Standing Committee for Economic and Commercial Cooperation of the Organization of Islamic Cooperation (COMCEC)

The Role of Islamic Finance in Supporting Microenterprises and SMEs Against COVID-19

COMCEC COORDINATION OFFICE
October 2021

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The research team is grateful to all the interviewees for their contribution to this study in relation to the case studies by allocating their valuable time in imparting their expert opinions.

It should be noted that the views and opinions expressed in the report are solely those of the authors and do not represent the official views of the COMCEC Coordination Office or the Member States of the Organization of Islamic Cooperation. The final version of the report is available on the COMCEC website.*

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ABBREVIATIONS

AAOIFI	:	Accounting and Auditing Organization for Islamic Financial Institutions
BAZNAS	:	Badan Amil *Zakat* Nasional [National Board of *Zakat*, Indonesia]
BIS	:	Islamic Bank of Senegal
BMT	:	Baitul Maal wat Tamwil
BoP	:	Balance of Payments
BPRS	:	Bank Pembiayaan Rakyat Syariah (Indonesia)
BPS	:	Badan Pusat Statistik (Indonesia)
BUS	:	Bank Umum Syariah (Indonesia)
CBJ	:	Central Bank of Jordan
CBK	:	Central Bank of Kuwait
CMA	:	Capital Markets Authority (Kuwait)
COMCEC	:	Standing Committee for Economic and Commercial Cooperation of the Organization of the Islamic Cooperation
CSR	:	Corporate Social Responsibility
DOS	:	Department of Statistics (Jordan)
FDR	:	Financing to deposit ratio
FMCG	:	Fast-moving consumer goods
GCC	:	Gulf Cooperation Council
GDP	:	Gross Domestic Product
ICD	:	Islamic Corporation for the Development of the Private Sector
IDR	:	Indonesian Rupiah
IFSB	:	Islamic Financial Services Board
IIFM	:	International Islamic Financial Market
IIH	:	Islamic Investment House
ILO	:	International Labour Organization
IMF	:	International Monetary Fund
IsDB	:	Islamic Development Bank
ITFC	:	International Islamic Trade Finance Corporation
JEDCO	:	Jordan Enterprise Development Corporation
JIB	:	Jordan Islamic Bank
JICA	:	Japan International Cooperation Agency
JLGC	:	Jordan Loan Guarantee Corporation
KAPF	:	Kuwait *Awqaf* Public Foundation
KES	:	Kuwait Economic Society
KFH	:	Kuwait Finance House
KIB	:	Kuwait International Bank

KNF	:	Kuwait National Fund
KZH	:	Kuwait Zakat House
LIPI	:	Lembaga Ilmu Pengetahuan Indonesia [Indonesian Institute of Sciences]
MESA	:	Middle East and South Asia
MFIs	:	Microfinance institutions
MSMEs	:	Micro, small and medium-sized enterprises
NBFIs	:	Non-bank financial institutions
NOM	:	Net Operating Margin
NPF	:	Non-performing financing
NPL	:	Non-performing loan
OECD	:	Organisation for Economic Co-operation and Development
OIC	:	Organisation of Islamic Cooperation
OJK	:	Otoritas Jasa Keuangan [Indonesian Financial Services Authority]
PAP2A	:	Adjusted and Accelerated Priority Action Plan
PEBS	:	Pusat Ekonomi dan Bisnis Syariah
PLS	:	Profit and loss sharing
PNM	:	PT Permodalan Nasional Madani
PSE	:	Plan Senegal Emergent
RFI	:	Rapid financing instrument
ROA	:	Return on Assets
ROE	:	Return on Equity
SESRIC	:	Statistical, Economic and Social Research and Training Centre for Islamic Countries
SMEs	:	Small and medium-sized enterprises
UAE	:	United Arab Emirates
USSR	:	Union of Soviet Socialist Republics
UUS	:	Unit Usaha Syariah (Indonesia)
VUCA	:	Volatility, Uncertainty, Complexity and Ambiguity
WHO	:	World Health Organization
WTO	:	World Trade Organization
YoY	:	Year-over-year

EXECUTIVE SUMMARY

This research aims at examining the Islamic banking and finance responses to the emerging financial needs of MSMEs in country cases studies (Indonesia, Jordan, Kuwait, Senegal and Russia). Considering that emergence of the Islamic economics movement focused on constituting Islamic development process (Chapra, 1993, 2000; Ahmad, 1979, 1994; Naqvi, 1981, 1994, among others), MSMEs financing should be an essential part of Islamic banking and finance, which is the main institutional emergence of Islamic economics discourse. Within the normative base of Islamic economics, developing real economy embedded and profit and loss sharing (PLS) and risk-sharing financing proposition is articulated as an existential operational principle for Islamic finance and banking. MSMEs are such a sphere that directly correspond to the real economy, PLS and risk-sharing tenets, and therefore, it is expected that Islamic banks and financial institutions develop structures to meet the financing demands of MSMEs whereby they could contribute to economic development. Thus, Islamic logic is expected to prevail over market logic on transforming the societies and demonstrate that Islamic finance is not only a transaction-based proportion. While there are credible criticisms raised against Islamic banks and financial institutions for giving up such morally constructed propositions and operations and surrendering to the market logic, this research has taken the task to test the performance of Islamic banking concerning their inclusiveness of MSMEs.

Such a query is crucial, as the world has been going through a very challenging period of health and well-being crisis. The emergence of COVID-19 as a pandemic has affected every corner of the globe resulting in human tragedies with millions of people died due to the pandemic. On the other hand, the sustainability of everyday life has become under threat due to lockdown. The VUCA World that marks the nature of the post-modern world has become vivid and so obvious. Volatility, Uncertainty, Complexity and Ambiguity (VUCA) has been closely witnessed from one day to another in the lives of everyone on earth through the COVID-19 process.

MSMEs are considered the backbone of the economy by contributing to economic wealth, job creation and innovation in every economy in the world. However, being embedded in the real economy and everyday lives of people, they were victims to COVID-19, as lockdown of societies and economies meant they could not operate their businesses. Hence, they lived through the realities of VUCA every day.

Each country and society developed policies within the realities of their socio-economic and political realities. Financially and economically robust nations were more proactive to respond to the needs of the society and businesses, including MSMEs, while financially less-off countries faced difficulties, yet MSMEs needed to survive to make the economy running even under the lockdown conditions. The financial sector, being an important stakeholder, is expected to be part of the efforts to ease the economic and financial tension in a way to test whether it is a 'good finance for a good society' (Shiller, 2013; Akgiray, 2019). However, unless the government directives provided specific incentives, financial institutions did not show the humanistic finance side expected to be a core value in the sustainable development era as they needed to maximise shareholder interest.

During all these developments and examining the impact and consequences of COVID-19, Islamic finance principles, shaped by the *iqtisad*'s (As Sadr, 2009) normative world of *adalah* (justice) and *ihsan* (beneficence and equilibrium) leading to sharing and participatory economy,

has given some hope that Islamic finance will be able to demonstrate a different narrative compared to conventional finance implying that a human well-being and social welfare oriented face of Islamic finance could emerge to illustrate the distinction of Islamic finance. Therefore, the expectation was that Islamic banks and financial institutions could move away, at least for a short period, in mitigation COVID-19 related risks and moderate its economic and financial consequences, such as providing a positive opportunity sphere for MSMEs who were suffering under the COVID-19 conditions. Against such hopes to return to the fundamentals of Islamic morality, as discussed below, market logic have been more prevalent than Islamic logic. While in some instances, Islamic finance was more vocal than others, the general trajectory has been 'doing finance' as usual with *Shari'ah* compliant manner regardless of the circumstances.

In the analysis presented below, various practices can be observed as Islamic banking and finance responses to the needs of the MSMEs. However, it is difficult to draw a line between Islamic and conventional banking and finance regarding their differences. In other words, the normative and theoretical distinctiveness of Islamic banks and financial institutions disappears in operation under the market logic, while the degree of difference between one country and the other has to be acknowledged due to the development of the Islamic finance ecosystem.

As the analysis in the following sections demonstrates, in countries with a better Islamic finance ecosystem and architecture, Islamic banks and financial institutions have been found to be better responding to the crisis. As a developed ecosystem provides the Islamic finance institutions with a more significant opportunity sphere to develop necessary toolkits, instruments and strategies to respond to the circumstances. Despite being under market logic, implementing normative implications of Islamic logic concerning Islamic finance is significantly more possible.

The findings suggest that public policy developed by the political process for the financial world has been deterministic on the strategies designed by Islamic and conventional banks in the case studies but also the world. This suggests that Islamic banks and financial institutions, in particular, should be more flexible to go beyond the shareholder maximisation paradigm and, at least during the crisis period to make use of the essentialised principles of Islamic finance such as PLS and risk-sharing and *qard al-hassan*. Such an expectation is also very obvious from the findings developed through the questionnaire survey as the majority of the respondents opted for equity financing and *qard al-hassan* to respond to the initial difficulties created by COVID-19 conditions.

It is also important to highlight that in responding to COVID-19 conditions, in some jurisdictions, traditional Islamic social welfare institutions (or as it is called Islamic Social Finance) such as *zakat* funds and *awqaf*, have been recourse to moderate the consequences of COVID-19 on the MSMEs, if not on the operational side but at least providing means of survival for the owners and workers. This shows that authentic Islamic institutions are more capable of responding to the crisis than the Islamised institutions of the market system could. However, as discussed in the following sections, there exist important examples of how Islamic banks mobilised their *zakat* funds and *waqf* based charities to provide *qard al-hassan* financing or pay off the debts of some customers, including the MSMEs within the frame of CSR.

The analysis presented in this report, hence, has been developed through interviews and questionnaire-based survey as well as an extensive search of published material by public administrations, Islamic banks and financial institutions, *zakat* funds and *awqaf*, NGOs and professional and academic research centres. We are all grateful to all the participants in the research process leading to the completion as a report.

It is hoped that the analysis and findings can shed some light upon the performance of Islamic banks and financial institutions under the VUCA conditions such as COVID-19. It will help to recognise the good practices in the Islamic finance industry and also identify the ways we can further develop Islamic banking and finance to demonstrate Islamic logic or substantive morality of Islam in economic and financing life that is *adalah* and *ihsan* as part of *tawhid* so that *ihsani* society or the good society can be achieved as '*rahmat al alameen'* (beneficence for humanity).

Efforts for *ihsan* should be expedited so that *tawfik* (success) may be granted by Allah (*swt*).

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1. INTRODUCTION

1.1. Aim, Objectives and the Scope of the Study

Almost all countries in the world have been going through a difficult phase with a high level of uncertainties due to the COVID-19 pandemic, which has adverse effects not only on the health system of each country but also in social and economic areas. As of 18 August 2021, cumulative confirmed cases and deaths from the pandemic have reached 207,784,507 and 4,370,424, respectively. In an attempt to curb the spread of COVID-19, 4,519,541,220 vaccine doses (as of 17 August 2021) have been administered according to the World Health Organization (WHO, 2021a).

While governments have been taking measures to control the spread of the pandemic and prevent the rise in the number of deaths by supporting the health system and promoting vaccination of their societies, they have been occupied with moderating the adverse consequence of the COVID-19 outbreak on their economies. Demand and supply-sides problems have been arising since the first quarter of 2020 because of the lockdowns and other measures taken to limit the spread of the virus. While the early forecasts [1] were around 5% shrinking in global GDP, the recent estimates indicate that the global economy contracted around 4% in 2020, the worst economic performance since the Great Depression in the 1930s. On the other hand, the global economy is expected to grow in 2021 with 5.1% and 4.2% in 2022 according to the International Monetary Fund's (IMF) forecasts in January 2021 amid uncertainty and concerns about the new variants of the coronavirus (IMF, 2021a). The latest and updated forecast of the Organisation for Economic Co-operation and Development (OECD) for GDP growth rate is likely to reflect these concerns with 4.2% in 2021 and 3.7% in 2022 (OECD, 2021), which are more conservative forecasts compared to the IMF. According to Moody's Investors Service's latest report, although a relatively strong recovery is expected for 2021, many countries will not be able to reach pre-COVID-19 levels until 2022 (Moody's Investors Service, 2021).

Health policies and measures designed to contain the pandemic have adversely affected different segments of the economy. One of the most impacted sectors are informal and formal micro, small and medium enterprises (MSMEs), which constitute 95 per cent of all companies and account for 80 per cent of employment globally (WTO, 2020). During the COVID-19, this significant segment of the economy has faced many challenges, such as decreased demand, high fixed costs, lack of adequate capital, and difficulties in accessing affordable financing. To support MSMEs, government and international bodies have been announcing support packages and tax breaks in an attempt to curb the adverse impact on MSMEs, which are the backbone of each national economy.

The Organisation of Islamic Cooperation (OIC) member countries have also been affected by the severe effects of the COVID-19 and introduced measures to support local economies. The MSMEs are among the priorities as their importance in OIC member countries is more evident. According to Islamic Development Bank (IsDB), while the average number of MSMEs per 1,000 people is 25.2 globally, it is 53.2 in OIC member countries (IsDB, 2020), indicating the concentration and

[1] *While the IMF expected -4.9% contraction in GDP, World Bank's baseline forecast was -5.2% for 2020. Please see the reports, IMF World Economic Outlook Update-June 2020 (https://www.imf.org/en/Publications/WEO/Issues/2020/06/24/WEOUpdateJune2020), and World Bank Global Economic Prospects-June 2020 (https://www.worldbank.org/en/publication/global-economic-prospects).*

heavy reliance of the OIC economies on MSME sectors. This shows how vital for OIC member countries to support this segment during and after the economic and social crisis caused by the COVID-19 pandemic.

In the search for economic and financial policies to counter the adverse impact of COVID-19, Islamic finance should be considered one of the main tools to reduce the pandemic's detrimental effects on the economy. PLS and risk-sharing as well real economy-oriented nature of Islamic finance, and the presence of integrated Islamic social finance institutions (*qard al-hassan*, *waqf*, *zakah*, etc.) make Islamic finance a significant vehicle to support MSMEs in such extraordinary situations. However, the role of Islamic finance and its potential, particularly in supporting MSMEs, have to be comprehensively examined. Therefore, the study aims:

(i) to analyse and reveal the policy responses of the countries, international bodies, and Islamic financial institutions to support MSMEs against the severe effects of the COVID-19,

(ii) to investigate the potential role of the institutions and instruments of Islamic financial sectors (Islamic banking, Islamic capital markets, *takaful*, Islamic social finance, and others) in local, regional and international levels, particularly focusing on MSMEs,

(iii) to reveal the role of Islamic finance during the COVID-19 crisis and point the good practices and weaknesses through in-depth analysis of the four OIC member countries (Indonesia, Kuwait, Jordan, and Senegal) and one non-OIC member country (Russia),

(iv) to provide policy recommendations to the OIC member countries, including consideration for alternative institutional and instrumental development need in the Islamic finance sphere for MSMEs,

(v) to present the findings and policy recommendations to the members of the COMCEC Financial Working Group.

1.2. Research Methodology

In order to achieve the objectives mentioned above, the study firstly develops a critical review of the existing body of knowledge, mainly in the two chapters of the report. The emerging literature about the economic impacts of the COVID-19 pandemic on MSMEs, policy responses by OIC member countries, and Islamic finance's role was reviewed. Quantitative data to identify the significance of the MSMEs for the global economy in general and the OIC member countries, in particular, were gathered from secondary sources and were analysed. Moreover, case countries were examined through secondary sources such as reports and policy documents, and primary data were obtained from the key people in the relevant case countries through interviews to develop a comprehensive understanding of the subject matter. Considering that this study aims to explore and analyse the institutional or supply-side responses developed by Islamic banks and financial institutions, this study also assembles primary data in the form of interviews from the bankers, financiers, *Shari'ah* scholars, regulators, and policy-makers. The primary data collected from interviews provided first-hand insight into the responses of the Islamic banking and finance sector to the crisis stricken MSMEs.

The interviews are planned to produce primary material in the following areas:

- Financial and fiscal policy responses towards adverse effects of the COVID-19.
- The role and significance of MSMEs in the country's economy.
- Challenges faced the MSMEs during the COVID-19.

- Public and private and their *Shari'ah*-compliant versions for the financing of MSMEs in the sampled countries.
- Financial challenges faced by MSMEs under COVID-19 pandemic conditions.
- *Shariah*-compliant products of the governments on tackling the problems in the economy due to the COVID-19.
- *Shariah*-compliant government financing extended to MSMEs under COVID-19 conditions.
- Islamic financial institutions' policies and strategies in relation to MSMEs during the COVID-19 pandemic on financing, operational, and product level.
- The challenges faced by the *Shari'ah* compliancy process in relation to financing.
- The appropriate Islamic financing institutional logic to respond to crises.
- Alternative products and institutions that could be consistent with the nature of MSMEs.

In addition to the country case studies, to uncover the emerging economic and financial reality, this research also conducted a survey-based study to measure the opinions and perceptions of other stakeholders in the OIC member countries and beyond. Despite a global attempt to assemble more extensive data set, this part of the research managed only to get 255 responses from individuals from various jurisdictions, including the case study countries. The increased fatigue due to the COVID-19 conditions could be considered as one of the reasons. The details of the survey and the analysis is presented in a later section in this research.

The collected data in the form of secondary and primary data are employed to:

(i) identify and assess the nature and dynamics of the MSMEs sector in the sampled countries focusing on financing gap and financing channels and technologies,

(ii) assess the development trajectory of Islamic finance in the sampled countries,

(iii) explore and examine the MSMEs related financing extended by Islamic banks and financial institutions,

(iv) explore and evaluate the role of non-banking financial institutions and Islamic social financing (*waqf* and *zakat* funds) in offering financing sources for MSMEs,

(v) explore the impact of COVID-19 on the dynamics of the MSMEs sector and also on the financing extended and facilities provided by Islamic banks and financial institutions and non-banking financial sector for MSMEs under the COVID-19 conditions to moderate the consequences of the pandemic,

(vi) explore and evaluate the Islamic banking and financing related structural challenges and macroeconomic and regulative related challenges for Islamic banks and financial institutions in their MSMEs related financing offerings,

(vii) analyse the distinguishing nature of Islamic social finance in the form of *waqf*, *zakat* funds, and Islamic charities in responding to MSMEs financing needs in general and in particular in crisis periods such as COVID-19,

(viii) develop country-specific analyses for Islamic banks and financial institutions and develop industry-based insight from the results. In this, specific attention is given to crisis response capabilities and capacities of Islamic financial institutions and offerings as well as Islamic social finance,

(ix) develop policy recommendations for the Islamic finance industry and Islamic finance-related multilateral institutions and the countries, which may have implications for contingency plans for future,

(x) explore alternative forms and institutional emergence of Islamic financing for MSMEs to develop a real economy based Islamic finance sector.

The assembled data through interview and questionnaire surveys were examined and analysed through descriptive and analytical methods as well as interpretative methods. The findings developed through analysing the survey data are presented before delving into a detailed analysis of the case countries.

Based on the findings developed through a descriptive and analytical approach to the primary and secondary data, policy recommendations were developed by considering the Islamic finance development levels in the OIC member countries. As can be found in the end of this report, these policy recommendations proactively involves new institutional and instrumental development and innovation in extending Islamic finance's effectiveness in the MSMEs sector, which requires a particular form of risk-sharing.

Regarding the sampled countries, Indonesia, Jordan, Kuwait, Senegal, and Russia (non-OIC member) are selected as case countries by considering the three regions and the development level of the Islamic finance sector (Table 1).

Table 1: Case Countries

Country	Region	Islamic Finance Development Level
Indonesia	Asia	Developing
Jordan	Arab	Developing
Kuwait	Arab	Matured
Senegal	African	Developing
Russia	Non-OIC	Infancy

The rationale for the selection of the country cases is provided as follows:

Indonesia is the largest Muslim populated country in the world, which is also the largest Muslim economy in the world, and therefore it is among the G20 countries. Being a dynamic economy, Indonesia's economic performance is supported by MSMEs. The Ministry of Cooperatives and SMEs of Indonesia (MCSMEsI) (2018) has reported that the number of SMEs reached 64.2 million units or 99.9% of total enterprises with 116 million workers or 97% of total employment by 2017. They have also contributed to 61.07% of the GDP, 60.42% of the investment, and 14.37% of export (OECD, 2018; Bank Indonesia, 2018). However, SMEs face higher barriers in their operation and business expansion than larger companies. A survey by Statistics Indonesia (Statistics Indonesia, 2019) revealed that access to finance is the primary impediment for SMEs in doing business. The traditional financing from the commercial banks remains the primary source of funds for SMEs in Indonesia, even though there is a massive growth of financial technology companies that can offer comparable loans to SMEs recently (Otoritas Jasa Keuangan, OJK, or Financial Services Authority, 2019). The FSA (2019) further reported that the banks, either conventional, Islamic, or conventional with Islamic windows (hybrid), distributed nearly USD 73,6 billion to SMEs sectors or 18,60% of total banks' portfolios by 2019. In addition, rural banks are not left behind in providing financial services for small businesses, particularly in rural areas. As reported by Bank Indonesia (2019), out of 110 banks, 14 are Islamic banks, and 20 are hybrid banks in the form of conventional banks with Islamic windows. IFSB (2020)[2] reports that Islamic banking claims about 5.5% of the total banking system in Indonesia, and Islamic banking assets constitute 2% of the global Islamic banking assets. However, in terms of

[2] *In this section, all the references to IFSB relates to this report.*

SMEs, the non-banking conventional and Islamic financial sector is a critical source of funding, which is the most remarkable distinguishing nature of Islamic financing in Indonesia. Islamic non-banking financial institutions claims about 4.6% of the financial system in the country. The strength of the non-banking financial sector makes Indonesia an attractive case study to explore the MSMEs financing dynamics.

Jordan, being a Middle Eastern country with very limited natural resources, has relied on its manufacturing sector for development, making MSMEs a vital dynamic of its economy and society. The essential distinguishing nature of the Jordanian political economy is that refugees have been an essential part of its MSMEs sector. Thus, traditionally Palestinians, but since Arab Spring, Syrian and previously Iraqi refugees found opportunity space within the MSMEs sector in the country. The emergence of Islamic finance in Jordan can be traced back to the 1980s when developmentalist oriented Islamic banking emerged in the country. However, due to the sluggish development of Islamic banking in the country, the total assets of Islamic banking remain at 0.7% of the global Islamic banking assets, while Islamic banking share in the country was recorded as 11% of the Jordanian financial system (IFSB, 2020). Thus, a manufacturing-oriented country where MSMEs dominate the manufacturing and service sector with a reasonable presence of Islamic banking and finance with its large refuge communities should be considered an important case study in this research.

Kuwait is a natural resource prosperous rentier economy in the Gulf Cooperation Council (GCC), and it is the only GCC country with a monarchical parliamentary system. To diversity its economy, Kuwait has been developing strategies to contribute to the growth of SMEs, which is an important pillar of its 2030 Vision. However, the share of SMEs financing is only 7% of the total financing portfolio in Kuwait (Al-Sharekh, 2018). Therefore, there is a need for alternative financing channels, which include Islamic banking and finance. Recent market research shows that SMEs in Kuwait are interested in Islamic banking and finance (Raghu, Sudhakaran, & Faraz, 2018). IFSB (2020) reports that Islamic banking claims more than 40% of the total banking sector in the country and 6.3% of the global Islamic banking assets in the world. The Kuwaiti government has taken an institutional initiative to facilitate fund access for SMEs by establishing Kuwait National Fund (KNF) for SMEs. However, KNF has limited financing products, which makes them setting specific criteria for SMEs funding and serving selected sectors only. Hence, Islamic banking and finance with a reasonable systemic presence in the country stand as an essential source for SMEs funding. It is also important to state that with the diminishing natural resources revenue, more Kuwaiti nationals are moving into developing start-ups in the SMEs sector, which necessitates alternative resource creation for SMEs, including expansions of Islamic finance offerings. Therefore, capturing such an emerging trend along with expatriate communities' demand for Islamic financing and exploring the facilitation offered by the supply side will constitute further distinguishing the nature of Kuwait as a case study.

Senegal is considered a case study in this country due to representing the African dynamics and being a low-income country with emerging and increasing interest in Islamic finance. Being a Muslim majority country (about 96% of the population is Muslim), there is an increasing interest in Islamic finance in the country. IFSB (2020) reports that Islamic banking claims about 4% of the total financial system in the country, while Senegal has recently commenced implementing Islamic banking legal and regulatory framework suggesting the political will for the Islamic financial development. Furthermore, being a developing country, MSMEs play an important role in the growth of the economy and social development of society. The National Agency for Statistics and Demography (RGE, 2016) shows that MSMEs account for 99.8% or about 250,000 units of the Senegalese business sphere. While most of these MSMEs remain in the informal sector (about 93%) (Wellen & Melle, 2017), this feature constitutes an important distinguishing factor

as to why Senegal should be considered a case study in the research. Furthermore, expanding Islamic finance provides hope for the population to increase financial inclusiveness and enhance financial accessibility for MSMEs.

Russia is considered as a non-OIC member country, while it remains to be an observer in the OIC due to its large Muslim populations mainly residing in its autonomous or semi-autonomous regions and states within the Russian Federation. Muslims are considered to be 10% of the total population, and beyond the main Russian cities where Muslims reside, there are eight recognized Muslim republics within the Federation: Tatarstan, Bashkortostan, Chechnya, Ingushetia, Dagestan, Kabardino-Balkaria, Karachay-Cherkessia, and Adygeya. Kalimullina (2020) provides an efficient survey of Russian companies and banks offering Islamic financial services even though there is no official recognition, demonstrating that the country's Islamic finance assets increased from 199 million RUR in 2010 to 5,179 million RUR in 2019, which represents an important dynamic. Considering that the manufacturing and production sector heavily dominate Russia, MSMEs constitute the economy's backbone. Exploring Islamic finance offerings for the MSMEs sector within such an economic sphere should be considered an important contribution to knowledge and practice.

1.3. Overview of the Study

The remainder of this study is structured as follows.

Chapter 2 discusses the role of the MSMEs in the OIC member countries in particular and the world in general and the challenges they have faced during the COVID-19. It also discusses the COVID-19, MSMEs, and financing responses through the secondary material. In addition, the challenges that MSMEs face are also explored in this chapter.

Chapter 3 focuses on Islamic finance's role in supporting economies, particularly MSMEs in OIC member and non-member countries. Before mentioning the initiatives taken in different countries by Islamic financial institutions, the distinct features of Islamic finance are presented. Moreover, Islamic social finance institutions such as *zakah* and *waqf* are discussed by considering the adverse effects of the COVID-19 pandemic on MSMEs. Finally, the best practices are provided.

Case countries, namely Indonesia, Jordan, Kuwait, Senegal, and Russia, will be examined through secondary sources such as reports and policy documents, and primary data were obtained from the key people in the relevant case countries through interviews to develop a comprehensive understanding on the subject matter in Chapter 4. The analysis in Chapter 4 also presents the results from the descriptive study of the survey-based data, which provides additional insights by the larger stakeholders in quantitative and qualitative meaning.

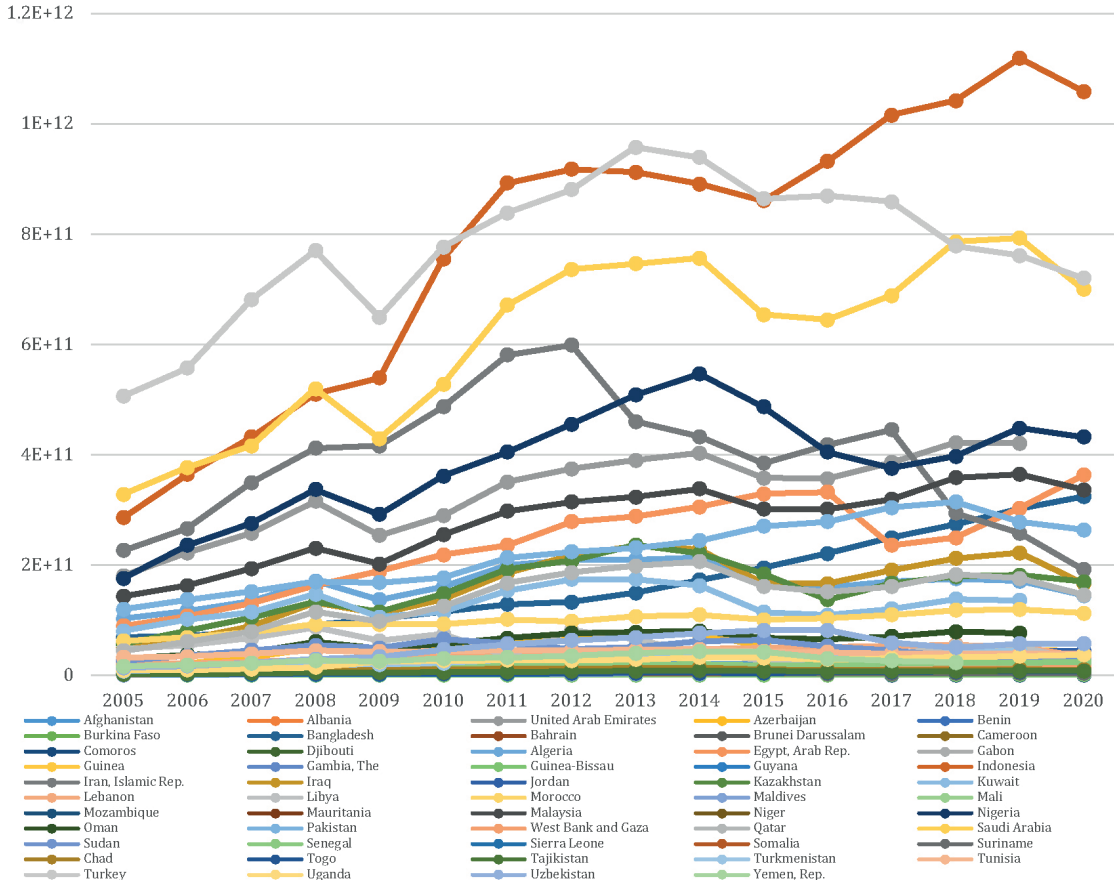
Chapter 5 draws up concrete policy recommendations on improving the role of Islamic finance with a particular focus on the MSMEs and concludes the report. Policy recommendations are designed in the form of a roadmap from which the OIC member countries could benefit from their efforts to support MSMEs during and after COVID-19. Each policy recommendation is presented as precise, applicable, and result-oriented. Furthermore, the chapter provides the rationale of each policy recommendation to pave the way to improve the best practices for all OIC member countries for knowledge and experience transfers and promoting the role of Islamic finance.

2. COVID-19 PANDEMIC CONDITIONS AND ITS IMPACT ON MSMEs FINANCING AND PERFORMANCE: GLOBAL PERSPECTIVE

2.1. Political Economy of COVID-19

COVID-19, a global health-related crisis or pandemic, has had a direct economic and financial impact in every part of the globe, affecting the social formation and structure of each society. Due to the inevitable lockdowns observed by every society in the world to keep individuals and society safe from COVID-19 infections, millions of people lost their jobs and faced severe reductions in their incomes amid millions losing their lives to the pandemic. According to the International Labour Organization's (ILO, 2021) recent estimates, 8.8 per cent of global working time during the pandemic was lost compared to the fourth quarter of 2019, comparable to 255 million full-time jobs (ILO, 2021). These figures demonstrate the devastation experienced is around four times bigger than the impact of the global financial crisis in 2009, as the latter affected the countries with large financialised economies.

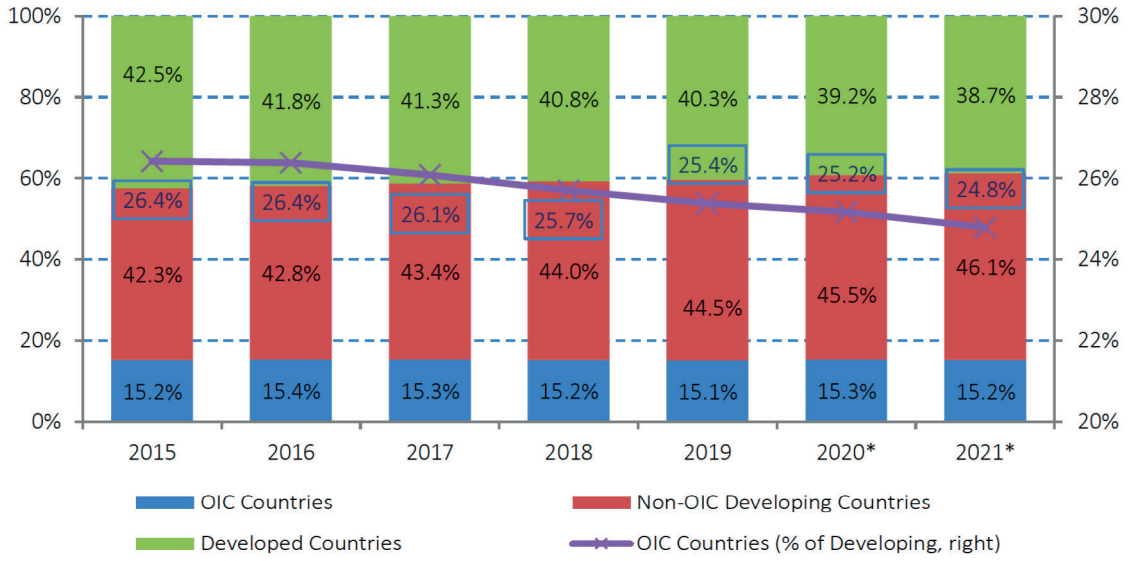
Figure 1: GDP of the OIC Member Countries



Regarding the OIC economies, Figure 1 depicts the trends in the GDP of the OIC countries (with current USD), which captures the impact of the 2008 Global Financial Crisis as well the COVID-19. Since the data for 2021 are not available, it is difficult to observe how long it will take for the OIC economies to bounce back to the pre-COVID-19 period. However, as the trends show,

the OIC economies suffered a decline in their GDPs in 2020. Examining the impact of the 2008 Global Financial Crisis, it is evident that most of the OIC member countries bounced back very quickly, which can be explained by their relatively limited exposure to financialisation and global financial connectiveness at that time. However, the impact of COVID-19 has been on the real economy, taking a heavy toll on business activities and resulting in increased unemployment. Therefore, it may take longer for most economies to bounce back, as the decline in the tax revenues and increased debt would imply that the public sector will find it challenging to provide further incentives for a speedy economic recovery.

Figure 2: Comparative Economic Performance (GDP) (PPP in Current USD)



Source: SESRIC (2020, p. 30)

In comparing the country groups, Figure 2 shows that the share of the OIC countries in the global GDP has not been heavily affected. While this relative performance in relation to other countries could be convincing, when OIC countries are taken as a single group as in Figure 2, the decline in GDP is rather apparent.

Due to lockdown and quarantines, economic activity has been slow down, resulting in liquidity easing through monetary policies and expansionary fiscal policies facilitated with extensive borrowing by governments from the private sector to fund the emerging costs of the COVID-19 impact. It has also resulted in the displacement of spending priorities, as development-oriented projects have to be postponed for the sake of urgent cash need for the budget to finance the contingency expenditures such as financial help to the business sector and also welfare support for the larger public.

The reduction in the tax revenues due to economic slowdown has increased the budget deficits resulting in increased public borrowing requirements. As a result, the total amount of the packages related to fiscal policies of many developed countries have reached more than 10% of their 2020 GDP to cope with the adverse effects of COVID-19 (IMF, 2021b). However, despite such expansionary monetary and fiscal policies pursued by governments all over the world, according to OXFAM's (2020) research, more than 2 billion people have not received any

assistance from their governments in times of need. The study further indicates that no social safety support for unemployed people, the elderly, children, and families has adequately met fundamental necessities in low and middle-income countries. Moreover, 41% of the government assistance was a one-time payment, and they did not continue (OXFAM, 2020). On the other hand, despite the welfare-oriented policies in some countries, the share of wage earners declined heavily throughout the world, while the capital owners increased their share in the wealth of each country. Thus, the observed inequality has increased globally due to the pandemic as the accessibility of the lower income groups to economic means has further been narrowed. This is evidenced by the movements in the stock markets, as stock indices have continued to grow despite the COVID-19 conditions implying the increased gains to the capital owners.

