



POTENTIAL OF ISLAMIC FINANCE AS ALTERNATIVE FINANCING OPTION FOR SMEs

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ABSTRACT

This study aims at investigating the potential of *Islāmic* finance as an alternative to the financing problem faced by companies operating as Small and Medium Enterprises (SMEs). *Islāmic* finance is a sector that continues to develop. In addition, finance and markets are important in terms of their impact on the real sector. Addressing the impact of *Islāmic* finance on these two situations not only reveals the basic motivation and necessity of the study but also emphasizes the originality and importance of filling the gap in the literature. Questionnaire forms were applied to 400 randomly selected SMEs operating in the provinces of İstanbul, Kocaeli, Sakarya, Bursa, Yalova, and Çanakkale by face-to-face survey technique. Explanatory and confirmatory factor analyses were applied to the scale within the scope of construct validity. Exploratory factor analysis determined that the scale has a 6-factor structure that explains approximately 76% of the scale. Therefore, it has been determined that the potential of *Islāmic* finance as an alternative to SMEs has six dimensions. These dimensions are determined as Alternatives in terms of Personal Value Judgments, Sectoral Suitability, Financing Policies and Opportunities, Accessibility, Cost, and Access to Finance.

JEL classifications: E02, E22, G21, G32

Keywords: *Islāmic* finance, Participation banking and SME, Alternative finance, SME financing, Scale development

Submitted: 08/11/2022 Accepted: 24/08/20223 Published: 28/12/2024

1. INTRODUCTION

Islāmic finance as a viable financing alternative for Small Medium Enterprises (SMEs) has rarely been investigated. This article looks at *Islāmic* finance as an alternative financial source for SMEs in Turkey. For consumption, production, and investment activities, the equivalent or price of resources received from traditional financial markets is interest. Since *Islām* advocates an interest-free business environment, *Islāmic* finance should be the alternative for financing SMEs especially. Interest is seen as a balancing phenomenon between fund supply and demand, and it has been discussed in all monotheistic religions and many ideologies. *Islām* brings various rules and regulations regarding worldly life of the individual and society, and it is against interest or usury. Hence *Muslims* support prohibition of interest in *Islāmic* commercial and financial activities. This situation, however, left *Muslims* out of the dominant conventional financial system. *Muslims* keep their savings idle, and those who want to invest cannot access the funds needed. Thus, *Muslims'* individual or institutional savings become inert cannot be transferred to real investments, cannot be included in economic processes, and these disrupt production-investment activities. Such problems have led to development of a system that prioritizes the financial concerns of *Muslims* or the institutions they have established.

The *Islāmic* finance sector carries out all kinds of financial transactions in accordance with *Islāmic* law. Today, *Islāmic* financial institutions provide global banking, insurance, and capital market services. The *Islāmic* finance sector offers financial services on an interest-free basis and it is an alternative financial sector for *Muslims* or their institutions. Besides being based on interest-free principle, the Muslim financial system is an alternative for *Muslims*, in terms of being an extra financial sector outside the conventional financial system.

Islāmic finance, as a dynamic finance subsystem, attracts serious global attention. Accordingly, demand exists for the IFSS (*Islāmic* Financial Services Sector) and its activities. This is evident in the growth of IFSS assets. Between 2009 and 2020, the global *Islāmic* financial services industry grew by an average of 11.38% per year (Cambridge Institute of *Islāmic* Finance, 2021). The IFSS expanded by 28.64% in 2008. This is a noteworthy development, especially considering the 2008 financial crisis. *Islāmic* banking is the locomotive of *Islāmic* finance with its 70.0% share (ICD –

Refinitiv *Islāmic* Finance Development Report, 2022). After *Islāmic* banking, *sukūk*, the sub-segment of the *Islāmic* capital market, took the second largest share of the Global IFIs pie. *Islāmic* Funds are in third place with a share of 3.3%. In this case, the *Islāmic* capital market has a significant place in the Global IFSS, although it is relatively smaller than the banking sector. Finally, *takaful* took fourth place in the Global IFSS with a 1.3% share.

Asset size of the Participation Banking sector in Turkey has been rising since 1999. The sector's Asset Size was 1.642 million TL in 1990, and it increased to 425.935 Million TL in 2020 (Türkiye Katılım Bankaları Birliği, 2022). The monetary distribution of the funds by the Participation Banks shows that as of 2020, some 253.001 million TL was disbursed in Turkish currency (Arıcan et al., 2021). In the same year, Foreign Exchange and Foreign Currency Indexed Loans (DEK) amounted to 65,535 million TL. Although funds made available by Participation Banks in Turkish Lira increased by 17.9% compared to the previous year, there was a much higher increase of 55.2% in available foreign currency funds (Katılım Finans Dergisi, 2018). While the share of Participation Banks in the total sector in Turkey was 1.9% in 2002, this increased to 7.3% in 2020 (Arıcan et al., 2021). Finally, while the share of loans extended by Participation Banks to SMEs in the banking sector was 6.8% in 2018, this ratio increased to 8.6% in 2020.

