**Shariah Compliance or Islamic Finance for Halal Business (industry), especially to support SME (small and medium enterprises)**

**Syed Nazim Ali**

Belgium, Brussel

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SMEs are backbone of any economies. Developing this sector to provide opportunities for young individuals to utilize their talents should be primary goals. Recently, we have seen Muslim countries and Muslim majority communities showing growing interest in halal business (industry). A common man when think of halal business usually brings halal food in the mind which is a pretty narrow definition. Halal business encompass of all actions which are unethical and against the social responsible action.

Recently we have seen this industry is growing, for e.g. Bank of China and Chinese government SME development agency SAME have partnered with Malaysia’s Halal Industry Development Corporation (HDC) to provide Islamic banking facilities to SMEs in the Halal industry through the Bank of China network. HDC also recently signed an agreement with Honk Kong’s MCH Halal International Holdings and Greenland Group to establish a Halal International Trade Center in Yunnan Province, with support form the Yunnan Provincial Government, to leverage the huge opportunities in Halal export (IFN Corporate Malaysia, Volume 1, Issue 4, 2016).

Investment accounts were introduced in Malaysia through the Islamic Financial Services Act that offers corporates and SMEs a valuable new source of funding. (IFN Corporate Malaysia, Volume 1, Issue 4, 2016).

The government’s RM100 million grant for the Halal industry in Budget 2016 will be used to elevate the standards of local small and medium enterprises (SMEs), says the Halal Industry Development Corporation (HDC). <http://www.smebank.com.my/halal-industry-fund-for-smes-to-add-value-improve-halal-products/> Friday, 22 March 2013

SME Corporation Malaysia – provides matching grants to SMEs for halal product development and product formulation, sample testing, acquisition of machinery and equipment, renovation expenditure for compliance to certification requirements and other costs related to the compliance on halal certification and promotional activities. (The Global Halal Industry: An Overview, 2012)

In early 2013, the SME Bank announced a RM200 million fund under its Halal Industry Plan that will be made available to small and medium enterprises to add value and improve their halal products. (The Global Halal Industry: An Overview, 2012)

Lack of Shariah compliant finance remains a key challenge, with the limited use of Islamic financing and with businesses facing to raise financing (The state of the Global Islamic Economy Report 2016/17, 2016): Mixed use of financing: 49% of respondents confirmed they either fully use Shariah financing or most of the time, while 32 percent respondents noted only using conventional financing, 7.4% majority conventional, 10% equal Islamic/conventional

Core needs for financing: The top two needs for financing included working capital financing, identified by 22 percent of respondents, followed by trade finance, identified by 19 percent of respondents, and long-term expansion finance, identified by 17 percent of respondents

Main constraints: High cost, long loan processing times, and cumbersome documentation requirements were the top three challenges noted with raising financing, together accounting for 46 percent of responses

Funding Capital and Refinancing Needs: Islamic Capital Market Propositions. In recent years, firms in the halal industry have also tapped the Islamic capital markets to meet their financial needs. Here, sukuk is playing a crucial role as a financing tool utilised by large and medium-sized firms in the halal industry to finance their general corporate purposes, specific projecting financing, investment programmes and debt refinancing. The sukuk market has been penetrated by halal industry players from different operation backgrounds ranging from food manufacturing, processing, finance and insurance, textile/garments, tourism and pharmaceuticals. To date, more than USD 5bln in capital has been raised through sukuk by approximately 40 issuers originating from the halal industry. For example, Saudi based halal food and beverages manufacturer AL-Marai has tapped the sukuk market three times to date since 2012, raising more than USD 1bln in proceeds. Moving forward, the full potential of sukuk financing in support of halal businesses is yet to be realised and the trend is likely to accelerate as the global halal industry expands (Malaysia World’s Islamic Finance Marketplace, 2014).

Financing is often a major obstacle in the operations of SMEs, restricting their investing capacity, reducing their liquidity and diminishing their contribution towards employment creation. Similarly, halal firms belonging to the category of MSMEs, are likely to face similar restrictions, in addition to facing hurdles in obtaining Shariah-compliant financing. To address this, the concepts of Shariah-compliant crowd-funding, venture capital financing and private equity funding are being proposed as solutions to address the financial crunch faced by SMEs and start-ups (Malaysia World’s Islamic Finance Marketplace, 2014).