Financial markets based on the credit system have suffered in the process, as the return of the credits has become challenging, while returns from financial investments have declined. In some countries, the banking sector has been further politically dominated to provide cheaper credit as a lubricant for the running of the economy, which brought the financial industry under further pressure. In addition, many policy measures regarding financial support to MSMEs, such as low-interest credits, have been extended mainly through state-owned banks.

The real economy has been affected by declining business cycles all over the world. As the foundation of the real economy, MSMEs were not speared from the same business and financial challenges. MSMEs constitute 95 per cent of all companies worldwide, contributing to 60 per cent of employment (WTO, 2020), which have suffered enormously from the COVID-19 conditions. In particular, insufficient financial support from the government and the relevant agencies has made their sustainability and survival very difficult, resulting into massive closures. The financial gap experienced by the MSMEs has been exacerbated during lockdown periods in the face of a business slowdown.

As part of the global solidarity, the rich nations have been called for support to the emerging countries through direct financial aid, debt reliefs, and other options along with tax increase (including wealth taxes) for the wealthiest citizens and corporations (OXFAM, 2020). International aid is expected to include vaccine donations from rich countries to the poor. However, the calls have not been realised yet, and the global inequalities have become more severe due to the detrimental and complex effects of the COVID-19, including vaccine poverty in the developing world, leading to a new dimension to global inequality. In the face of declining international aid from advanced economies to developing countries, the observed global inequality has also increased.

Consequently, a new political economy emerged as a result of the COVID-19 conditions, which has brought the state to the centre of economic life to reallocate the existing resources and generate new resources through borrowing for the business sector and citizen welfare. However, this will have an essential adverse impact on the welfare and budget prudence for years to come. Therefore, to overcome the impact of the increased budget deficit and public sector borrowing requirement, it is expected that the post- COVID-19 period will include austerity policies that will further deepen the observed national and global inequalities.

The new political economy also includes the dynamic role of the civil society institutions, such as charities in general and *zakat*, *waqf* and *sadaqah* type Islamic institutions in the Muslim world. Such traditional Islamic institutions have played a vital role to moderate the adverse consequences of COVID-19 on the well-being of individuals and the short-term needs of MSMEs in many Muslim countries in the face of social failures of modern financial institutions. Similar experiences have been witnessed in the advanced economies as charities reach out to the poor

and needy to ensure their well-being in the face of the formal system failing to reach. Therefore, the new and emerging political economy in the 'new normal' has to recognise the vital role of the civil society in responding to crises, whether health or economic and financial crises, by opening up the public sphere for the voices and activities of the civil society. This includes formalising the *zakat* funds and *waqf* in the civil society of the Muslim world as a rapid economic and financial force to respond to crises conditions beyond the red-tape of bureaucracy.

The new normal has to bring about new definitions of institutions and instruments as part of the emerging political economy. As COVID-19 conditions have proved, an essential quality of Islamic political economy that is *mizan* (balance) can be sustained only through *ihsan* (equilibrium functioning beneficence). This implies that those who are better off are expected to contribute to the well-being of those who are worse off so that equilirium can be achieved so that *mizan* can be sustained. Therefore, the institutionalisation of *zakat*, *waqf* and *sadaqah* in civil society will contribute to the wellbeing of the individuals and the welfare of the society at large.

In the redefinition of institutions, Islamic banks and financial institutions should be allowed a new opportunity space to fulfil their aspired objectives. While developments in Islamic finance and banking provide a unique opportunity to revitalise Islamic institutions to develop OIC economies and societies, this unprecedented success is limited only to transactional success. However, the transforming role of Islamic finance and banking has not been fulfilled as it has been forced to operate within the existing financial and market logic. Islamic logic as expressed in the aspirational description of Islamic finance (profit-and-loss sharing and risk sharing, real economic activity etc.), which is essential for the development of MSMEs, has not been operational yet, as institutional and operational mimicry from the market logic is forced upon these institutions. The emerging political economy must recognise the distinctiveness of Islamic finance beyond '*riba* prohibition' in terms of transforming role, and, therefore, must provide an alternative opportunity space so that Islamic finance can better respond to crises, can effectively contribute to the real economy, including MSMEs and job creation, and poverty alleviation and enhance human wellbeing and societal welfare, as the Islamic economic doctrine or Islamic logic suggests.

2.2. Effects of Pandemic on MSMEs and Policy Responses in Global

2.2.1. Impacts of Pandemic on MSMEs

Due to the declining business cycles and business operations, MSMEs have faced many challenges during the pandemic due to the unconventional measures not seen in previous crises, such as partial or complete lockdowns. According to the *ITC COVID-19 Business Impact Survey* (International Trade Centre, 2020), which covers 4,467 companies in 132 countries, the pandemic has strongly affected 55% of the respondents. Nearly two-thirds of micro and small firms stated that the pandemic adversely impacted their business operations, compared with 40% of large companies.

The adverse effects of the pandemic on MSMEs, which is the backbone of many economies, have been emerged in different ways, which are mainly related to the demand and supply sides. However, we can classify them into four broad categories: (i) demand reduction, (ii) supply chain problems, (iii) worsening accessibility to financing, and (vi) disruption in international trade operations.

Although several sectors have benefitted from the COVID-19, such as around 10% of firms in agri-food processing seen an increase in sales (International Trade Centre, 2020), demand reduction is one of the significant impacts of the COVID-19 on many MSMEs global. Many governments

have introduced lockdowns to tackle the spread of the virus. Therefore, especially service sectors such as shopping malls, tourism agents, and small retailers have faced a significant decrease in demand. For instance, in a study related to Brasil (Moreno, 2020), 89% of MSMEs indicated an average fall of 60% on revenues. When we consider the fixed operational costs and cash reserves of the MSMEs, the detrimental effects of the demand reduction have become more severe. This is not a severe issue only for MSMEs in developing countries but also for MSMEs in advanced economies. According to a critical study, in the USA, 47 per cent of the small businesses had two weeks or less cash liquidity, and only 40 per cent had more than three weeks cash buffer (Farrell *et al.,* 2019). In another recent survey by the OECD (2020), one-third of the examined SMEs could only cover fixed expenses of one month with current cash reserves and another third for two months. Therefore MSMEs may have high insolvency and bankruptcy risk if the liquidity problem persists due to the containment measures during the pandemic (Adian *et al.,* 2020; OECD Secretary-General, 2020). On the other hand, the insolvency of the MSMEs in some countries may expose further financial problems for financial providers, particularly microfinance institutions (MFIs) which play a leading role in financing micro and small enterprises. According to some estimates, for example, IsDB (2020, p. 25) report suggests that "MFIs offering only financing options may not survive through the lockdown if it exceeds more than two months".

Pandemic has also affected businesses in supply-side related dimensions. According to OECD (2020) businesses haced shortage in labour supply due to the COVID-19 related direct and indirect impact. "In addition, measures to contain the disease by lockdowns and quarantines lead to further and more severe drops in capacity utilisation. Furthermore, supply chains are interrupted, leading to shortages of parts and intermediate goods." (OECD Secretary-General, 2020, p. 3).

The impact of the COVID-19 on MSMEs have been more severe due to the chronic problem of this segment of the economy in accessing timely and affordable financing compared to the larger firms. Because of the reduction in revenues due to the decrease in demand, rise in costs, and limited cash reserves of the MSMEs, access to financing has become an important source of the difficulty. According to OECD's research (2018), fast-growing, innovative firms, micro-enterprises, start-ups, young SMEs, businesses located in remote and/or rural areas, and women-owned enterprises face more challenges in accessing financing. They, especially microenterprises, have been excluded from the conventional financial institutions due to several features of the MSMEs, such as lack of collateral, no credit history, financing being more costly than other financing segments, and operating peripheral places. Before the pandemic, the financing gap for MSMEs was estimated by IFC (2017) for developing economies around $5.2 trillion every year, and 65 million formal MSMEs representing 40 per cent of all enterprises in the 128 reviewed countries, are credit constrained. Due to the pandemic, the financing gap for MSMEs is estimated to increase by $2.9 trillion in developing countries (Adian *et al.,* 2020), which will remain a new challenged for the emerging political economy.

As another source of difficulty, MSMEs have been affected by the disruption in international trade during the COVID-19 period in both demand and supply sides. Because a large number of these firms "either … export their products through direct or indirect channels, or because they rely on imported inputs to manufacture the products they sell domestically" (WTO, 2020, p. 2).

The business and finance related challenges for the MSMEs have a spillover impact on the economy and society. While horizontally and vertically linked businesses have experienced such difficulties, the loss of business, closure of business and increased consequent job losses have a more considerable societal impact as the social fabric of the societies are adversely impacted, resulting in disharmony and decline in human wellbeing and social welfare.

2.2.2. Policy Responses towards MSMEs

In developing policy measures and responses, the private and public sectors in each jurisdiction in the world have introduced various measurements to tackle the problems faced by MSMEs during COVID-19. However, private sector initiatives were minimal compared to the public sector, using multiple fiscal and monetary policies. In the private sector, it is observed that some commercial banks have provided debt repayment moratoria for SMEs with liquidity shortages (OECD, 2020).

The governments have assumed a leading role, although the measures were insufficient to support MSMEs in many jurisdictions. Mainly fiscal policies in the form of demand inducing incentives, tax-relieves and monetary policies in the form of liquidity easing have been introduced to support MSMEs, which have fallen to liquidity shortages due to containment measures taken to limit the spread of the pandemic. According to the OECD, these measures include deferral of tax, social security, rent, utility and debt payments, faster payments for public procurement contracts, loan guarantees and direct lending to SMEs, grants and subsidies. (OECD, 2020).

The World Bank follows the policy actions taken by countries for MSMEs closely and classifies them in eight categories: (i) debt finance, (ii) employment support, (iii) tax, (iv) business costs, (v) other finance, (vi) demand, (vii) business climate, and (viii) business advice (Adian *et al.,* 2020). Different measurements have been used under these categories ranging from direct cash support to easing legal requirements. Also, several public institutions and private companies have an active role in implementing the measurements to support MSMEs. For instance, some governments have eased the capital requirements for commercial banks to encourage them to extend financing to the MSMEs, which have been firmly in need of funding in the face of pandemic conditions.

Table 2, thus, summarises the types of support provided to SMEs during the COVID-19 period.

Table 2: Support Types to SMEs During Pandemic

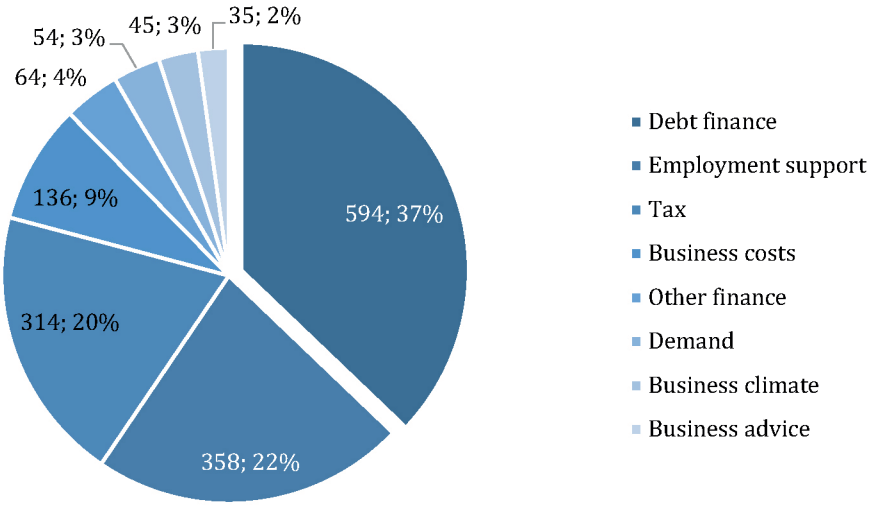
Type of Support	Instruments
Debt finance	(i) Capital buffer safeguards requirements on banks and central banks' actions to induce commercial banks to increase lending to SMEs, such as lowering capital requirements; (ii) Credit guarantees - new schemes, more generous guarantee levels; (iii) Delayed repayments; (iv) Deferral of payments, restructuring and rescheduling; (v) Existing lending with reduced or no interest, and/or lower collateral requirements; (vi) New lending – under concessional terms; (vii) Rapid approval/dispersal arrangements, low/no fees, removal of fees/penalties (e.g. for overdrafts)
Employment support	(i) Cap on layoffs; (ii) Increased labor training subsidies; (iii) New working schemes; (iv) Other Employment; (v) Provide wage subsidies (can be broad, or targeted – e.g. apprentices) as an alternative to direct payments to individuals; (vi) Retirement funds frontloading; (vii) Subsidies for employee sick leave; (viii) Support for informal or self-employed workers; (ix) Unemployment benefits

Tax	(i) Corporate tax – rate reductions, credits, waivers, and/or deferrals; (ii) Expedited tax reimbursements; (iii) Incentives for capital expenditure (larger/wider limits, accelerated depreciation, broader range of products eligible); (iv) Other Tax; (v) Payroll/social security/VAT taxes/land taxes - rate reductions, credits, waivers, and/or deferrals; (vi) Simplified tax procedures and regulations
Business costs	Changes to bankruptcy, business closure, insolvency, business restructuring regulations; New working arrangements; Reduction or waiver of administrative and government fees; Rent/leasing - reductions (if the government is the landlord), direct payment or indirect (e.g. tax concession for suppliers/ landlords); Utilities – reduction of direct or indirect (e.g. tax concession for suppliers/landlords) fees and payments
Other finance	Grants; Supply chain finance, factoring, leverage online platforms for conducting reverse factoring transactions that can facilitate supply-chain finance to MSMEs and shorten the maturity of the payments involved; Support for firms that need to close or have reduced their activities
Demand	Other Public Expenditure Programs; Procurement - Increase purchases from SMEs and/or Increase margin for SME-sourced product; ease procurement processes; Support for corona-related production - e.g. healthcare products (grants, procurement, et al.), either to ramp up existing capability or for new capability; Targeted (sector or region) expenditure programs
Business climate	Changes to bankruptcy, business closure, insolvency, business restructuring regulations; Reduced import restrictions (NTBs, duties) on intermediate goods; Simplified foreign exchange arrangements (for those countries where this is an issue)
Business advice	Mediation services (contracts, financial etc.); Subsidised business advice (e.g. through vouchers) and information (e.g. through chambers, industry organisations, accountants, etc.) on emergency support measures, and business operations; Other finance; Vouchers for remote business services (e.g. purchasing teleworking service products)

Source: Adian et al. (2020) and World Bank (2020)

According to the World Bank database, which provides policy measures taken by countries under the mentioned eight categories, globally, 1,600 types of instruments have been used in total. As shown in Figure 3, 37% of these measurements, namely 594, are debt finance type instruments, followed by employment support with 22%. Tax and business costs are other essential measurements groups in supporting SMEs. Each country has implemented these measures at different levels, depending on its internal dynamics and economic capacity. Apart from these measurements, some countries have supported SMEs in adopting new capabilities such as digitalisation (OECD, 2020).

Figure 3: Type of Measures and Their Percentages



Source: World Bank (2020)

Note: Percentages in the figure show share of each type of support in the total of support measures.

In addition, a survey conducted by International Trade Centre (2020) indicated that the government supports that business owners think are the most effective are tax waivers, temporary tax relief and financial programmes. In the same research, a third of small companies also emphasised the significance of cash transfers, revealing their concern about continuing their operations during the crisis. The expectation of cash support as a grant by MSMEs is also pointed by Adian *et al.* (2020, p. 3), and they emphasised that "the majority simply do not turn to banks for loans, despite record low-interest rates. But not all governments have the budget for grant support". On the other hand, the survey revealed that large companies had seen employment programmes more effective because these measures support their workers' income and ensure the sustainability of their businesses (International Trade Centre, 2020).

2.3. Policy Responses by OIC Member Countries towards Pandemic

MSMEs are an essential component of the economies of the OIC member countries as the average number of MSMEs per 1,000 people in OIC is 53.2, and the figure is more than double the world average of 25.2 (IsDB, 2020). Therefore, the policy measures taken by the OIC countries to support MSMEs have become more significant. Member countries have introduced several policy actions depending on the economic capacity and the severeness of the pandemic. The report by SESRIC (2020) categorised the initiatives in OIC member countries under three policies: fiscal, monetary, and balance of payments (BoP) and exchange rate. As shown in Table 3, while 42 countries out of 52 member countries have implemented fiscal stimulus package, the number of countries that introduced policies related to BoP and exchange rates have been relatively lower.

Table 3: Economic Policy Responses of OIC Countries to COVID-19 as of 27 April 2020

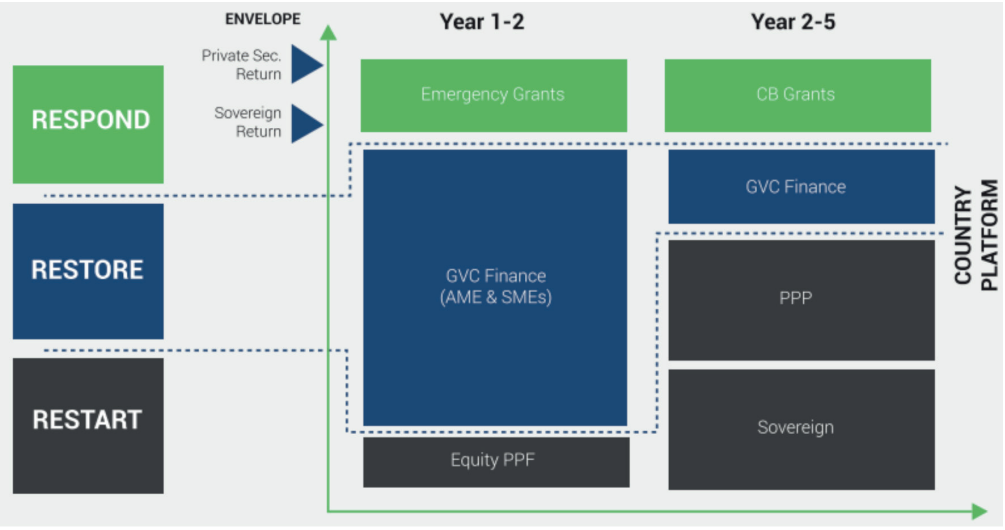
Policy Category	Intervention Type	# of Implementing OIC Countries
Fiscal Policy	Fiscal stimulus package	42
Monetary Policy	Interest rate cut	26
	Monetary stimulus package	19
	Other monetary policy measures	45
Balance of Payments (BoP) and Exchange Rate Policy	Direct monetary policy intervention to control BoP and exchange rate	5
	Accompanying monetary policy intervention to stabilise BoP and exchange rate	15

Source: SESRIC (2020)

Note: Total number of OIC Countries available in the database is 52.

Apart from government measurements, the most critical initiative for supporting member countries is the IsDB Group response package. "The total amount approved for the program is US$2.28 billion, which comprises US$1.58 billion from IsDB, Islamic Solidarity Fund for Development, and King Abdullah Program for Charity Works, and US$700 million from IsDB Group entities including ITFC, ICIEC, and IRTI" (IsDB, 2020, p. 39). As can be seen from Figure 4, the program consists of three phases: respond, restore and restart, and different steps are expected to be implemented within five years.

Figure 4: The IsDB's Response Program



Source: IsDB (2020, p. 37)

The Response track of the program targets to meet the emergency needs of the member countries, including healthcare and food security. IsDB has developed different projects and interventions by considering the specificities of each country. The Restore track aims to provide financing to SMEs and the trade activities related to strategic value chains. The last phase, namely the Restart track, focuses on 'Economic Resurgence' by helping the member countries to retake the economic activities to the sustainable growth path. The last trach has long term actions (IsDB, 2020).

The plan primarily targets supporting MSMEs to help them recover quickly through different programs implemented by the Group entities. These policies include financing, trade facilitation, and providing insurance to the private sector (IsDB, 2020).

Each country within their jurisdictions endeavours to mobilise private resources, including the private sector such as banks and financial institutions. However, private gain plays a vital motive for banks and financial institutions to develop a more proactive role in responding to the pandemic conditions. In addition, since Islamic finance and banking is not fully integrated into the operations of national economies in the Muslim world, the direct relationship between monetary and fiscal policies and Islamic banking and finance is yet to emerge, which hampers the impact of Islamic finance in crisis response.

3. COVID-19 PANDEMIC AND ISLAMIC FINANCE

3.1. Distinct Features of Islamic Finance in Responding to Crises: An Islamic Economics Perspective

Islam is defined as a natural way of life, which implies that Islam ontologically relates to all aspects of human life. Through the ontological sources, namely Qur'an and *Sunnah/Hadith,* and also with the contribution of secondary sources such as classical knowledge and Islamic law, it brings rules and injunctions to regulate everyday life, which includes economy and finance.

As based on the Islamic view, the Islamic economy as a lived experience and Islamic economics as a theory is a part of the Islamic order, which is determined by *tawhid* (unitarity and complementarity), which consists of *aqidah* (faith and belief), *shariah* (practices and activities), and *akhlaq* (moralities and ethics). Islamic order leads to the Islamic worldview, which shapes the definition of human and the relationship between humans and other resources. Accordingly, a socio-tropic individual is defined, whose objective function is determined as *'falah'* (salvation in this world and hereafter) (Khan, 1984). Subject to the nature of *ihsan* (beneficence) one can do in relation to their respective wealth in contributing to equilibrium or *mizan,* namely balance.

As Islamic worldview, through *tawhid*'s complementarity and unitarity, constitutes the operation of the world and the relationships between humans, and humans and resources through *mizan* implying that each stakeholder compliments each other to reach unity (Asutay, 2019). Thus, *ihsan* as a micro behavioural norm and also a macro-level governance form constitutes the nature of Islamic economics or *Iqtisad* (As-Sadr, 2009) so that the sustainability of *mizan* can be possible. The foundational base of Islamic economics/*iqtisad* suggests that the main thrust is '*awqaf* (justice) and *ihsan* (beneficence)', the permenance around which Islamic economic activity takes place (Naqvi, 1981, 1994; Asutay, 2007b, 2012). As a consequence, the interest of all the stakeholders has to be in harmony *(tazkiyah)* as Islamic economics is predicated on the Islamic norm that Allah *(swt)* created all the stakeholders, including human, with a development path to reach their perfection *(rubbubiyah)* (Ahmad, 1979; Asutay, 2007a,b). Hence, *mizan* requires *ihsan* to be actualised so that *adalah* or justice can be actualised. Therefore, as the methodological base of Islamic economics, *maqasid al-Shari'ah* (the objective of *Shari'ah*) is defined as 'wellbeing of human and all the other stakeholders' (Chapra, 2000, 2008; Asutay, 2007a, 2012, 2013; Asutay & Yilmaz, 2018). Thus, any economic and financing activity has to produce positive consequences for the well-being of humans and other stakeholders. Consequently, Islamic economics logic provides a particular vision and covers all economic aspects of life through its principles and value system at both micro and macro levels.

As part of the Islamic logic, as distinct from market logic, *iqtisad* through *qasd* refers to 'directing towards an objective', 'true path', 'in line with an aim', 'equable' and 'temperate', while through *qist,* it refers to 'just share' and hence 'justice' (Al-Hasani, 1989). Thus, *iqtisad* relates to 'giving the right of everything', 'locating everything in its place', and hence 'establishing justice' so that *mizan* (balance) through *ihsan* can be sustained (Al-Hasani, 1989). This refers to stake-holding based development and embeddedness in the social formation of the society. Thus, all the economic and financial activity that emerges from Islamic logic must be embedded into Islamic norms. One of the implications of this embeddedness is real economic activity (Ayub, 2007) and ruling out financialization and fictitiousness (Asutay, 2007b, 2013).

In line with this, Islamic economics is defined as either constituting *adalah* or justice or preventing injustice so that *falah* can be achieved:

> "the science that deals with wealth and its relation to man from the point of view of the realization of justice in all forms of economic activities." (Abu al Makarim, 1974)
>
> "the knowledge and application of injunctions and rules of the *Shariah* that prevent injustice in the acquisition and disposal of material resources in order to provide satisfaction to human beings and enable them to perform their obligation to Allah and the society." (Hasanuzzaman, 1984, p. 52)
>
> "aims at the study of human *falah* achieved by organising the resources of earth on the basis of cooperation and participation." (Khan, 1984, p. 55)

Consequently, Islam emphasizes justice in all parts of society and aims to realize and promote human wellbeing (Chapra, 2000) through individuals, organizations, or institutions. In other words, the main target of the Islamic economy is to achieve human welfare and articulate knowledge through operational institutions. Thus, at the core of Islamic economics movement is centred on development discourse in the form of human wellbeing and the wellbeing of other stakeholders (see: Chapra, 1992, 1993; Ahmad, 1979, 1994). An essential consequence of this is to develop the empowerment of individuals such as through entrepreneurship (Asutay, 2019b) and hence the importance of why MSMEs financing remains an important area for Islamic banks and finance.

The emergence of the Islamic economics movement in the post-colonial period aimed at rescuing humans, labour, land/environment, and all the other stakeholders from domination so that Islam's objective of *tawhid* can be achieved (Asutay, 2019a). However, this counter-hegemonic movement could not reach its objective to deliver justice due to the dominance of market logic (Asutay, 2019b). However, the leading institutional development has been the emergence of Islamic banking and finance since the 1960s.

While Islamic finance is expected to operate within negative screening to avoid *riba* and *gharar* (Ayub, 2007; Iqbal and Mirakhor, 2006) in an aspirational sense, Islamic finance offers a larger paradigm. Islamic finance is expected to operate within a profit-and-loss sharing, and risk-sharing framework and work with real economy consequences (backed by assets) to prevent making money from money and fictitious transactions (Ayub, 2007; Iqbal and Mirakhor, 2006). Thus, within Islamic economics, Islamic finance and banking are expected to ensure the Islamicity of the transactions and work within the Islamic paradigm to essentialise transformative role (Asutay, 2013, 2019a) so that the wisdom in the prohibition of *riba* can be achieved. Therefore, as As-Sadr states (1982, p. 64):

> "To understand the Islamic economy, we must not study it by one part thereof excluded from others. For instance, we should not study Islam's prohibition of usury or the permission about private ownership as being separate from other parts of the general plan of the Islamic economy. Similarly, it is not permissible to study the whole of Islamic economy as being something separate and a doctrinal entity independent of the rest of the religious' entities including the social, political and other ones and of the nature of the relations existing between these entities. We must understand the Islamic economy as a part of the general system of Islam which organises different aspects of life in the society."

Islamic financial institutions, however, are the main institutional components and operational parts of the Islamic economic system along with traditional Islamic economy institutions such as *zakat* and *waqf.* While the initial experiments in the 1960s have been social credit nature in their essence, since 1975, Islamic commercial banks have emerged to operate within the market logic plus *Shari'ah* compliance (Asutay, 2012, 2013). Thus, the hybrid model has been under scrutiny regarding its proximity to the Islamic economics/*iqtisad* worldview.

In its hybrid nature (market logic plus *Shari'ah*-compliant nature), Islamic banking and finance has demonstrated unprecedented success within the modern global financial system. However, although the Islamic finance industry has grown substantially, it has mostly succeeded in a limited number of regions and mainly remaining as a financial alternative devoid of a transformational role (Asutay, 2007b, 2013). Therefore, there is a considerable amount of opportunity for the industry to grow further by increasing public awareness, but also there is an opportunity space to develop to achieve the aspirational objective to contribute to the general welfare of the society in terms of Islamic logic rather than only benefiting the capital owners as imposed by the market logic.

The historic juncture for the global development of the industry has been the global financial crisis of 2008. Since the core pillars of Islamic finance require the prohibition of speculation, promoting asset-backing principle, risk-sharing, the industry has proved its soundness and resilience against the financial crises. Therefore, Islamic finance has been recognized as part of global finance with its growing customer base, asset size, diversified instruments and institutions, and geographical spread.

Islamic finance, which showed resilience against the crisis during and after the global financial crisis in 2008. Therefore, it can be one of the primary institutional arrangements to reduce the pandemic's adverse impact and consequences, as observed since the beginning of the 20th century.

Theoretically, profit and loss sharing and asset-backed nature, having Islamic social welfare institutions/products *(qard al hassan, waqf, zakah,* etc.), and being embedded into the real economy makes Islamic finance a vital and significant vehicle to support MSMEs in such extraordinary or crises situations. Moreover, Islamic finance possesses robust and comprehensive tools to help vulnerable people and the health system during the pandemic and contribute to shared prosperity (S&P Global Ratings, 2020). Accordingly, Islamic finance provides two lines of defence against crises in general: (i) a close link with finance to real economic activities and (ii) a solid social safety (IsDB, 2020). While the former provides defence against endogenous risks, the social safety net tools such as *zakat* can help tackle exogenous risks. Consequently, Islamic finance should provide solutions and support society against the detrimental impacts of the pandemic, including economic and health-related issues, to ensure the overall objectives of Islam. In particular, Islamic finance is expected to contribute to the overall wellbeing of all the stakeholders, including the operations of MSMEs, which is the subject matter of the research presented in this research.

Despite Islamic logic's expectations, Islamic banking and finance has been under pressure from the market logic and the regulations and standardization developed for the industry under the market logic. Therefore, Islamic banking and finance is criticised for not delivering on the aspirational expectations and not contributing enough to the development of the Muslim societies whereby transformation can be achieved. A relevant area of criticism is the lack of available financial resources extended to the MSMEs and other productive sectors. Real estate and financial sector related financing seem to be dominant in the Islamic banking and finance sector (Jan and Asutay, 2019). Therefore, in recent years, we have seen the surge of emphasis on Islamic social finance to fill the gap and fulfil the aspirational promises through traditional and embedded Islamic institutions such as *zakat* and *waqf*. However, the emergence of Islamic fintech platforms is expected to expand the Islamic finance sphere and increase the accessibility for sectors such as MSMEs, which has not been touched by Islamic banking and finance.

3.2. The Performance of Islamic Financial Institutions under Pandemic Conditions

One of the areas most affected by the global pandemic, which has been felt almost all over the world since the end of 2019, is the economy. Not only individuals but also institutions have been affected by this unexpected situation and endeavoured to take steps to reduce the adverse effects. Islamic financial institutions, which have a systematically important place in the countries where Muslims are the majority, have also been affected by the pandemic. Various aspects similar to many countries, particularly demand contraction, economic slowdown and uncertainties, and different risks specific to countries, have also determined the degree of impact of the COVID-19 on the Islamic finance sector. For instance, some jurisdictions also have had challenges due to the decrease in the oil prices during the pandemic along with the demand reduction and other common adverse impacts of the COVID-19.

Regarding total assets of the Islamic financial sector is considered, according to the latest data by (IFSB, 2021) as depicted in Table 4, the total asset size of the Islamic finance sector has slightly increased from 2.44 trillion in 2019 to USD 2,70 trillion in 2020 with 10.7% YoY growth rate [2019: 11.4%] despite the negative effects of the COVID-19 pandemic. Regarding the concentration of Islamic finance according to the region, as indicated in Table 4, the GCC region still had the most significant share (48.9%), USD1,318.7 billion in 2020. GCC is followed by South-East Asia, one of the most potential regions for the growth of the Islamic financial market with the regional countries such as Malaysia and Indonesia, recorded USD670.6 billion total assets and 24.9% share in the global Islamic finance sector in 2020. The market share of the Middle East and South Asia (MESA) significantly decreased from 25.9% (in 2019) to 20.3% in 2020. It is important to stress also that the total Islamic finance assets of Africa reached USD46.9 million and has a share of 1.7 percent of the worldwide industry.

Table 4: Islamic Finance Components, 2020 (USD)

Region	Islamic Banking	Outstanding Sukuk	Islamic Funds' Assets	*Takaful* Contributions	Total	Share
GCC	979.7	280.4	46.3	12.3	1,318.7	48.9%
South-East Asia	258.2	366.4	41.9	4.1	670.6	24.9%
The Middle East and South Asia	499.0	18.9	22.8	5.5	546.2	20.3%
Africa	43.1	1.7	1.5	0.6	46.9	1.7%
Others	61.8	22.1	31.3	0.6	115.8	4.3%
Total	1,841.8	689.5	143.8	23.1	2,698.2	100.0%
Share	68.3%	25.6%	5.3%	0.9%	100.0%	

Source: IFSB (2021, p. 6)

Islamic financial sector compromises three main sectors: Islamic banking, Islamic capital markets, and Islamic insurance *(takaful)*. As shown in Table 5, Islamic banking was still the dominant segment, with 68.3 per cent [2019: 72.4%] in 2020. The Islamic banking sector grew 4.3 per cent and reached USD 1,841.80 billion [2019: USD 1,765.8 billion] in the relevant year. *Sukuk* market and Islamic funds constitute Islamic capital markets and represented 25.6 per

cent [2019: 22.3%] and 5.3 per cent [2019: 4.2%], respectively in 2020. Islamic funds showed significant growth, with a 40.6 per cent YoY increase in 2020. The share of the takaful segment decreased to 0.9 per cent in 2020, from 1.1 per cent in 2019. *Takaful* is the only sector among Islamic finance sectors contracted in 2020 (Table 5).

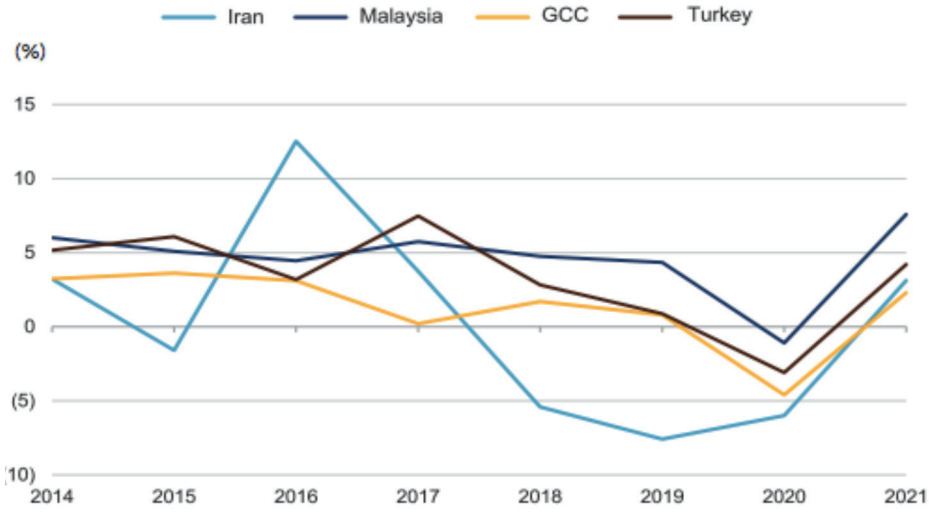
Table 5: YoY Performance of Islamic Finance by Sector (2019-2020)

	2020			2019	
Sector	**Billion USD**	**Share (%)**	**YoY Growth (%)**	**Billion USD**	**Share (%)**
Islamic Banking	1,841.8	68.3	4.3	1,765.8	72.4
Outstanding Sukuk	689.5	25.6	26.9	543.4	22.3
Islamic Funds' Assets	143.8	5.3	40.6	102.3	4.2
Takaful Contributions	23.1	0.9	-14.8	27.1	1.1
Total	**2,698.2**	**100.0**	**10.6**	**2,438.6**	**100.0**

Sources: Compiled from IFSB (2020, 2021)

Although Islamic finance has still shown relatively better growth performance compared to the conventional sector, the sector is expected to realize single-digit growth rates in 2021 due to the adverse effects of the pandemic (S&P Global Ratings, 2020). Moreover, apart from the uncertainties and economic slowdown, the decrease in oil prices negatively impacted most oil producer jurisdictions offering Islamic finance (IsDB, 2020). Therefore, while the size of Islamic finance assets is expected to shrink significantly in 2020, particularly in the key jurisdictions (Figure 5), recovery can be seen in the sector in 2021 due to liquidity injected by the governments and central banks through expansionary fiscal and monetary policies. However, the determinant of this recovery's size will depend on the extent to which the global pandemic can be controlled with vaccines and other mechanisms.