Turkey is in an ambitious position in *Islāmic* finance, although it is experiencing critical turning points in this field. Participation Banks are representative of the *Islāmic* financing method in Turkey because they are the strongest institutions in this field, where the mixed-finance sector is dominant. When *Islāmic* finance is considered in the context of the general financial sector and the real economy, in some cases it is considered as complementing the sector, and in other cases, it is considered as an alternative. The alternative position is often addressed in comparison to the conventional financial sector. The interest on which the conventional financial system bases its relations causes real and legal persons who are sensitive to interest to avoid the financial sector and therefore the general economy. *Islāmic* finance, which adopts interest-free as the basic principle, is also considered an alternative to the conventional banking system for these people.

The alternative position of *Islāmic* finance is not only highlighted by interest sensitivity but also has important claims in terms of the issues it considers in its financing activities and financing policies. The policy of supplying goods or services instead

of providing cash loans in financing activities excludes money trade and has a stimulating effect on the trade of real goods or services. Therefore, *Islāmic* finance supports the real sector. The project-oriented focus on financing policies also increases the real sector power and capacity; direct financing of a new venture or efforts to develop an existing venture brings rational investment results. *Islāmic* financial institutions have partnership in a project they finance in this way. *Islāmic* financial institutions commercially established for profit will thus show due diligence from the first stage to the last stage of the relevant project to create a positive image through both profit maximization and partnership success. This will have a catalytic effect in ensuring success of an enterprise developed by real sector elements. In this respect, Participation Banks use the funds collected and the resources owned within the framework of financing activities; while acting in accordance with commercial logic, they can also contribute positively to the real sector and the economy.

Positive contributions of *Islāmic* finance to the real sector are not fundamentally empirical or deterministic. In other words, the positive contributions to the real sector are not definite judgments but express possible contributions. Therefore, this situation is evaluated as the potential of *Islāmic* finance as an alternative to the conventional financing system in financing the real sector. The necessity of measuring the potential of *Islāmic* finance as an alternative in real sector finance has arisen. In various studies and literature reviews, no data suitable for measurements to be made are available in this regard. For this reason, the measurement should be made directly on the real elements. The real sector has a very broad meaning and also represents a higher dimension within the scope of the study. In the context of the research, SMEs, which can represent the real sector, were directly addressed as the research subject; besides using less capital, SMEs can be expressed as economic enterprises that work more with manual labor, can make quick decisions, operate with low administrative expenses, and perform cheap production (Kendirli and Kendirli, 2015).

Since SMEs are one of the dynamic driving elements of the Turkish economy as well as the rest of the world, they are keys to socioeconomic development (Kutlu and Demirci, 2007). Undoubtedly, the most important determinant of these institutions, where small touches have great effects, is financing opportunity. Today, due to their importance, although the state supports financing through its institutions, there are widespread support opportunities

based on mutual credit by the conventional (traditional) banking system. The fact of interest, which is the main problem of this system, deprives most *Muslims* of these opportunities because of both the interest burden with the principal and the sensitivity of interest. The SMEs are important for national economies, and their selection as the subject of the research was influenced by the financial difficulties they experienced. In this context, the study aimed at evaluating the potential of *Islāmic* finance as an alternative to conventional banking in financing the real sector and solving financing difficulties experienced by SMEs. Clarifying the meaning of *Islāmic* finance, which is offered as an alternative financing option, in terms of being a potential financier for SMEs, strongly increases the need for such research.

This study is structured as follows: After the introduction we present the Literature Review, followed by detailed information on the research methodology and discussion of research findings. In the Conclusion and Evaluation part, we give a general evaluation and discuss the implications of the research.

2. LITERATURE REVIEW

Aligned with the research objectives, scope, and subject matter, a comprehensive review of relevant domestic and international literature was conducted. Literature review found no similar published study related to the purpose, subject and scope of the research. Studies considered to be of close significance, however, were examined and evaluated in detail.

Many studies in the literature on financing, both in Turkey and abroad, are related to the importance of SMEs and financing policies. The shortcoming or weakness seen in all of the studies, in general, however, is the lack of research on approaches to *Islāmic* finance in terms of alternative financing and its contribution to the real economy. Mumani (2014) explores the role played by *Islāmic* banking and *Islāmic* financial institutions in SME financing using data obtained by questionnaire survey of SMEs in Jordan. The study shows that *Islāmic* banking is sufficient for SMEs. In addition, *Islāmic* banking plays an important role in increasing investor profit, reducing inequalities in society, besides increasing the standard of living and social welfare. The study also shows that the loan application evaluation period of *Islāmic* banks are comparable with that of traditional banks. Bank customers choose *Islāmic* banks and financial institutions because these have simple working methods

and work in accordance with *Islāmic* rules. Khaliq et al. (2020) in their study, provide an *Islāmic* entrepreneurship framework for Pakistani SMEs to address their problems from a knowledge-based economic perspective.

Wan Ahmad et al. (2008) found a dominant relationship between religion and bank choice in Malaysia. *Muslims* prefer *Islāmic* banks because these institutions perform activities according to *Islāmic* religious principles. This research shows that people with religious sensitivities choose *Islāmic* banks for their deposit transactions. Bley and Kuehn (2004) found that the preference for *Islāmic* banks is motivated by religious values rather than financial information. Ahmad and Haroon (2002) established that religion is the most influential factor in the preference for *Islāmic* banking, and also concluded that marketing channel management supports the favorability of *Islāmic* banking. Apart from these, other studies conclude that *Islāmic* teachings and principles are prioritized in the preference of *Islāmic* banking (Imtiaz et al., 2013; Okumus and Genc, 2013; Abduh and Omar, 2012; Al-Ajmi, Hussain, and Al-Saleh, 2009; Gait, 2009; Ismah et al., 2009; Gait and Worthington, 2008; Othman and Owen, 2001).