**Crowd-funding**. Crowd-funding is fast becoming an attractive alternative to traditional bank financing for a growing number of start-ups and SMEs around the world. In crowd-funding, individual investors contribute financing to an enterprise in exchange for private company shares (equity based crowd-funding) or returns on the financing (credit based crowd-funding), hence complementing conventional seed capital. Crowd-funding is generally popular among the youth and new budding entrepreneurs globally who might not readily have access to banking finance channels. As such, crowd-funding has tremendous potentials in the OIC since the population pyramid in this group of countries is densely concentrated at the bottom age-groups. The concept of crowd-funding fits in well with Islamic finance as the nature of this financing mechanism is participatory which corresponds to the Islamic finance emphasis on risk-sharing. There has already been a precedent and the world’s first Shariah-compliant crowd-funding platform was formed in 2012, with the stated aim of “bridging the gap between microfinance and big venture capital while prioritising ethics”. Moving forward, it is recommended to bring the Shariah-compliant crowdfunding market under a formal purview of the authorities and regulators. Along these lines and in a promising step forward, the Securities Commission Malaysia on 21st August 2014 did release a public consultation paper seeking public feedback on the proposed regulatory framework for equity crowd-funding.

**Venture Capital.** Venture capital (VC) is an alternative source of funding for technologically driven and innovative later-stage/high-growth enterprises. The value of global venture capital industry investments is estimated at more than USD41.5bln from as many as 4,970 investment rounds as of end-201215. Admittedly, so far the involvement of VC companies in the halal industries has been minimal at a global scale. However in Malaysia, it is reported that nearly MYR1bln or 20% of the country’s venture capital assets are Shariah compliant16. Going forward, the prospects for venture capital investments to fund halal industry start-ups is undeniably attractive, given the VC industry’s growing presence in many emerging markets with large Muslim populations.

**Private Equity Funding.** A private equity company fits into the company as a capital provider and is capable of sharing best practices in managing a business. Therefore, Shariah-compliant private equity funds can be another alternative source for funding halal industry start-ups and SMEs. In Malaysia, for example, Azka Capital (Malaysia) is established as the world’s first private equity fund solely focused on direct investments in halal companies. By raising Islamic funds, private equities will be able to engage with the halal industry investees in a way that guarantees complete Shariah compliance of investment rounds and all subsequent stages of the halal supply chain.

The Dubai Multi Commodities Centre (DMCC) and Dubai SME are partnering to develop a Shariah-compliant web-based trade finance platform for small and medium enterprises (SMEs) to pledge their assets for lending purposes, DMCC said in a media statement (© SalaamGateway.com 2017) <https://www.salaamgateway.com/en/story/dubai_to_develop_shariahcompliant_trade_finance_platform_for_smes-SALAAM26102017055929/> DMCC, the world’s leading Free Zone for trade and enterprise in Dubai, has signed a Memorandum of Understanding (MoU) with Dubai SME, the agency of Dubai Economy mandated to develop the small and medium enterprise (SME) sector. The collaboration sets out to create a web-based [trade finance](https://www.dmcc.ae/news/dmcc-and-maersk-team-bring-one-stop-shop-shipping-and-trade-finance-solutions-market) platform for SMEs, where they pledge their assets for lending purposes. The platform will be Sharia-compliant, and operate under the DMCC Authority regulatory framework. (October 25, 2017)

<https://www.dmcc.ae/news/dmcc-and-dubai-sme-develop-shariah-compliant-trade-finance-platform-smes>

ME Bank managing director Mohd Radzif Mohd Yunus said the bank has disbursed RM14.3 billion financing to help more than 8,700 SMEs. This works out to an average financing of RM2 billion approved for 1,200 SMEs annually. “This programme is also in line with the SME Masterplan (2012-2020) which was launched to accelerate the growth of SMEs through innovation and productivity,” he said. March 22, 2013 <http://www.freemalaysiatoday.com/category/business/2013/03/22/halal-industry-fund-for-smes-to-improve-halal-products/>

KUANTAN: The Malaysian Technology Development Corporation has approved RM18 million in loans from the Halal Technology Development Fund (Halal Fund) to eight small and medium enterprises (SMEs) since it was set up last year, its chief executive officer, Datuk Norhalim Yunus said.

