.7 2.5 1.9 4.2 2.7 1.7	528	2.4508	.71673
3.	Business establishment year	1980-1989 1990-1999 2000-More	70 150 308	13.3 28.4 58.3	528	2.6155	1.13839
4.	Economic sector	Craftsmen Traders Livestock Construction Agricultural business Medicine & Pharmacist	14 343 87 13 58 13	2.7 65 16.5 2.5 11 2.5	528	2.1989	.86259
5.	Education level	Uneducated Primary School High school Others	85 322 52 69	16.1 61 9.8 13.1	528	2.1269	.69492
6.	Capital size	*Less than JD3000 JD3001-6000 JD6001-1000 JD10001-More	72 343 87 26	13.6 65 16.5 4.9	528	2.0189	1.70267

*The Jordanian dinar is the official currency of Jordan. Since 1995, the dinar has been officially pegged to the IMF's Special Drawing Rights (SDRs). In practice, it is fixed at 1 U.S. dollar = 0.709 dinar most of the time.

6.4 Reliability and Factor Analysis

Factor analysis is a technique to reduce data through pursuing essential unobservable (latent) variables that are reflected in the observed variables or manifest variables.

The purpose of factor analysis is to reduce data to a smaller set of summary variables and Explore theoretical structure where theoretical questions about the underlying structure of psychological phenomena can be explored and empirically tested using factor analysis.

Reliability is to state the truth and correctness of a measurement process (Thorndike et al 1991). Cronbach Alpha test was used to find out instrument reliability. The value was = 72.3% for the questionnaire. All values are accepted since they are more than 60% (Malhotra, 2004). In addition, alpha values for each variable are greater than the accepted value 0.60 (APPENDICS B).

Reliability test is important to make sure that the instrument that developed to measure a particular concept is indeed accurately measuring the variable. A reliability test was carried out using Cronbachs' alpha, which measure the internal consistency of a construct. The recommended minimum acceptable limit of reliability (alpha) for this measure is (0.60) (Malhotra, 2004). The result showed a value of (.723) for the test which is a reasonable value indicating the tool consistency that enhanced its use for the study (See APPENDICS B).

Validity test

Pearson correlation (r) is used to test the content validity of the test. (Malhotra, 2004) suggests that the moderate value of r should be between 0.40-0.59. Table ( ) shows that there is a high and significant relationship between each questions and the total answers which means the test is valid with a value between 0.502-0.968.

Chapter 7

EMPIRICAL RESULTS

Statistical Package for Social Sciences (SPSS 18.0) program has been used as an effective tool for a series of statistical analysis to evaluate the collected data. The data were analyzed under quantitative approach by using descriptive statistics. Investor's demographic information and the responses to the statements were computed and the frequencies, percentages, means, and the standard deviations were also calculated.

From driven results, it's been evaluated that the highest mean score was in support of "Either Islamic Banks and Islamic Financial Institutions on one hand or on the other hand, conventional Banks are more supportive for small and medium enterprises (SMEs)". These results indicate that investors have positive perceptions of Islamic finance in general as compare to conventional system. However, the second highest mean score was in favor of the statement "Is Islamic finance playing a significant role in social welfare and Islamic finance is encouraging sustainable development businesses." Hence, according to investors the Islamic finance system is more beneficial for them.

Table 7.1. Mean and Standard Deviation for Each Questionnaire Item

Questionnaire Item		frequency	Percentage %	N	Mean	St.Dev.
1. Islamic finance increases investors' profits.	St. Agree Agree Natural Disagree St.Disagree	211 132 79 80 26	40 25 15 15.2 4.9	528	2.2008	1.24946
2. Islamic finance alleviates poverty and unemploy ment.	St. Agree Agree Natural Disagree St.Disagree	250 110 90 50 28	47.3 20.8 17 9.5 5.3	528	2.0455	1.22506
3. Islamic finance encourages sustainable developme nt businesses.	St. Agree Agree Natural Disagree St.Disagree	300 90 40 60 38	56.8 17 7.6 11.4 7.2	528	1.9508	1.32178
4. Islamic finance increases employmen t opportunity	St. Agree Agree Natural Disagree St.Disagree	245 105 100 53 25	46.4 19.9 18.9 10 4.7	528	2.0682	1.21623
5. Islamic finance minimizes operation costs.	St. Agree Agree Natural Disagree St.Disagree	215 140 85 75 13	40.7 26.5 10.1 14.2 2.5	528	2.1117	1.16104
6. Islamic finance improves good and service quality.	St. Agree Agree Natural Disagree St.Disagree	180 120 100 78 50	34.1 22.7 18.9 14.8 9.5	528	2.4280	1.33928
7. Islamic finance offers a viable and competitive financial product.	St. Agree Agree Natural Disagree St.Disagree	230 105 95 65 33	43,6 19.9 18.0 12.3 6.3	528	2.1780	1.28135