The preference for *Islāmic* finance, however, is not only attributed to religious factors based on customers. Al-Ajmi et al. (2009) concluded that the customer does not choose *Islāmic* banking based only on *Islāmic* values, but also on economic factors such as service and transaction costs, the effect of family and friends, and convenience factors such as parking facilities, which affect their decisions. Similarly, Marimuthu et al. (2010) found that many factors such as ATM and branch network, service quality, and influence of family and friends are effective in the selection of *Islāmic* banking, along with religious values and beliefs. In addition, many studies show that better quality service delivery and customer satisfaction are important factors in choosing an *Islāmic* bank (Dusuki and Abdullah, 2006; Hanson and Kalyanam, 2000; Levesque and McDougall, 1996; Leeds, 1992). Fast and easy banking transactions (Omer, 1992), friend/relative advice (Hegazy, 1995), the approach and interest of the institution personnel in the customer (Ramadan, 2013), the rate of return and low transaction cost (Subhani et al., 2012) were also important. In the study conducted by Kamarudin and Kassim (2022), the relationship between *Islāmic* bank deposits and economic growth was examined. The findings show that in the short run, the link between *Islāmic* bank deposits and economic growth is positively insignificant.

Other studies have indirectly compared *Islāmic* finance with conventional finance. These include Amin and Isa (2008) who investigated the level of awareness among Muslim and non-Muslim customers in Malaysia toward *Islāmic* products and services. They inferred that the awareness level of both groups toward *Islāmic* products and services is quite high and that the majority of *Islāmic* banking customers are satisfied with the service quality in all aspects. Hamid and Nordin (2001) in Malaysia affirmed that many customers know about *Islāmic* banking, but some still do not, and they find that these customers cannot distinguish between *Islāmic* banking and traditional banking. Ahmad et al. (2010) found that the perception levels of male and female customers of *Islāmic* banks differ, but they have the same perception of service quality as the traditional bank customers.

Studies so far have focused on why customers prefer *Islāmic* finance or its components. This study differs from existing studies in that it explores the potential of *Islāmic* finance as an alternative based on SMEs. The absence of such a study in the literature reveals both the necessity of the study and its originality value.

3. RESEARCH DATA AND ANALYSIS METHOD

3.1 RESEARCH DATA

The study is aimed at analyzing the subject based on primary data. For this reason, the face-to-face survey method was chosen. After the research method was determined as a face-to-face survey method, a unique survey form was designed to obtain original appropriate data suitable for the research subject and purpose. At the questionnaire design stage, questions about obtaining statistics that would define the participant group of the questionnaire were included. Later, since the research aimed at measuring potential, it was necessary to include a scale to obtain these data in the questionnaire form. Based on this, a scale for use in the questionnaire form was developed by the authors. A Likert scale was used because it measures the potential of *Islāmic* finance as an alternative for SMEs. Likert scales are based on the fact that the participants give information about their views. The scale development process was carried out according to steps in developing a Likert-type scale as explained by Anderson (1988).

In the first stage of scale development, the literature was searched, and statements that could measure the potential of *Islāmic*

finance as an alternative for SMEs were created. In creating these statements, *Islāmic* financing principles, activities, and policies were considered. The statements were itemized by the characteristics of SMEs. Before creating the items, a pool of 30 items was created following the 5-point Likert scale to measure the responses. Because a unique scale was developed, this item pool, the subject, scope, purpose, and objectives of the study were explained in detail, and a candidate scale consisting of 21 items was created as a result of expert opinion and pilot research. The developed candidate scale was piloted to test the comprehensibility and applicability of the items in the scale on the participant group to detect possible errors in the research phase and to avoid unexpected situations during the actual research. In this way, the 21-item Potential *Islāmic* Finance as an Alternative for SMEs Scale (PIFAS) was developed. The questionnaire forms prepared for obtaining data were applied in the field study to the randomly selected businesses that agreed to participate in the survey.

It was aimed that the study represented Turkey. Since it was impossible to carry out the study throughout Turkey given the time and financial constraints, six cities in the Marmara Region, where there is a density of SMEs that can represent Turkey, were selected. These cities are: Istanbul, Sakarya, Kocaeli, Bursa, Yalova, and Çanakkale. The universe of the study consists of SMEs in these cities.

The universe of the study consists of a total of 681,716 businesses from six locations. Since it was impossible to reach this number within the scope of the study, sample selection was made. The Minimum Sampling Method was used to determine the number of samples as in Equation 1.

$$(1) n = \frac{N \times P \times Q \times Z^2}{[(N - 1) \times d^2 + P \times Q \times Z^2]}$$

P = Probability of Observation of Main Audience X = 0.5

Q = Probability of Not Observing = 0.5

d = Effect Size = 0.05

t = Critical Value of the Distribution

N = Universe Magnitude

z = Distribution Value = 1.96

According to Equation 1, the sample number of the study was determined as approximately 385. Since, sampling errors, were expected in the study, it was aimed at reaching 400 samples, taking into account the issues. Because the universe of the study also represents different regions, the number of samples was distributed to these regions as a percentage, and the number of samples was determined according to the number of SMEs available in each region. The number of samples distributed as a percentage is shown in Table 1. Accordingly, the data of the study was obtained mainly from Istanbul.