Figure 5: Core Islamic Finance Markets (S&P Expectations for 2020 and 2021)

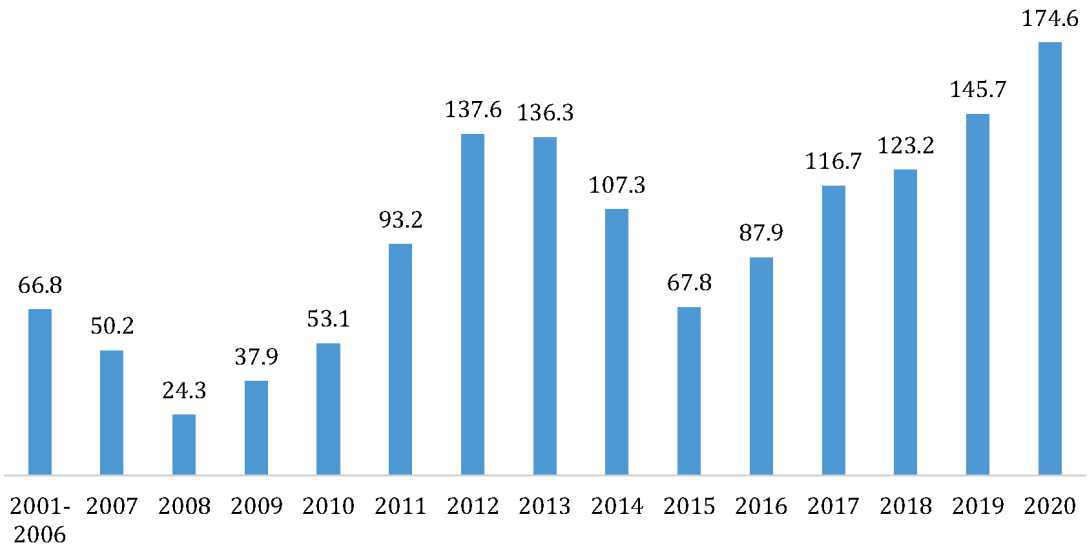


Source: S&P Global Ratings (2021)

Banking will continue to be the most important component of the Islamic finance sector during the COVID-19 period. However, Islamic banks have also been adversely affected, mainly due to the contraction of the economies. As a result, the asset quality of the Islamic banks has deteriorated, and non-performing loans increased. The recovery in the asset quality is closely related to the economic rebound. On the other hand, worsening credit ratings have constrained access to the international markets through *sukuk* issuance. Besides, the problems of low profitability and weak capital buffers, which were prominent in Islamic banking in some countries before the pandemic, have deepened with the pandemic (IsDB, 2020). Therefore, the recovery is expected to take some time for Islamic banking.

Islamic capital markets continued to a positive trend in 2020 despite the negative expectations (see S&P Global Ratings, 2020) towards Islamic finance due to COVID-19. As a result, *sukuk* remained attractive to issuers, although severe conditions occurred in the financial markets in 2020. As happened in 2019, the *sukuk* market observed double-digit growth rates again because of the IsDB's socially responsible *sukuk* issuance and other core *sukuk* issuer countries such as Malaysia, Saudi Arabia, Indonesia, Turkey. As seen in Figure 6, total global *sukuk* issuances increased 20 percent in volume from USD 145.7 billion in 2019 to USD 174.6 billion in 2020 [YoY growth was 18% in 2019] (IIFM, 2021). This can be explained by the funding needs of sovereigns to overcome the deficits in the budgets to finance their projects for sustaining the running of the economy.

Figure 6: Global Sukuk Issuances (2001-2020, USD billion)

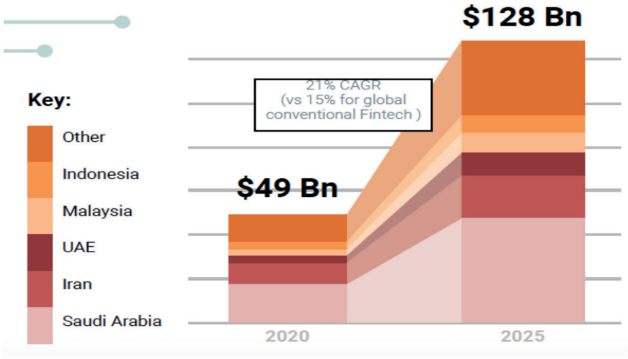


Source: IIFM (2021)

Despite the unexpectedly strong performance of the *sukuk* market in 2020 amid the uncertainties and problems in the global economy, the complexity of the *sukuk* issuance is still seen as an obstacle in front of the sector. S&P Global Ratings (2021, p. 16) raises this issue by asserting that "some market observers have wondered why governments in the GCC and other core Islamic finance markets rushed to conventional capital markets instead of issuing *sukuk*" emphasized the need for a more inclusive approach in designing issuance standards.

The COVID-19 conditions have not only revealed the problems in the *sukuk* markets and the views on their solutions and also showed the importance of Islamic financial technologies and social finance instruments. As a result, there are expectations for a transformation in the Islamic finance sector during and after the pandemic, particularly in these two areas, namely technology adaptation and social responsibility. Figure 7 clearly demonstrates the potential of Islamic fintech suggesting a 21 percent growth rate from 2020 to 2025 by growing from USD49 billion to USD128 billion, respectively. Copnsidering that one of the main consequence of COVID-19 is the increased use of digital platforms for business, Islamic fintec platforms will continue to develop.

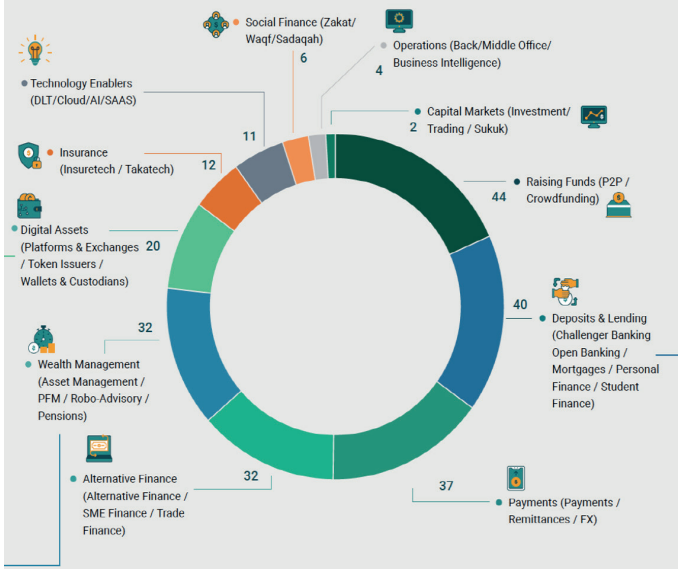
Figure 7: Islamic Fintech Industry Development Trajectory



Source: GIFT Report 2021 (p. 5)

In highlighting the potential of Islamic fintech for post-COVID-19 recovery, Figure 8 depicts the sectorial involvement of Islamic fintech in terms of numbers. The diversity in the sectors already got accustomed to Islamic fintech provides a new impetus for further growth in volume and numbers and expansion horizontally to new industries and deepen penetration in each sector.

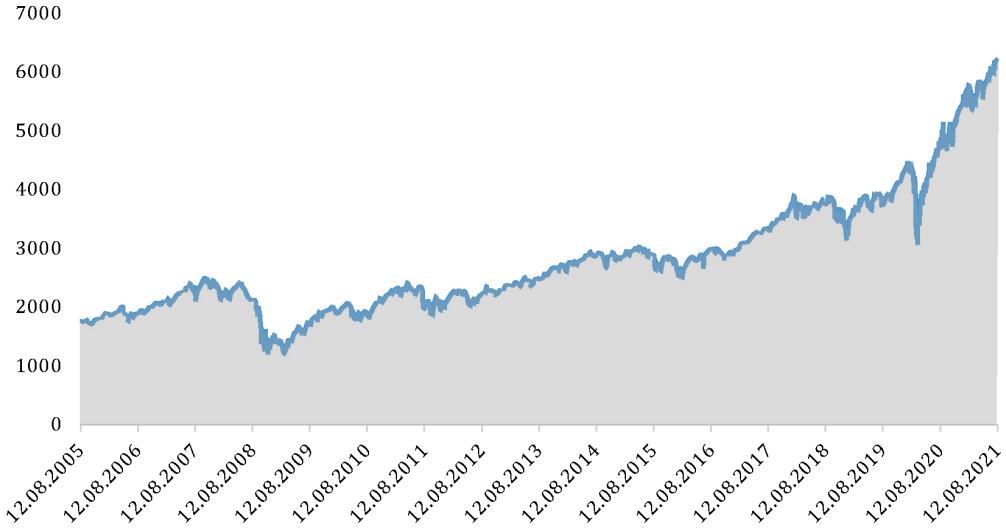
Figure 8: The Sectorial Involvement of Islamic Fintech (numbers)



Source: GIFT Report 2021 (p. 10)

To reflect on the crisis and its impact on the performance of Islamic financial markets, Figure 9 depicts the trend in the performance of the Dow Jones Islamic Price Index.

Figure 9: Trends in the DJ Islamic Price Index



Data Source: Dow Jones Islamic Price Index

The impacts of both the 2008 Global Financial Crisis and the COVID-19 is clearly visible in the trends of the DJ Price Index. The sharp decline in the trends at the beginning of 2008 could only go back to its pre-crisis level in 2014, implying that it took nearly six years for the index to get the same pre-crisis level. A similar but even sharper decline is also observed from the beginning of 2020. However, the trends were re-established before the end of the year, implying that the recovery was speedy. In addition, the trend has demonstrated an even higher pace of increase from the beginning of 2021. Despite the sustained impact of the global financial crisis, the effect of the COVID-19 on the DJ Islamic Index has been very swift and short, paving the way for even higher index levels. The quantity easing based monetary policies and expansionary fiscal policies pursued by the government have impacted the markets, as DJ Islamic Index can evidence.

It should be noted that similar financial means were not available for most countries in the world in the aftermath of the global financial crisis of 2008, which explains the differences in the trend. When examining the trend through a financial lens, it is encouraging that the index immediately picked up the pre- COVID-19 trend. However, while the economies have suffered heavily, including millions of job losses, the high trend is a source of concern in forcing us to question how embedded Islamic/*halal* economic and financial activity to the Islamic norms and real economy.

3.3. Islamic Financial Institutions and Their Response to the Pandemic

As described above, due to being embedded into Islamic normativeness and also the real economy, Islamic finance, in a theoretical manner, has the potential ability to respond to crises more effectively. For example, the PLS and risk-sharing nature of Islamic finance implies that it is not merely for transactional purposes, but it also aims at transforming society by creating sharing and participation economy. Therefore, Islamic banks and financial institutions demonstrated

relatively better performance and resilience in the 2008 Global Financial Crisis. Although the experienced resilience could be due to other factors such as lesser exposure of OIC countries with Islamic finance systemic to financialisation, nonetheless Islamic finance has inherent stabilising role if it is allowed to operate within Islamic logic. Hence, Islamic finance and banking is expected to operate with such social optimality along with financial optimality in facing the challenges of COVID-19, which is a crisis in itself. The challenges by the COVID-19 will be an essential test to observe if Islamic banks and financial institutions can live up to their normative principles, which is also examined in this report in the case of MSMEs financing facilitation by Islamic banks under the COVID-19 conditions.

The current experience, recent research, and the findings in this study indicate that Islamic banks have taken some critical measures to help their customers in general and MSMEs in their books. As evidenced, many Islamic banks have resorted to postponing debts and instalments of the credit customers in economies affected by containment measures during the COVID-19. Accordingly, private and public banks were asked to provide convenience to their current financing customers, especially SMEs. On the other hand, banks, including Islamic banks, were encouraged to provide further financing to SMEs, as in Kuwait, through the central bank (S&P Global Ratings, 2021).

In addition to the initiatives taken by individual Islamic banks either as part of their strategies or under the directives of the public policy in different countries, IsDB, is one of the leading institutions that have been proactively involved in extending support to member countries and the private sector in those countries. IsDB has developed products and packages according to Islamic finance principles to tackle the adverse impacts of the pandemic. For example, IsDB introduced this comprehensive program - with three stages: Respond, Restore and Restart (3R) (IsDB, 2020) – which were put into practice in some OIC member countries. Different organizations and departments affiliated with the IsDB have taken part in the COVID-19 response program. For instance, Islamic Corporation for the Development of the Private Sector (ICD) provides financing to the Islamic finance institutions in OIC member countries through *wakalah* and *murabahah* transactions in financing the eligible beneficiaries/projects (IsDB, 2020).

One of the main target segments of the IsDB program is MSMEs, which constitute most of the economic activities in member countries (B. Hajjar, 2020). For example, USD10 million loan was provided to support the SMEs in Palestine under IsDB SERVE and SPRP COVID-19 Pandemic – Palestine by the Islamic Solidarity Fund for Development. Similar to this initiative, a wide range of support programs, especially towards MSMEs in member countries, were included in IsDB's COVID Response Package.

Islamic capital markets were also used to raise funds to combat the challenges faced under the COVID-19 condition. Among others, IsDB's US$1.5 billion first sustainability *sukuk*, which is listed on Nasdaq Dubai, is one of the most important examples of the use of *sukuk* for COVID-19 related consequences. The funds raised through *sukuk* will be used for the sectors negatively affected by the pandemic including the health sector. In addition, new funds generated with sustainable or social impact *sukuk* issuances will be used for tackling the impacts of the COVID-19 pandemic are expected to continue (S&P Global Ratings, 2021).

It should also be noted that some of the Islamic banks took the initiative and took steps towards social responsibility projects as part of developing COVID-19 related response strategies. For example, Kuwait Finance House paid KD20 million in debts to release approximately 10,000 defaulting debtors as corporate social responsibility in collaboration with the Ministry of Justice

of Kuwait (KFH, 2021). Such strategies are essential to overcome the debt burden on MSMEs, as deferment and restructuring of debt results in debt accumulation for future, while lost income cannot be recovered by the MSMEs. Similarly, the recent call to rich countries to write off developing countries' debts at the global level carries a similar rationale.

As discussed above, the consequences of a crisis like the COVID-19 pandemic can be better overcome if the Islamic logic-based financing shaped by the Islamic moral economy's normative principle of *adalah* and ihsan is developed and applied by Islamic financial institutions. In other words, substance based Islamic finance solutions will be more affected compared to form based merely *Shari'ah* compliant finance.

3.4. Islamic Social Welfare and Financing Institutions and Pandemic: Alternative Responses

Apart from Islamic banking, insurance, and capital markets, in recent years, a sector that has become more popular in Islamic finance sphere is Islamic social welfare and financing institutions. As discussed above, the Islamic moral economy essentialised social optimality by creating a sharing economy within the framework of *adalah* and *ihsan*, aiming for social equilibrium in society to fulfil the maqasid aim of human and stakeholders' well-being can be achieved. In this process, individual emancipation and empowerment is considered as an objective.

To serve social equilibrium in the society, Islamic social welfare institutions such as *zakat*, *waqf* and *sadaqah* and Islamic social financing instruments such as *qard al-hassan* and Islamic commercial institutions with social objectives such as Islamic microfinance and social impact investment along with green and social impact *sukuk* can be mentioned. The primary purposes of these institutions or organizations are not totally for profit but the fulfilment of social goals, although some of them charge fees and others to ensure the organization's sustainability.

Since Islamic banks and financial institutions operate within the market institutional logic, they have to abide by the universal operational objective of profit maximisation within the universal risk framework. Within such a firework, Islamic banks are expected to focus on transactional success, while the transformational purpose is negated with a reference that '*riba* is *haram*, trade is *halal*'. However, as discussed, Islamic normativeness requires social equilibrium and equity over efficiency, namely essentialisation of transformative role. In the face of 'social failure of Islamic banks', therefore, in recent years, Islamic social finance and Islamic social welfare institutions have become important alternative Islamic institutions for socio-economic development

In this context, financial services have been provided to a wide segment of society through *shariah*-compliant instruments or institutions. While the target segment is generally economically active people such as micro-enterprises, women, and the poor who cannot meet their basic needs also included.

While microfinance institutions, *awqaf*, *zakat* and *zakat* funds can be shown among Islamic social finance institutions, social impact *sukuk* can also be evaluated as a product, even if they are not an institution, because the purpose of this type of *sukuk* is to raise funds for social purposes. On the other hand, *qard al-hassan* is a powerful instrument for supporting particularly the people who suffer short term liquidity problems. For example, the Akhuwat microfinance institution in Pakistan, one of the world's most prominent Islamic microfinance institutions, uses *qard al-hassan* financing to support microenterprises (see; Akhuwat, 2021).

The pandemic has affected all segments of society. The low-income segments of each society have become further vulnerable. In addition, small businesses employing a few people or self-employed have also been adversely affected by the consequences of COVID-19. The use of Islamic social finance instruments to support these segments is also expressed more in the literature and also by international organizations as an alternative instrument. S&P (2021) emphasized the potential role of *qard al-hassan*, *zakat*, *waqf*, and social *sukuk* during the COVID-19 pandemic. For instance, S&P Global Ratings (2021, p. 10) notes that while "the *waqf* could help provide affordable housing solutions or access to health care and education for people that might have lost a portion of their income, *zakat* could help compensate for lost household income because of COVID-19". On the other hand, the effect of *zakat* and *sadaqah* on the fight against poverty has been noticed by international organizations and implemented through projects (IsDB, 2020).

Different institutions have widely used *zakat* and *sadaqah* as direct cash transfers during the COVID-19 process. Such as Indonesia's National Board of *Zakat* (BAZNAS) has a significant role in organizing *zakat* to cope with the detrimental impacts of the pandemic (BAZNAS, 2021a). Some OIC countries have formally established institutions to collect *zakat*, while others have left to individual efforts. However, to enhance the impact of *zakat*, formal institutionalisation either within public administration or in civil society has become a new movement. In the same way, the *waqf* sphere has been extended by allowing individuals to donate to the existing *waqf,* which again contributes to socio-economic development.

Regarding *sukuk*, the issuance of *sukuk* to alleviate the adverse impact of COVID-19 has been limited. However, *sukuk* issued by IsDB and Malaysia are among those with social impact. In particular, there is a great need for *qard al-hassan* financing to meet short-term liquidity needs and recover small businesses.

In order to generate further positive impact from Islamic social finance and Islamic social welfare institutions, a holistic approach is needed to create an Islamic eco-system where Islamic social finance instruments can be used in a coordinated manner with the other Islamic offerings and in coordination with the public policy so that, for example, poor and needy can effectively be served (IsDB, 2020). However, it is essential to note that it seems that traditional Islamic financing institutions are more effective for social objectives.

4. FINDINGS ON THE ROLE OF ISLAMIC FINANCE INDUSTRY IN MODERATING THE ADVERSE IMPACT OF COVID-19 ON MSMEs

Based on the Research Methodology explained in Section 1.2 and the extensive literature discussed in the preceding sections, this chapter presents the findings concerning the role of the Islamic finance industry in moderating the adverse impact of Covid-19 on MSMEs in the selected case studies. The discussion commences with the analysis of the survey findings and then proceeds to the country case studies.

4.1. SURVEY FINDINGS

As mentioned above, in order to capture the perceptions and opinions of all the stakeholders in giving meaning to the findings established by case studies, a questionnaire survey was conducted during Summer 2021 using online platforms. While the expectation was high in terms of the number of observations, it was disappointing to receive only 255 responses despite all the efforts. However, as can be seen below, the participants' diversity of jurisdictions and background should be appreciated in presenting additional and valuable sources of developing further knowledge. The following offers descriptive analysis from the questionnaire survey.

4.1.1. Demographic Information

As Table 6 demonstrates, 26 percent of the participants are female, and the remaining 74 percent are male. The vast majority of the respondents have masters (43.1%) and PhD (45.5%) degrees, while the majority of the respondents are younger than the age of 40. As shown, a more evenly distributed professional experience is observed, with the highest percentage (34.1%) participants having 11-20 years of experience. Regarding the nature of professional institutions affiliated, as can be seen from Table 6, the majority of the respondents (42.7%) are academic and professional researchers, while 20 percent of the participants are Islamic bankers and financiers. Thus, about 52.8 percent of the respondents are from various economic, financial and banking related institutions, including chambers of commerce, civil society organisations and vocational associations. Table 6 also shows that 88.6 percent of the respondents are from the OIC countries.

Table 6: Demographic Information about the Respondents

Gender	**Frequency**	**Percent**
Female	67	26.3
Male	188	73.7
Total	***255***	***100***
Academic Degree	**Frequency**	**Percent**
Bachelor's Degree	28	11
High School	1	0.4
Master's Degree	110	43.1
PhD	116	45.5
Total	***255***	***100***
Age	**Frequency**	**Percent**
20-30	57	22.4
31-40	116	45.5
41-50	54	21.2

51-above	28	11
Total	***255***	***100***
Average	38	-
Professional Experience (Year)	**Frequency**	**Percent**
1-5	65	25.5
6-10	64	25.1
11-20	87	34.1
21-above	39	15.3
Total	***255***	***100***
Average	12	-
The Nature of the Institution Affiliated	**Frequency**	**Percent**
Academics or Professional Researcher	109	42.7
Central Banker	20	7.8
Chambers of Commerce and Industry	3	1.2
Civil Society Organisations / NGO	9	3.5
Conventional Banker & Financer	13	5.1
Economic and Financial Bureaucracy	15	5.9
Financial Services Authority or Equivalent	18	7.1
Islamic Banker & Financer	51	20
MSME Owner	8	3.1
Multinational Development Institution	6	2.4
Vocational Associations	3	1.2
Total	***255***	***100***
Country Groups and Respondents	**Frequency**	**Percent**
# of OIC Member Countries (MCs)	28	70.0
# of non-OIC MCs	12	30.0
Total	***40***	***100***
# of respondents from OIC MCs	226	88.6
# of respondents from non-OIC MCs	29	11.4
Total	***255***	***100***

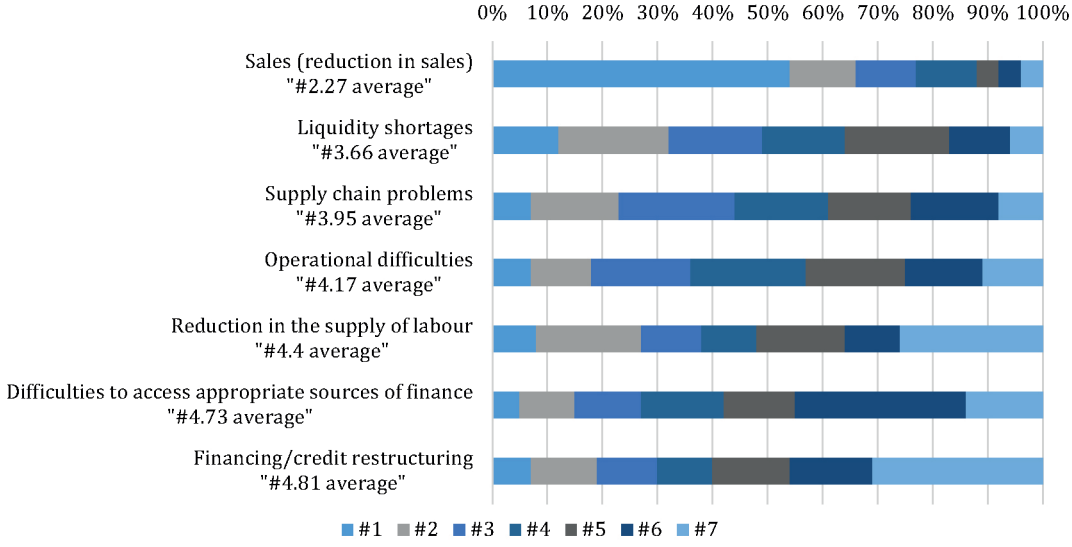
4.1.2. COVID-19 Effect on MSMEs and Policy Responses

Figure 10 depicts the responses to the main challenges faced by MSMEs during COVID-19. The participants were allowed to choose from the given options, and they were requested to rank their choices for each potential challenge, with 1 being the most important and 7 is the least important factor. As the average ranking of the factors demonstrates, sales reduction was selected as the most important challenges among the options. More than 50% of the respondents put the reduction in sales at the first place while ordering the all seven challenges.

As the responses demonstrate, 'liquidity shortages' and 'supply chain problems' scored with 3.66 and 3.95, respectively. With average value of 4.17, 'operational difficulties' is the forth most important factor. While the 'financing/credit restructuring' (#4.81) was stated at the least important challenge, it was followed by another financing related issue, namely 'difficulties to access appropriate sources of finance' with 4.73 average. The respondents have seen the negative effects of the containment measures more important compared with the funding issues faced by MSMEs during the COVID-19.

Figure 10: The Main Challenges Faced by MSMEs During COVID-19

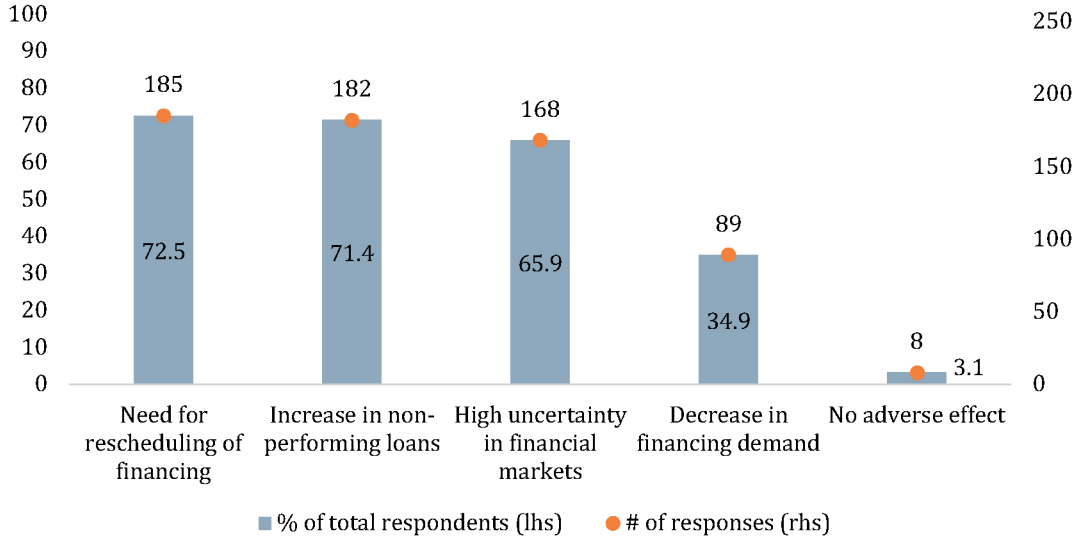
Question: "What are the main challenges, financial and non-financial, faced by MSMEs during the COVID-19? Please rank from 1 to 7; 1: most important, 7: least important."



In searching answers to the question about the effect of COVID-19 impacted MSMEs on the financial institutions, the participants were offered a set of responses to choose as many they considered appropriate. As depicted in Figure 11, 'need for rescheduling financing' is ranked first, 'increase in non-performing loans' second, and 'high uncertainty in financial markets' is ranked as the third highest effect on the financial institutions. Thus, finance related factors are considered the most important effects led by rescheduling financings due to the ceased business activity as a result of COVID-19. As the results show, 'decrease in financing demand' is expressed as the fourth factor, which can be explained by the fact that stagnation of business meant ceasing of searching finance for new business activities. Thus, the results show that financial institutions are affected mainly by rescheduling and deferment of the expected payment and non-performing loans, which can be explained by the decline in business activities.

Figure 11: Adverse Effects on Financial Institutions of COVID-19's Impacts on MSMEs

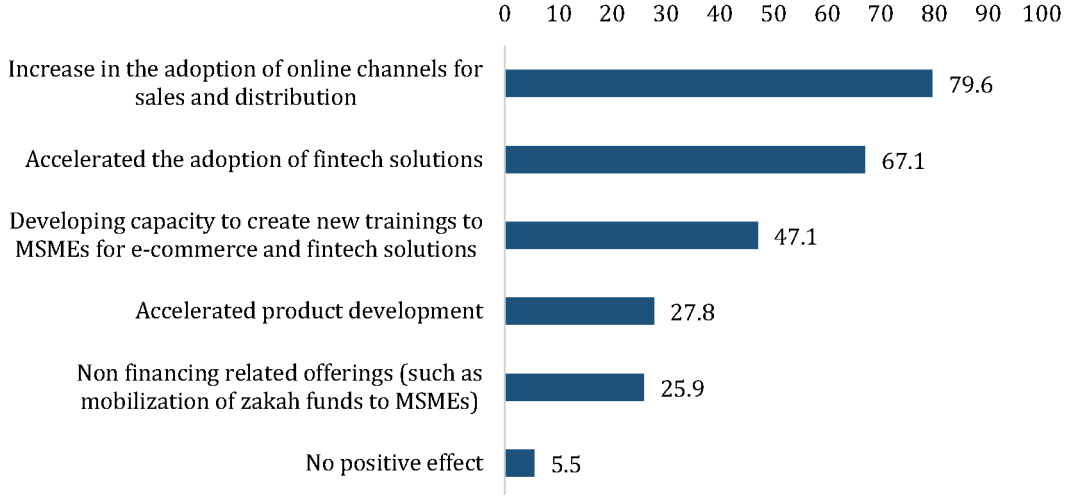
Question: "In what ways COVID's impacts on MSMEs have adversely affected financial institutions? Please choose as many as you consider appropriate."



COVID-19 has created severe challenges for every aspect of life, including the business sector. However, it has also pawed the way for the emergence of new opportunity spaces and innovations such as online channels and fintech platforms. Therefore, the respondents were requested to identify positive outcomes for financial institutions because of the impact of COVID-19 on MSMEs. They were given the option to select as many potential positive impacts among the options provided.

Figure 12: Positive Effects on Financial Institutions of COVID-19's Impacts on MSMEs

Question: "In what ways COVID's impacts on MSMEs have affected financial institutions, positively? Please choose as many as you consider appropriate."



As the findings show in Figure 12, 79.6 percent of the respondents considered the 'increased adoption of online channels for sales and distribution by the MSMEs' as the most significant positive effect. This has been observed as a new sphere of development for businesses all over the world. However, digital inequality between the regions in a country and between the countries should be considered an essential caveat in evaluating this response. Similarly, 'accelerated the adoption of fintech solutions' received the second highest response with 67.1 percent, verifying the observed development in the business environment. In some jurisdictions, financial institutions opted for providing training to develop the necessary capacity for MSMEs to move onto electronic platforms, which should be considered an essential effort to develop the essential social capital for the future. In line with this, 47.1 percent of the respondents considered provisions of such training as the third critical positive effects financial institutions faced under the conditions of COVID-19 impacted MSMEs. It goes without saying that moving onto electronic platforms through e-commerce and fintech has a positive impact on financial institutions as well as MSMEs.

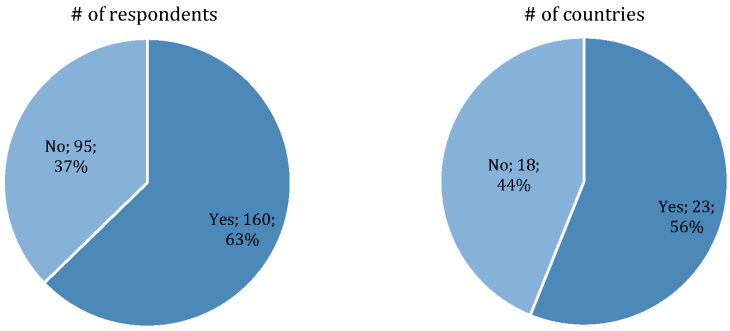
The crisis can create opportunities, too, which can be true for all businesses, including banks and financial institutions. For example, developing new products and strictures to respond to the emerging realities by also considering the emerging risks is an important consequence for the financial institutions. As shown in Figure 12, 27.8 percent of the participants believed 'accelerated product development' by financial institutions as an important consequence for the financial institutions under the environment of COVID-19 affected MSMEs.

In recent years, Islamic social finance is mobilised for economic activity to empower individuals. Therefore, around 26 percent of the participants considered non-financing solutions such as *zakat* fund mobilization to MSMEs as an important consequence for financial institutions due to the COVID-19 conditions. Thus, social responsibility and Islamic social finance mix will be an essential solution for future developments in supporting micro-businesses, creating an opportunity space for businesses to avoid the criticism raised against the financial institutions for not doing enough for the micro-businesses.

In addition to the financial institutions and their provisions for MSMEs, this research has also explored the participants' perceptions on the appropriateness of government measures in responding to the emerging support for the MSMEs in their respective jurisdictions. As shown in Figure 13, most of the respondents (63%) stated that they found the government measures were appropriate. However, when we cross-tabulate the data according to the participants' jurisdictions, the approval rate declines to 56 percent. In many countries, the fiscal challenges resulted in a varying but restricted degree of support extended to MSMEs through fiscal and monetary policies. Nevertheless, in either case, the majority of the participants have expressed approval.

Figure 13: Appropriateness of Governments' Measures to Support MSMEs during COVID-19

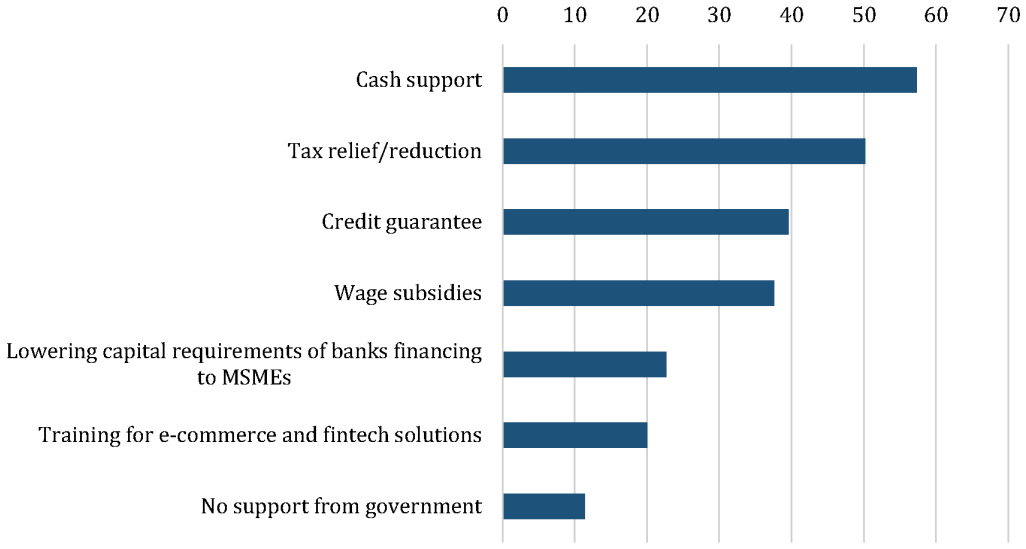
"Question: Do you think that the government in your resident country has acted/introduced appropriate measures to support MSMEs during COVID-19?"



In further elaborating the economic and financial public policy measures extended for MSMEs under the COVID-19 conditions, the respondents were requested to identify such measures in their respective resident countries. As can be seen from Figure 14, the majority of the respondents identified 'cash support' (57%), followed by 'tax relief and/or reduction' (50%). In addition, about 50 percent of the participants stated 'credit guarantees', while 38 percent informed 'wage subsidies' among the public policy measures extended to MSMEs under the COVID-19 conditions. As evidenced by the findings in Figure 14, about 12 percent stated 'no government support' observed so far as part of relief package for MSMEs. However, approximately 23 percent of participants reported the government intervention in their jurisdictions for 'lowering capital requirements of bank financing to MSMEs' as part of the financial accessibility. Furthermore, 20 percent of the participants opined 'training for e-commerce and fintech solutions' as part of public policy, which is an important provision to create alternative channels for MSMEs to adopt the digital environment under the emerging conditions due to the COVID-19. Hence, according to the participants' perceptions and opinions, the public policies in various countries have attempted to develop pro-active policies in extending support for MSMEs to moderate the adverse consequences of the COVID-19 conditions.

Figure 14: Public Policy Supports towards MSMEs During COVID-19

"Question: What public policy measures were developed by the government in your resident country to support MSMEs during COVID-19? Please choose as many as you like."



4.1.3. COVID-19, Islamic Finance and MSMEs

This research is primarily interested in exploring the financing responses developed by Islamic banks for MSMEs in moderating the adverse impact of COVID-19. Therefore, the participants requested to express their opinions on the ways they considered Islamic banks facilitated MSMEs' expectations under the emerging conditions. For this, they were provided with a number of options, and the results are reported in Figure 15.