Table 7.1. Mean and Standard Deviation for Each Questionnaire Item (continue)

8. Islamic finance applies Islamic financial forms (Murabaha, Musharkh, Modharbh, Istisnaa and Leasing) legitimately.	St. Agree Agree Natural Disagree St.Disagree	150 100 168 70 40	28.4 18.9 31.8 13.3 7.6	528	2.5265	1.24100
9. Islamic finance provides sufficient trade products.	St. Agree Agree Natural Disagree St.Disagree	185 130 87 83 43	35 24.6 16.5 15.7 8.1	528	2.3731	1.31946
10. Islamic finance plays a significant role in social welfare.	St. Agree Agree Natural Disagree St.Disagree	256 114 93 58 7	48.5 21.6 17.6 11.0 1.3	528	1.9508	1.10435
11. Islamic finance collects and distributes Zakat.	St. Agree Agree Natural Disagree St.Disagree	78 48 122 144 136	14.8 9.1 23.1 27.3 25.8	528	3.4015	1.35170
12. Islamic finance participates in eliminating society's inequalities and improves general standard of living.	St. Agree Agree Natural Disagree St.Disagree	252 119 97 37 25	47.7 22.5 18.4 7.0 4.4	528	1.9773	1.15557
13. Performance cannot be judged only on profit or return on investment.	St. Agree Agree Natural Disagree St.Disagree	63 37 152 89 187	11.9 7.0 28.8 16.9 35.4	528	3.5682	1.34654
14. Islamic finance applies new know-how in executing banking transactions.	St. Agree Agree Natural Disagree St.Disagree	192 158 114 39 25	36.4 29.9 21.6 7.4 4.7	528	2.1420	1.13287

Table 7.1. Mean and Standard Deviation for Each Questionnaire Item (continue)

15. Islamic banks do their service the same way as the conventional banks.	St. Agree Agree Natural Disagree St.Disagree	101 80 115 75 157	19.1 15.2 21.8 14.2 29.7	528	3.2027	1.48702
16. The time period between the submission of the application and receiving the answer less than conventional financial institutions.	St. Agree Agree Natural Disagree St.Disagree	247 119 103 38 21	46.8 22.5 19.5 7.2 4.0	528	1.9905	1.14504
17. Customers have unpaid installments cannot be paid.	St. Agree Agree Natural Disagree St.Disagree	73 42 369 11 33	13.8 8.0 69.9 2.1 6.3	528	2.7898	.92782
18. Customers face loan repayment difficulties.	St. Agree Agree Natural Disagree St.Disagree	77 44 362 13 32	14.6 8.3 68.6 2.5 6.1	528	2.7708	.93961
19. Customers choose and prefer Islamic finance because of simplicity of collateral requirements	St. Agree Agree Natural Disagree St.Disagree	239 121 99 46 23	45.3 22.9 18.8 8.7 4.4	528	2.0398	1.17546
20. In case customers are in need of financing in the future will choose Islamic finance again.	St. Agree Agree Natural Disagree St.Disagree	241 137 86 41 23	45.6 25.9 16.3 7.8 4.4	528	1.9924	1.15083

Statement number 1 was conducted to see either Islamic finance is helping to increase investor’s profits or not? 65% of respondents were agreed with the statement. Interestingly, 20.1% of the respondents said that they do not increase their profits when acquiring Islamic finance while 15% said neutral, which means probably they might don't have an idea yet. When the mean score for this statement was observed, most of the answers gone with strongly agree statement, which shows a positive perception about Islamic financial system in increased investor's profits. In the same lines with the previous finding, 68.1% of the respondents also indicate that it is alleviating poverty and unemployment. In contrast, 14.8% denied about it completely.