<http://www.theborneopost.com/2017/08/17/eight-smes-get-rm18-million-financing-from-halal-fund/>

* <https://kapitalboost.com/> - crowd-funding project

Dubai, UAE: Tawreeq Holdings, the region’s first Sharia-compliant supply chain finance group, has Tawreeq Holdings Logooriginated more than $55 million in Supply Chain Finance services for small and medium-sized enterprises (SMEs) and mid-size companies, meeting an important milestone for the company, which launched its operations at the beginning of this year. The rapid take-up of Tawreeq’s novel supply chain finance solutions highlights the significant demand in the region, especially for its unique Sharia-compliant structure, which has brought factoring and reverse factoring to the region’s ethical investors and businesses for the first time. September 19, 2015

* <http://halalfocus.net/uae-tawreeq-holdings-offering-shariah-compliant-financing-for-smes/>

Also taking its cue from the burgeoning halal industry was Malaysia’s Westports, which raised RM800 million (US$220.7 million) via Sukuk Musharakah in 2008.

“Thai businessmen have also been looking at how halal parks in Malaysia — such as the Tanjung Manis halal hub — are being set up and managed, especially those in the Northern Corridor like Perlis as well as in the Eastern Corridor, and to see how they can supply the ingredients for the halal food products made in these parks. This interest shows that there is potential for growth.

“There are potential synergies between Islamic banks and halal producers, as one is a capital allocator and the other is a seeker of capital. This can be seen in the increasing number of SMEs which are entering the halal industry, and are looking to Islamic banking for their funding needs. The majority of the local and foreign Islamic banks in Malaysia do offer financing facilities to SMEs.

“As at March 2008, the banking and development financial institutions had approved RM13.3 billion (US$3.66 billion) to more than 38,000 SME accounts under the National SME Development Blueprint 2008. For example, in February 2009, a foreign Islamic bank in Malaysia opened a new branch at the Tanjung Manis halal hub to support SMEs in this market,” Faiz added

<http://halalfocus.net/islamic-funds-for-halal-food-why-not-more/>

Limited access to finance for SMEs is one of the main obstacles to their growth in the majority of Islamic finance territories. Most SMEs do not have access to credit, or have limited access to credit. SMEs’ limited access to finance reflects the interaction of demand, supply, institutional, regulatory, and other policy factors that are a hindrance for the growth of SMEs. SMEs also lack awareness and knowledge regarding Islamic banking products and what products may suit their requirements. Additionally, the cost of credit charged by Islamic banks is relatively higher than conventional banks for the same sector. Growth is also hindered in those countries with developed Islamic banking by the lack of suitable Islamic finance offerings for SMEs. On average, around 35% of SMEs in MENA and Pakistan are not borrowing money despite the significant demand due to the lack of Islamic finance offerings.

Most SMEs in Muslim countries operate as sole proprietorships or family businesses. These enterprises primarily engage in cash transactions (due to their small size) and, thus, prefer to acquire funds through other channels. Moreover, a large number of SMEs operate outside urban areas and owners are not financially literate (literacy rates are generally lower in Muslim countries) and thus have limited information regarding their banking needs. They prefer informal funding routes based on trust that offer more flexibility in terms of documentation, repayment, timing, and transactions costs, which formal financial institutions do not provide. This is further aggravated by lack of knowledge of Islamic financial products and solutions by most SMEs. SMEs are generally unaware of Islamic financial products that suit their needs given the complexity of Islamic financing models.

<https://www.ifac.org/global-knowledge-gateway/islamic-finance/discussion/islamic-finance-opportunity-sme-financing>

The Pakistani government realizes the problems affecting SMEs. The Small and Medium Enterprises Development Authority (SMEDA) is the main agency that promotes SME growth by implementing policies for improving the business environment, access to finance, human resource development, and support for technology upgrade and marketing. In addition to SMEDA, numerous other national and regional agencies – SME Bank, Khushhali Bank, Punjab Small Industries Corporation, Sindh Small Industries Corporation, and KPK Small Industries Development Board – are complementing SMEDA’s efforts and improving the business environment to promote SME growth. IFC’s Business Edge program has played a significant role in enhancing the capabilities of SMEs.

Most SMEs in Pakistan operate as sole proprietorships or family businesses. These enterprises primarily engage in cash transactions and, thus, prefer to acquire funds through informal channels. Moreover, a large number of SME owners, especially outside urban areas, are not financially literate regarding their banking needs. They prefer informal funding routes because they are based on trust and offer more flexibility in terms of documentation, repayment, timing and transactions costs, which formal financial institutions do not provide (Islamic Banking Opportunities Across Small and Medium Enterprises, Pakistan 2014)