As depicted, around 56 percent of the participants stated 'financing restructure', and 44 percent observed 'principal and instalments deferment' as facilitation extended by Islamic banks. As part of relief efforts, it seems that some Islamic banks have opted for 'reduction in financing rates for MSMEs' as observed by 24 percent of the participants. In addition, a similar percentage of the participants agreed that Islamic banks 'facilitated public policy solutions for financing

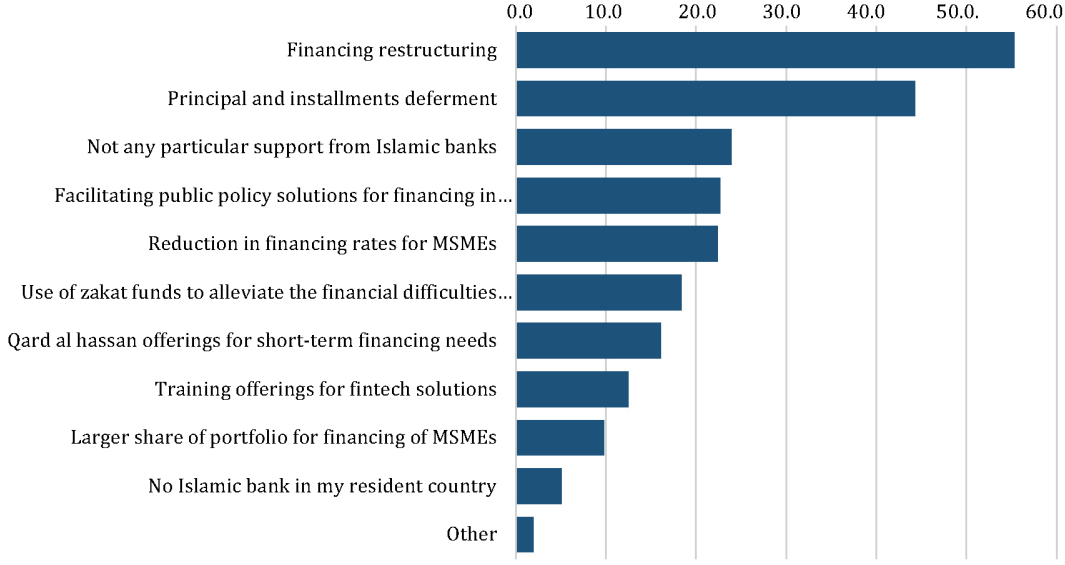
in supporting MSMEs', which should be considered a coordinated solution between public and private sector to ease the financial tension on MSMEs under the circumstances.

An essential facility by Islamic finance theory is the provision of *qard al-hassan* financing and also Islamic social financing such as *zakat* from their *zakat* funds. The results show that some Islamic banks in certain jurisdictions opted for providing 'good financing'. As shown in Figure 15, about 16 percent of the participants observed Islamic banks in their jurisdictions facilitating the financial needs of MSMEs through '*qard al-hassan*', and around 18 percent of the participants observed the 'use of *zakat* funds to alleviate the financial difficulties of MSMEs'. It is also important to note that about 10 percent of the participants observed that Islamic banks in their resident country 'allocated a larger share of portfolio for the financing of MSMEs', which shows proactivity on the side of Islamic banks despite being a very small percentage. As part of such proactivity, 12.5 percent of the participants observed that Islamic banks in their jurisdictions 'provided training opportunities for fintech solutions', which should be considered a positive action in preparing the MSMEs for the new business environment.

Nevertheless, approximately 25 percent of the participants did not observe 'any particular support by Islamic banks', which was also raised by many participants in their comments. This is also an important claim raised over many years, including by the MSMEs, concerning Islamic banks' lack of financial preference. While Islamic logic essentialises such financial solutions, under the shareholder-based market logic of efficiency and risk shifting, Islamic banks are constrained to extend specialised financing for MSMEs to support the real economy.

Figure 15: Islamic Banks' Financing Responses for MSMEs During COVID-19

"Question: In what ways have Islamic banks facilitated MSMEs' expectations under COVID-19 conditions in your resident country? Choose as many as you like."



The distinctive features of Islamic finance are considered a robust alternative solution against various crises, including pandemic, as Islamic banks and finance were considered resilient against the 2008 financial crisis. Therefore, participants were requested to express their opinions on the performance of Islamic finance supporting MSMEs during and post-COVID-19 period. The results over the Likert scale are depicted in Table 7, as statements are ranked according to the mean score.

Since one of the main distinctive features of Islamic finance is PLS financing as essentialised by Islamic normative logic, the majority of the participants considered PLS financing for MSMEs by Islamic finance will ensure resilience during and post-COVID-19 period with a mean score of 4.01 (weighted average out of 5). Similarly, the respondents attached high importance to the real economy orientation of Islamic finance in developing an efficient response to the challenges posed by COVID-19, with a mean value of 3.95. Therefore, the majority of the participants with a mean value of 3.90 expressed that 'Islamic finance is a viable solution to the crisis after the pandemic', which verifies the importance attached to Islamic finance in transforming societies. However, despite such a positive opinion on Islamic finance, the support for the statement that 'Islamic banks have played a supporting role towards MSMEs in the respective country during COVID-19' is lowest at the mean score of 3.18. This highlights the observed gap between aspirations in the form of 'what Islamic finance can do' and realities in the form of 'what Islamic finance has done'.

Table 7: The Role of Islamic Finance in Supporting MSMEs During COVID-19

Statements	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Average*
The profit and loss (PLS) financing by Islamic finance for MSMEs will help to reach resilience during and after the crisis.	34.1% (87)	39.2% (100)	20.8% (53)	5.1% (13)	0.8% (2)	4.01 3.95
Islamic finance's real economy orientation has been witnessed as an important quality to face the challenges posed by COVID-19	31.0% (79)	41.2% (105)	20.8% (53)	6.3% (16)	0.8% (2)	3.95
Islamic finance is seen as a viable solution to the crisis after the COVID-19 pandemic.	35.3% (90)	29.4% (75)	27.1% (69)	6.3% (16)	2% (5)	3.90
OIC member countries have benefitted from the Islamic finance potential during COVID-19.	8.6% (22)	29.4% (75)	47.8% (122)	12.5% (32)	1.6% (4)	3.31
Islamic banks have played a supporting role towards MSMEs in my resident country during COVID-19.	13.3% (34)	29% (74)	28.2% (72)	20.8% (53)	8.6% (22)	3.18

Note: *Weighted average (out of 5). The numbers in parentheses show the number of the respondents

Similarly, as depicted in Table 7, the mean score for the opinion expressed for the statement that 'OIC member countries have benefitted from the Islamic finance potential during COVID-19' remains at 3.31 with 38 percent 'strongly agreed and agreed', while 14.1 percent 'disagreed and strongly disagreed'. However, 47.8 percent of the respondents remained 'neutral' for this statement, which is most probably is a reflection of inhibition of avoiding to state disagreement. With this, about 62 percent of the respondents do not think that OIC member countries benefited from Islamic finance's potential positive impact. Again, this can be explained by the imposed market logic on Islamic banks, which prevents them from operating with Islamic features such as providing PLS and risk-sharing financing.

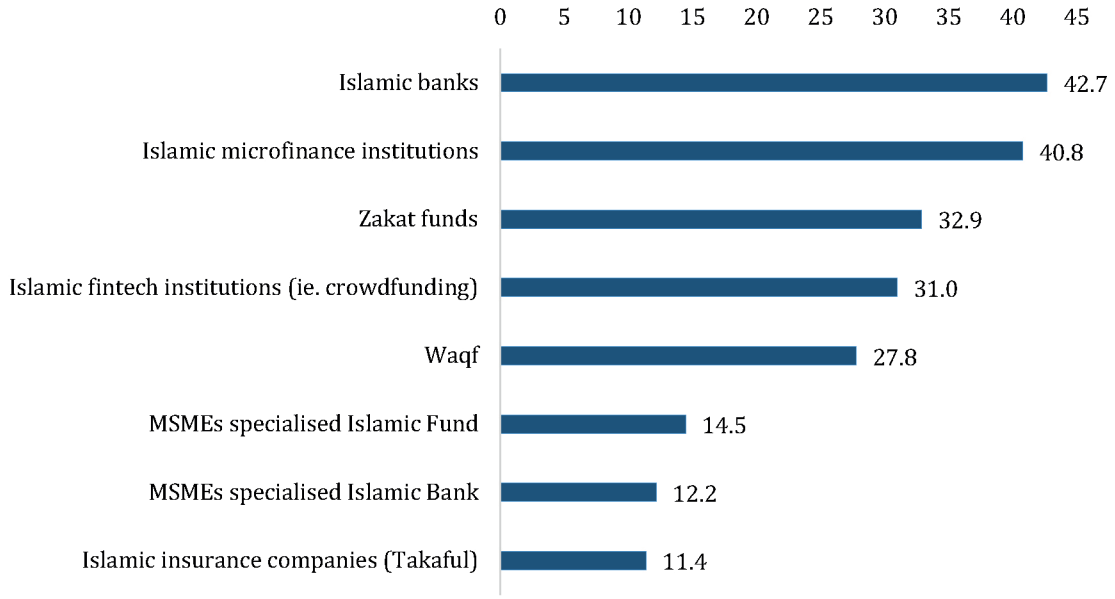
As shown in Table 7, the 'neutral' position in the answers given to each statement is relatively high, which compromises the meaning given to the mean score. The shining away from giving

negative responses to the aspirational position could be the reason for the high 'neutral' position, which should be on the side of the disagreement. Thus, positive responses should be considered with caution.

In further evaluating the opinions of the participants on the institutional responses provided by Islamic finance institutions in light of the responses given so far, at this stage, the respondents requested to rank the Islamic finance and economic institutions in terms of their 'perceived effectiveness for tackling financial problems faced by MSMEs faced by MSMEs'.

Figure 16: The Most Effective Islamic Finance Institutions to Support MSMEs During COVID-19

"Question: Which of the following Islamic finance institution(s) provide the most effective solution for tackling financial problems faced by MSMEs? Make between 1 and 3 choices"



As shown in Figure 16, Islamic banks are ranked as the most efficient institutions by 42.7 percent of the participants despite the misgivings expressed earlier. Islamic banks are followed by Islamic microfinance institutions, as chosen, by 40.8 percent of the participants.

As known, *zakat* is not associated with return due to being in the form of help and support; *zakat* funds are ranked as third by 32.9 percent approval from the participants, while *waqf* based financing is ranked fifth by 27.8 percent of participants.

Since Islamic fintech is an emerging but not fully prevailing sphere, 31 percent of the participants considered as an efficient institution by ranking it forth efficient institution.

This research considers *Shari'ah* compliant specialised financing institutions for MSMEs financing as a way forward and therefore has tested the participants' opinions on such institutional forms. However, 'MSMEs' specialised Islamic fund' and 'MSMEs specialised Islamic banks' are ranked as sixth and seventh in their perceived effectiveness. Such a low appeal can be explained by the limited availability of such institutions in the OIC countries.

The effectiveness of *takaful* institutions in supporting the MSMEs during the COVID-19 period scored the lowest, with 11.4 percent of the participants approving their efficacy. Considering that the *takaful* industry has not achieved its potential in the OIC countries, it is not surprising

that their impact is regarded as insignificant.

In furthering the analysis after examining the perceived effectiveness of Islamic finance institutions in responding to the COVID-19 affected MSMEs, the participants were requested to state their perceived effectiveness of Islamic finance instruments to support MSMEs under COVID-19. For this, the respondents were asked to specify the effusiveness of Islamic finance instruments for the first, second, third and fourth stage of COVID-19. The respondents were provided with the definitions of each stage, which is also provided underneath Table 8 below.

Table 8: The Most Effective Islamic Financing Instruments to Support MSMEs under Four Stages [3] of the COVID-19

"Questions: Which instrument(s) is(are) more suitable for supporting MSMEs during the 'first', 'second', 'third' and 'fourth' stage of COVID-19? (more than one instrument can be selected). Please make between 1 and 5 choices"

Instrument Type	1st stage	2nd stage	3rd stage	4th stage	The first preferred stage	The last preferred stage
Qard al-Hassan	57.6% (147)	35.3% (90)	41.2% (105)	27.8% (71)	1st	4th
Zakat	46.7% (119)	23.5% (60)	27.8% (71)	19.6% (50)	1st	4th
Mudarabah	39.6% (101)	46.7% (119)	45.1% (115)	63.5% (162)	4th	1st
Waqf	39.6% (101)	18.0% (46)	24.3% (62)	18.0% (46)	1st	2nd-4th
Musharakah	38.4% (98)	45.5% (116)	44.7% (114)	57.6% (147)	4th	1st
Sadaqah	37.3% (95)	17.6% (45)	24.7% (63)	14.1% (36)	1st	4th

[3] *Stages of the COVID-19 according to the classification of the "International Trade Centre. (2020). SME Competitiveness Outlook 2020: COVID-19: The Great Lockdown and its Impact on Small Business. Geneva. 29-30."*

"**Stage 1.** *Shutdown impacts: Shutdown impacts have affected countries and regions where the pandemic led governments to adopt measures shutting down economic activity. In the short run, governments in affected countries have focused on keeping SMEs in these sectors afloat."*

"**Stage 2.** *Supply chain disruption: Supply chain disruptions have affected companies around the world. The pandemic-induced lockdowns in China, the European Union (EU) and United States, also known as the group of three (G3), have had major impacts on production, imports and exports. Halts in production in affected economies reduced the inputs available for global supply chains. SMEs elsewhere in the world that supply affected countries have seen their orders reduced as demand declined. The extent of this trade-induced cascading contagion of input and output effects has differed by supply chain and country."*

"**Stage 3.** *Demand depression: Demand depression has occurred first in pandemic affected countries, where confinement reduced sales to consumers and businesses. But even when the health emergency begins to ease, business investment can remain low due to run-down savings. Households may reduce spending in the medium to long term to compensate for lower incomes during the pandemic period. Confidence might be low, credit overstretched, and bankruptcies among SMEs may follow."*

"**Stage 4.** *Recovery: Recovery has begun gradually in instances where containment measures have been eased. The evolution of business recovery in each country depends on how the health situation evolves and on the depth, and timing of the original suppression of demand. In the weeks after lockdowns cease, economic activity is likely to rebound sharply as people go back to buying products they have missed from their favourite small businesses. Manufacturing and agricultural businesses may have higher sales as inventories are restocked, and consumers make postponed purchases."*

Murabahah	19.6% (50)	29.0% (74)	29.8% (76)	42.4% (108)	4th	1st
Ijarah	15.7% (40)	29.8% (76)	28.2% (72)	33.3% (85)	4th	1st
Salam	15.3% (39)	28.6% (73)	24.7% (63)	27.1% (69)	2nd	1st
Istisna'	9.8% (25)	31.8% (81)	22.4% (57)	22.7% (58)	2nd	1st

Note: The numbers in parentheses show the number of respondents selecting this choice

As can be seen in Table 8, the majority of the respondents considered Islamic social instruments, namely *qard al-hassan*, *zakat*, *waqf* and *sadaqah*, are deemed to be most effective, which implies that in the initial stage of shutdown impact and its shock, financing is expected without additional return or no return and therefore Islamic social finance is considered to be most effective in responding to the initial shock. In addition, *salam* and *istisna* is regarded to be effective in responding to supply chain distribution in the second stage. Furthermore, the respondents considered *mudarabah*, *musharakah*, *murabahah* and *ijarah* as the instruments that can be effective for stage four of COVID-19, the recovery period. As in the recovery period, the businesses may need expanding and hence, their need for the usual business finance instruments. It should be noted that each of these instruments were considered in each stage of the COVID-19; however, the highest percentage located stages are mentioned as it shows critical relevance to the features of such a stage.

4.1.4. Conclusion

The analysis of the data gathered through a questionnaire survey in this section demonstrates that participants are convinced of the promise and potential of Islamic finance in general and in crisis periods in particular. However, it is also apparent that there are concerns over the current performance of Islamic finance within the existing institutional form within the market economy.

Due to the expressed concerns, the references to traditional Islamic economics institutions such as *zakat*, *waqf* and *sadaqah* along with *qard al-hassan* has received relatively more attention in terms of developing authentic structures as Islamic financing method and source. This is verified in this research as well. Therefore, Islamic banking and finance should be rescued from being grafted into a straitjacket in which they are only operating with *murabahah* and *tawarruq*.

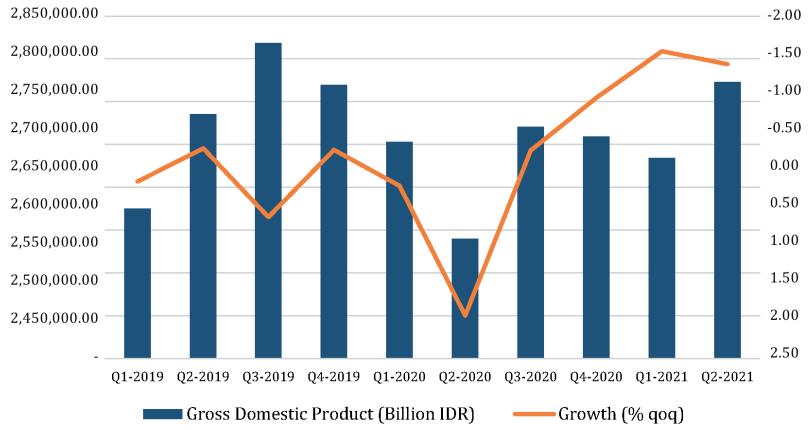
Despite the misgivings and shortcomings, Islamic banking and finance has a critical potential to make a difference as envisaged by the founders of the Islamic economics and banking movement, such as being embedded in the real economy and hence supporting MSMEs. However, institutional constraints and regulative environment has been grafting Islamic finance towards market logic beyond Islamic normatively defined forms and operational mechanism. To unleash the potential of Islamic finance as expressed by the Islamic economics, there is an urgent need to provide the authentic operational environment for Islamic banks. "We must understand the Islamic economy as a part of the general system of Islam which organizes different aspects of life in the society" (As-Sadr, 1982, p. 64). Therefore, public policy should also consider the institutionalization of Islamic economy and finance beyond providing a level playing field for Islamic banks and financial institutions within the definition of the existing system.

4.2. CASE STUDY: INDONESIA

4.2.1. Economic Structure and the Role of MSMEs

Indonesia experienced a steady growth of Gross Domestic Product (GDP) between 4-6% in 2019, but had a decline in the beginning of 2020. Due to pandemic, Indonesia experienced a negative growth in the second quarter of 2020, which then rebound slowly for the following quarters although there is a low decline in the second quarter of 2021 (see: Figure 17).

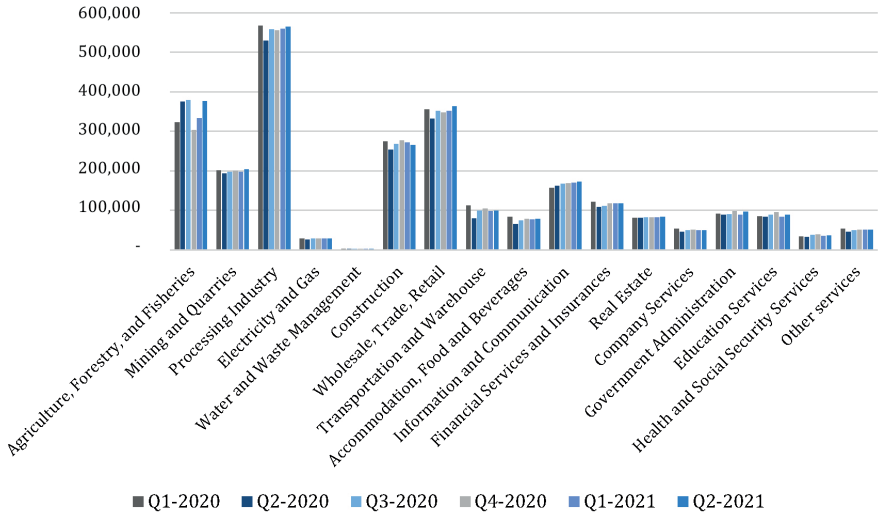
Figure 17: Gross Domestic Product and Its Growth 2019-2020



Source: Badan Pusat Statistik—(BPS, 2021)

In terms of the distribution based on the sectors, Figure 18 presents that processing industry sector has the highest proportion, followed by agriculture sector, trade, and construction sectors. It can also be seen that there is a sharp decline in the second quarter of 2020, but there is a rebound for the following quarters until Q2-2021. However, agriculture sector experienced an increase in the second quarter although there is a decrease in the fourth quarter of 2020, which then increase again in the following quarters.

Figure 18: Gross Domestic Product Based on Sector



Source: BPS (2021)

MSMEs Definition within Indonesian Business and Regulative Environment

The definition of MSMEs in Indonesia is based on the Regulation No 20/2008 about MSMEs, which then being amended with Government Regulations No 7/2021[4] that classifies MSMEs based on its capital or annual revenue as follows:

a. Micro-scale business:

   i) Has a maximum capital of IDR 1 billion, excluding land and building for business; or

   ii) Has a maximum annual revenue of IDR 2 billion.

b. Small-scale business:

   i) Has net wealth between IDR 1 billion – IDR 5 billion, excluding land and building for business; or

   ii) Has annual revenue between IDR 2 billion – 15 billion.

c. Medium-scale business:

   i) Has net wealth between IDR 5 billion – IDR 10 billion, excluding land and building for business; or

   ii) Has annual revenue between IDR 15 billion – IDR 50 billion.

In addition to the official definition in relation to business volume, there are some characteristics for the different scale of MSMEs, which is explained in Table 9:

Table 9: Characteristics of MSMEs in Indonesia

Characteristics	Micro	Small	Medium
Type of products	Not permanent	More stable	Stable
Place of business	Not permanent	Permanent	Permanent
Financial bookkeeping	Not yet	Simple	Clear accounting procedure
Separating financial business and family	No	Yes	Yes
Spirit of entrepreneurship	Low	Medium, shown by not yet conducting planning part	High, shown by clear task division
Level of education	Low	Medium	Educated
Access to financing	Non-bank financing	Bank and non-bank	Bank and no-bank
Legality	Mostly no	Yes	Yes
Example	Sellers in traditional market, food stall	Wholesaler, distributor	Stone mining for construction and artificial marble

Source: Bank Indonesia (2015)

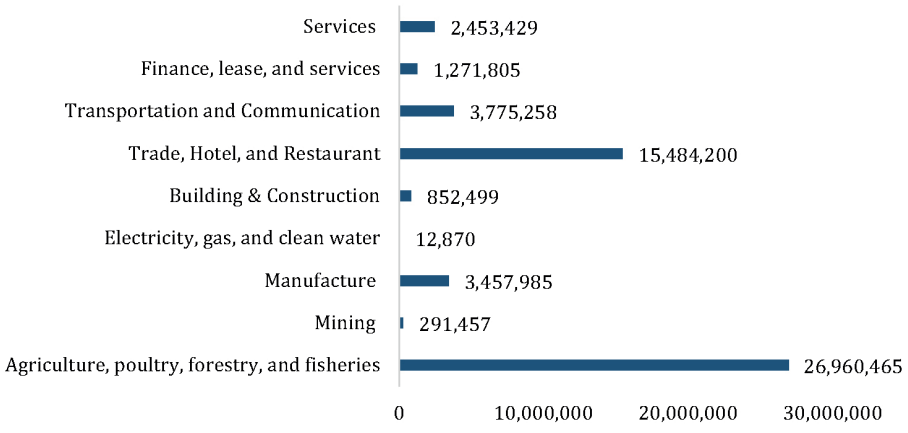
As can be seen, the products, operational nature, entrepreneurship level, and legal form are considered essential factors in determining whether a business is micro, small, or medium.

[4] *https://jdih.setkab.go.id/PUUdoc/176384/PP_Nomor_7_Tahun_2021.pdf*

The Role of the MSME Sector in the Indonesian Economy

In Indonesia, there are approximately 64 million units of MSME contributing to 61% of the GDP and having an export value of IDR 2,045 trillion (15.6% of total export for non-oil and gas), which also provides employment to 121 million people (96.9% of total labor force) (Kemenkop, 2018). MSMEs are operating and hence contributing to all sectors, such as agriculture, forestry, fisheries, mining, manufacture, electricity, building, accommodation, transportation, financial services, and other services. Table 10 presents the classification of sectors and their definition, while Figure 19 shows the number of MSMEs classified in each sector based on data from Indonesia's central bank in 2015.

Figure 19: Number of MSMEs Based on Sectors (2015)



Data Source: Bank Indonesia (2015)

The statistics show that the highest number of MSMEs are in the agriculture, livestock, forestry, and fisheries sectors, followed by the trade, hotel, and restaurant sectors. These two sectors have been playing an essential role considering the abundance of natural resources and supporting the tourism activities in Indonesia by providing accommodation and food supplies.

Table 10: Classification of Sectors in MSMEs Spheres

No	Sector	Definition
1	Agriculture, livestock, forestry, and fisheries	Including all business related to living object from nature to fulfill needs and other business
2	Mining and Quarrying	Including sub-sector oil and natural gas, non-oil and gas, and sub-sector quarrying
3	Processing Industry	Activities involving the transformation of the basic material (raw material) into finished/semi-finished goods and/or less valuable goods to more valuable goods through mechanic/chemical process using machine or manual
4	Electricity, gas, and clean water	Electricity includes generation, transmission, and distribution of electricity for household, business, industry, government offices, public road, and others Gas includes activities of processing liquid gas, production of gas with carbon (from charcoal) or process that mixing gas with natural gas or petroleum or other gas, also distribution of liquid gas through pipe system to household, industry, or other commercial users Clean water includes water reception, filtering, and distribution to household, industry, or other commercial users

5	Building & Construction	Activities of preparing, making, building, and maintaining/repairing building/ construction, used as residence or other facilities
6	Trade, Hotel, and Restaurant	Trade is sale activities (without any technical change on the product), it can be new or second-hand goods Hotel is part of business sector in providing accommodation and beverages Restaurant is involving activities to provide food and beverages for public
7	Transportation and Communication	Transportation is activity to move people/passenger and/or goods/livestock from one place to another place on road, water, and air, using motor or non-motor vehicle
8	Finance, lease, and services	Including financial intermediary activities, insurance, pension fund, supporting activities, real estate, leasing, and business services
9	Services	Including service activities for public/society to serve household, business, government, and other institutions

Data Source: Bank Indonesia (2015)

Regarding the credit extended to the MSMEs, as can be seen in Table 11, the highest volume of banking credit received by MSMEs is for wholesale and trade sector, amounting to 49.22%. It is followed by the agriculture sector for around 12.67%, and processing industry sector for 10.51%. It also shows that these sectors have the potential future return that banks are willing to provide financing for them, implying that they are considered relatively less risky.

Table 11: Volume and Percentage of Credit for MSMEs Based on Sector

Sector	2018		2019		2020		May-21	
	Nominal	Share	Nominal	Share	Nominal	Share	Nominal	Share
Agriculture, hunting, and forestry	89,560	9.23%	104,989	10.05%	122,350	11.98%	129,837	12.67%
Fishery	7,200	0.74%	8,642	0.83%	10,090	0.99%	10,739	1.05%
Mining and quarrying	6,608	0.68%	7,947	0.76%	7,534	0.74%	7,334	0.72%
Processing industry	99,028	10.21%	106,936	10.24%	107,409	10.51%	107,638	10.51%
Electricity, gas and water	4,307	0.44%	6,288	0.60%	3,603	0.35%	3,458	0.34%
Construction	62,521	6.45%	65,148	6.24%	52,587	5.15%	49,972	4.88%
Wholesale and retail trade	499,248	51.47%	526,356	50.40%	505,330	49.47%	504,210	49.22%
Provision of accommodation and the provision of eating and drinking	37,877	3.90%	43,364	4.15%	48,490	4.75%	50,079	4.89%
Transportation, warehousing and communications	37,975	3.92%	42,466	4.07%	40,226	3.94%	39,547	3.86%
Financial intermediaries	16,267	1.68%	14,087	1.35%	11,480	1.12%	10,611	1.04%
Real estate, Business Ownership, and Business Services	48,371	4.99%	54,162	5.19%	46,696	4.57%	45,816	4.47%
Government administration, defense and compulsory social security	532	0.05%	142	0.01%	88	0.01%	54	0.01%

Education services	3,612	0.37%	3,633	0.35%	3,852	0.38%	3,704	0.36%
Health services and social activities	8,131	0.84%	8,654	0.83%	7,801	0.76%	7,793	0.76%
Community, Sociocultural, Entertainment and Other Individual Services	46,281	4.77%	49,008	4.69%	51,473	5.04%	51,072	4.99%
Individual services which serve households	2,199	0.23%	2,209	0.21%	2,249	0.22%	2,314	0.23%
International Agency and Other Extra International Agency	4	0.00%	6	0.00%	5	0.00%	7	0.00%
Business activities are not clearly defined	252	0.03%	273	0.03%	228	0.02%	219	0.02%
Debtor is not the business field - other	0	0.00%	0	0.00%	1	0.00%		0.00%
Total	969,973	100.00%	1,044,310	100.00%	1,021,492	100.00%	1,024,404	100.00%

Source: (OJK, 2021a)
Notes: debt outstanding; nominal credit includes credit from conventional and Islamic banks; nominal is in billion IDR

The Financing Sources for the MSMEs and the Financing Gap in Indonesia

In terms of financing sources for MSMEs, it has been an ongoing discussion that financing is one of the main challenges faced by MSMEs. In 2007, the government issued a regulation[5] called 'Kredit Usaha Rakyat' (People's Business Loan; further called as KUR), particularly intended for providing loans for MSMEs. The loan can be accessed by MSMEs directly through banks that are appointed by the government or through cooperatives or microfinance institutions as a channeling from the designated banks.

There are several conditions for delivering the KUR, such as at least 60% of KUR should be provided for the productive MSMEs, for example MSMEs in the agriculture and processing industry. The remaining 40% can be provided for other sectors, but the highest proportion is given to the retail and trade sector. Another condition is that each Indonesian citizen can only receive KUR twice, as a capital for them to start or support their business. In addition, KUR has a very low cost of fund (approximately 6%, where the regular margin is around 16.5%-18%) since the allocation is for the unbankable.

Further to improve the financing issue faced by MSMEs, the Central Bank of Indonesia, namely, Bank Indonesia, issued a regulation PBI No 14/22/PBI/2012, that is then being amended in PBI No 17/12/PBI/2015[6] , suggesting commercial banks to allocate their loan for MSMEs at minimum of 20% from their total credits. If the bank could not reach the minimum value, they are required to provide training classes for the MSMEs.

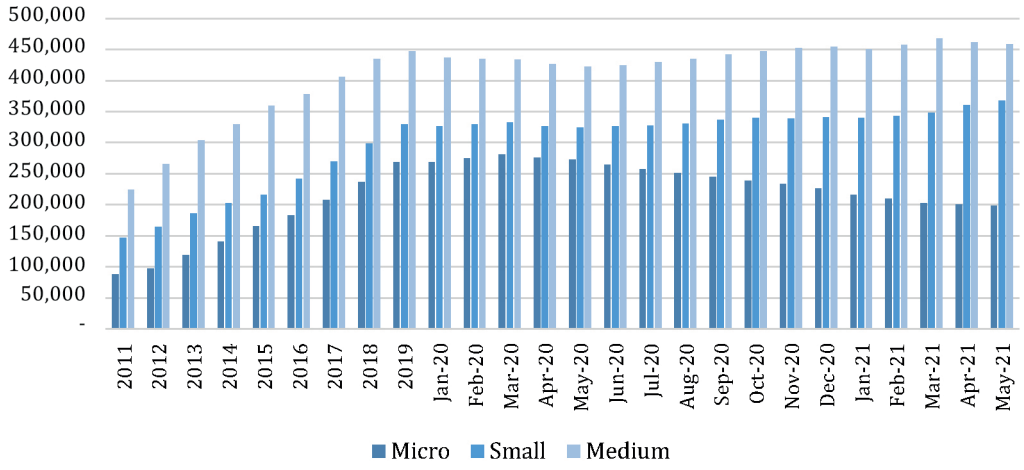
The most recent support provided by the Indonesian government, issued in 2018[7] , is by establishing an ultra-micro loan for MSMEs, which is unbankable, and the loan is capped at a maximum of IDR 10 million. This loan scheme is distributed through non-bank financial institutions (NBFIs) that are appointed by the government, such as PT Pegadaian, PT Permodalan Nasional Madani (PNM), and PT Bahana Artha Ventura (channelled through cooperatives).

[5] *https://jdih.kemenkeu.go.id/fulltext/2008/135~PMK.05~2008Per.HTM*

[6] *https://peraturan.bpk.go.id/Home/Details/135527/peraturan-bi-no-1712pbi2015-tahun-2015*

[7] *https://peraturan.bpk.go.id/Home/Details/113137/pmk-no-95pmk052018*

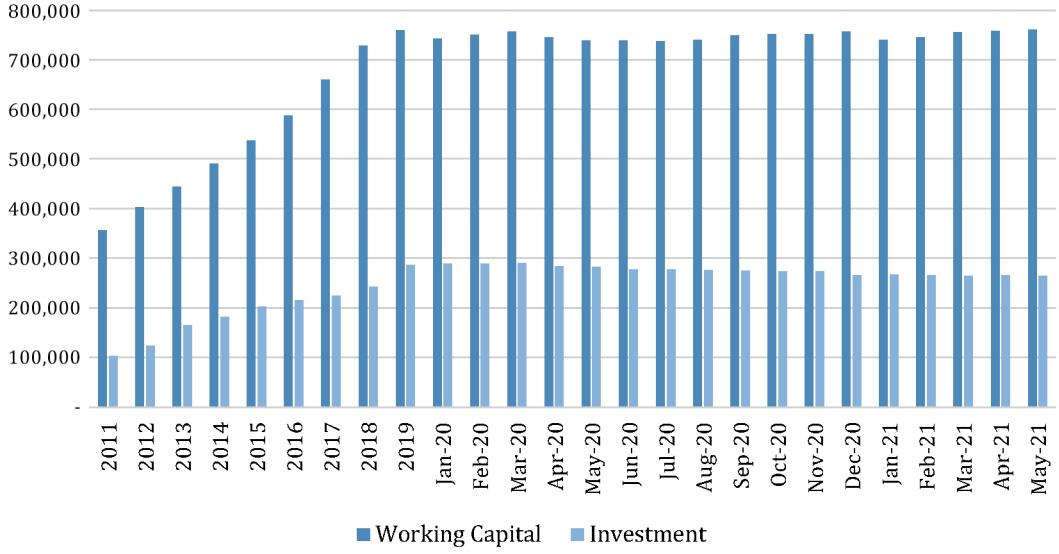
Figure 20: Distribution of Credit by Banks for MSMEs Based on Business Scale



Source: (OJK, 2021a)
Notes: debt outstanding; includes conventional and Islamic banks; in billion IDR

Figure 20 shows the distribution of outstanding debt for MSMEs in the banking sector, both conventional and Islamic commercial banks, based on the business scale. It shows that the proportion of credit has a positive relationship with the scale of business. Figure 20 shows that there is a decrease for outstanding debt in the micro-scale business, starting from March 2020 until May 2021. It might represent that banks are being more attentive in delivering their financing, focusing more on small and medium enterprises, which Figure 20 shows that there is an increase for those two scales. Figure 21 presents that the proportion for working capital credit is higher compared to the investment, implying that MSMEs are still in need of credits for the operational activities of their business.