The mean score for statement two (mean=2.0455, n=528) shows that investors find that it is alleviating poverty and unemployment. Similarly, more than half of the respondents (82.8%) suggested that Islamic finance is encouraging sustainable development businesses. Although, 7.6% of respondents totally denied of having any idea about it. According to the responses of the investors, nearly 66.3% support that Islamic finance also increase employment opportunity while few were in against with this statement. These results are consistent with Osman (1994).

In the fifth statement, the respondents were asked if Islamic finance minimizes operation costs. Approximately 67.2% stated that they strongly agree and agree with this statement, and the main reasons behind this was that the Islamic financial system prohibit charging interests and according to the truth that interest, the creditors and the borrowers work as partners and contribute in both the risks and returns of an investment. Ten point one percent responded as neutral (mean=2.1117). We can conclude from this finding that investors believe that Islamic finance reduce business expenditure as long as it contributes in risk and does not take interests.

In respond to the statement number 6, 56.8% agreed that the Islamic finance improving goods and services quality. While 18.9% responded were neutral. From these findings, it can be seen that investors think Islamic finance improving goods and services quality. In fact, experts say that the Islamic financial system have the possibility to improve economic equality throughout the development of financial access. It has to be mentioned here that Allah SWT does not prohibit high standard of life in terms of high quality goods or services. (In the Qur'an; sure 7, verse 32)

Statement 7 was about a viable and competitive financial product. About one fourth of the investors (18.6%) disagreed Islamic finance offers a viable and competitive financial product and 18% stated that they do not have an idea. According to Islamic financial system which is more focuses on the genuine economy and places important emphasis on risk sharing. However, in conventional financial system there is no concept of risk sharing.

In relation to if Islamic finance is applying Islamic financial forms (Murabaha, Musharkh, Modharbh, Istisnaa and Leasing) legitimately as investors were asked in statement, 31.8% of respondents answered neutral for this statement (mean=2.5265). Despite, these findings show that most of the investors don't have any idea about if Islamic finance is applying Islamic financial forms (Murabaha, Musharkh, Modharbh, Istisnaa and Leasing) legitimately.

Statement 9 was used in this survey to investigate if investors get sufficient retail products. Respond of this statement with the previous findings shows that 54.6% enjoy get sufficient retail products. Thus it was clear that the investors get sufficient retail products when applying for Islamic finance. Islamic financial system designed not only to serve Muslim community, although this system started benchmarking its product to others in terms of consumer's convenience, gains and standard services. Just recently Lioyd TSB in the UK has started offering to its customer's shariaa compliant account and home finance products, which is a big proof of this statement.

Statement no 10 was aim to see if Islamic finance is playing a significant role in social welfare or not? Approximate 70.1% of the investors are agree with this, they admit that the Islamic finance is playing a major role in social welfare (mean=1.9508). On the other hand, few investors were not able to determine whether Islamic finance is playing a major role in social welfare or not. The Islamic financial system is a superior combination of community welfare, principles, integrity and investments in the real economy. As mentioned in Qur'an verses and sayings of Prophet Muhammad (PBUH), "Zakat is a very good example where Allah (SWT) has made Zakat obligatory on the Muslims". It is to be collected from the rich people and distributed among the needy ones.

In eleventh statement investors were asked that if Islamic finance is collecting and distributing Zakat or not? Response from this statement indicate that almost half of the investors nearly 53.1% think that they do not collect and distribute Zakat. Only 23.9% of the respondents agreed and strongly agreed with the statement. So, we can understand from the results that collecting and distributing Zakat perhaps is an uncertain issue. Collecting and distributing Zakat is an important element in Islamic society. As we can see from them findings in statement 14, 70.2% of the respondent are strongly agree and agree the Islamic finance participating in eliminating society's inequalities and improve general standard of living. On the other hand Zakat describes the standards of economic activity and, through its consequence on economic variables, determines the path by the side of which the economy should go.

When the mean score for statement 12 is observed, the favorable results found about respondents' believe on Islamic financial system improvement in general standard of living and eliminating society's inequalities.