TABLE 1
Number of Regionally Distributed Samples

Provinces	Universe	Sample
Çanakkale	14.375	8
İstanbul	515.977	302
Kocaeli	44.937	26
Sakarya	22.453	13
Yalova	6.949	6
Bursa	77.025	45
Total	681.716	400

Source: The authors of the study.

3.2 DATA ANALYSIS METHOD

Reliability and validity analyses were applied to the obtained data in accordance with the research subject and purpose. The reliability analysis was aimed at testing the internal consistency of the scale items and Cronbach's Alpha coefficient was calculated. Exploratory factor analysis (EFA) was done to reveal the dimensions of the alternative potential investigated during the validity analysis phase of the scale; Confirmatory factor analysis (CFA) was used to determine the model validation status of the scale and to evaluate its construct validity.

4. RESEARCH FINDINGS

4.1 DESCRIPTIVE STATISTICS

As seen in Table 2, 301 participants were male (75.3%) and 99 participants were female. The participants are mostly aged between 46-55. Another cluster falls between the ages of 36-45. These two

age groups represent approximately 73% of the total participants. Some 57 participants are below 35 and 51 are over 55.

TABLE 2
Distribution of Participants by Some Demographic Characteristics

Socio-Demographical Feature		Quantity	Percentage (%)
Gender	Male	301	75.2
	Female	99	24.8
Age Groups	35 and Below	57	14.25
	36-45	117	29.25
	46-55	175	43.75
	55 and Above	51	12.75
Educational Status	Primary Education	8	2.0
	High School	115	28.7
	Associate Degree	14	3.5
	Faculty	246	61.5
	Graduate	17	4.3

From Table 2, approximately 61.5% of the participants within the scope of the research received education at the undergraduate level. Some 155 participants received high school level education. Those with high school education represent approximately 29% of the total sample.

Statistical findings regarding the cities in which the businesses operate are given in Table 3. Accordingly, within the scope of the research, approximately 75.5% of the enterprises operate in Istanbul.

TABLE 3
Statistical Findings Regarding the Cities Where the Businesses Operate

Cities	Quantity	%
İstanbul	302	75.5
Bursa	45	11.2
Kocaeli	26	6.5
Sakarya	13	3.3
Çanakkale	8	2.0
Yalova	6	1.5
Total	400	100

4.2 STATISTICS ON SME AWARENESS OF PARTICIPATION BANK OFFERINGS

In order to understand their awareness, the participants were asked whether they had an idea about the Participation Banks themselves and their products (Table 4). Their responses show it is evident that approximately 63% of the enterprises have sufficient knowledge about Participation Banks, and 37% have no idea. In addition, some 47% of the enterprises have information about the products and transactions of Participation Banks, while 53% do not (Table 4). Some 238 of the enterprises work with Participation Banks and 162 of them do not. Although it shows that Participation Banking is in a good position in terms of awareness, the findings suggest that customers lack the same level of awareness in terms of products and services. For this situation, it is possible to say that Participation Banking cannot introduce itself in detail, and/or customer relations are weak.

TABLE 4
Statistical Findings Regarding the Level of Awareness About Participation Banks

Awareness About Participation Banks		Quantity	%
Having Information about Participation Banks	YES	253	63.2
	NO	147	36.8
Status of Participation Banks to have Information about their Products	YES	189	47.2
	NO	211	52.8
Whether or Not to Work with Participation Banks	YES	238	59.5
	NO	162	40.5

4.3 RELIABILITY AND VALIDITY ANALYSIS

There should be a consistent and meaningful relationship between the data to be obtained from the answers given to the scale used in the research. This relationship explains the scale reliability. In this context, before the statements in the scale are analyzed, it is necessary to see whether the statements are reliable. Hence, Cronbach's Alpha test was applied to determine internal reliability among the scale items. Cronbach's Alpha value obtained was 0.831 for the answers given to the scale with a total of 21 statements. Since Cronbach's Alpha value falls between 0.70 and 0.90, the scale has a high level of reliability and can be used in community surveys and in forming scientific judgments (Özdamar, 2016).

Factor analysis was performed to determine the dimensions of meaningful expressions together (Büyüköztürk, 2002). When examined alone, the statements in the scale cannot adequately explain the view and understanding of the research as a whole. In this respect, in the next stage of the research, exploratory and confirmatory factor analyses were performed, respectively, to reveal the implicit structure of the scale and to confirm the structure explained in its original form.

4.3.1 EXPLORATORY FACTOR ANALYSIS

Exploratory factor analysis was applied to measure the dimensions of the potential of *Islāmic* finance as an alternative for SMEs and to determine its factors. Before applying factor analysis, it is necessary to examine the suitability and adequacy of the data and sample for principal component analysis. For this purpose, Kaiser-Meyer-Olkin (KMO) and Bartlett sphericity tests were applied to the expressions in the scale, and the results are shown in Table 5.

TABLE 5
Results of KMO and Bartlett Test of Sphericity

KMO		0.817
Bartlett Test of Sphericity	Chi-Square	6990.007
	SD	210
	Sig.	0.000

Results displayed in the following Table 6 have the necessary values for factor analysis. In addition, the KMO sample adequacy coefficient of the research scale was found to be 0.817. Again, the Bartlett test of sphericity result was also significant, indicating that the data were suitable for factor analysis. After confirming that the results obtained have sufficient value, the data were subjected to factor analysis.