Figure 21: Distribution of Credit for MSMEs Based on Types of Use

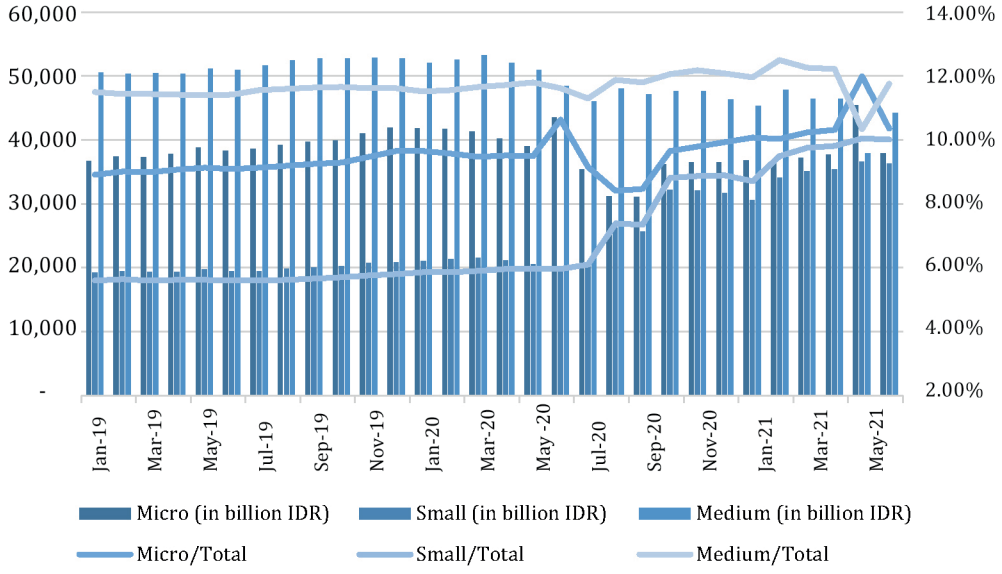


Source: (OJK, 2021a)
Notes: Debt outstanding; includes conventional and Islamic banks; in billion IDR

Aside from financing by the banking sector, financing for MSMEs is also provided by non-banking financial institutions, particularly financing companies. Figure 22 shows that there exists steady trend of financing for medium-scale businesses (see: grey-coloured bar) from January 2019 to March 2020, but then the financing has declined until January 2021. On the other hand, the financing for small-scale businesses (see: orange-coloured bar) experienced a slight decrease at the beginning of 2020, but had a sharp increase in mid of 2020 until second quarter of 2021.

As for financing for the micro-scale business (see: blue-coloured bar), the trend shows a decreasing volume in the mid-2020, which managed to bounce back by September 2020 and has a steady proportion . The increase in the third and fourth quarter of 2020 can be due to the rise in the number of people who started their micro- or small-scale business and obtained financing from the financing companies (non-banking financial institutions). The proportion on total financing provided by non-bank financing accounts for around 20-30%, with the highest proportion for medium-scale businesses, followed by micro-scale and small-scale businesses.

Figure 22: Distribution of Credit for MSMEs from Non-Bank Financing Institutions



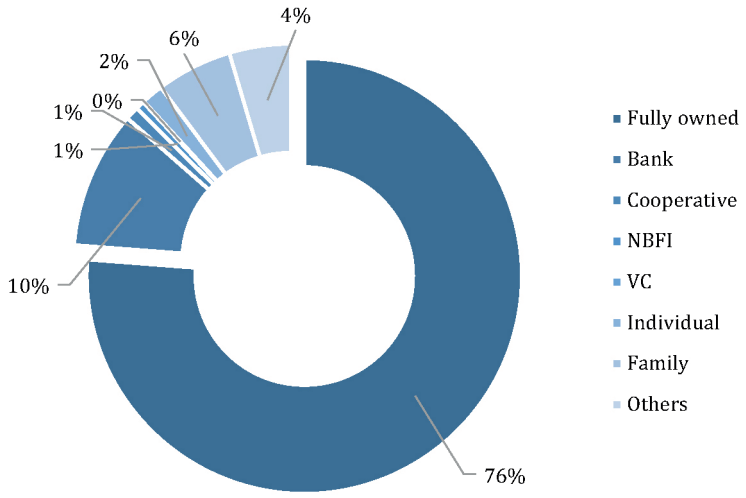
Data Source: OJK (2021b)

In addition, the impact created by non-banking Islamic financing institutions should be mentioned, which include *Baitul Maal wat Tamwil* (BMT) and Micro *Waqf* Bank that also provide financing for MSMEs. BMT has two functions, to collect social funds and provide financing for MSMEs that can be in the form of group lending (PEBS, 2020). As for Micro *Waqf* Bank, it provides financing for the lowest level of customers in the society.

Other than financing from banking and non-bank financial institutions, a statistic from Statistic Bureau on manufacturing MSMEs in 2015 shows that 76% of the MSMEs are fully owned (*see*: Figure 23), implying that the business owners are relying on their own capability in running their business financially. It is then followed by MSMEs having a bank loan, which accounted for 10%, and financing from a family accounted for 6%.

As for the Islamic cooperatives *(koperasi syariah),* there are 3,905 active units per December 2019 or beginning of 2020 (Kemenkop, 2021). They have 3,429,216 active members with total asset of IDR 10,284 trillion, owner's equity of IDR 1.9 trillion, external capital of IDR 8.38 trillion, business volume of IDR 12.33 trillion, and retained earnings of IDR 197.31 trillion. They also experience a decline during pandemic with a decrease in the savings by 8-25%, an increase in operational cost by 11-15%, and a decrease in retained earning by 12-20%.

Figure 23: Types of Source of Capital for MSMEs in Manufacturing Sector (2015)



Data Source: Badan Pusat Statistik (BPS, 2016)

Considering MSMEs have a significant contribution in the economy, government has formulated different types of financing, such as micro *waqf* bank ("Bank *Wakaf* Mikro" or BWM for the abbreviation)[8] . BWM is an Islamic microfinance institution, regulated by the Financial Service Authority, that provides financing for unbankable parts of the society in the form of *qard al-hassan*. As for the source of funds, BWM obtains their fund from private companies' CSR (Corporate Social Responsibility). Hence, they can deliver their financing at a low cost, that they only charge 10% of fee from any financing received by the debtor. In addition, in delivering the financing, BWM runs within Islamic boarding school, which they also monitor the debtors by having a regular spiritual gathering (*halaqah*). BWM started in 2018 and currently has 60 institutions in different parts of Indonesia, has a cumulative financing delivered to 46,200 of customers with value of IDR 69.2 billion, and has an outstanding financing of IDR 13 billion for 13,900 customers. Appendix 1 shows the list of BWM, the amount of financing being delivered, and the products being produced and sold by the debtors.

Another effort by the government to provide financing for MSMEs is through the establishment of securities crowdfunding in 2017, which is still focusing on the equity crowdfunding and currently formulating the debt instrument for crowdfunding. The regulation is explained in POJK No 37/ POJK.04/2018[9] , that is being amended into POJK No 57/POJK.04/2020[10] . According to the

[8] *http://lkmsbwm.id*

[9] *https://www.ojk.go.id/id/regulasi/Documents/Pages/Layanan-Urun-Dana-Melalui-Penawaran-Saham-Berbasis-Teknologi-Informasi-%28Equity-Crowdfunding%29/POJK%2037%20-%202018.pdf*

[10] *https://www.ojk.go.id/id/regulasi/Documents/Pages/Penawaran-Efek-Melalui-Layanan-Urun-Dana-Berbasis-Teknologi-Informasi/pojk%2057%20-%2004%20-%202020.pdf*

regulation, types of MSMEs that can join the platform will be SMEs, considering that the micro-sized enterprises haven't had a proper financial report yet. In addition, the maximum amount of capital that can be raised by the SMEs is IDR 10 billion, that is within the range of medium-sized entreprises. Currently, there are five equity crowdfunding platforms that have obtained permit from the Financial Service Authority to operate as equity crowdfunding, namely Bizhare, CrowdDana, danasaham, LandX, and Santara. Table 12 presents the summary of activities being conducted by the equity crowdfunding.

Table 12. List of Activities by Equity Crowdfunding

No.	Name	Activities
1.	Bizhare	48 entrepreneurs registered[11] and obtained fund from the crowdfunfing platform
2.	CrowdDana	Focusing on property and there are eight entrepreneurs registered
3.	LandX	14 issuers; 44,464 registered investors; IDR 69.2 billion investment; IDR 1.72 billion dividend paid Focus on business and property
4.	Santara	89 registered business; 289,697 registered members, IDR 149.9 billion fund collected

46 business in F&B, 14 poultry, 2 agriculture, 3 health and social services, 2 fisheries, 17 retail and wholesale, 2 processing industries, 1 transportation, 1 real estate, 1 leasing and business services, 1 education services, 2 social and individual services.

The details of business registered in Bizhare and Santara can be found in the Appendix 2 and 3, respectively.

As for the mechanism in offering the shares, there is a particular period for each business to offer their shares (collect the fund) and it can only be sold in primary market for a year. After a year, the shares can be traded in the secondary market, allowing the initial shareholder to sell their shares to other interested investors or the SMEs to buyback their shares.

In terms of bookkeeping, these shares are also registered in the Indonesian stock exchange and the SMEs have to deliver dividend or return to the investors. Currently, the regulator and association for equity crowdfunding is formulating the regulation for debt issuance, which can be *sukuk* or obligation, that can be issued by SMEs in Indonesia.

The Challenges Faced by MSMEs During the Pandemic

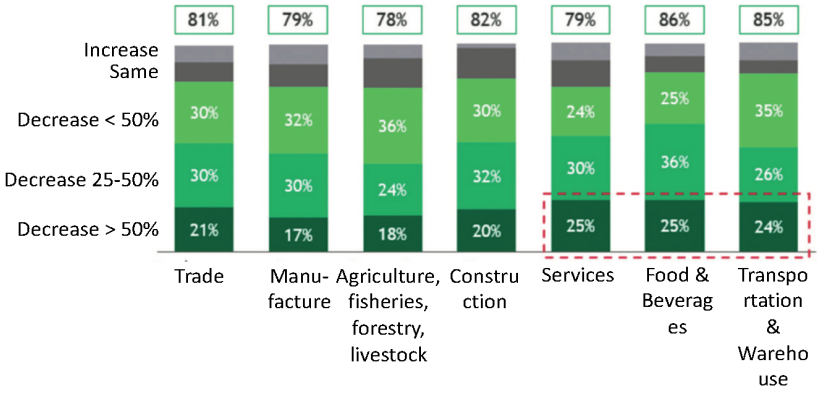
The pandemic has restricted the movement of people. In Indonesia, the government implemented large-scale social restrictions at the beginning of the pandemic to restrict people from traveling outside their houses. As a result, closures of many facilities and implementation to work from home have become the new norm. Besides, the pandemic also created anxiety in the society, resulted in lower purchasing power as the individuals face insecurity for the future (OJK, 2020). The pandemic affects the economy, directly and indirectly, and MSMEs have inevitably been affected by the adverse impact faced in the global and Indonesian economy.

The adverse impact of the COVID-19 on MSMEs is classified into four categories: sales, funding, operational, and supply (OJK, 2020). Based on a survey distributed to 3,136 MSMEs, as can be seen in Figure 24, OJK found that the three most answered impact for sales are (i) lower purchasing power, (ii) the implementation of health protocol that hindered the sales, and (iii) the

[11] *Retail, F&B, laundry, mechanics & services, services, agriculture, beauty care, education, technology*

decline in physical interaction. As for funding, the three most answered impacts are (i) difficulty in getting financing or cash inflow, (ii) customers are unable to pay or there is a delay and (iii) difficulty in repaying the existing loan. In terms of operational, the adverse impacts are related to (i) the productivity of employees, (ii) difficulty in predicting the demand, and (iii) hindrance from the health protocol. From the supply side, the issues are related to (i) price instability, (ii) longer delivery time, and (iii) difficulty in finding a supplier.

Figure 24: Percentage of Respondents Having Decrease in Sales



Source: OJK (2020)

The most apparent adverse impact that is directly faced by MSMEs is declining in their sales. According to a report by the OJK (2021), sectors that are highly affected are transportation and warehouse (85% of respondents experience a decrease in their sales), food and beverages (86%), and construction (82%). Figure 24 shows the percentage of respondents who experienced a decrease in their sales and their degree of decline. Services, food and beverages, and transportation and warehouse sectors have experienced the highest percentage for sales that decrease higher than 50% (shown by the red dotted line in Figure 24).

The decrease in the sale of the food and beverage sector can be explained by the high decline in tourism due to the travel restriction, as tourism is one of the important sources for the food and beverages sector. In addition, large numbers of MSMEs in the food and beverages sector operate in schools, universities, shopping malls, and offices, which could not operate their business due to the closure of those facilities. Further, the transportation and warehouse sectors are also impacted, considering that people have not been allowed to travel. Furthermore, many consumers have also faced difficulties, resulted in the decrease of demand towards goods and services.

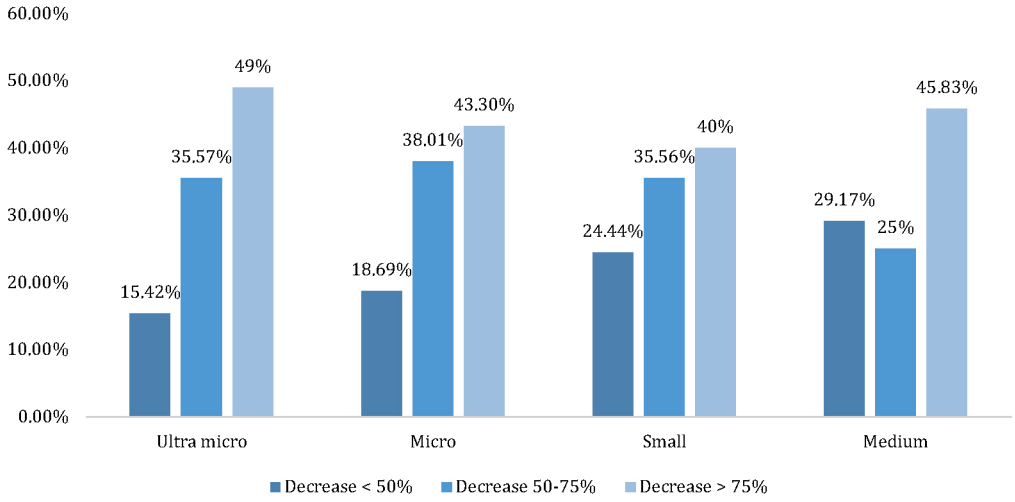
Table 13: Sectors Being Impacted by COVID-19

Three Sectors Having the Highest Respondents Being Impacted by COVID-19		Three Sectors Having the Lowest Respondents Being Impacted by COVID-19	
Accommodation and Food-Beverages	92.47%	Water and Waste Management	68.00%
Other services	90.90%	Electricity and Gas	67.85%
Transportation and Warehouse	90.34%	Real Estate	59.15%

Source: BPS (2020)

Table 13 presents the sectors having lower sales based on the respondents surveyed by the Statistics Bureau (BPS, 2020), showing the similar results as the survey conducted by (OJK, 2020). On the other hand, sectors related to services provision for society, such as water, waste management, electricity, and gas, have a lower degree of impact in terms of their sales decrease.

Figure 25: Distribution of Impact Based on Business Scale



Data Source: LIPI (2020)

Categorizing the business into its scales, another survey conducted by the Indonesian Institute of Sciences *[Lembaga Ilmu Pengetahuan Indonesia]* (LIPI, 2020) for 679 MSMEs' owners - in Figure 25 - shows that the micro-scale type of MSMEs has experienced the highest decline in their revenue (higher than 50%).

Related to the impact mentioned above, another study by the Statistics Bureau on surveying 34,559 businesses (micro, small, medium, and big business) conducted in July 2020, business owners expressed different policies on responding to the changes due to pandemic. Around 59% of respondents were still operating as usual, while 24% have been operating by decreasing their capacities, 8.76% stopped their operational activities, 5.45% were working remotely for half of the employees, 2.05% have been working remotely for all the employees, and 0.49% experienced an increase in their capacities (BPS, 2020).

Furthermore, OJK report also shows that there are several technical measures taken by MSMEs to moderate the consequences of the pandemic, which can be classified into short-term (quick) and long-term measures (OJK, 2020). The short-term measures include (i) taking an additional loan, (ii) working remotely from home, (iii) layoff, and (iv) a decrease in salary. Regarding the long-term measures, considering that it will take time for the implementation or effects, they are related to (i) diversifying their business by entering a new sector or producing new products, and (ii) attending various training programmes or seminars to improve their capacity. On the implementation, different sectors of the MSMEs respondents being surveyed by the OJK expressed a different degree of implementation for those measures. Table 14 provides the distribution of the respondents in relation to the implementation of the identified measures.

Table 14: Measures Taken in Each Sector

Sector	Laying off	Imple-menting Wage Cut	Work from Home	Diversify-ing New Product	Diversify-ing New Sector	Attending Seminar/ Training	Taking New Loan
Trade	32%	23%	41%	31%	37%	34%	39%
Manufac-ture	42%	42%	51%	45%	41%	44%	58%
Agriculture	34%	30%	36%	27%	35%	34%	51%
Construc-tion	32%	28%	46%	35%	42%	34%	43%
Services	30%	31%	55%	30%	40%	41%	36%
Food & beverages	45%	34%	35%	39%	36%	37%	47%
Transpor-tation & warehouse	40%	38%	54%	32%	40%	39%	49%
Average	35%	30%	45%	33%	38%	37%	45%

Data Source: OJK (2020)

Table 14 shows that the food & beverages sector has the highest percentage of the layoff, followed by the manufacture and transportation & warehouse sectors.

Considering the survival condition faced by MSMEs, it is important to observe the assistance required by MSMEs to face the pandemic. A survey organised by the BPS (2020) shows that 69.02% of respondents stated that they need help for business capital, 41.18% required facility for their business' electricity bills, 29.98% asked for deferment of loan repayment, 17.21% required ease for the administration in loan submission, and 15.07% asked for deferment in tax payment (BPS, 2020). Breaking it down by sector, Table 15 shows that most MSMEs responded that the assistance needed by MSMEs is related to the financial condition of MSMEs, for example in processing industry, 84% respondents are in need of financial support. On the other hand, for real estate and health services sectors, most respondents require a support in the form of facility for electricity bills (shaded with orange-colour).

Table 15: Support Needed Across Sector

Sector		Sector		Sector	
Mining	73%	Trade and vehicle reparation	74%	Real estate	49%
Manufacture	84%	Transportation and warehouse	67%	Business services	71%
Electricity and gas	68%	Accommodation and Food-Beverages	67%	Education services	58%
Water and waste management	69%	Information and communication	59%	Health services	57%
Construction	67%	Financial services	57%	Other services	71%

Data Source: BPS (2020)

With the advancement of technology, it might be necessary to observe MSMEs' impact and their involvement with technology. Based on the survey conducted by LIPI (2020), 78.84% of respondents who only used physical stores experienced a decrease in their sales by more than 50%. It is followed by MSMEs having both physical and online platforms, as 76.85% of the respondents in this category experienced more than a 50% decrease in their sales. As for the MSMEs using an online platform, 76.07% of the respondents experienced a similar decrease. Similar results are obtained by (OJK, 2020), who found that MSMEs with the online channel has the lowest number of respondents, experiencing more than a 50% decrease in their sales (19% of the respondents). On the other hand, 20% of respondents using traditional platforms experienced more than 50% decrease in sales, and 26% of respondents using offline-online platforms experienced a similar situation.

By classifying the issues of impacts experienced by MSMEs, a survey by Ministry of National Development Planning (Kemenkop, 2021) presents several strategies employed by MSMEs in tackling the pandemic (*see*: Table 16). Table 16 shows that in relation with production, the highest proportion for all scales is changing in their operational hour, considering there is a regulation for early closure of activities in several cities and regencies. The second and third actions are modifying the goods being produced and having a temporary closure of the business. Modification of goods is supported by the interviewees, who explain that several MSMEs modify or change their products, for example from tailoring clothes to producing masks and/or Personal Protective Equipment (PPE).

> "Some businesses are able to change or modify their products, based on their experience and an open-minded vision, also with a small research on market." – R1

> "MSMEs working as tailor shifts their work into making facial masks; a tailor works on school uniform shifts their product line into making PPE for medical workers." – R2

In relation with financial condition, the highest answer is by reducing utility costs, such as electricity, gas, water, and communication. The second and third most answered are reducing transportation costs and looking for new loan/financing. In relation with marketing, the highest answer for action taken by MSMEs is selling with different method or online. It is also supported by the interviewees that the financial institutions and regulator are providing training for the MSMEs to sell their products online.

> "We have a program called Halal Market in Instagram, which mustahiq that has business can sell their products in the Instagram." – R2

> "We collaborate with other ministries and institutions to provide training for MSMEs to sell their products in marketplace." – R4

> "We collaborate with the online platforms to assist MSMEs for the onboarding in using digital platform to sell their products, which we have the target of MSMEs go digital." – R5

Table 16: Ability of MSMEs to Survive During Pandemic

Activities	Micro	Small	Medium
Ability of MSMEs to Survive in Relation with Production			
Temporary closure	18%	24%	36%
Change the business focus	20%	23%	17%
Modification of goods produced	22%	29%	23%
Change the production technique and/or material composition	17%	21%	17%
Change in operational hour	31%	35%	36%
Others	7%	8%	9%
No effort	16%	9%	11%
Ability of MSMEs to Survive in Relation with Financial			
Reduction of utility cost	50.90%	46.50%	52.30%
Reduction of rent cost	14.50%	19.30%	23.50%
Reduction of transportation cost	37.50%	36.10%	37.10%
Looking for new loan	25%	34.30%	37.90%
Others	7.10%	9.50%	12.10%
No effort	13.60%	12.40%	9.80%
Ability of MSMEs to Survive in Relation with Marketing			
Selling with different method (online)	61%	68%	50%
Prividing discount or gift	22%	27%	36%
Making package or edition	14%	22%	25%
Selling smaller packaging	22%	20%	15%
Receiving order as sub-contractor	7%	14%	23%
Others	4%	6%	6%
No effort	22%	16%	20%
Ability of MSMEs to Survive in Relation with Labor			
Reducing salaries for workers	11%	31%	39%
Paying full salaries for workers	3%	6%	7%
Paying the salaries in installments	15%	22%	23%
Reducing bonus	11%	18%	21%
Laying off workers (partly)	17%	42%	35%
Laying off workers (full)	9%	8%	8%
Others	10%	6%	7%
No efforts	42%	15%	11%

Source: KemenkopUMKM (2021)

It can be seen that MSMEs have put their best effort into surviving and running their business under very challenging times. However, the Statistics Bureau report (BPS, 2020) explains that 55% of respondents do not know how long they can survive, as predictions under such uncertain times force great difficulty. Among the respondents BPS (2020) study, 26% of them have been optimistic that they could survive for more than three months, while 19% of them expressed

that they could only survive for a maximum of three months. In addition, for the business that diversified their operational activities, 45% are optimistic that the business can survive more than three months. On the other hand, 55% can only survive for a maximum of three months.

In preparing for the business development after COVID-19, 55% of respondents in the LIPI (2020) study mentioned that they have contingency plans for the future. Taken from another survey by OJK (2021), 44% of respondents stated that they would expand their current business in the next year. In addition, 34% of respondents will diversify their sector and products, while 21% will not make any change in their business.

At the latest survey and statistics, a report by Mandiri Institute in 2021 (Kemenkop, 2021) shows that 84.8% of business can run normally in March-April 2021, while it was only 35.2% in 2020. 8.1% of the remaining can only operate within a limit, and 7.1% stop their business. The reasons for business to stop their operations are due to lack of capital (45%), potential in the future (23%), raw material (14%), and supply of labor (5%).

4.2.2. The Trajectory of Islamic Finance: Institutionalization, Legal and Regulatory Framework, and Financial Standing

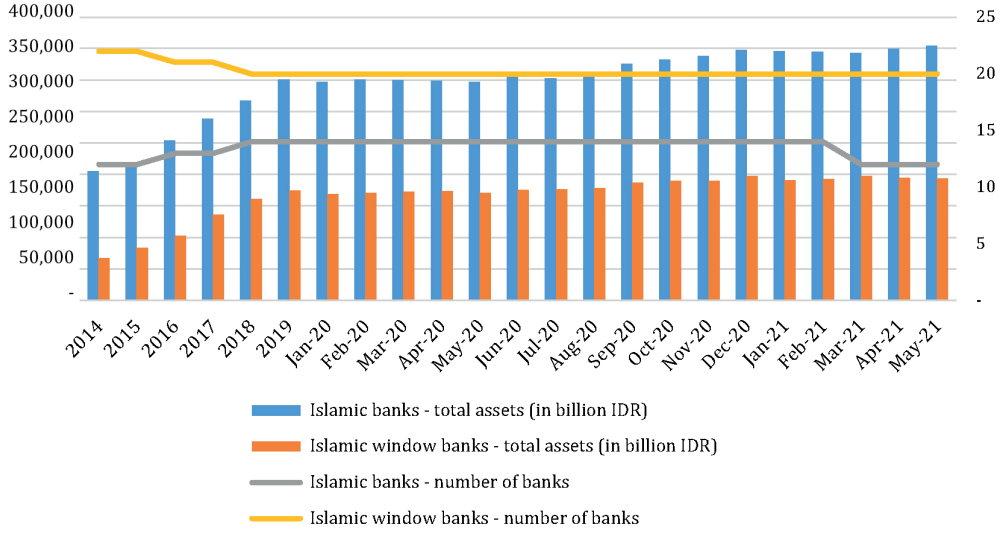
The development of Islamic banking institutions in Indonesia began in 1992 with the establishment of Bank Muamalat as the first *Shari'ah* bank in Indonesia, followed by the issuance of the first *Shari'ah* mutual fund in the capital market in 1997 and the first corporate *sukuk* in 2002. The Islamic finance sector continues to grow higher than the conventional sector and provides an alternative for society in conducting their financial transactions resulting in the development of financial inclusion. Other than the development of *Shari'ah* banks, mutual fund, and *sukuk*, the Indonesian government also encourages the establishment of *Shari'ah* non-bank financial institutions such as insurance, financing companies, venture capital, *Shari'ah* specialized financial institutions, and microfinance.

Within the Indonesian Islamic finance sphere, there are four types of institutions which has been experiencing remarkable growth; they are full-fledged Islamic banks, Islamic unit banks, *Bank Pembiayaan Rakyat Syariah* (BPRS) [Islamic rural banks], and BMT (Hasanah & Yusuf, 2013). BMT is considered as a distinctive institution that exists only in Indonesia, which was developed in 1980 by Muslim civil society to respond to the financing needs of the community in a *Shari'ah* compliant manner and is currently being led by some foundations, Islamic banks, Islamic traditional boarding schools, and other parties who have strong social and religious influence in the society (Dewanti, 2013). BMT aims to support poverty alleviation by doing socio-economic activities, such as collecting Islamic social fund (*zakah, waqf, infaq,* and *sadaqah*) and delivering it to the society in the form of *qard al-hassan*, which is widely set up in the rural area due to the condition that commercial banks are not able to cover the rural area (Hasanah & Yusuf, 2013; Nazirwan, 2015; Yuniar, 2015).

Having four different types of Islamic financial institutional forms requires a comprehensive strategy to have a specific task for each institution without any intersection and inefficient works resulting in better operational and financial sustainability (Nazirwan, 2015). The weakness of Islamic banks in their ability to reach the rural areas could be complemented by Islamic rural banks and/or BMTs, which have higher flexibility on delivering the financing to villages and small-scale business, shown by the establishment of a linkage program consisting of three models: channeling, executing, and joint financing (Nasution & Ahmed, 2015).

In accordance with these different types of Islamic financial institutions in Indonesia, one essential point is that there is a significant role of commercial banks, both conventional and Islamic, as a source of fund directly delivered to the entrepreneurs or indirectly administered through other institutions such as Islamic rural banks (BPRS) and/or BMT.

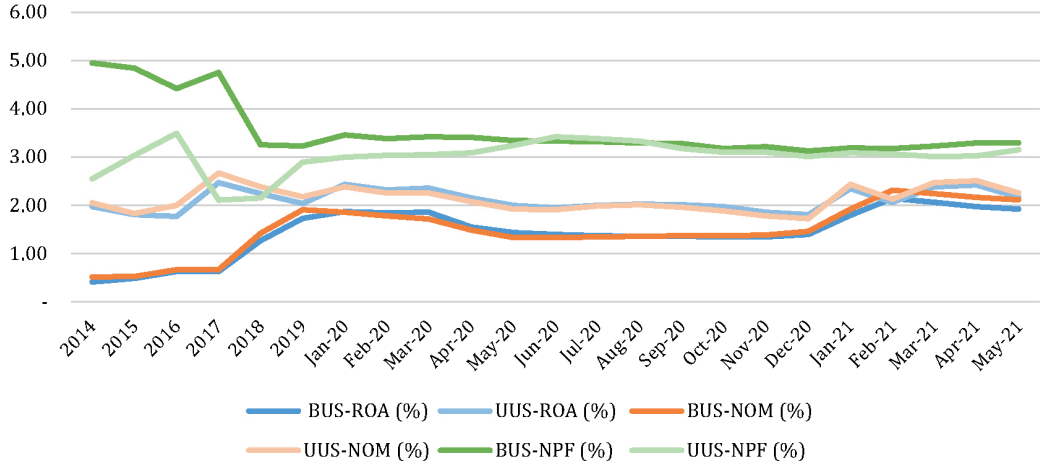
Figure 26: Trajectory of Islamic Banks in Indonesia



Data Source: OJK (2021c)

Figure 26 presents the trend of Islamic banks in Indonesia for several Islamic banks, Islamic window banks, and their respective total assets. There is an increasing number of Islamic banks and decreasing number of Islamic window banks, which can be due to the regulation that after a certain period, Islamic windows are expected to arrange a spin-off from its holding. In terms of total assets, as can be seen, there is a steady increase annually. In early 2021, three state-owned Islamic banks merged into one bank, resulting the number of Islamic banks becomes 12 units.

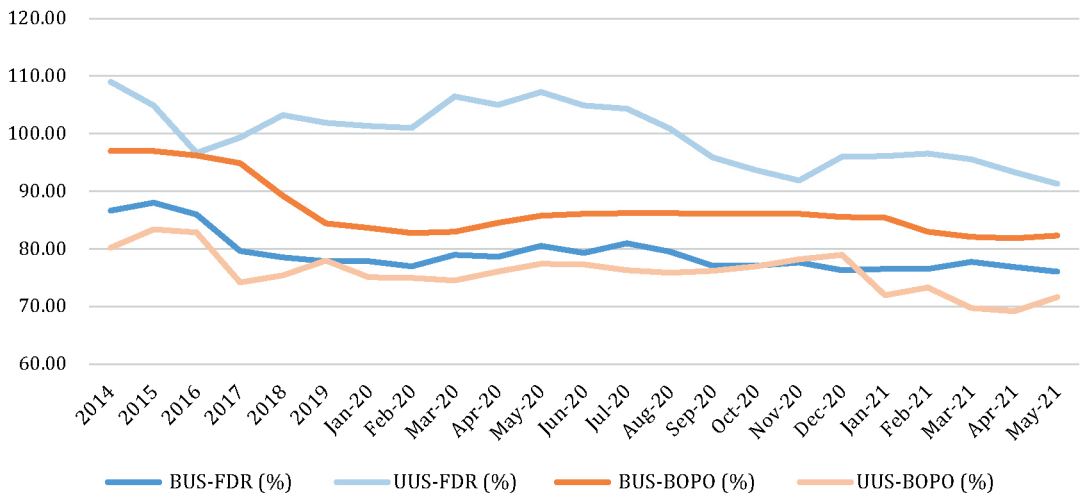
Figure 27: Performance of Islamic Banks in Indonesia



Data Source: OJK (2021c)

Further, Figures 27-29 present the performance of Islamic banks, including profitability, non-performing financing, efficiency, and capital requirement. Figure 27 shows the profitability trend and the non-performing financing from *Bank Umum Syariah* (BUS) [Islamic banks] and *Unit Usaha Syariah* (UUS) [Islamic windows]. There was an increase in profitability, demonstrated by the trend for Return on Assets (ROA) and Net Operating Margin (NOM), but it declined in March 2020 onwards due to the pandemic although it then increases from the end of 2020 going towards 2021. It is supported by the trend of the non-performing financing (NPF) that has a slightly increasing trend after March 2020 due to the pandemic. However, the proportion of NPF has been maintained at a stable level due to the restructuring policy from the regulator for the banking institution to relax the repayment of financing from their customers affected by COVID-19.

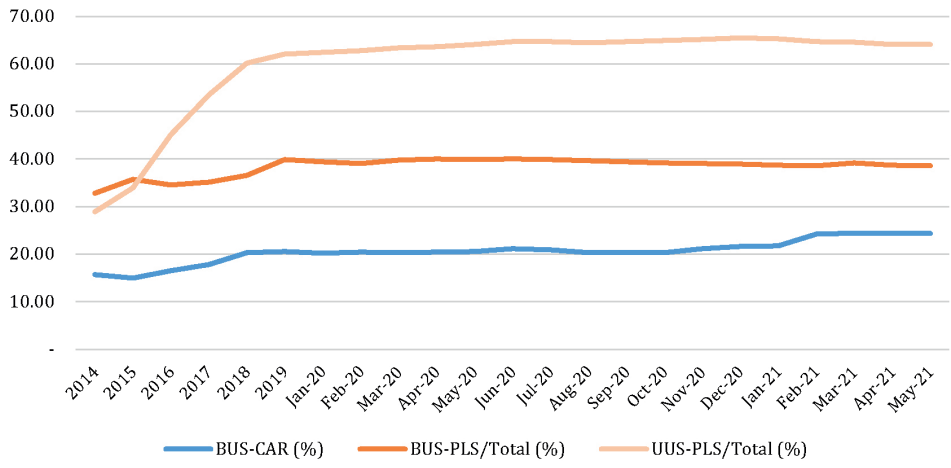
Figure 28: Performance of Islamic Banks in Indonesia



Data Source: OJK (2021c)

In terms of financing and efficiency, Figure 28 shows that there was a decrease in the financing to deposit ratio (FDR) from August 2020 onwards. This can be due to the banking sector's consideration to be more prudential in disbursing their financing and low demand from the market. As for efficiency, the ratio of operational cost to operational income (BOPO) has a slightly increasing trend, which might be due to the adjustment from the banking sector in providing their services during the pandemic, such as digitalisation of their services and strengthening their information-technology platform. As for Figure 29, the value of CAR and ratio of PLS financing to total financing experiences a steady trend.

Figure 29: Performance of Islamic Banks in Indonesia



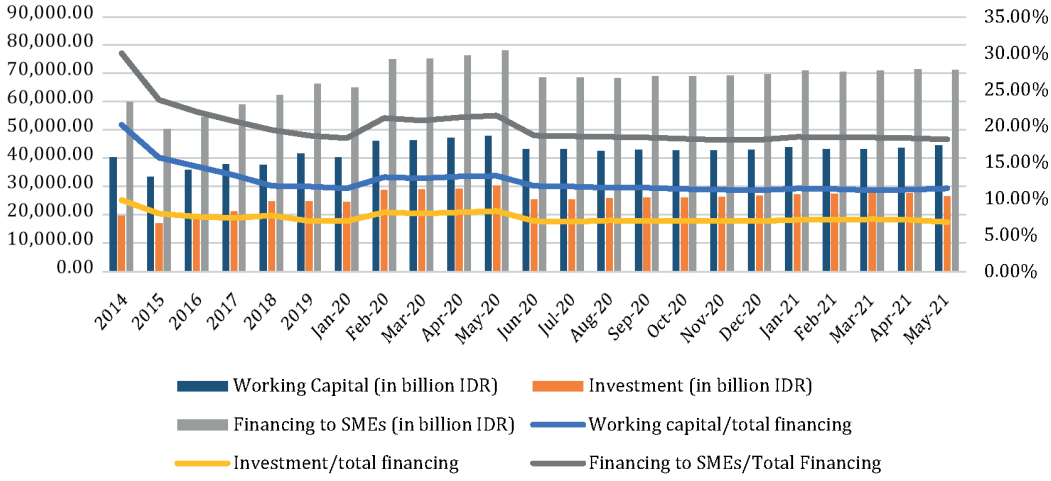
Data Source: OJK (2021c)

4.2.3. Islamic Financing Provisions for MSMEs: Institutions, Products, and Offerings

As part of the Indonesian financial system, Islamic banks also play their part in providing financing for MSMEs. As shown in Figure 30, financing extended by MSMEs for investment is higher compared to financing for working capital. However, the proportion of financing provided for MSMEs is less than 20% of the total financing provided by Islamic banks. It has been gradually decreased from 2014 until 2019, having an upward trend at the beginning of 2020 although it experienced a decrease in the mid-2020 due to COVID-19 conditions.

In providing financing for MSMEs, one of the Islamic bankers explain that the financing provided for agriculture sector has a flexible contract in which the payment can be based on the harvest time of the farmers.

