



Influence of Awareness on SME's Intention towards adoption of Islamic Finance in Pakistan

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ABSTRACT

A large number of SMEs in North Africa, Middle East and South Asia prefer Islamic financial products over their conventional counterparts. Similarly, in Pakistan SME owner-managers prefer Islamic finance as 20-25 percent of SMEs are not willing to take conventional finance. Despite higher demand, however, these firms are unable to access Islamic finance from financial institutions. There are several factors behind this dilemma on both supply and demand side. The present study discusses demand side issues pertaining to lack of adoption of Islamic finance by SMEs in Pakistan. Among various demand side factors, this paper has focused on the issue of lack of financial knowledge or awareness of Islamic financial products. In Pakistan, due to financial illiteracy of SME owner-managers, they seldom are able to identify suitable available financing options for their business financial needs. Thus, this study intended to determine the importance of awareness factor in influencing intention of SMEs to adopt Islamic finance. A conceptual framework has been constructed based on Theory of Planned Behaviour (TPB) and research propositions are developed in order to elaborate role of awareness in influencing SME managers' intention towards Islamic finance adoption. A preliminary analysis has been conducted through pilot study to check the internal consistency and reliability of instrument and found valid for further research. These both outcomes of the study are expected to lay foundation for more structured research on the issue of demand side factors of adoption of Islamic financial products.

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1. Introduction

Small and medium enterprises (SMEs) are widely known as engines of economic growth. These small and medium sized businesses are key contributors towards sustainable gross domestic product (GDP) across the world. SMEs operate predominantly in services and manufacturing sectors and create employment for both skilled and unskilled workers (Freeman & Nick, 2015). Moreover, without any doubt there is substantial demand of Islamic products and services not only among Muslims but also in

non-Muslims. Islamic banks are considered as good platform to increase access to financial inclusion as well as easy access to finance for SMEs to support economic development and growth (Abdesamed&Wahab, 2015).

The assets of Islamic banking growing at 20 percent of rate annually and as per statistics are set to reach \$2.3 trillion by 2017. However, in spite of high growth rate this represents only 3 to 4 percent of total global banking assets and there are several reasons behind this shortfall such as; conservative behavior of Islamic banks, similar products and services offering conventional banks, lack of standardization and Sharia-compliance different interpretations. Conventional banks are now approaching SMEs as this sector is a huge opportunity for them to increase their profitability. Therefore, to diversify revenue streams and asset portfolio it's necessary for Islamic banks to focus on this particular sector (albaraka.com).

A large number of SMEs including North Africa, Middle East and South Asia preferred Islamic banks instead of conventional banks, however these firms are unable to access financing services from Islamic banks. International Finance Corporation (IFC) studied MENA region including Pakistan and highlighted huge demand of Islamic finance by SMEs, approximately 1.5 million businesses (32 percent of SMEs) remain excluded from formal banking sector due to lack of Sharia-compliant products and services. Additionally, only 17 percent of Islamic banks are offering their products and services to SMEs and other banks share is 36 percent. In Pakistan, about 20 to 25 percent of SMEs are not taking any formal finance facility because they are seeking for Islamic finance only (IFC, 2014a). These small and medium firms have a deeper craving for Islamic products and services than corporate firms, because these firms operate by a single owner-manager who behave similar to an individual consumer. In financial market, conventional banks offering their services to fulfill SMEs business financial needs in limited capacity, thereby creating opportunity for Islamic banks. However, Islamic banks lack adequate focus on this portion to facilitate by providing SMEs their desired Sharia compliant products and services. It indicates the reluctant behavior of Islamic banks, it's either because of unclear business strategy or high risk perception. Despite of enormous demand of Islamic finance among SMEs both supply and demand side issues creating hurdles towards development (Alam, 2015). Among others SMEs lack of awareness and less knowledge about Sharia-compliant products and services is also an impediment towards growth of SMEs and banks are also not supportive in this matter. For example, Islamic banks and conventional banks with Islamic windows provided products information in Urdu/English but explained in purely Shariah language which is not understandable for owner-manager of SMEs, the mid-tier officials of banks also admit this (IFC, 2014b; Aazim, 2016). In this regard, prior research have only investigated the awareness level and attitudes of individual consumer. There have been not enough studies done in examining SMEs awareness level towards Islamic financing, so, there is need to measure this factor. Although, several Islamic products and services offering by financial institution but due to lack of financial knowledge or awareness SMEs are not able to choose the suitable products and services as per their business financial needs, thus the study aims to analyze the aforementioned gap.