Factor analysis determined 6 factors (Factor 1: Being Alternative in terms of Personal Value Judgments, Factor 2: Alternative in terms of Sectorial Suitability, Factor 3: Being Alternative in terms of Financing Policies and Opportunities, Factor 4: Alternative in terms of Accessibility, Factor 5: Cost Alternative, Factor 6: Alternative for Access to Finance) explained the research scale. The expressions in each of these 6 factors were examined together and it was seen that the expressions complemented each

other semantically. Based on this, the six factors are named in connection with the potential of *Islāmic* finance, which is the subject of the research, to be an alternative for SMEs and are shown in the following Table 6.

TABLE 6
Factors Obtained from the Analysis

Expressions that Construct Factors	Factor Loads	Eigenvalue	Variance %
Factor 1: Being Alternative in terms of Personal Value Judgments			
My customers (and my business partners, if any) expect me to use interest-free financing.	0.914	5.906	19.696
The opinions of my business circle about participation banking influence me to use interest-free financing.	0.900		
The interest of the personnel of the participation banks increases my desire to work with them.	0.894		
I prefer participation banks because of religious obligations.	0.878		
My close environment influences me to use interest-free financing	0.863		
Factor 2: Alternative in terms of Sectorial Suitability			
Participation banks offer a range of products and services to SMEs.	0.894	3.640	16.133
Participation banks are more suitable for the entrepreneurial spirit than interest-bearing banks.	0.890		
Participation banks are more useful for the SME sector as they work with a project focus.	0.886		
Participation banks tend to provide more loans to SMEs.'	0.858		

TABLE 6 (continued)

Expressions that Construct Factors	Factor Loads	Eigenvalue	Variance %
Factor 3: Being Alternative in terms of Financing Policies and Opportunities		2.368	15.024
Participation banks supply the product directly instead of giving money, ensuring the correct use of resources.	0.864		
It is important for the continuation of our activities that participation banks provide extra financing beyond the existing financing opportunities.	0.861		
Participation banks are a successful banking system because they bring the money of people who want to work without interest to the economy.	0.825		
Since participation banks work on a partnership basis, being a partner in the projects we develop increases our competitiveness.	0.820		
Factor 4: Alternative in terms of Accessibility		1.591	9.370
Participation banks offer special communication channels to SMEs.	0.794		
Participation banks communicate with us frequently.	0.772		
Participation banks have many branches and ATMs that we can reach whenever we want.	0.665		
Factor 5: Cost Alternative		1.315	8.897
Participation banks are a good alternative in terms of cost.	0.913		
Participation banks offer loans on more favorable terms than interest-bearing banks.	0.906		
Factor 6: Alternative for Access to Finance		1.157	6.961
Loan approval processes are faster in participation banks.	0.805		
The product variety offered by participation banks facilitates access to financing opportunities.	0.685		
It is possible to get loans with lower collateral from participation banks.	0.543		
Total			76.079672

The factors shown in Table 6 are listed according to their eigenvalues and the variances they explain. It is seen that 6 factors obtained by exploratory factor analysis explain approximately 76.08% of the total variance. This rate is commendable. The 6 factors determined are explanatory for most of the study. The factors obtained will be evaluated in detail under separate headings:

4.3.1.1 FACTOR 1

This factor, which ranks first with its eigenvalue and the percentage of variance it explains, consists of 5 expressions and explains approximately 19.7% of the total variance. Looking at the expressions making up this factor, it is seen that these factors play a role in the preference for interest-free financing. These statements are aimed at measuring the effectiveness of religious obligations, the expectations of customers and partners if any, and the views of their close circle and business environment in the preference of *Islāmic* finance for SMEs. "The interest of the personnel of the participation banks increases my desire to work with them" expression was also included under this factor. All these statements were taken together and the factor was defined as *Islāmic* finance for SMEs as "Alternative in terms of Personal Value Judgments."

When the eigenvalues and variances of the expressions under the factor are examined, it is seen that the expectations of the customers and partners, if any, are the most important factor in the preference for *Islāmic* finance for SMEs. In parallel with this, it is seen that the business environment is very effective in the choice of *Islāmic* financing for SMEs. The most striking element among the findings is the effect of religious obligations on the choice of *Islāmic* finance. While this is expected to be the most important element in the research and scale design phase, the "I prefer participation banks because of my religious obligations" expression ranks fourth under the factor. The interest of the personnel of the Participation Banks ranks third in the *Islāmic* financing preference for SMEs. Although this ranking is a situation brought about by professionalism, the interest of the other party always plays a decisive role not only for SMEs but also for all real and legal persons in general, in an environment where they will be in business or a different kind of relationship. In this regard, "The fact that the personnel of the participation banks is interested increases my desire to work with them." The order of the statement is quite understandable within the scope of the research. In addition, this statement is an important

indicator for authorized decision-makers and policymakers in this field. Looking at the last statement under the factor, this statement is also an expression to measure the effect of the business environment on the preference of *Islāmic* finance for SMEs.

When evaluating in general, saying the potential that SMEs of the entire business environment might prefer *Islāmic* finance is seen in the broader background of one's religious completion and close circle. The attitude of staff in small-scale participation banks is also important.