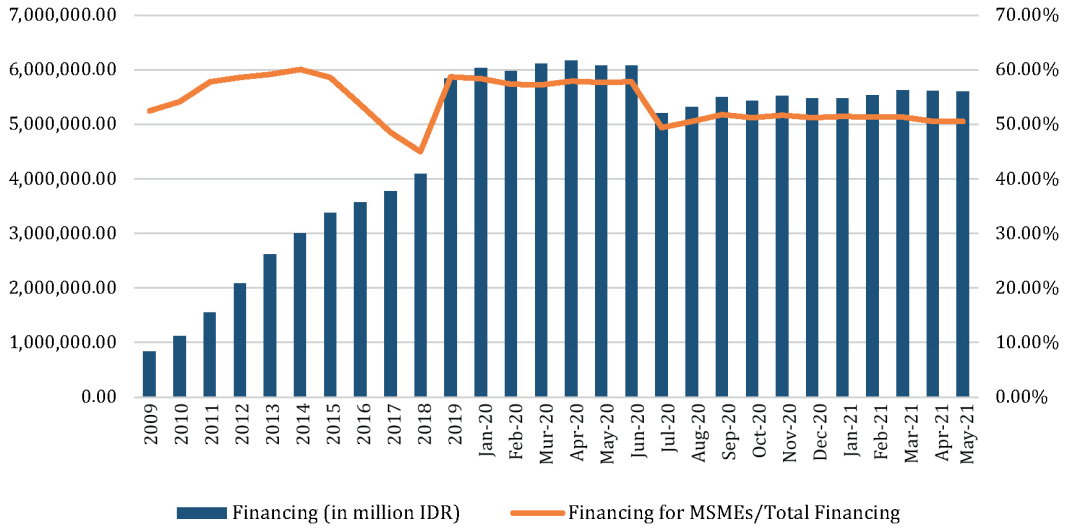
Figure 30: Financing for MSMEs by Islamic Banks



Data Source: OJK (2021c)

In addition to Islamic commercial banks, financing for MSMEs is also provided by Islamic rural banks with narrower scope compared to commercial banks. As such, rural banks are closer to the customers and are expected to provide more financing and more specialised financing for MSMEs compared to non-MSMEs. Figure 31 shows that financing provided by Islamic rural banks for MSMEs has been experiencing an increase from 2009 onwards, although there is a decrease in July 2020 due to the pandemic, but it picked up again in the following months through new strategies adapted.

Figure 31: Financing for MSMEs by Islamic Rural Banks



Data Source: OJK (2021c)

As explained in the previous section financing for MSMEs is also provided by equity crowdfunding and BWM. In terms of the equity crowdfunding, the association is also preparing to have the Islamic equity crowdfunding. As fo the debt issuance for MSMEs through capital market, the regulation and institutions are still being developed, including the Islamic one.

4.2.4. COVID-19 Conditions and Islamic Financing Responses for MSMEs

The Nature of Financial Challenges faced by MSMEs under the COVID-19

Due to the decrease in sales, as discussed so far, MSMEs face several challenges, such as difficulty to buy materials, paying wages, transportation costs, rental fees, loan repayment, and other costs related to their business (LIPI, 2020). Additionally, the more challenging feature of Indonesian MSMEs is that it is still on the subsistence fulfilment, resulting in lack of cash flow and financial planning in the MSMEs itself. As some MSMEs still run on daily basis in order to fulfil their daily needs, this pandemic hit very bad because they have to stop their operation and unable to generate income. Notwithstanding, MSMEs are already experiencing a difficulty in accessing capital for their business.

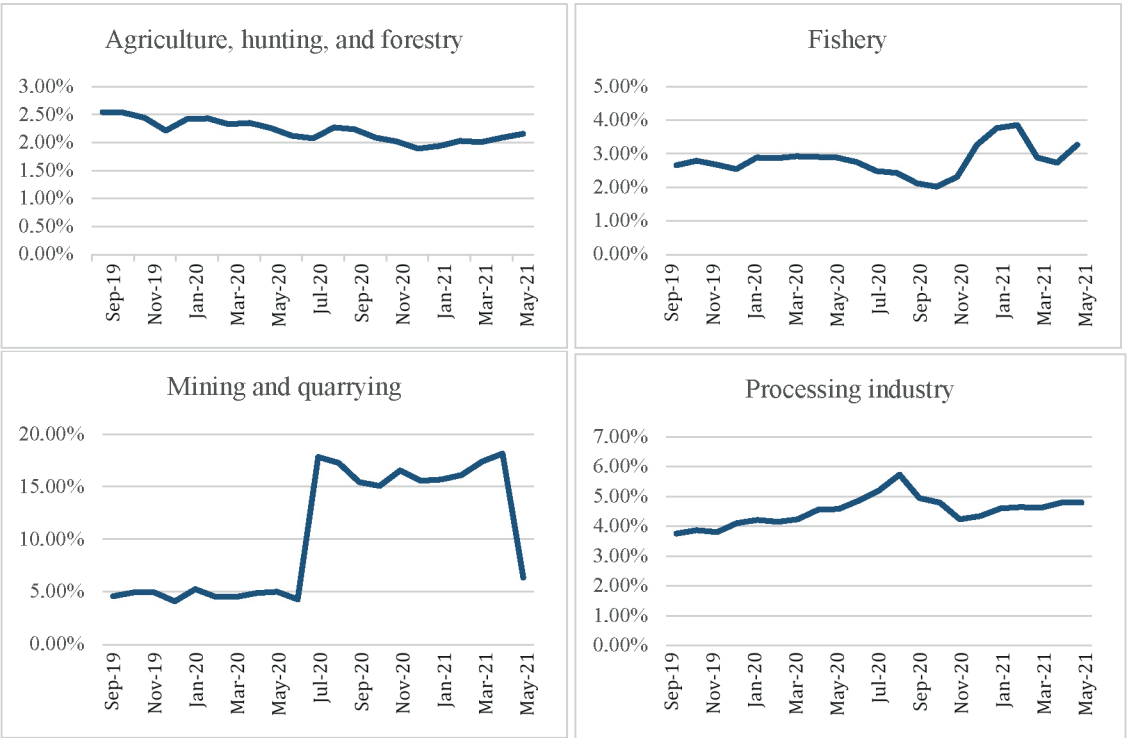
> "With the travel restriction, businesses that rely on people movement, such as businesses related with tourism, are affected that they experienced a decrease in their income, unable to pay their workers and loan, and have to close their business. " – R6

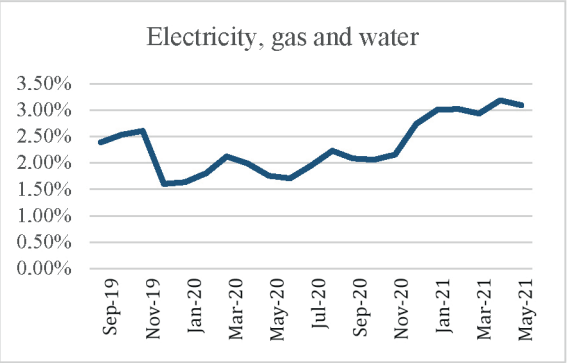
> "It has been widely known that MSMEs have difficulty in accessing loan/financing from banking sector, considering that majority of MSMEs is from the micro-scale enterprises." – R6

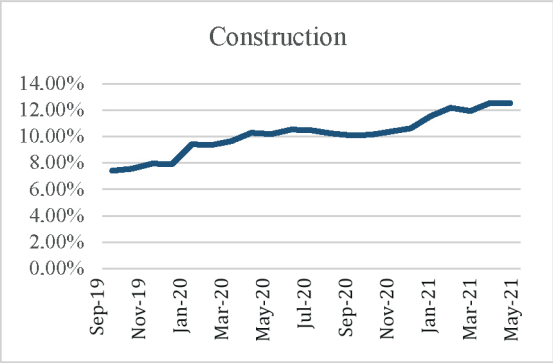
> "Many MSMEs are operating on subsitence level, generating the income daily. It makes MSMEs does not have a proper cash flow, which then badly impacted by the travel restriction during pandemic." – R5

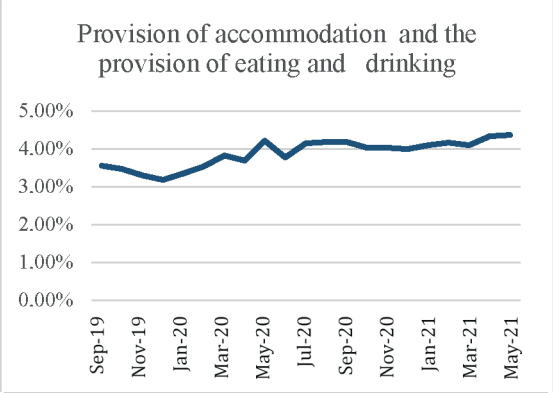
As a result, MSMEs might not be able to repay their liabilities, which can affect the banking sector, shown by an increase in non-performing loans. Figure 32 presents the NPL of bank loans for MSMEs based on the sector. It shows that the effort by the regulator to ease the restructuring is reflected in the NPL figure. The value of NPL is maintained to be stable, considering the business cycle and economic conditions. In addition, Figure 33 presents the trend of NPF in Islamic rural banks for financing provided for MSMEs. It shows a steady increase in early 2020, but it can be managed to decrease at the end of 2020 although it starts to increase in 2021. It is highly probable due to the longer effect of pandemic that some businesses do not have the capability to survive any longer. The NPF is a portrait that shows the post-effect after the condition whether the business can operate or not.

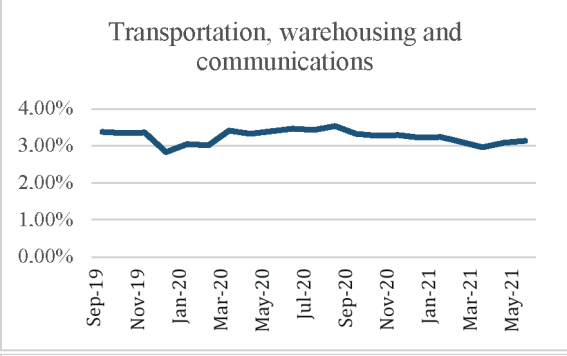
Figure 32: Non-Performing Loans in Bank Loans – MSMEs by Sector

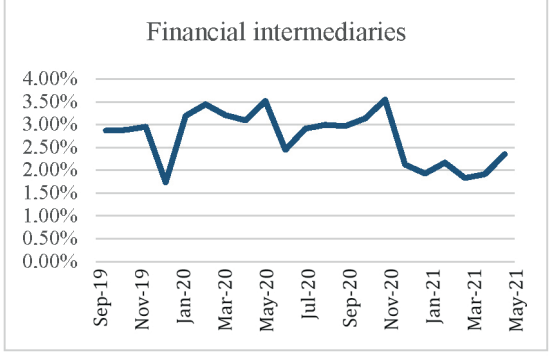


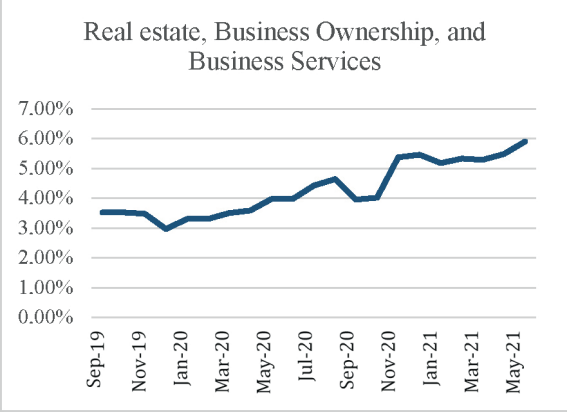


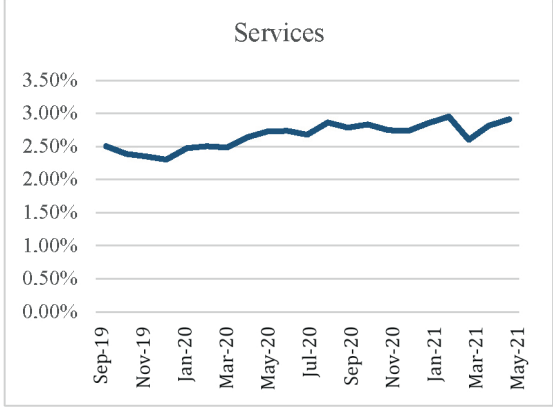






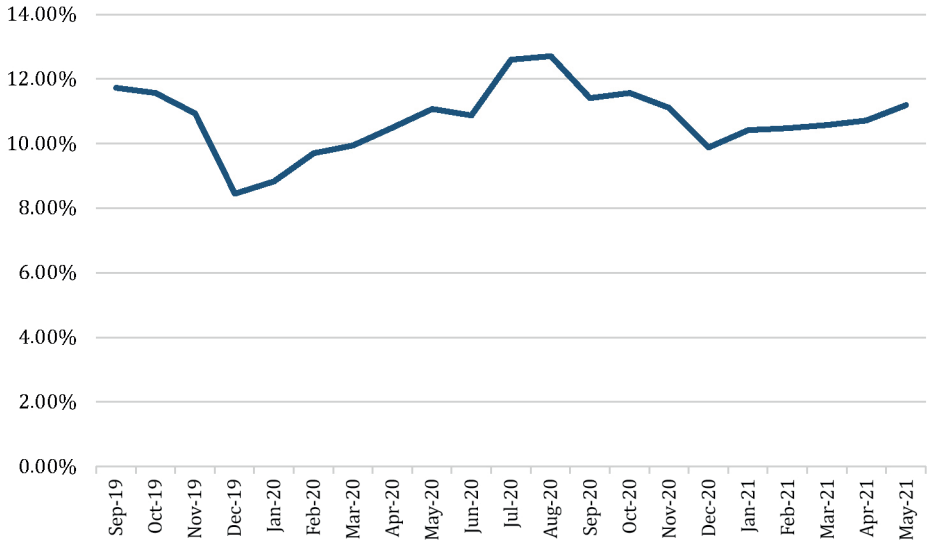






Data Source: OJK (2021a)

Figure 33. NPF for MSMEs' Loans in Islamic Rural Banks



Data Source: OJK (2021c)

The Nature and Type of Support Including Financial Support Extended by Various Institutions to the MSMEs in Indonesia

Various support mechanisms and facilities have been provided by various institutions for MSMEs in Indonesia, both from the the regulator and private sectors. Financial Service Authority, as a regulator for financial institutions, issued regulation POJK No.11/POJK.03/2020 [12] and another two following regulations to lessen the impact of credit quality on the banking sector. There are three principal regulations: (i) financing for less than IDR 10 billion can be based on the punctuality of principal repayment and/or interest/margin/profit sharing/ujrah only until 31st of March 2021; (ii) restructuring facility for debtors who are affected by COVID-19, whether it is individual, MSMEs, or corporation, that have good historical performance. During the restructuring period, the debtors are still classified as good borrowers; banks are still allowed to provide new credit/financing for debtors affected by COVID-19, which the credit quality is still attached to the previous credit quality.

To support the economy during the pandemic, Bank Indonesia cut the interest rates from 4.75% (20 February 2020) to 4.25% on the 18th of June 2020 (OECD, 2020). The central bank also lowered the reserve requirement ratio by 50 bps for banks involved in financing MSMEs.

Further, as part of the government's effort in reviving the country's economy, the government issued several actions to support MSMEs, as shown in Table 17. There is direct cash support for MSMEs that is channelled through two state-owned banks. Other financial supports are in the form of low-interest loans in which the government is providing interest subsidies for the financial institutions so that they can still distribute financing to MSMEs. There is also fiscal support extended by the government providing income tax subsidy for MSMEs in the form of not deducting the tax from MSMEs' income for 2020.

[12] *https://www.kemenkeu.go.id/media/14810/pojk-11-2020.pdf*

Table 17: Program from Government for MSMEs during Pandemic

Type	Program name	Description	Data Provider	Distribution channel	Target (IDR T)	Reach out (per May 2021)
Direct	Productive Support (year 2020)	Cash support IDR 2,4 million per MSME [13]	State-owned Banks, PNM, Cooperatives Bureau	BRI, BNI*	22	9.8 million business units
	Productive Support (year 2021)	Cash support IDR 1.2 million per MSME [14]		State-owned banks	28.8	11.8 million business units
Financial	Investment financing – cooperatives	Revolving Fund Agency (LPDB) distributing funds as a low-interest loan via cooperatives [15]	Cooperatives	Cooperatives	1	
Financial	Financing placement	Distributed as low-interest loan/margin by bank	Bank	Bank	52.3	Credit delivered at amount og IDR 380.05 T # of debtor: 5.13 million
Financial	Interest subsidy [16]	Subsidy for bank's interest rate/margin For MSE→ 6% for the 1st 3 months and 3% for the next 3 months For Medium-scale business → 3% for the 1st 3 months and 3% for the next 3 months	Bank	Bank	7.7	
Financial	Credit assurance for SMEs	Loan insurance for SMEs provided for banks through credit insurance companies to cover potential of SMEs to default	Bank	Bank	6	Working capital loan: 30.78 trillion # of debtor: 1.65 million
Financial	Electricity subsidy	100% electricity for MSMEs who subscribes for B1 450 VA and I1 450 VA				

[13] *Regulation from Ministry of Cooperatives and MSMEs No 6/2020, can be accessed in this link https://kemenkopukm.go.id/uploads/laporan/1598606210_PERMENKUKM%20NO%206%20TAHUN%202020%20tentang%20BPUM.pdf*

[14] *Regulation from Ministry of Cooperatives and MSMEs No 2/2021, can be accessed in this link https://kemenkopukm.go.id/uploads/laporan/1616726438_Permen%20BPUM.pdf*

[15] *Regulation from Ministry of Cooperatives and MSMEs No 4/2020, can be accessed in this link http://jdih.kemenkopukm.go.id/ildis/www/storage/document/PERMENKUKM%20NO%204%20TAHUN%202020%20ttg%20Penyaluran%20Pinjamam%20atau%20Pembiayaan%20LPDB.pdf*

[16] *Ministrial Decision by Ministry of Cooperatives and MSMEs No 22/2020, can be accessed in this link https://kemenkopukm.go.id/uploads/laporan/1600165087_KEPMEN%2022%20TAHUN%202020.pdf*

Financial	Final income tax for SMEs	Subsidy for final income tax for SMEs No 0.5% tax that is based on PP 23/2018	SMEs	Direct cut when the SMEs report their taxation	2.4	
Region Incentive Fund *(Dana Insentif Daerah)*	For economic recovery in the region-level	Intended for affected MSMEs	2.4			
Trainings		e-learning program EDUKUKM Podcast series to provide guideline in digital business model Webinar series SPARC campus Video series with the theme of New Normal	Ministry of Cooperatives and MSMEs	Ministry of Cooperatives and MSMEs, Indonesian Association of Entrepreneurs (Apindo), SMESCO Indonesia		
Digitalisation		Buddy program for sales in e-commerce Digitalizing MSMEs that are supervised by PLUT-KUMKM	Ministry of Cooperatives and MSMEs	Ministry of Cooperatives and MSMEs, Indonesian Association of Entrepreneurs (Apindo), SMESCO Indonesia		

Source: OJK Report (2020), Kemenkop (2021)

Notes: *state-owned banks

In addition, government also provides a special fund for MSMEs that are focusing on export activities. The fund is provided through Export-Import Bank (Exim Bank), a special bank in Indonesia that assists for export-import activities. This is to support the MSMEs to be able sell their products to other countries amidst the pandemic.

Another support is by providing discount of MSMEs' products sold on the digital platform and several supports to increase the scale of economies and market expansion by (i) business incubator, (ii) targeting the creation of 1,500 productive entrepreneurs, (iii) ease of business permit for MSMEs, (iv) targeting the 2.5 million MSMEs to obtain business permit and *halal* certification, and (v) allocating the ministries' expenditure towards purchasing MSMEs' products.

From the private sector, several state-owned enterprises and large corporations have provided their financial support for MSMEs so that MSMEs are still able to operate during the pandemic. In addition, as part of civil society, many initiatives are developed by individuals or groups in collecting funds to support a particular project or business to withstand the crisis. Ministry of Cooperatives and MSMEs also collaborate with several stakeholders, such as Ministry of State Owned Enterprises, Grab and Gojek (online ride-hailing platform) to support MSMEs' business process and digitalization.

Aside from the financial support, the government and other sectors have provided non-financial support, such as training and digitalisation. It aims to increase MSMEs' capabilities to survive by entering the online platform as consumers are still doing their shopping through e-commerce and online platforms. The government encouraged using e-commerce platforms by conducting a pilot project to provide a discount of as much as IDR 1 million for 2 million people to register with the e-commerce platform (OECD, 2020). There is also an effort to support the small stall/ shop by utilizing the database from e-commerce for people to buy goods from small stalls.

In terms of financial support, there is an issue of information distribution in which MSMEs are not well-informed regarding the financial support that they can receive through the banking sector. From the OJK (2020c), 58% of MSMEs are aware of the facility to restructure their loans. However, only 39% of them took the facility (from 1,663 respondents who have a banking loan). Only 19% of the micro-scale business (N=1,817) took the cash support, and 21% of bankable MSMEs take interest subsidy.

Public Sector Provision of Shari'ah Compliant Financial Solutions to the MSMEs

In terms of public sector provision, the regulator also stipulated the *shari'ah*-compliant scheme for any regulation that is going to be issued for supporting the financial system. However, there is no particular mobilization of fund specifically designed with *shari'ah*-compliant scheme. This is due to the policy from the government that Islamic finance industry and its counterpart should have the same treatment for any product or regulation being developed by the government. The *shari'ah* compliancy will then be consulted to the National *Shari'ah* Board for them to formulate the *shari'ah* aspect of the product. As explained before, the financial support provided are also channeled through Islamic state-owned banks and other Islamic state-owned financial institutions. In addition, the policy regarding loan restructuring is also formulated for the conventional institution first, which then being formulated for its *shari'ah* compliancy. For example with the Islamic microfinance, there is a separate document that explains in detail about the procedure and technicality of loan restructuring that is in accordance with *shari'ah* compliance.

In addition, Bank Indonesia has also provided assistance for MSMEs under their program through training and marketing for the MSMEs' products. Other than that, various ministries and institutions collaborate for providing technical supports for MSMEs, including MSMEs who are customers of Islamic banks and other financial institutions. These technical supports include training, matching with marketplace, and others.

Islamic Social Finance and Financial Support for MSMEs

The social fund in Indonesia is collected by various institutions, including the national body, namely *Badan Amil Zakat Nasional* (BAZNAS). In relation to financing for MSMEs, BAZNAS has several programs that support the empowerment of it mustahiq (*zakat*'s recipients), such as:

(i) Zmart

There are currently 1,304 *zakat*'s recipients in 10 provinces (covering 28 cities/regencies) that are classified as Zmart. The program is to provide for stores' renovation and capital support. As for the support during pandemic, BAZNAS has facilitated the delivery services for the switch towards online sales in Zmart.

(ii) Support for entrepreneurs

There are currently 1,351 *zakat*'s recipients in 10 provinces (covering 38 cities/regencies), who are classified as entrepreneurs. This support is given for entrepreneurs in the ultra-micro and micro scale in the culinary and services sectors.

(iii) Food supply (Lumbung Pangan)

There are 644 *zakat*'s recipients in six provinces (covering 17 cities/regencies), who are operating in the food supply sector. It is focusing on the agricultural product, particularly rice, by providing capital and various assistances. During the pandemic, this sector is not badly affected and it can still operate as usual.

(iv) BAZNAS Microfinance

There are 11 BAZNAS Microfinance institutions that have distributed their financing and support to 3,933 recipients, which the distribution can be seen in Table 18. It provides a rolling fund for micro-scale entrepreneurs, which the fund is provided under a village-based schme. It currently operates in 10 regions and the repayment is paid in weekly basis

During the pandemic, there is a moratorium (March-July 2020) for the customers to delay their payments. On the other hand, the assistance is still being conducted to encourage the MSMEs to sell their products via online channels. One type of support is by providing a training how to have proper and attractive photographs for their products.

(v) Livestock

In the livestock-related activities, BAZNAS supports the entrepreneurs by providing and directing the use of Personal Protective Equipment (PPE), prevention, and disinfecting their business process.

(vi) *Zakat* Community Development (ZCD).

The program includes economy, education, humanity, and dakwah.

Table 18. List of BAZNAS Microfinance

No	Area	Total Recipients	Trade	Services	Production	Creative Industry	Home Industry
1	BMD Bojong Rangkas	570	257	34	46	34	200
2	BMD Bukittinggi	431	336	86	0	9	0
3	BMD Gunungsari	802	417	64	144	56	120
4	BMD Jabon Mekar	587	446	47	29	0	65
5	BMD Sigi	374	112	0	262	0	0
6	BMD Sukaindah	295	38	44	9	9	204
7	BMD Lampaseh Kota	310	267	12	0	0	15
8	BMD Sawojajar	115	100	0	0	0	15
9	BMD Bedono	77	52	5	19	0	6
10	BMD Jogjakarta	80	30	0	44	0	6
11	Titik Layanan Matraman	292	102	12	161	9	9
Total		3,933	2,157	304	714	129	628

In terms of the social fund, there has been an increase in zakah, infaq, and sadaqah collection during the pandemic. Based on the Badan Amil *Zakat* Nasional (BAZNAS) [National Board of

Zakat] report released in June 2020, there was a 248% increase of social fund collection from January to May 2020, which has increased by 70% compared to the same period in 2019 (BAZNAS, 2020). This increase is also due to the initiatives from BAZNAS to collaborate with the digital platform and e-commerce in the social fund collection. Although many people experienced a decrease in their income, a new group of *muzakki* (*zakat* payers) during the pandemic wanted to help others.

Furthermore, BAZNAS also reports that the collection of social funds in 2020 experienced an increase of 30% compared to the collection in 2019, increasing from IDR 296 billion to IDR 385.5 billion (BAZNAS, 2021b). From the collection, 88.7% has been distributed under various programs in BAZNAS such as support for medical, non-medical, and economic activities.

In terms of support for MSMEs, BAZNAS and other *zakat* institutions have provided financial assistance and operational/managerial support for MSMEs under their assistance/training program. There are 79 online trainings conducted during 2020 with the highest number of trainings being conducted on April-June. The platforms used are Zoom, Instagram, Google Meet, and Youtube with total of 58,829 viewers for all the trainings. Aside from the training, BAZNAS also provides support in the form of PPE for the entrepreneurs, such as mask and gloves, for them to use during the selling activities.

BAZNAS also has cooperation with several parties to empower the MSMEs and also helps to lessen the effect of pandemic, such as injecting additional capital for tailors to produce masks and PPE, empowering the MSMEs in the food sector to prepare food for the medical staff in the hospitals that the funding is obtained from company's Corporate Social Responsibility (CSR).

Aside from the financial support, BAZNAS and other *zakat* institutions have been taking part in the health emergency project, providing logistic packages, cash for work, cash assistance, and providing cooked food for direct consumption (Hudaefi *et al.,* 2020). In the future, BAZNAS is preparing to cluster the entrepreneurships and cooperatives that are owned by the *zakat*'s recipients.

In addition, the initiatives do not only come from the government institution but also from the society through the crowdfunding platform known as "Kitabisa"[17] . In May 2020, two months into the pandemic, this platform raised around IDR 130 billion from various campaigners for different purposes, such as medical equipment and helping people affected by the pandemic. There have been several campaigns that raise funds for assisting the MSMEs running their business by purchasing the goods from the MSMEs and distributing goods to people in need.

The Financing, Operational and Product Level Support and Responses Developed by Indonesian Islamic Banks towards MSMEs

According to an interview with an employee of one Islamic bank, there is no particular response, but it follows the regulation issued by Financial Service Authority for the banking sector regarding the restructuring facility and less requirement for new financing. In addition, Islamic banks are still providing financing for MSMEs that have a good condition by implementing prudential regulation.

An interview with an employee from another Islamic bank explains that Islamic banks have focused their financing on business with a strong ability to utilize technology or digital platform, as the pandemic has strengthened the use of technology for the interaction between customers and producers/retailers. Thus, Islamic banks have also been channeling their financing through financial technology (fintech) companies to reach the end customers, as fintech companies have

[17] *For more information please see: www.kitabisa.com*

better capacity in reaching out to wider market. From this, Islamic banks take a profit-sharing scheme (*musharakah*) for the financing provided.

As have also been explained in the previous section, Islamic banks have been having cooperation with several parties, such as Ministry of Tourism and Creative Economy, society organization such as Nadhlatul Ulama and Muhammadiyah, and e-commerce platform in providing training for the MSMEs. Islamic banks have also provided the payment platform for the MSMEs to support the cashless payment and minimize physical contact required during this pandemic.

What Lessons Can be Drawn for Islamic Banks in Relation to the Responses to Crisis/ COVID-19?

The pandemic has hit the Indonesian economy with different magnitude for different sectors. Banking industry, including Islamic banks, is also impacted since business being financed is affected by the pandemic that limits their operational activities. As a result, business experience a decline in their sales, affecting their ability to pay the financing provided by banks. As an effort to minimize the impact, the Indonesian government and regulator have put several measures, as explained in the previous section. The condition has given several lessons for the Islamic banks. According to an interview with an employee of one Islamic bank, the macroeconomic condition should be analysed realistically so that sectors who are able to survive can be extended financing. It is according to the repayment capability of business during the pandemic, as explained in the previous section. Transportation and warehouse sector, provision of accommodation and food-beverages sector are two sectors that were hit the hardest. On the other hand, processing industry sector, provision of water, electricity and gas sector, real estate sector, and trade sector are less affected. Hence, there is opportunity for Islamic banks to provide financing for those sectors.

> "Islamic banks should be more aware about macroeconomic condition, to see which sectors that have the ability to survive and potential to grow." – R7

Another lesson that can be drawn from another interviewee is that the banking sector should consider other business models in reaching out to their customers, in an attempt to maintain their performance. There is a shift from providing direct financing to providing technology for other financial institutions, such as Islamic rural banks and cooperatives, the technology for the financial services that can be used by the end customers. This is due to the stronger presence of digital infrastructure during the pandemic that forces the banks to operate more innovatively to compete with the fintech companies. Additionally, it raises the awareness to escalate the development of database for MSMEs, which was already in the pipeline, but during the pandemic/crisis it becomes more significant as it can ease the process of financial support disbursement during crisis.

> "Islamic banks should consider more in the adaptation of technology for their operational, including having collaboration with fintech." – R8

> "The main insight is to embark into digital technologi and develop the database for MSMEs." – R9

Additionally, Islamic banks and other financial institutions have developed digital applications for easing their business process, for example to get more customers so that they can deliver more financing. The Islamic banks' officers are acquipped with digital applications that can process the customers' acquisition in a timely manner. In addition, an application is also being developed to ease the monitoring from bank to the customers. While waiting for that. The officers

and customers are communicating intensively through mobile phone's messenger.

To strengthen the presence and contribution of Islamic banks, there are several programs to include, one that can involve the community, mosques, and Islamic boarding schools, particularly in relation to providing training and financing during the pandemic. These programs will not only last during the pandemic, but in the longer term expecting to increase the market share of Islamic banks. As for the training provided, it is organized via Zoom online platform, by gathering MSMEs being supervised by Ministry of Tourism and Creative Economy and society organization, such as *Nadhlatul Ulama* and *Muhammadiyah.*

In relation with MSMEs, the interviews give insight that the current crisis has a different impact compared to previous crisis that have occurred in Indonesia. In the previous crisis, MSMEs acted as the backbone and could show their resilience in facing the crisis. However, the pandemic hits the MSMEs differently as they are the ones most impacted due to their nature that has to operate in offline manner and requires social mobility for their business to obtain sales. With the restriction for conducting their activities, MSMEs experience financial issues, which actually has been the main issue of MSMEs that is financial inclusion and access. The pandemic accentuates these problems, as MSMEs have more difficulty in proving that they can fulfil the credit requirements.

As also have mentioned in other sub-section, there are many MSMEs that have a nature of fulfilling subsistence, hence obtaining revenue in daily basis to support the daily needs. As a consequence, the MSMEs have issues with cash flow and financial planning, with most activities are conducted offline implying that it needs social mobility. When the pandemic hits, it accentuates the issues with MSMEs, such as the scale, capability, and business process, aside from the issue with financial access.

The pandemic also gives an insight that having *mudarabah* and *musharakah* as the contracts for financing and funding might work better for the relevant parties, as the shock will be absorbed by both sides. Shock in the debtor side will be channeled to the banks, and it will be channeled towards the depositors. However, it would not work if the depositors do not understand the consequences of depositing their money using profit-loss sharing contract, particularly with the mindset of conventional counterpart that gives a fixed return. Further, on the financing side, the debitor has also been accustomed with the culture of debt and interest, making it more complicated with the profit-loss sharing contract. In addition, the issue of moral hazard has been widely discussed with the profit-loss sharing contracts, as apparently the Indonesian customers have the tendency of having moral hazard, as experienced by one of the respondents who has tried to provide profit-loss sharing financing for the society, but facing difficulties in the implementation.

> "The use of profit-loss sharing instruments might be beneficial for the financial sector and economy, but we have to ensure that the depositors also understand the consequences of saving their money with PLS contract." – R10

4.2.5. Best Practices: Lessons Learned

The pandemic has hit the Indonesian economy hard, including MSMEs that is the backbone of the economy as it employs 121 million people and contributes to 61% of the Indonesian GDP. One source of financing obtained by MSMEs is from the banking sector, including Islamic banks. As a highly regulated industry, banks must act to balance their risk and return in raising funds and delivering financing. During the pandemic, the borrowers experienced difficulty in repaying the

financing, shown from respondents' responses in survey conducted by Otoritas Jasa Keuangan (OJK, 2020). It will eventually lead to high non-performing financing for the banking industry, presented in Figure 32. To ease the burden from both sides and maintain the economy, regulators have put several measures to reduce the impact, such as subsidy for the banking margin and financing restructuring for the banking industry.

The social fund institutions have also provided support for helping society during the pandemic by raising funds and distributing them to people in need. In doing so, the social fund institutions have utilized the digital platform to reach out to wider audiences and provide convenience for them. The pandemic has strengthened the use of technology in conducting daily activities, including financial transactions. It apparently also affected how the banking sector can operate their daily activities, especially during the pandemic, such as developing more reliable and robust technology infrastructure, since physical interaction is limited. It also affects the sectors to be considered by banks to finance as the banks will tend to develop a strong presence to online or digital capacity oriented business as opposed to offline business model.

The technology advancement has forced both sides, namely banks and MSMEs in the economy, to utilize the digital platform on their business model. Under the pressure of the pandemic, the pace of digitalisation and fintech companies has increased, as fintech companies have more flexibility than the the banking sector, leading to more efficient customer service delivery for retail customers. With this trajectory, Islamic banks will need to collaborate with fintech companies to reach their customers, as most Islamic banks in Indonesia are categorized into banks with small assets that there is a limitation on the activities to be executed. However, from the MSMEs' side, not all business sectors can shift their activities towards digitalisation, as digitalisation could be expensive or not possible for some MSMEs. Hence, there should be a balance in managing risk and serving the customers.

The existence of various institutions in providing financing for MSMEs can differentiate types and characteristics of MSMEs that need to be assisted. For example, the BWM and Islamic social fund can help the ultra-micro scale of entrepreneurs, such as retailers or people who sell various stuffs on the street. For business with higher expected income can apply for subsidized financing from the state-owned banks and/or microfinance. When they get more stable, they can shift to the regular financing from the banks. As fort he small- and medium-scale businesses, they also have the option to raise fund from the equity crowdfunding. However, there is a point to be noted that the source of fund should be diversified as well, to reduce the systemic effect on the financial system. The role of venture capital, as well as angel investor, can also be strengthened so that MSMEs can have various alternatives in obtaining financing. The emergence of financial technology can also be benefitted by using Peer-to-Peer Lending (P2P Lending) for MSMEs that have the capacity to tap into the fintech financing.

4.2.6. Country-specific Policy Recommendations

In the emergence of Islamic banking, it was expected that Islamic banks would tend to be generating more financing to the real economy sectors, including the MSMEs, through effective Islamic instruments such as *musharakah* and *mudarabah*. However, the experience has demonstrated, which has become clearer, Islamic banks have not been able to fulfill such an objective at the level that was expected. Institutional logic of Islamic banks should be designed in such as the way they could facilitate MSMEs financing; for this, regulators should not treat the Islamic banks in the same way as conventional banks so that the expectations from Islamic banking institutional logic can be fulfilled in the long run. Islamic banks can be at the forefront

to support SMEs due to their inherent comparative advantages, albeit they need to continuously improve their operational efficiency and to be closely monitored by regulators to avoid the exploitation of SMEs.