2. Literature Review

SMEs in Pakistan

At present, different definitions of small and medium enterprises are abound. In each country, institutions use different criteria to define SMEs such as; number of employees, net assets or sales. In Pakistan, most authentic and reliable source of information and data is central bank of Pakistan known as State Bank of Pakistan (SBP). Following table highlighted some definitions of SMEs announced by the core institutes of Pakistan.

Table 1: Definition of SMEs in Pakistan

Institution	Category	Employees	Capital/Annual Sales
Small and Medium Enterprises Development Authority (SMEDA)	Small	Up to 36	Up to 20 million
	Medium	Up to 99	Up to 40 million

Federal Bureau of Statistics, Pakistan	Small	Less than 10	N/A
	Medium	N/A	N/A
State Bank of Pakistan	Small	20 to 50	Rs 75 million to Rs 150 million
	Medium	51-250 (Manufacturing & Service MEs) 51-100 (Trading MEs)	Above Rs 150 million and up to Rs 800 million

Source: Chughtai, 2014; SBP, 2016; SMEDA, 2013

Geographically, a large population of SMEs are placed in the province of Punjab followed by Sindh, Khyber Pakhtunkhwa (KPK) and Baluchistan. In Punjab, approximately 65 percent of SMEs are operating actively. Punjab and Sindh both provinces are facilitating SMEs in term of government services and schemes, presence of large industrial cluster as well as easy access to finance. Overall, the most preferable SMEs ownership pattern is sole proprietorship. The reason behind the liking is minimum regulatory requirements in establishment of such enterprises. A large population of sole proprietors are based in three major cities of Pakistan; Lahore, Karachi, and Faisalabad, who are contributing about 50 percent of total SME financing of country (IFC, 2014a).

Sector wise most of the enterprises are manufacturing based followed by trade/commerce and services. In terms of employment generation, value addition and export contribution manufacturing based SMEs have higher impact on economy. Same report explored that this particular sector dominate the enterprises with 49 percent of total population. In manufacturing sector the most valued sub-sectors are metal products, cotton weaving, jewelry making and wood furniture (Khan & Khalique, 2014).

Islamic Financing for SMEs in Pakistan

In Pakistan, Islamic banking institutes' network consists of 6 full-fledged Islamic banks and 16 Islamic banking windows operating by conventional banks. As per Islamic banking bulletin of SBP, (2016) approximately 2,146 Islamic banks branches are working actively in 98 districts, similarly, 1,062 Islamic banking window branches under conventional banks functioning. Despite of large branch network SMEs still excluded or getting very small portion of financing from Islamic banks, as the share of corporate sector stands on 78.1 percent as compare to SMEs which is only 2.8 percent. Moreover, statistics shows that conventional banks are more supportive towards financing to SMEs instead of Islamic banks, overall SMEs getting only 7 percent of financing from Islamic banks (including windows) and remaining 93 percent facilitating by the conventional banks (SME finance review, 2016). This indicates reluctant behavior of Islamic banks towards SMEs and their limited outreach to SME sector. Islamic banks are not approaching SME sector appropriately because of these firms poorly structured operations, informal nature and non-professional behavior towards taking finance from financial institutions (SBP, 2015).

SMEs Attitude towards Islamic Financing in Pakistan

The attitude of SME owner-managers in Pakistan normally considered as negative because of less knowledge regarding financial products and services, size of firm and nature of business. However, with the passage of time upsurge in literacy level changed the attitude of SMEs and being reported positive, it effected mostly experienced family businesses and medium size firms (Bhutta et al., 2008; Saleem, 2014; Siddique, Saleem & Abbas, 2016). Moreover, towards Islamic financing SMEs shows positive attitude and overwhelming demand of Islamic finance, as mentioned above nearly 20 to 25 percent of SME population interested in Islamic financing. SME owner-managers are now more sensitized towards their benefits, the improvements in overall performance of Islamic banks with the help of SBP's initiatives over the past 10 years has further consolidated this opinion (IFC, 2014a). Despite this positivity of SMEs towards Islamic finance several factors deter these firms to approach formal financial institutions for their business financial needs.

Researchers revealed that personal characteristics (gender, age, education, experience) and firm characteristics (firm size, ownership, firm type) effect the decision making of SMEs towards selection and adoption financial products and services (Low, 2006; Xiang et al, 2011; Zabri et al, 2015). To understand influence of attitudinal factors of SME owner-managers or entrepreneurs towards adoption of Islamic finance scholars conducted several studies. Strong business support have impact on business firms' attitude towards adoption of Islamic finance (Jalaluddin, 1999). Gait and Worthington, (2009) found religion as the primary motivation towards potential use of Islamic finance among business firms. Moreover, Haque, (2010) stated Shariah-compliance or factor of religion as important factor which drives Muslim owner-managers towards Islamic finance. Further, among other factors banks reputation, image, profitability and cost benefits, considered by SMEs owner-managers before selection of formal financial products and services. Social pressure effect the SMEs attitude, explored by researchers that family and friends recommendation influence the decision making of owner-managers to take Islamic financing (Amin, Abdul Rahman&Abdul Razak, 2014). Jaffar and Musa, (2013) highlighted the salient belief factors of owner-managers attitude; religion obligation, knowledge and awareness, cost benefits, business support and reputation towards adoption of Islamic financing. Andoh and Nunoo (2012) explored that financial literacy influence SMEs behavior as financially literate entrepreneurs' shows positive attitude towards formal financial products and services.