Performance cannot only be judged on profit or return on investment, the answer of this issue retrieved through statement no 13 and as results 52.3% answer was not agree, while 28.8% responded were neutral. Now it's easy to understand that investors do not think that performance cannot only be judged on profit or return on investment.

Statement no 14 asked respondents if Islamic finance apply new know-how in executing banking transactions? Findings from this case reveals that 66.3% respondent were strongly agreed with the statement (mean=2.1420). Hence, it proved that investors have touched the new knowledge while executing banking transaction in Islamic banks.

In statement 15, it's been asked that if Islamic banks do provide their service the same way as the conventional banks? 43.9% of respondents were not agreeing with that. Interestingly 34.3% of the respondents said that they do agree that Islamic bank's services is as same as the conventional bank's services while 21.8% said they even don't have any idea. When the mean score for this statement is observed as it is close to the neutral statement, which suggests that there is a balance between investors who agree that Islamic bank’s services is as same as the conventional bank’s services and investors who deny.

Statement 16 was used in this survey to investigate if the time period between the submission of the application and receiving the answer less than conventional financial institutions? The outcome supports the previous findings and shows that 69.3% the time difference. Hence, it is clear from results that the most of the respondent feel satisfied with the procedures when they deal with Islamic financial institutions.

The concern in statement 17 was to find out about unpaid installments that investor are unable to pay. More than 2/3 means approximately 69.9% respondent said that they are neutral about the issue. In relation to unpaid installments, investors were asked in statement 18 if they face any loan repayment difficulties the majority of the respondents (69.9%) replied natural, even though these findings shows that most of the investors may face loan repayment difficulties but despite this they can get over it in a meantime.

In accordance with statement 19, investors choose and prefer Islamic finance because of simplicity of collateral requirements. Therefore, driven results shows that the most of the investors are in favor to deal with Islamic banks and Islamic financial institutions since the requirements are straightforward and easy to afford.

As far as, the twentieth statement was evaluated to investigate if investors will choose Islamic finance in case they are in need of financing in the future?

Nevertheless, around 71.5% gone with strongly agree term, which means that they feel more satisfied to deal with Islamic banks and Islamic financial institutions rather than anyone else.

Chapter 8

CONCLUSION AND RECOMMENDATIONS

The detailed review and analysis bring us to the point that the Islamic Banks and Islamic Financial Institutions have a significant role in financing and developing SMEs. There is no doubt that Islamic financial system is more efficient and supportive than conventional financial system in supporting SMEs.

Study analysis also revealed that the Islamic banking system developed with aims to achieve socio-economic objectives of Islam in its honest and comprehensive way. The development of Islamic banking system under Islamic religion's rules is itself a major fact that clearly distinguishes the conventional financial systems from Islamic financial system. Islamic religion rules are sign of honesty, reliability and credibility.

All financial sectors sustain on various other sources, thus the study of different sources on which Islamic finances relied upon also claimed that the most important funding in development and support of SMEs sector is from Jordan Islamic Bank (JIB). The orphans fund development foundation of Jordan (OFDF) and the Agricultural Credit Corporation of Jordan (ACC) are some other sources of Islamic finances.

The overall results of this research affirmed that the SMEs sector is deemed as a vital sector to achieve many development processes in various fields of the society. Due to its significant role, this sector can be represented as a foundation for the overall development process of the economy. Despite the SMEs sector's magnitude in the Arab world, interest does not amount to the desired level and its importance that has a prominent role in the development process.

Hence, it is concluded that the development of the SMEs sector depends significantly on the development of its sources. These sources are the backbone of financial institutions and they are more efficient and effective in supporting SMEs projects. Therefore, funding those sources can proportionately impact on SMEs development.

The better support and funding of SMEs sector can be achieve easily and effectively, if following recommendations would be taken into considerations:

- Islamic banks and Islamic financial institutions play a vital role in economic and social development but this can only be achieved by financing SMEs. Thus, this sector should be funded by Banks and financial institutions as much as possible.
- A separate department should be developed that support and look after SMEs issues. Although, productive industrial and agricultural projects should also be taken into consideration.
- Adoption in Islamic forms of financing and other investment forms which are related to the SMEs should be taken into consideration by Islamic banks and Islamic financial institutions.
- SMEs' owners facing challenges of insufficient funds and training, a supreme body consisting of ministries and national institutions for the promotion of SMEs must be formed for their support.