4.3.1.2 FACTOR 2

This factor consists of 4 statements and explains approximately 16.13% of the total variance, ranking second in terms of subject level by the participants. The expressions making up this factor consist of expressions that measure the suitability of *Islāmic* finance for the SME sector. In this regard, this factor has been defined as *Islāmic* finance as an "Alternative in terms of Sectoral Suitability" for SMEs.

Expressions under this factor aimed at measuring the claim of *Islāmic* finance in terms of financing the real sector, both theoretically and practically, by the SME sector, which is the real sector element. From these expressions; "Participation banks are more suitable for the entrepreneurial spirit than interest-bearing banks." and "Participation banks are more useful for the SME sector as they work project-oriented." While trying to theoretically measure the potential of *Islāmic* finance to be an alternative in terms of sectoral suitability for SMEs, "Participation banks offer product ranges and services for SMEs." and "There is a tendency for participation banks to extend more loans to SMEs." statements were tried to be measured in terms of practical applications.

When evaluated in general, it is considered a successful and meaningful result within the scope of the research that this factor is in second place and that the expressions under the factor that have a meaningful relationship between them are complementary in terms of semantic and conceptual aspects.

4.3.1.3 FACTOR 3

This factor explains approximately 15.02% of the total variance and ranks third in the general factor ranking. The factor consists of 4 statements, and these statements measure the potential of *Islāmic* finance policies, the possible effects that may arise based on this, and

the potential of *Islāmic* finance to be an alternative financing option for SMEs, as an extra financing option in the general finance sector.

The semantic and conceptual aspects of the expressions combined under the factor were evaluated together with the research topic and named "*Islāmic* Finance's Alternative in terms of Financing Policies and Opportunities for SMEs." The emergence of *Islāmic* financing policies and financing opportunities as a dimension within the scope of the research is considered a very meaningful result for the study.

4.3.1.4 FACTOR 4

One of the reasons *Islāmic* finance is preferred especially in the banking sector is accessibility to banks. Both the branch network and the communication channels offered can positively or negatively affect the potential of a bank or institution to be an alternative to others. Considering this issue during the preparation phase of the scale, statements to measure it were included. As a result of the exploratory factor analysis, it was seen that these expressions were combined under a factor.

The conceptual and semantic aspects of the expressions under the factor were evaluated together with the scope of the subject and named "*Islāmic* Finance's Alternative in terms of Accessibility for SMEs". The variance of this factor explains approximately 9.38% of the total variance.

4.3.1.5 FACTOR 5

Interest forms the operational basis of the conventional financial system. In this respect, an additional interest cost is incurred in the real sector financed by the conventional system. Considering SMEs specifically, SMEs that obtain financing from conventional banks at the stage of supporting their enterprises have to pay the interest as well as the principal of this financing. The basic principle of *Islāmic* finance and institutions is interest-free. It is wondered how an interest-free banking activity can affect the costs. In the preparation phase of the scale, it was tried to be measured specifically for SMEs by considering these situations. As a result of the exploratory factor analysis, the statements to measure this showed a significant relationship together and a dimension consisting of two statements emerged.

The semantic and conceptual aspects of the expressions under this factor were evaluated together with the research topic and named "The Potential of *Islāmic* Finance to Become a Cost Alternative for SMEs". This factor explains approximately 9.38% of the total variance. The fact that this factor, which ranks 5th in terms of importance, emerged within the scope of the research and that the expressions under this factor have semantic integrity is considered a successful and understandable result for the study.

4.3.1.6 FACTOR 6

One of the important factors that may affect the potential of choosing one financing option over another is access to that financing. Within the scope of the research, the scale was included in order to measure the speed of loan approval processes, the variety of products offered, and the potential of alternative loan terms, and the answers given to these statements were combined under a factor consisting of 3 statements. In this respect, this factor is named an "Alternative in terms of Access to Finance."

The variance value of this factor explains about 7% of the total variance. The emergence of this factor within the scope of the research is evaluated as a successful and understandable result as a dimension that should be seen in the potential of *Islāmic* finance to be an alternative for SMEs.

4.3.2 CONFIRMATORY FACTOR ANALYSIS

The findings obtained as a result of CFA were examined with the goodness of fit indices. The results are given in Table 7.

TABLE 7
Confirmatory Factor Analysis Findings of Research Data

Compatibility Indexes *	Perfect Fit Criteria *	Acceptable Compliance Criteria *	Study Findings
χ^2 /sd	$0 \leq \chi^2 /sd \leq 2$	$2 \leq \chi^2 /sd \leq 3$	2.86
<i>AGFI</i>	$0,90 \leq AGFI \leq 1,00$	$0,85 \leq AGFI \leq 0,90$	0.86
<i>CFI</i>	$0,95 \leq CFI \leq 1,00$	$0,90 \leq CFI \leq 0,95$	0.95
<i>NFI</i>	$0,95 \leq NFI \leq 1,00$	$0,90 \leq NFI \leq 0,95$	0.92
<i>NNFI</i>	$0,95 \leq NNFI \leq 1,00$	$0,90 \leq NNFI \leq 0,95$	0.95
<i>RFI</i>	$0,95 \leq RFI \leq 1,00$	$0,90 \leq RFI \leq 0,95$	0.91
<i>IFI</i>	$0,95 \leq IFI \leq 1,00$	$0,90 \leq IFI \leq 0,95$	0.95
<i>RMSEA</i>	$0,00 \leq RMSEA \leq 0,05$	$0,05 \leq RMSEA \leq 0,08$	0.068