H1 SMEs attitude have influence on their intention to adopt Islamic finance

Awareness

Awareness is the knowledge and understanding of an individual about something, e.g. place, person, product and services etc. It stimulate an individual to take some decision which based on his/her positive or negative attitude towards subject matter. The chances of positive attitude of a person increase or decrease with level of awareness (Ahmad & Bashir, 2014). According to Sarbo, (2016), the first step of an individual in product adoption process is awareness followed by knowledge, persuasion, decision and confirmation.

In Pakistan, lack of awareness among SMEs is a major concern for Islamic banking Industry. Major population of SMEs do not understand Islamic methods and Shariah compliance mechanism. Thus, SMEs are unaware about Islamic products and services they actually want to use for their business financial needs. According to KAP SBP, (2013) only 3 percent consumers have awareness regarding Islamic products and 5 percent of users have understanding of Islamic banking model (KAP SBP, 2013). However, report further exposed that corporate customers have a little more knowledge of Islamic methods, products and services then individual customers.

Researchers highlighted awareness as one of the key factors which influence individual's attitude towards adoption of Islamic banking products and services in different contexts (Daud et al., 2011; Keong et al., 2012; Thambiah et al., 2011, 2012). Some studies also presented the positive relationship of attitude and awareness (Wahyuni, 2012; Echchabi& Abdel Aziz, 2012 b, Faisal et al., 2014).

In Pakistan, awareness level of consumer much better for the general products such as deposit accounts and current account, however, the awareness level is very low for specialized products such as Murabahah, Musarakah, Ijarah etc. (Khan&Asghar, 2012). In context of SMEs, Jaffar and Musa, (2016)and Tolba et al. (2014) explored the awareness and knowledge as influential factors towards adoption of financial products. However, mostly studies examined the awareness level of individuals in context of Islamic banking. Yet, insufficient research work created by academicians to measure SMEs awareness level in context of Islamic banking.

H2 SMEs awareness have influence on their intention to adopt Islamic finance

Subjective Norms

According to Ajzen, (1991), this variable refer to the SMEs owner-manager perceived social pressures which influence their behavioral intention towards adoption of Islamic products and services,however, the social pressure vary in different contexts. Prior research explored the direct impact of subjective norms on behavioral intention to use Islamic products (Amin etal., 2011; Tolba et al. 2014).

H3 SMEs subjective norm have influence on their intention to adopt Islamic finance

Perceived Behavioral Control

Perceived behavioral control refers to SMEs owner-manager perception of ease or difficulty to perform the behavior of interest (Ajzen, 2006). Espel et al. (2009) stated that along with attitude variable, perceived behavioral control needs to be decomposed in three factors; first related to SMEs understanding of Islamic financing as better understanding increase the chances of Islamic financing usage/adoption, second related to SMEs perception that how easy is to access Islamic financing, third one is SMEs beliefs regarding access of available options in market.

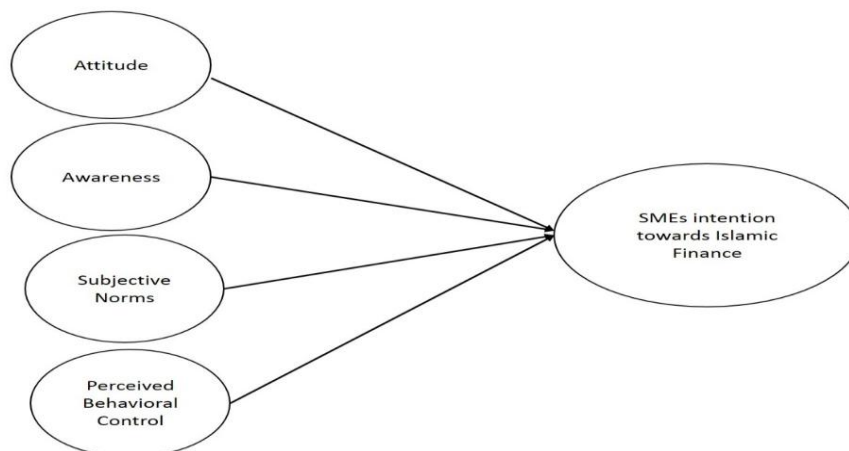
H4 SMEs perceived behavioral control have influence on their intention to adopt Islamic finance