In a similar vein, the state-owned banks are still the indispensable partners for the government to support various government programs in empowering SMEs. Lastly, the enabling environment that empowers SMEs and related parties should also be instituted, including developing financial technologies.

To facilitate the extension of financing towards MSMEs, which are the backbone of the Indonesian economy, specific *Shari'ah*-compliant funds should be considered between state-owned Islamic banks and the relevant ministry so that an efficient financing model can be developed for MSMEs. It is also important to develop micro-*takaful* for the MSMEs sector to respond to the crisis periods such as the pandemic. İt will be beneficial for the MSMEs and also financial intermediaries that there is assurance of coverage for any impact caused by crisis in the future. It can be in the form of social insurance rather than corporate type in which focusing on the profit-oriented activities. This is to consider that MSMEs are relatively small and to ease the liability of the MSMEs towards the IFIs.

The efficiency and effectiveness of Islamic social financing has proven again under the pandemic conditions, and Indonesia has developed a very effective institutional structure to enhance impact. However, Islamic social finance should be extended to MSMEs under the crisis conditions such as pandemic within the provision of *Shari'ah*. While zakah may not be the most efficient tool due to the *fiqhi* restrictions, emergency and contingency funds should be developed from Islamic social funds for the pandemic type of crisis.

According to the explanation from the interviewees and the regulations being put for financial institutions, it can be suggested that there should be different treatment between conventional and Islamic financial institutions, in relation to the product being developed and any policy for the activities. In this regard, IFIs might be able to run in accordance to their aspirations rather than just mimicking the conventional ones.

Another suggestion is that to provide segmentation for the business, which IFIs are suitable for the MSMEs. As mentioned in the previous section, different types of IFIs can be assigned for specific scales of MSMEs. In Indonesia, there is ultra micro scale of business, that is smaller in asset and revenue size compared to the micro ones. This scale of business can be financed by *Baitul Maal wa Tamwil* (BMT) that has a social aspect in it. The orientation of BMT should not be making profit, but helping the business while still being able to cover the initial value of loan/financing. This way, the initial purpose of BMT can be revived, that is to provide social and financial support for the society.

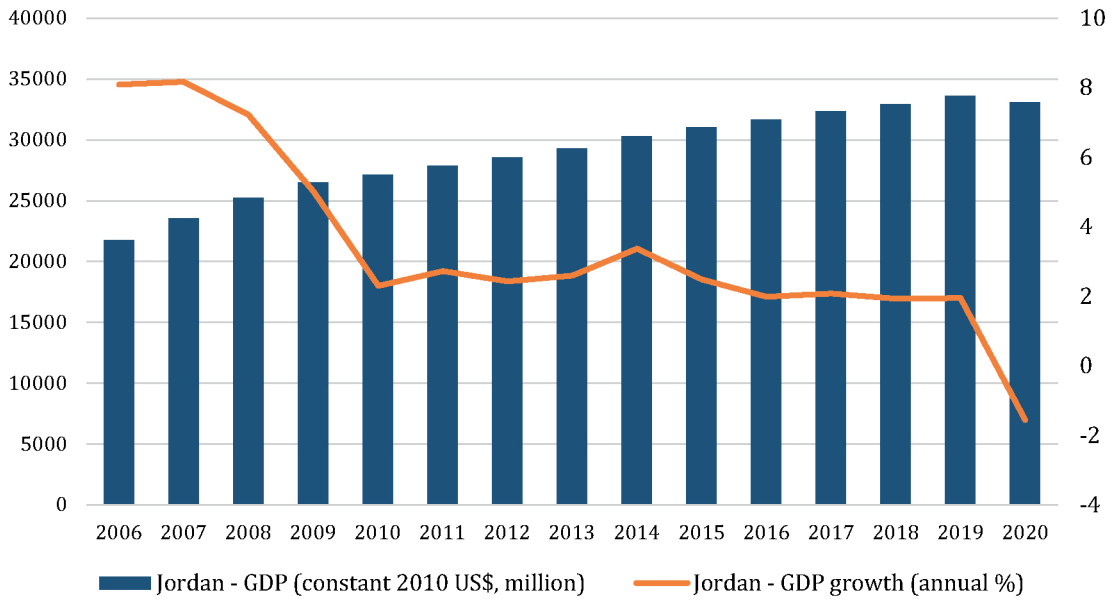
Furthermore, the interviews give insight that there is a need to scale up MSMEs in Indonesia, which can be done by establishing a cluster/center based on area or product so that the product can be more standardized and to reduce the competition among the enterprises. Another way to scale up is having closer coordination with the regional government, as they are the closer mentor for MSMEs in each region. Islamic financial institutions can enter into these initiatives by providing supports, such as financing and empowering the society.

4.3. CASE STUDY: JORDAN

4.3.1. Economic Structure and the Role of MSMEs

Jordan is an emerging market economy in the Middle East, which is governed by liberal economic policies since 1999. However, the 2008 Global Financial Crisis and the Arab Spring had an adverse impact on the economy, which slowed down the economic growth observed in the 1980s and 1990s. In addition, the significant immigration initially from Iraq and later from Syria has exacerbated the economic difficulties.

Figure 34: Gross Domestic Product and Its Growth 2006-2020



As shown in Figure 34, Jordan's economy has demonstrated a steady increase, as indicated by GDP growth. However, when the economic growth rate is considered, as can be seen from the figure, with the 2008 Global Financial Crisis, the economic growth has continuously decreased at varying paces. Between 2010-2019, the economic growth rate demonstrated declining yet steady performance. However, with the COVID-19 impact, for the first time, economic growth declined to negative in 2020. Hence, it has been challenging years for Jordan, and it seems that COVID-19 conditions have added to the observed economic difficulties.

With large immigrant communities, Jordan has an essential burden on its economy, making MSMEs rather critical for the economy to ease the burden. Hence, MSMEs for the general economy as well as for the immigrant communities are vital, which has adversely been affected by COVID-19 conditions.

MSMEs in Jordan

The definition of MSMEs, varies between countries and economic entities according to various factors: size of economy and market technical advancements, infrastructural ability to allow MSMEs to grow, and internal economic policies coupled with market potential for MSMEs. The

main financial regulatory body of the Hashemite Kingdom of Jordan, namely the Central Bank of Jordan (2021) defines and classifies MSMEs based on three main factors, as depicted in Table 19: the number of employees, total turnover (revenue scale), and operation size (total assets). Micro enterprises usually have fewer than 5 employees, whereas small enterprises are defined as those with 5-19 employees and total assets or turnover of up to JOD 1 million. On the other hand, medium enterprise is with 21-100 employees and holds total assets or turnover of JOD 1 to 3 million.

Table 19. Classification of MSMEs in Jordan

Business	Employment Scale	Assets/Turnover
Micro	1-4	< 100K JOD
Small	5-19	100K - 1M JOD
Medium	20-100	1M - 3M JOD

The Department of Statistics (2021) identified over 180,000 MSMEs in Jordan in 2020. As can be seen in Table 20, vast majority of these are micro enterprises, accounting for almost 90% of total enterprises. Large enterprises account for less than half a percent of all Jordanian businesses.

Table 20. Size Distribution of Enterprises in Jordan in 2021

Classification	Number	Percentage
Micro	169,086	89.1%
Small	16,858	8.8%
Medium	3,036	1.6%
Large	948	0.5%
Total	189,772	100%

Source: DOS (2021)

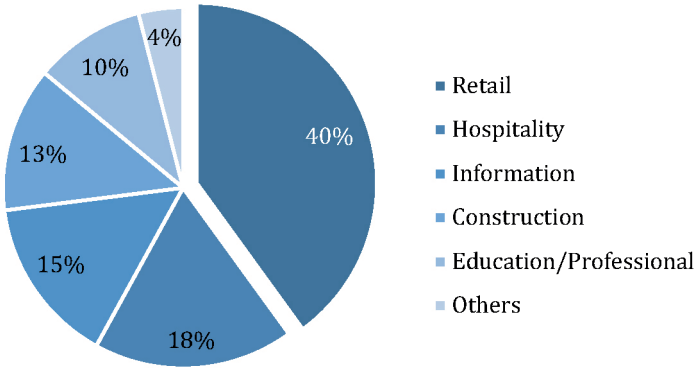
The role of the MSMEs sector in the Jordanian economy and the sectoral distribution

MSMEs account for 90% of businesses globally and employ 50-60% of the world's total workforce (Sanad, 2021). In Jordan, MSMEs have an even stronger presence, with more than 98% of the economy comprised of MSMEs firms, which employs 70% of the total workforce across all economic sectors, whether manufacturing or services (Sanad, 2021). MSMEs are considered the largest contributor to Jordan's Gross Domestic Product, with a total value of around 50%, and a significant role in adjusting the BoP (DOS, 2021). In terms of the formal sector, it should be noted that 78% of the MSMEs registered at the Ministry of Industry and Trade are in the services sector (MIT, 2021).

As depicted in Figure 35, within the services sector, retail sector represents the majority of the MSMEs (40%) operating throughout the country but primarily concentrated in the cities of Amman, Irbid, Zarqa, and Aqaba. This sector also represents the largest number of micro businesses, which indicates that the majority of microfinance customers come from this slice. Retail is followed by hospitality, which is correlated to the tourism industry, a greater than JOD 5 billion industry contributing almost 20% of Jordan's pre-pandemic GDP (Knoema, 2019). The hospitality sector almost came to a standstill during the COVID-19 pandemic, and therefore became the target for many international microlending agencies especially. The information,

construction and education sectors, which together contribute 38% of service sector based MSMEs, experienced an increase in operations throughout the pandemic, while still facing many challenges as explained later.

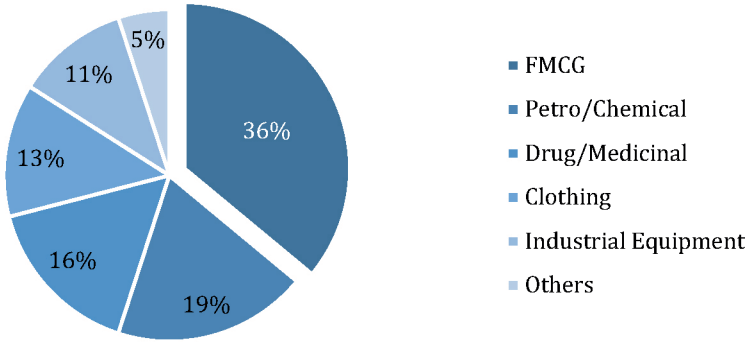
Figure 35. Service MSMEs Distribution by Sector



Source: DOS (2021)

In the manufacturing sector (see: Figure 36), as of 2021, the fast-moving consumer goods sector makes up the majority of MSMEs (36%). This sector has become more important during the pandemic as there has been increasing demand for replenishable gloves, sanitizers, PPE, and other related products. Furthermore, the production of food for home delivery became a need rather than a want. The second-largest sector is chemicals and pharmaceuticals. For MSMEs in this sector, production is on a smaller scale than large companies due to the robustness and ease of production. Clothing and specific customised machinery and personal equipment comprise almost a quarter of manufacturing MSMEs.

Figure 36. Manufacturing MSMEs Distribution by Sector



Source: DOS (2021). FMCG = fast-moving consumer goods

MSMEs are also credited for their tremendous ability to empower the Jordanian economy and the Jordanian workforce (JCB, 2021), allowing them to become more technically and commercially

sound. In addition, MSMEs in Jordan offer many advantages due to their simple structures, lack of bureaucratic complications and red tape, easy to set up, adaptable, bridges the gap in the local market due to their closeness to their customers, and their importance to big corporations as they provide necessary complimentary and auxiliary services (JCB, 2021).

Financing sources for MSMEs and the financing gap

Jordan first started funding MSMEs through the newly established Agricultural Credit Corporation in 1959, which was primarily directed at farmers and agricultural related business such as agricultural development and marketing. A few years later, the Industrial Development Bank was established, which aimed to support small craft enterprises, such as pottery, artifacts, natural soaps, chemicals and cleaning products (Nabulsi *et al.,* 2009). A government shift towards MSMEs took place in the 1970s, through the establishment of the Jordan Loan Guarantee Corporation and the Union of Charitable Societies to encourage handicraft business, which aimed to encourage businesses with manufacture offerings that would replace imported products as part of import substitution policies of the 1970s.

1978 saw the establishment of the Jordan Islamic Bank in 1978, which met a long-held desire of the nation to support small scale businesses and individuals. In 1981, Islamic Investment House (IIH) was established, which was the first institution to work on an Islamic portfolio for investments throughout Jordan. However, IIH claimed bankruptcy in 1986 (Salameh, 2014).

A breakthrough came in 2003, with an ambitious plan to develop selected 25 SMEs to develop them into significant exporters. The Ministry of Industry and Trade (2019) report shows that JOD 17 million were spent in the first two years, which resulted into an exponential development with the establishment of many MSME funding agencies.

As of 2021, there are 18 specialized institutions that provide finance to MSMEs in Jordan, varying from financial institutios to banks operating in Jordan. These are: Jordan's Micro-Fund for Women; Ahli Micro-financing Company; IRADA; Arab National Leasing Company; Vitas of Jordan; National Microfinance Bank; Tamweelcom (Jordan Microfinance Company); The Islamic Company for Small Enterprises; ISRA for Investment and Islamic Finance; Tamkeen; NOMOU; The International Charity Organization; The First Finance Company; Al-Tas-Heelat; Agricultural Credit Corporation; FINCA; and the Middle East Micro Credit Company. There are also several microfinance agencies and development institutions operating in the field to provide financing to MSMEs such as: International Financial Corporation; European Development Bank; international credit insurance companies such as COFACE; and local export credit agencies such as Jordan Loan Guarantee Corporation, Jordan Enterprise Development Corporation (JEDCO) and the Development and Employment Fund.

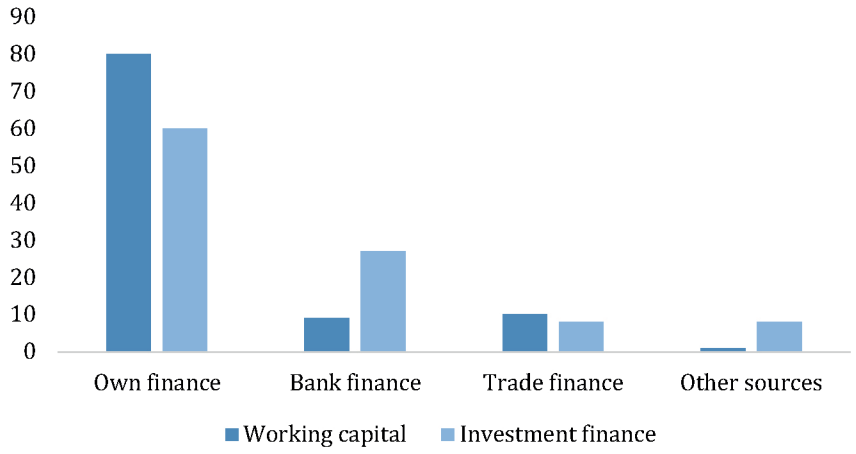
There are four Islamic banks that provide support to MSMEs, which are SAFWA Islamic Bank, Jordan Islamic Bank, Islamic International Arab Bank, and Al-Rajhi Bank. These institutions provided a total of JOD 500 million in financing to more than 250,000 customers in 2019 alone including for MSMEs (Alghad, 2019).

Access to finance is a major problem for MSMEs in Jordan, where the financing gap ranges between 35 and 40% (World Bank, 2021). This can be attributed to a number of factors. Firstly, while the liquidity in the banking system can greatly help the banks give loans, the Central Bank has strict measures and for strategic purposes keeps a very tight control over the liquidity. Secondly, there is little capacity in the banking system for risk-bearing, while financing MSMEs

are considered very risky. There is one loan guarantee institution (Moassaset Daman Al-Qurood) which has very poor performance and offers little help to MSMEs. In addition, Jordanian banks do not have a culture of cooperative dynamics (e.g. portfolio approach) to offset or mitigate this risk through other forms of guarantees or risk-sharing. Such approaches would also help to resolve other drawbacks in the current financial structure such as a lack of information about credit, methods for secure financial transactions, and issues with insolvency. A further challenge in this domain is a lack of access to equity finance for start-ups. This is coupled by the lack of enterprise and business skills in MSMEs, which indicates the need for a governmental program to foster capacity building relating to loans. This would be likely to increase and improve access to finance, thus reducing the finance gap.

In addition to inadequate access to finance, there is inadequate investment in technology and a lack of intra-industry partnerships. According to the European Investment Bank (2019), only 20% of MSMEs in Jordan report no difficulty in obtaining finance, and approximately 43% of Jordanian firms report major or very severe constraints in relation to access to finance. As can be seen in Figure 37, MSMEs in Jordan depend heavily on their own saving or retained earnings to finance their fixed assets purchases or to pay for the working capital: almost 60% of the fixed assets and 80% of the working capital is financed by owners' personal sources. Credit from commercial banks is easier to attain in the case of fixed assets, with almost 26% of the total investment finance sourced from the commercial banks, compared to only 9% for the working capital. Other financial institutions do offer equity-based financing, but with very strict conditions: they contribute only 5% of both fixed and working capital. An important source is trade credit, contributing 10% of the total. it is important to note that Islamic banks have provided a specific group of offerings for financing MSMEs, which will be covered in the following section.

Figure 37. Distribution of Sources of Finance Distribution (%)



Source: EIB (2021)

4.3.2. The Trajectory of Islamic Finance: Institutionalization, Legal and Regulatory Framework, and Financial Standing

On 1st April 1983, the Central Bank of Jordan issued Law No. 13, which regulated the work of Islamic Banks in Jordan in response to overwhelming demand by customers for a non-interest-based banking system that is compliant with *Shari'ah* law and refrains from using *riba.* Since

then, Islamic banking has witnessed exponential growth in Jordan, although there has been stages where political instability slowed the development of other Islamic forms of financial institutions.

Since 1988, the Central Bank of Jordan has developed its regulations four times to adapt to changes in the Islamic banking scene. There are now nine articles in the banking laws regulating and outlining the main institutional framework for Islamic banking to operate within. In parallel, the General *Ifta' (Fatwa* Giving) Department enforced the creation of a *Shari'ah* Council (*Fatwa* Department) in each Islamic bank to play a very vital role in developing *Shari'ah* compliant finance and also for solving disputes arising related to Islamic financing. These committees they liaise closely with the General *Ifta'* Department.

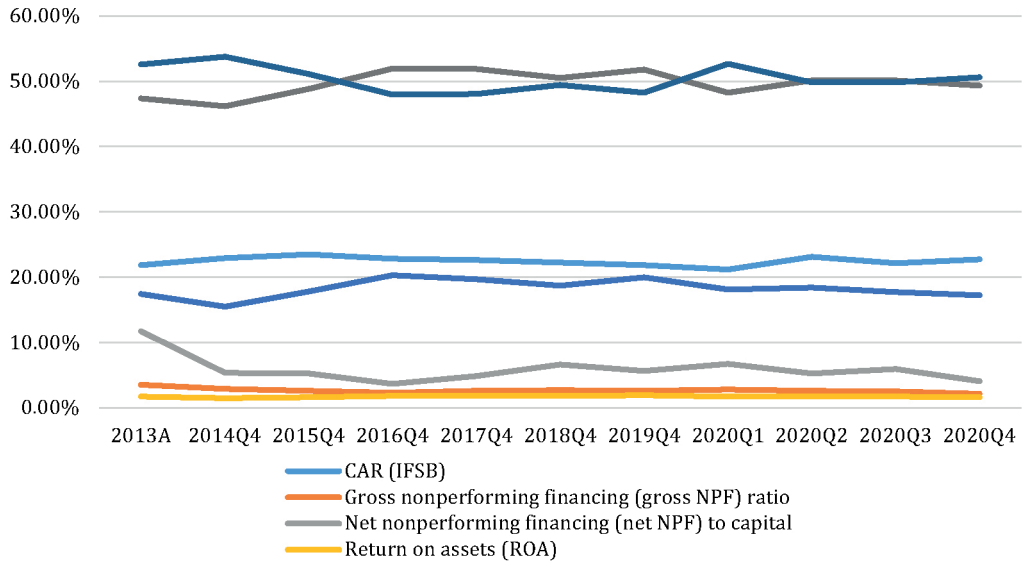
More recently, the government recognised the importance of Islamic banking and finance and provided full support for its growth. The Ministry of Finance, along with the Japan International Cooperation Agency (JICA) has launced *sukuk* of JOD 34 million to finance the completion of the new ministry's offices in 2016. The Central Bank of Jordan also issued *sukuk* to finance the National Electric Power Company (NEPCO). The Jordan Islamic *Sukuk* Company for financing governmental projects was listed at the Amman Stock Exchange in December 2018 (Jordan Times, 2018). Today, the Islamic Banks in Jordan (SAFWA Islamic Bank, Jordan Islamic Bank, Islamic International Arab Bank, and Al-Rajhi Bank) are operating profitably, with sound, financial positions. Each has demonstrated a growth trajectory, with a combined liquidity of over JOD 1.9 billion. These four banks offer a variety of products and Islamic offering to MSMEs as we will discuss in the next section.

Table 21: Main Indicators of Islamic Banking Sector in Jordan

Item	2013 A	2014 Q4	2015 Q4	2016 Q4	2017 Q4	2018 Q4	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4
CAR (IFSB)	21.85 %	22.96 %	23.53 %	22.88 %	22.71 %	22.26 %	21.84 %	21.21 %	23.17 %	22.14 %	22.79 %
Gross nonperforming financing (gross NPF) ratio	3.57 %	2.95 %	2.66 %	2.38 %	2.60 %	2.77 %	2.64 %	2.87 %	2.69 %	2.59 %	2.19 %
Net nonperforming financing (net NPF) to capital	11.76 %	5.44 %	5.27 %	3.71 %	4.86 %	6.62 %	5.70 %	6.73 %	5.30 %	5.93 %	4.10 %
Return on assets (ROA)	1.75 %	1.52 %	1.69 %	1.89 %	1.88 %	1.85 %	1.96 %	1.76 %	1.80 %	1.72 %	1.67 %
Return on equity (ROE)	17.48 %	15.53 %	17.86 %	20.34 %	19.74 %	18.77 %	20.00 %	18.13 %	18.43 %	17.81 %	17.25 %
Net profit margin	47.37 %	46.21 %	48.91 %	51.97 %	51.90 %	50.54 %	51.80 %	48.28 %	50.14 %	50.17 %	49.40 %
Cost to income	52.63 %	53.79 %	51.09 %	47.99 %	48.06 %	49.42 %	48.29 %	52.67 %	49.86 %	49.86 %	50.60 %
Number of Islamic banks	4	4	4	4	4	4	4	4	4	4	4
Total assets (million national currency)	5505.2	6135.2	6830.1	7402.6	7692.2	7948.9	8857.9	8960.6	9126.6	9676.7	9803.5

Data Source: IFSB Database

Figure 38: The Performance of Islamic Banking Sector in Jordan



Data Source: IFSB Database

Regarding the performance of the Jordanian Islamic banks, Table 21 and Figure 38 depict the trends in the main Islamic banking indicators which includes the trends in 2020 in four quarters. As can be seen, only in quarter 3 of 2020 there is slight adverse effect on the variables, which continued in the quarter 4. Otherwise, from 2013 to 2020Q4, the trend in each variable remained very much around the same level with slight deviations from one year to the other. However, it is important to note 'Net nonperforming financing (net NPF) to capital' demonstrating declining trend during the COVID-19 period. The trends in the main indicators, hence, does not show any significant adverse impact on Islamic banking performance in Jordan.

4.3.3. Islamic Financing Provisions for MSMEs: Institutions, Products, and Offerings

The nature, type and magnitude of finance extended to MSMEs by Islamic banks

The four Islamic banks in Jordan constitute 17% of the total assets of the banking system in Jordan, with estimated assets of 10.9 billion JOD. In addition, they represent 19% of the total deposits in the Central Bank of Jordan, with a surplus liquidity of 1.9 billion JOD and a combined net profit of 230 million JOD for the financial year 2019 (UAB, 2020). The share of the four from in the total credit facilities of Jordanian banks is 35%.

Jordan Islamic Bank (JIB) reported a market cap of JOD 670 million for the first quarter of 2021, 17 million investment accounts at banks and banking institutions, and one million active customer accounts with 906 million JOD in cash deposits at the Central Bank. In the early 1980s JIB started to provide finance to small businesses: today its MSME portfolio contains a variety of financial Islamic solutions such as *musharakah* (diminishing partnership), *mudarabah* that ends with ownership, craftsmen financing, investment in real estate, *musawama, zafafi* (marriage package), deferred sale, maintenance and finishing works for buildings and covering workers' wages, *murabahah* (cost-plus), *ijarah muntahia bittamleek* (for apartments and houses,

commercial stores, offices, medical clinics, financing land) , letters of credit, *qard al-hassan*, and *zakat* fund. JIB has established itself as the leading Islamic bank, with 9% ownership of the entire banking sector Jordan and 48% of the Islamic banking sector. This is largely due to the bank's responsiveness to customer needs for creative Islamic products. JIB has continued to enjoy rapid growth except for the pandemic year of 2020, where it had to fund more governmental projects to fight the pandemic effects on the Jordanian economy, but the financial situation remained sound (Table 22). JIB's response to COVID-19 and support to MSMES will be explained in more detail in following sections.

Table 22. Financial Performance of Jordan Islamic Bank, 2017-2020

	2020	2019	2018	2017
Ijarah assets - Net	705,745,523	629,600,753	605,801,762	590,844,435
Qard al-Hassan loans - net	79,600,000	20,400,000	11,725,757	8,997,535
Real Estate investments	107,608,263	111,190,169	107,340,284	120,212,403
Ijarah Assets Revenues	42,783,234	42,249,023	43,075,593	43,535,584
Total assets	4,844,498,859	4,449,172,148	4,160,642,210	4,211,617,666
Total income	162,886,685	165,500,941	147,050,826	146,970,499
Net income	52,121,669	54,349,292	49,807,927	54,139,053
Net Income / Total Income %	31.999	32.840	33.870	36.840
Total Income / Total Assets %	3.362	3.720	3.530	3.490
Debt Ratio %	90.208	90.524	90.540	91.090
Return on investment %	1.076	1.222	1.197	1.285
Return on equity	10.988	12.891	12.661	14.439

Notes: All values are JOD, unless otherwise specified

Source: Jordan Islamic Bank annual financial reports, 2017-2020

The Islamic International Arab Bank was established in 1998, two decades after JIB, yet it managed to quickly capture a significant market share of the Islamic banking (32%) due to the strength of its parent bank (The Arab Bank), which is well established internationally. IIAB was therefore able to capitalise on a strong presence in the Jordanian, Arabic, and Islamic markets. IIAB offers a range of Islamic financial products in addition to the traditional products of *musharakah* and *murabahah*. They offer targeted packages to women, youngsters, MSMEs, renewable energy providers and users, contractors, and entrepreneurs. For example, kafalah is the first *Shari'ah*-compliant finance guarantee scheme in Jordan providing an alternative to SME's financing collaterals, while INHAD is a self-employment scheme that provides training and certification as well as finance. IIAB has maintained a sound financial position as demonstrated in the Table 23 although the effects of the pandemic in 2020 are evident, as is the case for JIB.

Table 23. Financial Performance of Islamic International Arab Bank, 2017-2020

	2020	2019	2018	2017
Ijarah assets - Net	729,668,006	682,859,790	657,162,067	620,283,994
Qard al-Hassan loans - net	52,214,777	48,098,103	40,510,079	27,695,418
Real Estate investments	23,531,190	23,177,139	21,794,384	21,508,775
Ijarah Assets Revenues	50,536,117	53,603,014	50,729,523	46,681,918
Total assets	2,543,190,782	2,300,388,811	2,159,047,552	2,052,079,165
Total income	83,535,813	86,134,859	80,802,843	75,712,852
Net income	30,439,997	34,384,101	31,890,902	28,797,704
Net Income / Total Income %	36.439	39.920	39.470	38.040
Total Income / Total Assets %	3.285	3.740	3.740	3.690
Debt Ratio %	90.380	90.690	91.020	91.490
Return on investment %	1.197	1.495	1.477	1.403
Return on equity	12.442	16.052	16.448	16.495

Note: All values are JOD, unless otherwise specified

Source: Islamic International Arab Bank annual financial reports, 2017-2020

The third Islamic Bank in Jordan in size is Safwa, which emerged from the acquisition of Dubai Islamic Bank in 2017 by Al-Etihad Islamic Investment Co., which is owned by Al-Etihad Bank (Amman, Jordan). Safwa Bank has acquired a good market size of Islamic banking (12%). While it is considered a new entrant, the bank has added more Islamic products to the market in addition to the products offered by JIB and IIAB. Their products include investment certificates, hajj *sukuk*, education financing, medical treatment financing, *yusur* for refinancing, cars financing, and specialised packages for marriage, women, renewable energy, self-employment, and entrepreneurs as well. Safwa Islamic bank reported a market cap of 175 million JOD in the first quarter of 2021, with a sound financial situation despite adverse effects of the 2020 pandemic (Table 24).

Table 24. Financial Performance of Safwa Islamic Bank, 2017-2020

	2020	2019	2018	2017
Ijarah assets - Net	422,067,496	382,860,291	327,252,472	255,708,619
Qard al-Hassan loans - net	962,062	509,660	509,660	509,660
Real Estate investments	0	0	0	0
Ijarah Assets Revenues	31,653,197	30,417,721	26,099,095	19,133,685
Total assets	1,820,239,203	1,556,920,583	1,121,473,515	957,802,640
Total income	42,398,214	42,878,371	36,728,790	31,258,090
Net income	10,167,139	10,016,219	8,350,661	5,707,350
Net Income / Total Income %	23.980	23.360	22.740	18.260

Total Income / Total Assets %	2.329	2.750	3.280	3.260
Debt Ratio %	91.506	90.720	87.400	85.580
Return on investment %	0.559	0.643	0.745	0.596
Return on equity	6.576	6.934	5.91	4.131

Note: All values are JOD, unless otherwise specified

Source: Safwa Islamic Bank Annual Financial Reports, 2017-2020

The fourth bank is Al-Rajhi Islamic Bank, which is a Saudi bank operating in Jordan. The bank capitalised on the strength of the parent bank, which is very strong player in the Arab and Islamic World. Al-Rajhi's portfolio of products includes the same offerings as the other three Islamic banks, with the addition of trading with precious metals and stones, and gold bullions. Furthermore, the bank offers the facility of *'bai al ajel',* which provides cash to clients by selling them the goods and then the clients appoint the bank as the agent to sell them in the market. Al-Rajhi Islamic Bank is not listed on the Amman Stock Exchange and are not open about all their operations in Jordan, largely due to the political climate between the two countries. The bank launched its operations in 2010 with a heavy dependence on the Rajhi's strong reputation, but without an aggressive growth strategy due to political volatility: the bank still only has 10 branches throughout Jordan. Al-Rajhi Islamic Bank's total income constitutes only 0.8% of Al-Rajhi's total income (Rajhi, 2020). However, the bank is still holding its position, with a reported 13% increase in revenue to 27 million JOD in the financial year 2020, and a 19% net profit increase to 13.5 million JOD. Furthermore, the bank's customer base increased by 2,000 new customers in 2020. The bank reported total assets of JOD 502 million and a finance portfolio JOD 348 million, with an increase of shareholders' equity of 10% to JOD 68 million.

In summary, the four Islamic banks were in a strong position before the pandemic, offering a wide variety of products to all different sectors and particularly MSMEs. The following section discusses the effects the pandemic on MSMEs and the role of the government and Islamic banks in responding to and tackling these challenges.

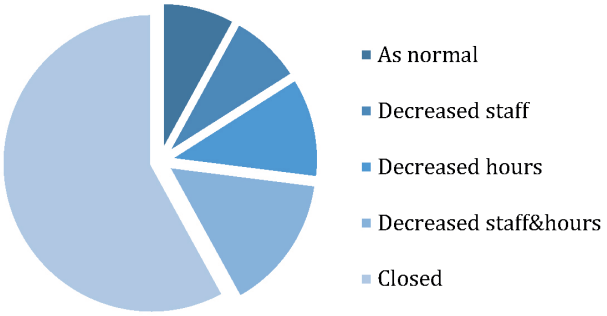
4.3.4. COVID-19 Conditions and Islamic Financing Responses for MSMEs

Challenges faced by MSMEs during the pandemic

The first COVID-19 case was not reported until 2nd March in Jordan, giving the country five weeks to prepare after the strategy was developed by the National Epidemics Committee and Health Ministry. The country had one of the strictest initial responses, with borders closed, returning travellers quarantined, and full and partial curfews implemented in the first half of 2020. While these measures resulted in effective suppression of COVID-19 for some time, Jordan experienced two main waves of infection, centred around November 2020 and March 2021, and as of July 2021, there was a total of more than 750,000 cases and 9,800 deaths (Johns Hopkins, 2021)

The full curfew in March 2020 was followed by a tiered opening, with factories in industrial zones allowed to reopen in early April 2020, and the majority of companies reopened in May (CBJ, 2021). As reported in Figure 39, a survey of 1,190 MSMEs in April 2020 found that just 7% were operating as normal, with 51% completely closed. The remainder were operating with decreased staff and/or hours (Figure 39; International Labour Organisation, 2020).

Figure 39. Status of Operations of MSMEs in Jordan in April 2020

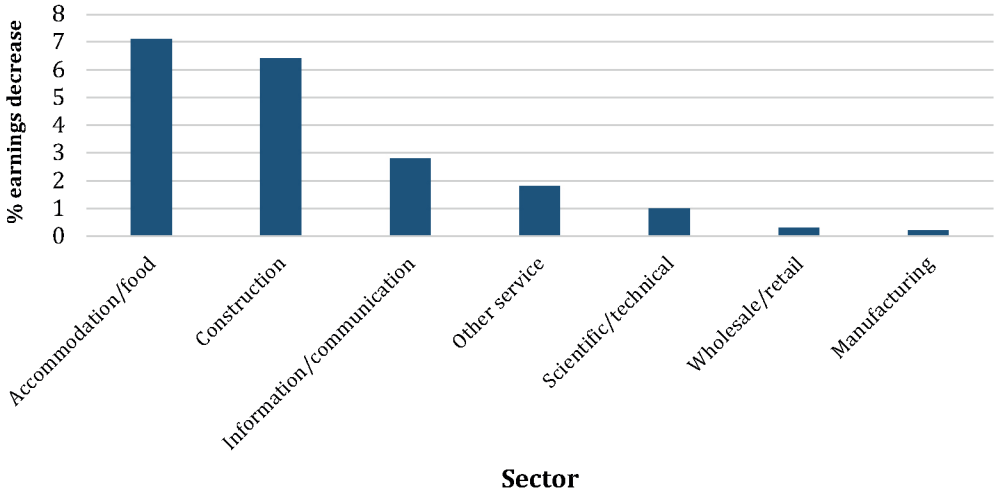


Note: n = 1190

Source: International Labour Organization, 2020

The sectors in Jordan most strongly affected by the COVID-19 pandemic are tourism, entertainment, travel, and retail. The mobility restrictions imposed on the population, as well as the shift towards remote working affected local transportation, while a reduction in exports affected the manufacturing sector. While government assistance was provided to ensure continuity of wages, the accommodation/food services and construction sectors experienced the greatest wage decreases as a result of the pandemic. This is depicted in Figure 40.