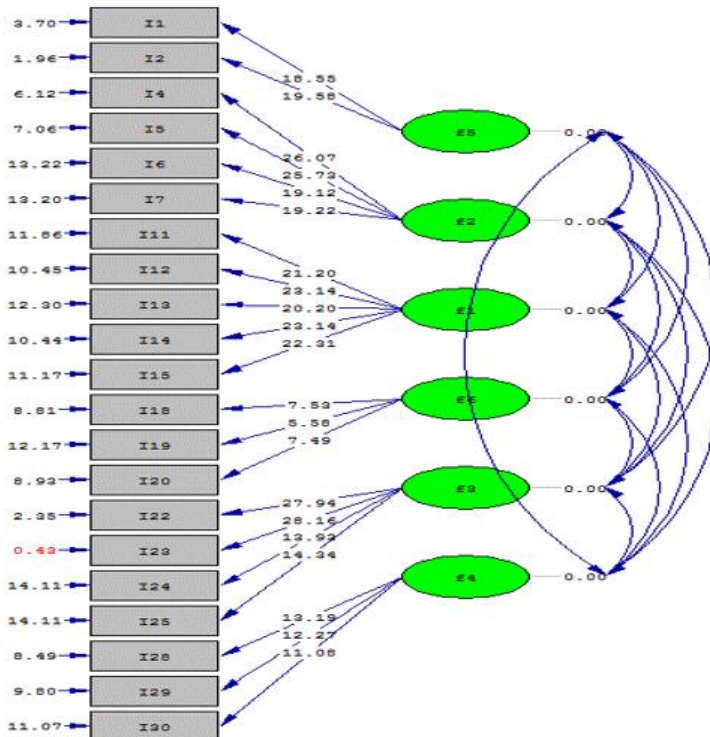
TABLE 7 (continued)

Compatibility Indexes *	Perfect Fit Criteria *	Acceptable Compliance Criteria *	Study Findings
<i>SRMR</i>	$0,00 \leq SRMR \leq 0,05$	$0,05 \leq SRMR \leq 0,10$	0.049
<i>PNFI</i>	$0,95 \leq PNFI \leq 1,00$	$0,50 \leq PNFI \leq 0,95$	0.76
<i>PGFI</i>	$0,95 \leq PGFI \leq 1,00$	$0,50 \leq PGFI \leq 0,95$	0.67

Note: * Perfect Fit Criteria and Acceptable Fit Criteria were prepared by the author of the study, using the study of İlhan and Çetin (2014).

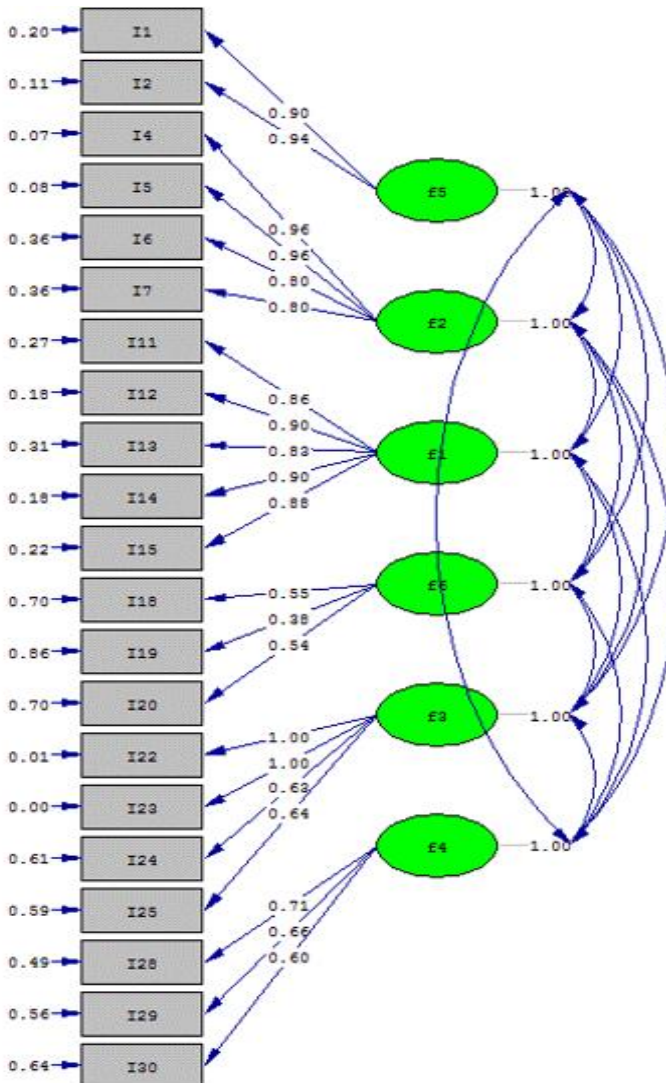
Considering the fit indices obtained as a result of the analysis; It is seen that χ^2 /sd , AGFI, NFI, RFI, RMSEA, PNFI and PGFI indices have acceptable values, CFI, NNFI, IFI, SRMR indices have excellent fit criteria. These fit index values show that the model fits well. The path diagram and t values of the model are shown in Figure 1. Figure 1 provides the standardized values and t-scores.

FIGURE 1
Path Diagram and T Values of the Model



The findings obtained as a result of confirmatory factor analysis and showing the standard distribution of factor loads are illustrated in Figure 2. The standardized values should not exceed '1', as these values provide information about how well each item represents its latent variable. It is also ensured in the measurement model that the error variances of all items are lower than 0.80.