Awareness of Individual customers' extensively examined by scholars in context of Islamic finance. However, few studies focused on SMEs behavior towards Islamic finance and examined the awareness factor in context of Pakistan. Moreover, so far researchers applied behavioral intention theories just to examine the individual behaviors, though,some scholars have measured SMEs behavioral intention with application of Theory of Planned Behavior (TPB) but few provided the empirical evidences. TPB proposes three key determinants which influence the intention; attitude, subjective norms and perceived behavioral control. In this study, it is hypothesized that awareness influence the intention of SMEs towards adoption of Islamic financing.

3. Proposed Research Model

Current study proposed research model (Figure 1) is developed on the basis of theory of planned behavior (Ajzen, 1991) Figure 1. The model explains that SMEs behavioral intention towards adoption of Islamic finance is resulted from the attitude, awareness, subjective norms and perceived behavioral control. The proposed model integrates the factor of awareness with key variables of TPB model to assess SMEs behavioral intention within the context of Islamic finance.

Figure 1: Proposed Research Model



Research Design

Current study uses quantitative method (i.e. survey questionnaire) for better understanding of SMEs behavioral intention towards Islamic finance in Pakistan. According to Bhattacharjee (2012) as compare to other research methods survey research has inherent strengths. Moreover, it is suitable to identify trends or discover explanation for relationships among variables (Creswell, 2002). A 5 point Likert scale used and designed to examine that how strongly respondents agree or disagree with a statement (Sekaran, 2009).

Reliability and Validity Analysis

To collect data on attitude, awareness, subjective norms and perceived behavioral control self-administered structured questionnaire was used. The questionnaire was adapting from previous studies and finalized after required modifications, table 1.1 representing the summary of sources. The adapted scales are not used in context of Pakistan, thus, there is need to test these scales in SME sector which will help to create its ecological reliability and validity. Moreover, awareness have not been previously tested in SME sector, therefore, it requires validation in sector of SME setting too.

Table 1

Construct	No of Items	Sources
Intention	5 Items	Jaffar& Musa, (2013); Tolba et al. (2014); and Hockerts, (2015)
Attitude	5 Items	Adam et al. (2016); Tolba et al. (2014); Jaffar& Musa, (2013); Siddique et al. (2016)
Awareness	5 Items	Ringim&Yussof, (2014); Jaffar& Musa, (2013); and Tolba et al. (2014)
Subjective Norms	5 Items	Koropp et al. (2014); Koropp et al. (2013); and Tolba et al. (2014)
Perceived Behavioral Control	5 Items	Ahad et al. (2012); Tolba et al. (2014); and Jaffar& Musa, (2013)

Pilot Study

In line with Gay, Mills, & Airasian, (2006) pilot study basically suggests going for a small scale study for the trial purpose before conducting the full study. Therefore, the sample size for pilot testing suggested should be smaller which could range from 15-30 respondents. However bigger sample size leads towards the stronger results. The survey questionnaires were distributed at major cities of Pakistan, Lahore and Karachi, a large population of SMEs are located in both cities. Questionnaire distributed by using stratified random sampling technique on 100 respondents, however, rate of return was 70% and 60 questionnaires researcher found useable. The reliability of measurement instruments were observed through internal consistency of Cronbach's alpha values. Results of the pilot study are presented in Table 1.2.

Table 2

Construct	No of Original Items	Cronbach's Alpha	Item deleted	Cronbach's Alpha if item deleted
Intention	5	0.816	Nil	0.816
Attitude	5	0.896	Nil	0.896
Awareness	5	0.798	Nil	0.798
Subjective Norms	5	0.910	Nil	0.910
Perceived Behavioral Control	5	0.783	Nil	0.783

The Cronbach's alpha for all constructs used in current study are more than 0.7 as suggested by Nunnally and Beinstein (1994) as a minimum acceptable limit. As per Hair et al. (2010) who referred a Cronbach's alpha value of more than 0.6 as a construct with acceptable reliability. Thus, results shows that the items of questionnaire are reliable and effective, so, based on alpha score proposed survey instrument fulfilled the basic requirement of valid instrument.

4. Conclusion

The purpose of the study to check the reliability and internal consistency of the instrument used in current study is achieved after checking Cronbach alpha score which are above the threshold of 0.60 (Hair et al, 2010). Thus, the instrument is valid for collection of main data as well as for further use within the SME sector in context of Pakistan.

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