- A specialized body should be developed in regards to offer such seminars, courses and programs that help develop in providing more opportunities for education, training and rehabilitation for workers and owners of SMEs.
- A law should be made in favor of large-scale projects to encourage private sector-investment in those projects, and to minimize the tax that limit the growth of SMEs.

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APPENDICES

Appendix A: Questionnaire

I am pursuing master in Department of Banking and Finance at Eastern Mediterranean University, North Cyprus and I am performing an academic research on whether Islamic financial system is more efficient and supportive or conventional financial system in financing SMEs. I would appreciate you to denote your valuable five minutes for answering the questionnaire. Thank you in advance.

- Gender: Male Female City: ……………………………
- The funded project establishment year……………….
- The main activity of the project……………. taxi, workshops, others.
- Education level: ……………primary school, high school, other.
- The total size of the invested capital in the project:

  Less than 3000 JD 3000-6000

  6001-10,000 More than10,000

No:		Strongly Agree	Agree	Natural	Disagree	Strongly Disagree
1.	Islamic finance increases investors' profits.					
2.	Islamic finance alleviates poverty and unemployment.					
3.	Islamic finance encourages sustainable development businesses.					
4.	Islamic finance increases					

	employment opportunity					
5.	Islamic finance minimizes operation costs.					
6.	Islamic finance improves good and service quality.					
7.	Islamic finance offers a viable and competitive financial product.					
	Islamic finance applies Islamic financial forms (Murabaha, Musharkh, Modharbh, Istisnaa and Leasing) legitimately.					

No:		Strongly Agree	Agree	Natural	Disagree	Strongly Disagree
8.	Islamic finance provides sufficient trade products.					
9.	Islamic finance plays a significant role in social welfare.					
10	Islamic finance collects and distributes Zakat.					
11	Islamic finance participates in eliminating society's inequalities and improves general standard of living.					
12	Performance cannot be judged only on profit or return on investment.					
13	Islamic finance applies new know-how in executing banking transactions.					
14	Islamic banks do their service the same way as the conventional banks.					
15	The time period between the submission of the application and receiving the answer less than conventional financial institutions.					
16	Customers have unpaid installments cannot be paid.					
17	Customers face loan					

	repayment difficulties.					
18	Customers choose and prefer Islamic finance because of simplicity of collateral requirements					
19	In case customers are in need of financing in the future will choose Islamic finance again.					

Appendix B: Reliability Statistics and Communalities

Reliability Statistics

Cronbach's Alpha	N of Items
.723	19

Table 1: Communalities

	Initial	Extraction
Islamic finance is increasing profit to investors.	1.000	.502
Islamic finance is alleviating poverty and unemployment	1.000	.450
Islamic finance is encouraging sustainable development projects.	1.000	.510
Islamic finance afford employment opportunity	1.000	.343
Islamic finance minimizing operation cost.	1.000	.512
Islamic finance is improve good and service quality	1.000	.889
Offering viable and	1.000	.625

competitive financial product		

Extraction Method: Principal Component Analysis.

Table 1: Communalities (continue)

	Initial	Extraction
Do you think Islamic finance applying Islamic financial forms (Murabaha, Musharkh, Modharbh, Istisnaa and Leasing) legitimately?	1.000	.897
Is Islamic finance providing sufficient retail products?	1.000	.619
Is Islamic finance playing a significant role in social welfare?	1.000	.968
Is Islamic finance collecting and distributing Zakat?	1.000	.889
Is Islamic finance participate in eliminating society's inequalities and develop general standard of living?	1.000	.965
Performance cannot be judged only during good proportion of profit or return.	1.000	.610
Does Islamic finance apply new	1.000	.889

know-how in executing banking transaction?		
Dose Islamic totally serve as same as conventional financial system?	1.000	.679

Extraction Method: Principal Component Analysis.

Table 1: Communalities (continue)

	Initial	Extraction
Do you have unpaid installments that you could not repay	1.000	.588
Do you face any loan repayment difficulties?	1.000	.558
I choose and prefer Islamic finance because of Simplicity of collateral requirements	1.000	.620

Extraction Method: Principal Component Analysis.