FIGURE 2
Standardized Weights for the Model



5. CONCLUSION

In the study, the Potential of *Islāmic* Finance as an Alternative for SMEs was investigated. The 21-item Potential *Islāmic* Finance as an Alternative Scale for SMEs (PIFAS) was developed by the author of the study. Some 400 SMEs operating in Istanbul, Kocaeli, Sakarya, Bursa, Yalova, and Çanakkale cities participated in the research. Explanatory and confirmatory factor analysis were applied to the scale within the scope of construct validity. As a result of the EFA, it was determined that the scale had a 6-factor structure that explained approximately 76% of the scale.

An *Islāmic* financing model can be considered as an alternative by real and legal persons who have an interest-free attitude due to religious concerns against the interest principle of conventional finance. From the findings obtained, the effect of religious obligations on the potential of *Islāmic* finance as an alternative for SMEs is quite high. In addition, the factor of personal value judgments as a whole explains about 19.7% of the scale.

This situation requires the utmost care and attention from *Islāmic* financial institutions and *Islāmic* finance regulatory authorities. It is necessary to avoid actions and attitudes that will negatively affect personal value judgments when presenting *Islāmic* finance and to prioritize the ethical and moral aspects of *Islāmic* finance. This is especially because religious factors underscore demand for *Islāmic* financing. Participants in this study moderately agreed that *Islāmic* finance is more suitable for the SME sector. This result shows that sectoral suitability is effective in making *Islāmic* finance a potential alternative for SMEs. The extent of participant agreement with this view is especially meaningful for decision-makers and policymakers in this field. The interests and tendencies of individuals and institutions operating in *Islāmic* finance toward SMEs, and the variety of services to be developed for them will strengthen the potential of *Islāmic* finance as an alternative for SMEs.

Islāmic finance, besides being an alternative based on interest-free principle, has the potential as alternative financing alongside existing financing opportunities. This has been confirmed by SMEs in this research, and it was seen that the role of extra financing has a decisive effect on the potential of being an alternative for SMEs. This situation, however, needs to be supported at the access point. Within the scope of the research, the potential of *Islāmic* finance in terms of access to finance for SMEs remains at

very low levels; both the slowness in financing transactions and the difficult conditions for obtaining financing restrict SME access to financing. Hence, we recommend that *Islāmic* financial institutions, authorities, decision-makers, and politicians make arrangements to at least facilitating SMEs in accessing funds. Besides the importance of SMEs for national economies, they are also important for financial institutions and organizations. Successful SMEs, which have a large capital and volume of activity, will reflect positively on the institutions financing them, and the financing will not only be a material transfer but also a spiritual and institutional success for a sector, *Islāmic* finance, that emphasizes its moral and ethical attitude. This success should come before financial gain for the relatively young *Islāmic* finance sector.

Within the framework of the *Islāmic* financing policies of SMEs, the fact that financing provided in the form of goods or services instead of cash financing is more efficient and effective is accepted by the SMEs. Although the need for liquidity and the demand for direct cash financing from time to time to run the SME business are reasons preventing high degree of participation, the results obtained positively reflect potential of *Islāmic* finance as a viable alternative for SMEs. The partnership principle, which is also a financing policy, is a factor strengthening the potential of being an alternative for increasing SME competitiveness. Revealing the real equivalent of this potential can only be achieved if the parties make sufficient efforts in both theoretical and practical aspects of their collaboration.

In the conventional financial system, the parties are in a debtor-creditor relationship and based on interest. The party using the loan is the debtor and is debited in addition to the principal of the loan used, as well as the calculated interest amount. This interest charged creates an additional cost on the principal used. This study investigated the potential of *Islāmic* finance, which carries out financial activities in accordance with the interest-free principle, as alternative financing for SMEs in terms of cost. The findings show that *Islāmic* financing has a potential that cannot be found in real terms in evaluating its cost as an alternative for SMEs. This result means that the cost of interest-free *Islāmic* financing does not differ much from the cost of interest. This finding is important and should be considered by decision-makers and policymakers in *Islāmic* finance. Undoubtedly, the financing cost does not arise only from interest, but also the transaction cost of money itself. Considering the share of Participation Banks in the Turkish banking sector, it is

understandable that *Islāmic* financing costs cannot be very low for SMEs in Turkey. It is appropriate, however, to take steps to reduce this cost to levels compatible with the conceptual dimension and philosophy of *Islāmic* finance. Otherwise, a negative change in personal value judgments will be inevitable.

One determinant in choosing a financial institution as an alternative is accessibility. The inability to reach a financial institution when requested will lower demand for that institution. Especially for a financial sector touted as an alternative, the potential to be an alternative will remain at very low levels. In this research, the potential of *Islāmic* finance as a more accessible alternative for SMEs remained at very low levels. Since no similar study was found at the international level, it is uncertain whether this result is unique to Turkey. In the Turkish context, however, these results are understandable, although unacceptable, for the newly developing *Islāmic* finance sector which has also experienced various difficulties in its historical development. Nevertheless, these results are quite decisive in the potential of *Islāmic* finance as an alternative for SMEs. Hence, necessary steps should be taken with devotion to ensure that SMEs, especially in Turkey, have access to *Islāmic* finance.

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