Figure 40. Decrease in Average Individual Earnings due to Decreased Work or Delayed Payment Caused by COVID-19 pandemic



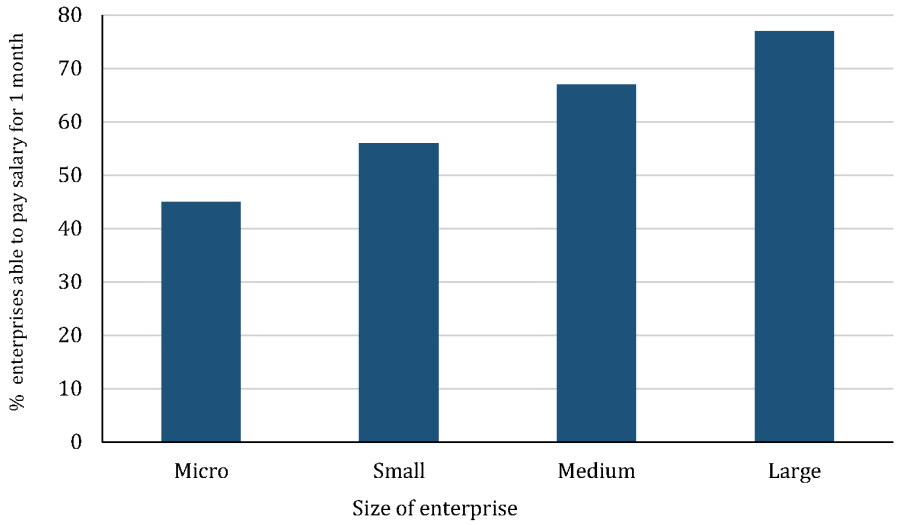
Source: Building Markets (2020)

Amongst the most significant challenges faced by MSMEs were the government restrictions imposed in an effort to curb the pandemic. While the forced closure of businesses during lockdowns and curfews had the most marked effect, the reduced mobility of both workers and consumers also had significant consequences. MSMEs also suffered from decreased demand for luxury goods, with a focus on spending on essential items.

Financial challenges faced by MSMEs under the COVID-19 pandemic

The challenges of the pandemic on MSMEs identified in the previous section have had considerable financial impact. Within a month of the initial lockdown, a survey of enterprises identified that 42% of companies would not be able to pay salary for the following month, with a further 42% not able to cover salary for three months (International Labour Organization, 2020). As depicted in Figure 41, crucially, the ability of enterprises to contribute salary markedly decreased as the size of the company decreased.

Figure 41. Percentage of Enterprises Surveyed in April 2020 with the Means to Contribute Salary for at least Month



Note: n = 1190

Source: International Labour Organization (2020)

One of the main financial challenges for MSMEs in Jordan because of the pandemic has been access to capital. This is due to the liquidity shortage that arises from the recurrent curfews, decreased consumer demand, decrease purchasing power, lack of investments from expatriates, and decreased exports. Many MSMEs experienced at least one complete shutdown, while still having to pay operating costs. A study (Building Markets, 2021) carried out in August 2020 found that while 94% of MSMEs were open, 90% had needed to spend from their savings, liquidated assets or borrowed money to cover expenses in the previous two months. The same study found that while 38% of MSMEs needed to obtain a loan to cover costs, only 14% had received a loan in response to COVID-19, with a further 28% receiving subsidies and deferrals.

The nature and type of support extended by various institutions to MSMEs

On 20th March 2020, Jordan declared a state of emergency in response to the COVID-19 pandemic. As can be seen in Table 25, using emergency military law, the government passed a series of defence orders to protect the economy, a number of which directly affected MSMEs. These not only aimed to protect workers, but also to ensure support for the hardest-hit sectors, such as travel and tourism.

Table 25. Defence Orders Passed by the Jordanian Government Affecting MSMEs

Defence order number	Date passed	Impacts on MSMEs
1	Mar 19, 2020	A law to delay and alter aspects of the social security law. Enterprises can suspend social security payments for three months and pay in installments.
6	Apr 8, 2020	Enterprises resuming operations must pay workers full wages; they can negotiate to reduce wages by no more than 30%. Enterprises not resuming operations after April 1st should pay workers 50% wages.
9	Apr 17, 2020	Programmes to protect businesses, freelance workers and daily wage workers and workers in private sector.
10	May 3, 2020	Enterprises and individuals have extension of submission of withholding tax statements.
11	May 3, 2020	Specific measures to reduce transmission, including face masks and gloves to be work in public serving spaces.
13	Jun 15, 2020	Financial guarantees for businesses in travel and tourism liquidated.
14	Jun 15, 2020	Enterprises in the tourism industry cannot lay off workers.
16	Sep 19, 2020	Introduction of strict penalties on individuals and businesses that do not comply with health safety measures.
19	Oct 22, 2020	Restaurant operations restricted to 50% capacity

Jordan received significant international support to deal with the financial effects of the COVID-19 pandemic. The executive board of the IMF approved emergency financial assistance of Jordan of the order of USD 400 million under the rapid financing instrument (RFI) in May 2020. This was further supplemented in December 2020 with a sum of USD 148 million, followed by USD 200 million in June 2021 (IMF, 2020).

Within the country, as can be seen from Table 26, the Ministry of Finance announced a broad range of measures to enable both individuals and companies to remain solvent during the pandemic.

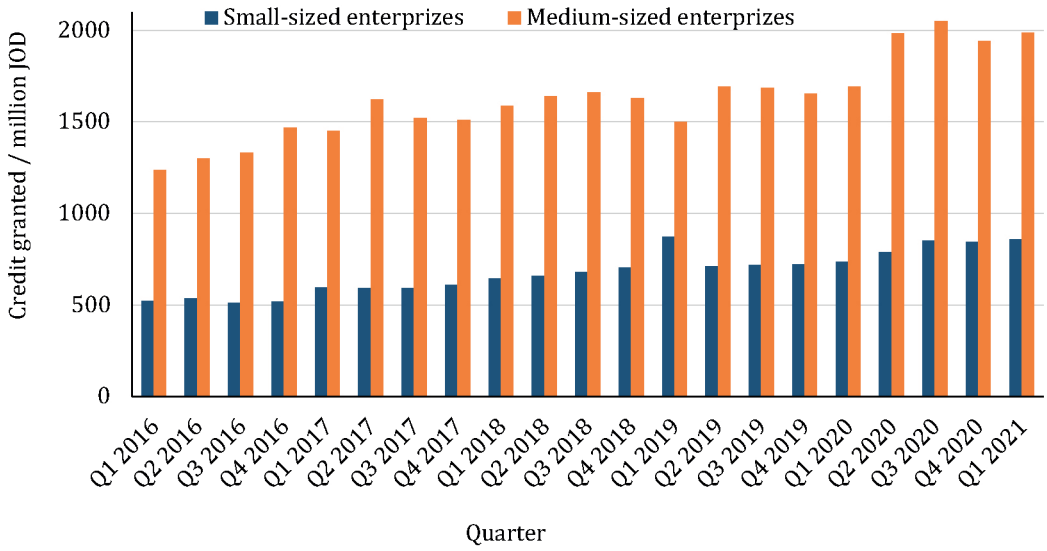
Table 26. Steps Taken by the Ministry of Finance to Support MSMEs during the COVID-19 Pandemic

Date	Details
March 18, 2020	Sales tax exemption on hygiene products and medical equipment; introduction of price ceilings on essential products; postponement of 70% customs duty collections due from selected companies; decreased social security contributions from private sector.
March 31, 2020	50 million JD additional spending for COVID-related costs; 81 million JD for temporary cash transfer program for unemployed and self-employed.
June 15, 2020	Support for tourism sector by allowing payment of 2019 tax liability instalments penalty-free; reducing general sales tax and service tax for hotels and restaurants.
December 3, 2020	Funding to protect more than 170,000 in hard-hit sectors; additional support for tourism sector.
March 31, 2021	448 million JD COVID stimulus package, including job-protection program (113 million JD).

The Central Bank of Jordan (CBJ) announced several financial measures to support MSMEs. These include allowing banks to postpone repayments for clients in affected sectors; broad reductions

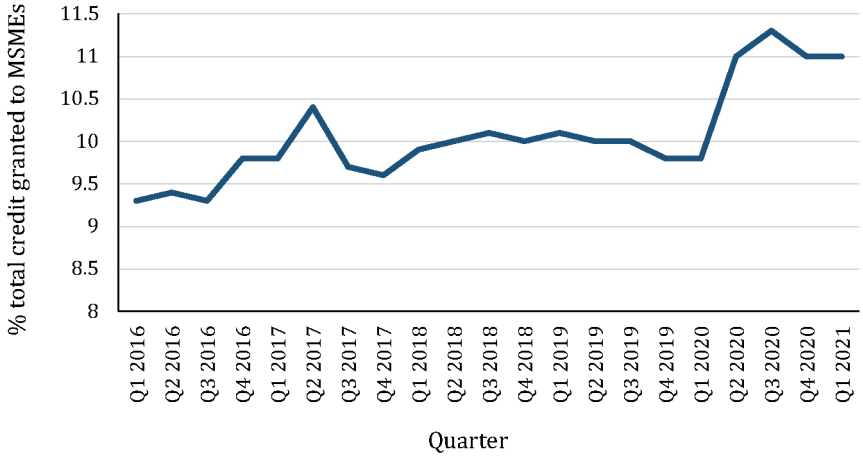
in interest rates; and a reduction in cost and expanded coverage of guarantees on MSME loans, including 150 million JD credit facilities for the tourism sector. As can be seen in Figure 42, this resulted in a small rise in credit facilities granted by banks to medium enterprises since Q2, 2020, although the increase was less pronounced for small enterprises. These measures also led to a significant increase in the proportion of total credit facilities granted to MSMEs (see: Figure 43). Finally, in March 2021, CBJ announced that its subsidised lending schemes for MSMEs would be expanded from JOD 500 million to JOD 700 million. The CBJ also extended the moratorium on bank loan servicing for borrowers who were negatively impacted by the pandemic.

Figure 42. The Value of Credit Facilities Granted by Banks to SMEs



Data Source: CBJ (2021)

Figure 43. Percentage of Total Credit Facilities Granted by Banks to SMEs to Total Private Sector Credit Facilities



Data Source: CBJ (2021)

Public sector provision of shari'ah compliant financial solutions to MSMEs

In the years since the establishment of the Jordan Islamic Bank, the Jordanian government and Central Bank gradually recognised the role of Islamic banking in solving the country's challenges relating to the financial gap. Recently, they have attempted to develop a strategic approach to provide *Shari'ah* compliant financial solutions to SMEs. First, a legislative framework was put in place to govern and support the work of the Islamic banks. Articles 50 to 59 of the Banking Law (SDC, 2021) support the provision of banking services, finance or investment on an interest free basis. Under these articles, Islamic banks are tasked with developing means of raising funds and savings, and investing them in a *Shari'ah* compliant method. This includes establishment of credit, mutual funds, and private investment accounts in addition to issuing mutual bonds. Islamic banks are also given permission for financing in *mudarabah*, diminishing *musharakah*, *murabahah* for purchaser's order, and any other financing approved by the Islamic Jurisprudence Supervision Board. Moreover, the law encourages the Islamic banks to develop new products that meet market desires, and supports the local economy.

The public sector, represented mainly by the Central Bank, Ministries (Ministry of Finance, Ministry of Industry and Trade, Ministry of Social Development), and public finance and planning agencies such as Jordan Enterprise Development Corporation (JEDCO) and Jordan Loan Guarantee Corporation (JLGC), resorted to Islamic finance to support their operations and initiatives to mend the economy, including the special plans to support the MSMEs. The use of *sukuk* to fund government plans such as NEPCO development, the public sector restructuring, and the COVID-19 response package all involved Islamic banks in providing *Shari'ah* compliant finance to MSMEs. Each Islamic bank cooperated with the central bank to play a significant role in the rollout of various government packages to support the MSMEs.

An important package launched by the Jordanian government in response to the financial strain caused by the pandemic was the JOD500 million soft financing program for supporting MSMEs. The financing is provided by both Islamic banks and non-Islamic banks and is guaranteed by the JLGC. It is worth mentioning that the Central Bank owns 45% of the JLGC. The program aims at facilitating the financing of craftsmen, professionals, and MSMEs on lenient terms and costs to help these sectors pay for their operational expenses, working capital and fixed assets. The program's main goal was to ensure the continuity of business for MSMEs by enabling them to retain their employees and to continue providing their services during the first period of the pandemic, during which the heavy lockdowns had significant impacts. As Jordan went into a full curfew in March 2020, the government kept people from leaving their houses by providing them with the necessary services that MSMEs could deliver food, protective equipment, fast-moving consumer goods, home delivery, and access to information in real time. The program also aimed to have consequent funding to prepare the MSMEs for disruptions in the international supply chain and the consequent demand depression by providing financial support and technical support for those able to provide a local substitute (CBJ, 2020). The latest program launched by the Central Bank of Jordan, worth JOD 700 million JOD, is targeted to help MSMEs to bring their businesses up to speed with the demands of the recovery stage of the pandemic and grow bigger and quickly and Islamic banks will play a major role in it.

Responses of Islamic banks towards MSMEs and their Shari'ah compliant solutions

The Islamic banks in Jordan responded quickly to the COVID-19 pandemic, an Islamic banker interviewed stated Islamic banks customised their offerings, collaborated with government and the Central Bank of Jordan, and expanded their charitable giving especially from *zakat* funds and *qard al-hassan* financing. JIB increased its *qard al-hassan* financing by 290% to support MSMEs

during the pandemic. The bank also sought to inject more cash into the economic system by distributing cash dividends to shareholders for the year 2020 at 12% of the nominal value of the share, which is the maximum permissible limit defined by the Central Bank of Jordan (JIB, 2021).

All the Islamic products offered by JIB were increased to meet the needs of MSMEs for direct finance, with minimum requirements. Moreover, the bank provided *zakat* and *sadaqah* to help the local community and the national economy. JIB supported the government's efforts by giving JOD 2.15 million to the *Himmat Watan* Fund, which was established to enable government military and civil branches to continue to provide services during the pandemic, and to the Ministry of Health. In addition, JIB gave special attention to the retail sector, namely the individual clients and MSMEs by making it easier for them to be reimbursed, and by postponing the instalments or restructuring loans (JIB, 2021). Loans were also stretched to meet the needs of MSMEs, with new procedures such as rental returns and quick loans to make sure that MSMEs could continue to operate and could expand their scale of work to meet increased demand. Finally, the bank issued and purchased *sukuk* to support government projects for development across all sectors during the pandemic.

IIAB responded with the same speed to the pandemic by participating in the government scheme through their own product called EDAMAH which is an initiative to support continuity and sustainability of small firms in collaboration with Central Bank of Jordan, and by expanding its loans on all fronts. This is observed in the reduction of the bank's balances with other banks and financial institutions to raise cash for its small-scale businesses and strengthen its financial position. IIAB expanded its *kafalah* system by 80% to facilitate MSMEs gaining access to finance and expanded *sukuk* issuance and investment to support the government's plans. IIAB also donated to *Himmat Watan* fund under the *zakat* item and signed an agreement with The Ministry of Education to provide *Shari'ah* compliant finance for all ministry staff at preferential rates including *qard al-hassan*. IIAB also supported some of the ministry's social activities as part of the Bank CSR in fighting the effects of the pandemic.

Safwa Bank also followed suit, increasing its *qard al-hassan* giving by 88%, donating JOD 1 million to *Himmat Watan*, and participating actively in the government scheme to support the MSMEs through their product Inhad which is an initiative that aims at reducing unemployment for new graduates through giving them extra access to finance through the pandemic.

It should be noted that Al-Rajhi Bank responded differently to the challenges of COVID-19 on the MSMEs, focusing on the digital side of the process. The bank implemented business continuity plans during lockdowns as teams were physically split between various locations, which required online training for employees. The bank therefore focussed on changing its core activities by making them all digital. While this is a long-term project, estimated to take three years before being fully operational online, the move is anticipated to enhance the customer segmentation and MIS reporting, and to make it easier for customers and MSMEs to attain finance and do business. Meanwhile, during the pandemic, the bank's retail banking and the Graduate Development Programme for talented young graduates continued as planned. Al-Rajhi provided support to MSMEs by deferring their financing instalments and waiving certain fees in relation to cash withdrawals and electronic services. The bank also donated to the Ministry of Health and *Himmat Watan* Fund (JOD500 thousands) and introduced a local shares financing product (Rajhi, 2021).

All four Islamic banks followed a lengthy and thorough processes to ensure that the government plans and schemes offered to them were *Shari'ah* compliant, and that the solutions the banks offered in response would also be *Shari'ah* compliant, consistent with the teachings, ethical

code, and values of Islam. To do so, the *Shari'ah* Board in each bank operated on two fronts: each *Shari'ah* Board's own bank and the fellow Islamic banks operating in Jordan. Solutions and products were also studied and discussed with the general *Ifta'* Directorate.

The compliance process was highly related to social impact, documentation and profit. The social impact meant that each product must satisfy Islamic conditions of serving the people and the community as a whole, with the purpose of rendering a service that will alleviate hardships. Secondly, the documentation for *Shari'ah* compliant products met the requirements of Islam in a manner that protects the rights of all involved: that is, the documentation was far more thorough and demanding than that of a non-*Shari'ah* compliant bank because the terms of financing are lengthened and the tendency to link financing with commodities is also important. This required more time from banks to study the documents for each product. Therefore, due to the time-constraints imposed by the pandemic, the banks had to invest considerable time and effort to ensure that they could issue new products and solutions quickly. As for the profit calculation, which is a continuous challenge under normal conditions let alone in a pandemic, the banks put more efforts into calculating profit not only on market conditions and volatility, but also its impact on the customers and the economy as whole under the COVID-19 crisis guidelines. The main challenge was in applying a profit that is fair and that will capture all the market risks that may be encountered in taking on the loan. To mitigate this risk, several factors were taken into consideration to determine the most reasonable profit, such as: (i) MSMEs sector of business; (ii) time / value for money; (iii) credit-worthiness; (iv) number of years in the market; (v) probability of default based on financial and non-financial factors; and (vi) the impact on the economy and community (Ifta's Councils, 2021).

4.3.5. Best Practices: Lessons Learned and Country-specific Policy Recommendations

Islamic finance and banking has proven to be the most prepared and resilient system to deal with crisis due to the collaborative and wholesome approach to economy in Jordan that the Islamic banks adopt as part of their doctrine that is based on the teachings of Islam. The banks focussed on alleviating the hardship of MSMEs by responding quickly to their needs even before the government launched its business continuity plans, giving both the clients of Islamic banks and MSMEs owners who were not clients of Islamic banks much-needed relief. Confidence in the Islamic banking system increased as a result of various pandemic responses: the eased loans, the quick shift to digital banking, access to finance in a wide variety of forms, and training and certification offered to MSMEs. These activities, combined with government support, provided an invaluable lifeline to the MSEMs.

The best practices of the banks included cooperation with the Central Bank of Jordan and the different entities of the government to provide interest free loans to MSMEs with eased eligibility criteria, in addition to issuance of *sukuk* to medium-sized companies and to government agencies who quickly needed cash injections. Their own best practices included longer grace periods, easier financing, longer financing terms, letters of credit, letters of guarantee, salary subsidies to needy clients, and payments deferral. Furthermore, the banks eased the terms of *musharakah* and *murabahah* contacts for the clients. The banks' swift change to e-banking and digitisation demonstrated their resilience and their ability to quickly adapt and respond to crisis.

When non-Islamic banks were charging higher rates in Jordan, and even charging a 2% rate on the zero interest rate loans provided by government, the Islamic banks were offering *qard al-hassan*, *zakat*, *sadaqah*, and *waqf* investments and funds to help in the speediest manner.

This contrast was obvious to MSMEs, and contributed to a considerably shift towards Islamic banking during the pandemic. In figures, Islamic banks helped more than 50% of MSMEs since the beginning of the pandemic with financing of over JOD500 million out of the JOD1.4 billion provided in total by the banking sector. They also deferred payments (JOD 400K in total), and offered longer-term financing, despite this being risky even in normal market conditions. On a structural level, the Islamic banks extended digital banking to all their MSME clients and doubled the number of ATMs throughout Jordan, which is considered not only best practice, but is also an important model for the banking sector in general.

Another lesson learned in Jordan was the need to offer more non-borrowing services to the MSMEs such as cash management, payroll services, cash delivery, and trade advice. Furthermore, the pandemic response has highlighted that an understanding of the regulatory and legislative environment goes a long way in empowering Islamic banks to offer innovative solutions that are *Shari'ah* compliant and meet the specific details of the client base. From 25 interviews conducted with financiers, *Shari'ah* scholars, government officials, and MSME owners in Jordan, 23 stressed the importance of a supportive legislative umbrella in making Islamic products easily accessible. During the pandemic this was a critical success factor.

One more lesson is the importance of the support of the masses for Islamic banking in terms of substantiating the demand side of the equation. An increasing demand for Islamic banking means that governments and banks should listen carefully and act quickly. In the case of Jordan, customers' shift from the conventional banks to Islamic banks has been steadily increasing at annual rate of 3-7% (UAB, 2020). In responding, therefore, conventional banks have also begun to pursue a hybrid system in which they offer Islamic products. This approach was seen as a simple way to win back MSME owners as clients rather than to continue ignoring this increasing demand for Islamic solutions for MSMEs.

This case study has demonstrated that it is important to engage with international, intermediaries, and multilateral organisations that have a keen interest in providing finance to MSMEs in the region and to capitalise on their offers to it easier, faster and more fit for purpose for MSMEs for accessing finance. In the case of Jordan, international aid agencies such as Japan International Cooperation Agency (JICA) provided collateral to guarantee the loans of MSMEs and government agencies seeking finance through *sukuk* funding. The European Investment Bank, European Bank of Reconstruction and Development, UKAID, USAID, World Bank, International Monetary Fund are all keen on supporting MSMEs in Jordan, and the Islamic Banks need to capitalise on this.

Going forward, the Jordanian government needs to keep supporting the growing shift towards Islamic finance as it has proven to be efficient, responsive and resilient in the direst of situations. Helping Islamic finance institutions to provide their classic and innovative solutions in the digital age, such as through digital selling of loans and easy online applications for and management of loans is crucial to this end. This can be supplemented by work on reducing credit sensitivity analysis, extending Islamic banking to uncharted areas such as blockchain finance, e-supply chain, and e-agriculture. Further measures include developing non-borrowing services, improving the skills of both employees and MSME owners, and giving considerable and exclusive attention to women's empowerment projects. As it was in the 1970s when Jordan introduced Islamic banking to the region, Jordan can be an example of how to take Islamic banking to new heights in the changed world of the 2020s.

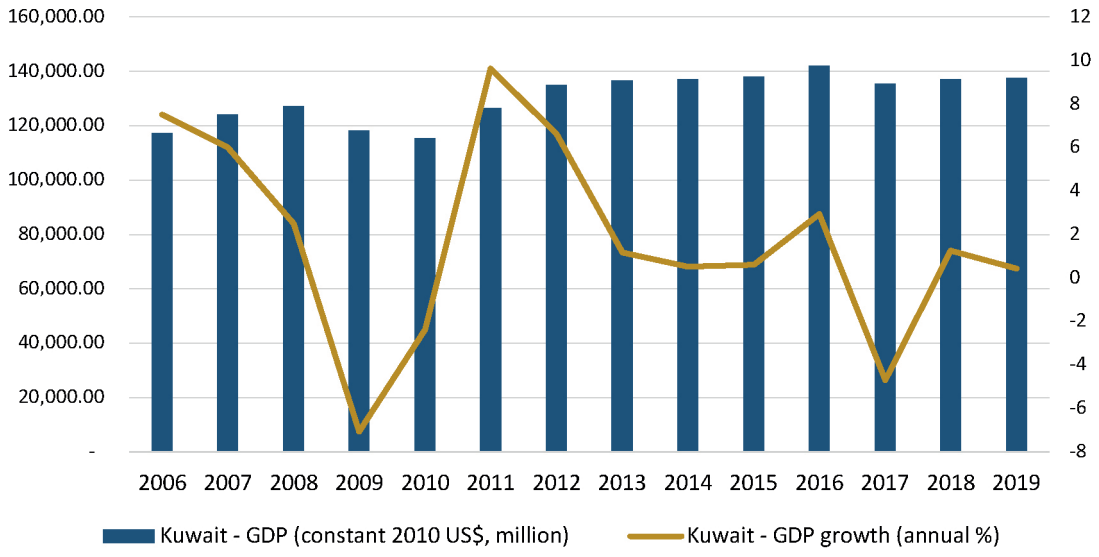
4.4. CASE STUDY: KUWAIT

4.4.1. Economic Structure and the Role of MSMEs

Kuwait is located in the Gulf region and is one of the member countries of the Gulf Cooperation Council (GCC). Its economy is dominated by the rent extracted from hydrocarbon export. However, similar to other GCC countries, Kuwait aims to diversify its economy. To put a perceptive, in 2017, 90% of state revenue was from oil and oil related sectors (TIGG, 2018). While Kuwait has a stable economic structure, it has not engaged in an aggressive economic development programme as can be seen in the region, but it has instead opted for a conservative development trajectory. However, "it is a country established by traders" (Interviewee), and such a legacy should provide a new direction for sustainable development for which Islamic finance can be an essential source in financing SMEs for development.

Kuwait 2035 Vision is a new national development project, which aims to transform the economy by making it an international hub for trade and investment. An essential promise of Kuwait 2035 Vision is to achieve economic diversity by providing a conducive business environment for motivating and developing the private sector in every sector, including industry and financial sector. 'Sustainable diversified economy' is among the seven pillars of Kuwait 2035.

Figure 44: Gross Domestic Product and Its Growth (2006-2019)



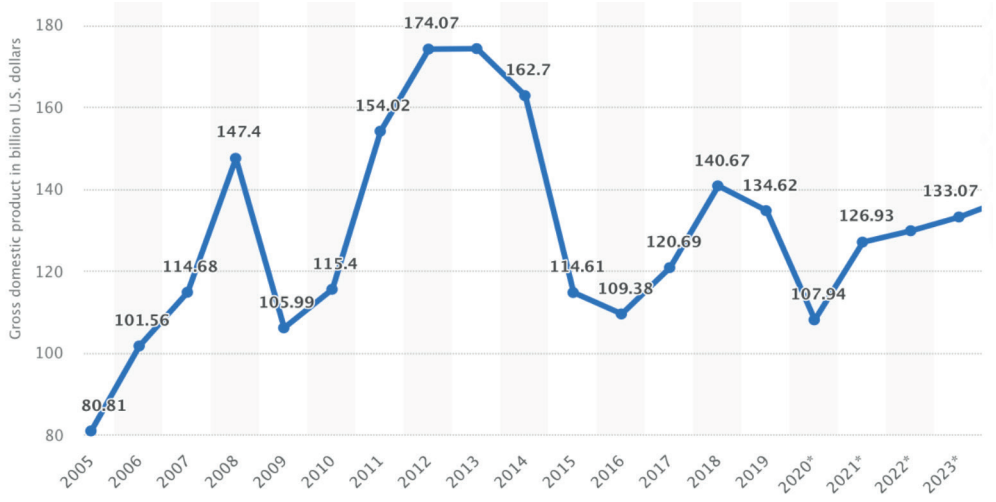
Data Source: Statista

As can be seen in Figure 44, the Global Financial Crisis of 2008 had a substantial adverse impact on the country's economic growth, as economic growth plunged into negative with -7 percent in 2009. The recovery was, however, quick as the economy bounced back, and in 2011 the growth rate reached 10 percent. Such a speedy recovery should be considered a success. However, except for 2016, economic growth has been in a declining trend since 2011, which resulted in a further decline in the economic growth to -5 percent in 2017. While 2018 witnessed the bouncing back of the economy with small positive growth, the 2019 growth rate was lesser than 1 percent. Similar to any other economy in the world, the impact of COVID-19 for Kuwait has been inevitable, resulting in a further decline in economic growth. In the post-2011 period, the

declining trends in economic growth could be explained by the decline in oil prices, which has reduced the available liquidity for the growth of the economy.

As shown in Figure 45, the declining trend from 2019 is further visible in 2020, with the economic growth rate declining to the 2017 level, which is due to the COVID-19 impact as a result of the lockdown of the country. The new low in the economy is similar to the global economy. However, as part of the global economic recovery, Kuwait is expected to show a dynamic bounce back in 2021.

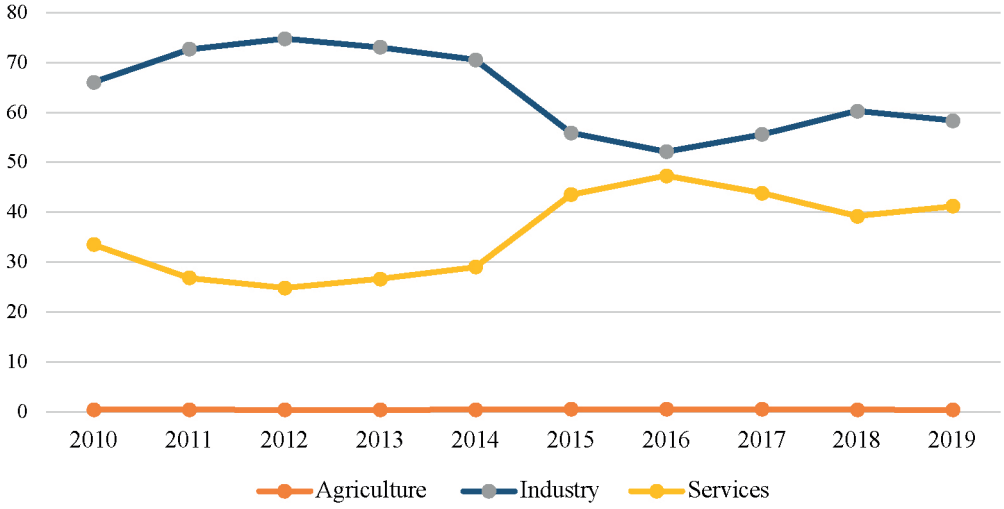
Figure 45: GDP Trends (2006-2021)



Note: Current USD

Data Source: Statista

Figure 46: Sectoral Distribution of the economy (2010-2019)



Data Source: World Bank

Regarding the sectoral distribution of the economy, as shown in Figure 46, despite the economic diversification attempt, oil and gas dominated industry as a sector has been dominant in Kuwait. However, since 2012, there is a visible increase in the value-added of the services sector, which was 24.84% of the GDP in 2012 and increased to 41.24% in 2019. Moreover, it is expected that the share of the services sector to further increase under the COVID-19 conditions due to the increased online and e-commerce services.

Economic diversification policies require the development of the private sector, for which SMEs play an essential role. "Building a vibrant ecosystem for SME development is seen as critical to promoting long-term economic diversification in Kuwait. In the next 20 years or so, the private sector is expected to play a leading role in creating jobs for the next generation of Kuwaitis" (World Bank, 2016). By developing the entrepreneurship culture, SMEs will contribute to the economic value-added and create job opportunities for the increasing youth unemployment. Therefore, Kuwait has developed particular policies and institutional funding for the development of the SMEs sector. In 2010 when the Kuwait Parliament approved the development plan for 2010-2014, it also identified the development of SMEs in the country as an important concern for economic diversification (Koch, 2011).

MSMEs definition in Kuwait

As stated by Girgis and Al-Fulaij (2018: 8), the Kuwaiti Law 98/2013 state the nature and characteristics of SMEs as "as any industrial, commercial, agricultural, professional, service, intellectual or technological or any economic project that contributes directly to the development and diversification of the national economy, fulfil local or external market needs, if possible, provide job opportunities for nationals and develop their interest in pursuing nongovernment activities and self-employment". However, it should be noted that no particular reference was made to 'micro enterprises' in the law, which were considered as part of small entrepreneurs.

The law 98/2013 also identifies the objectives of SMEs as fostering growth, creating jobs, diversifying sources of income, reducing the financial burden on the government budget, supporting human resource development, encouraging self-employment, enhancing competitiveness, and promoting innovations (Girgis and Al-Fulaij, 2018: 8).

Within such a framework, the main body created for financing SMEs in Kuwait, namely KFN (National Fund for Small and Medium Enterprise Development), defines "an SME as a small company with capital of less than 250,000 KD and 1 to 4 Kuwaiti employees. A medium-sized company is considered to have capital of between 250,000 and 500,000 KD and employs 5 to 50 Kuwaiti nationals" (Al Bazie & Bragazna, 2020: 13), which is also verified by Girgis and Al-Fulaij (2018: 8).

However, in its recent report by Markaz (2021), it is stated that according to the KNF, "Entities that employ less than 50 Kuwaiti people and have an asset base of less than KD 500,000 with revenues of less than KD1,500,000 are considered as SMEs".

The role of the SME sector in the Kuwaiti economy

In any country, SMEs are considered the backbone of the economy, which is not necessarily the case with Kuwait. World Bank (2016) states that in 2019, "SMEs contribute around 3% of the GDP, with the gross value added by the SMEs of KD 1,216 million", which is much smaller than in most of the economies in the world. As a comparison, "the share of SMEs' contribution to GDP is around 40% in emerging economies, 50% in high-income economies and 53% in UAE"

(Markaz, 2021). As indicated in the interviews conducted for this research, the larger percentage of entrepreneurs are expatriates, which explains the narrow opportunity space in terms of development. However, the interviewees also acknowledged the emerging entrepreneurship culture among the new generation Kuwaitis, which should provide a new impetus for the development of SMEs and their contribution to the GDP.

In terms of the number of SMEs in the country, Markaz (2021) provides an estimate that "there are approximately 25,000 to 30,000 SMEs in Kuwait, representing about 90% of a total number of companies". However, an interviewee from Kuwait Economic Society (KES) had insider and informed information and therefore suggested that about 70,000 enterprises are considered as SMEs in Kuwait. Despite the confusion on the numbers, the statistics evidence that around "40% of SMEs are in wholesale/retail trade and hotels and restaurants, and 33% in construction and industry sectors" (Markaz, 2021).

As regards the employment provided by the SMEs, "less than 7% of Kuwaiti national workforce or about 27,000 work in the SME sector[18] " (Markaz, 2021), a majority of the Kuwaitis nationals (81 percent) are employed in the public sector (Markaz, 2021). Furthermore, considering the foreign workers in the economy, World Bank (2016) states that "Kuwaiti SMEs only employ around 23% of the country's total workforce, which is less than half of SME employment figures for both high income and emerging economies".

Special institutionalisation for SMEs

The establishment of the KNF to provide financing for the SMEs development in 2013 came with the 98/2013 law with KD2 billion, which have remained the main public financing body along with commercial conventional and Islamic banks. Before KNF, "banks, Industrial Bank of Kuwait, funds and portfolios and Kuwait Small Projects Development Company (A Kuwaiti Shareholding Closed Company) [were] the principal source of financing for the SME sector in Kuwait" (Markaz, 2021). Thus, the establishment of KNF as a unified institution is an "expression of Kuwait's commitment to developing institutional formation for effective eco-system commenced to support SMEs", which started with initial institution for such a purpose in 1995" (Interviewee).

KFN is mandated with a more extensive portfolio of tasks for the development of SMEs as part of the mentioned ecosystem. However, as reported by Al Sharekh (2018: 5), "the initiative's success hinged on four main components:

- Government support for start-up capital and assistance in restructuring regulations and processes to facilitate the establishment of businesses; this included granting access to land and giving National Fund SMEs priority in government procurements.
- Educational support, or early student interventions.
- A 'venture friendly' legal framework.
- Changing mind-sets."

Considering such an objective function, KNF should be hailed as a vital development in contributing towards the New Kuwait as aimed by Kuwait Vision 2035.

[18] *Kuwait Labor Market Information System, TICG: Post Oil Gulf - SMEs to the Rescue*

As an independent public corporation, KNF aims to "help the country make a major stride in the efforts to support the youth, combat unemployment, and enable the private sector to drive economic growth"[19] . By defining the eligibility criteria for SMEs, the law for KNF provides a definition: "SMEs as enterprises that employ 1 to 50 Kuwaiti workers, with financing requirements that do not exceed KD 500 thousands… [which can] finance up to 80 percent of the capital for feasible small and medium projects submitted by Kuwaiti nationals". [20] However, reference to Kuwaiti nationals excludes the expatriate entrepreneurs, who constitute the central portion of the SMEs. Considering that expatriates own the majority of the SMEs but with a maximum 49 percent stake due to the regulation, and since their "Kuwaiti partners are mostly slipping partner" (Interviewee), this definition excludes the majority of those businesses from financing, which does not help with the wealth generation ability of the private sector, as aimed by the Kuwait Vision 2035.

To further reflect, in "Kuwait …, expatriate workers represent more than 75% of the private sector workforce" (TIGG, 2018). While a single entity specialising in SMEs financing should help create efficiency and opportunity spaces by reducing transaction costs, its effectiveness is constrained by the law and institutional logic of supporting only the Kuwaiti nationals. As identified by an interviewee, "for expatriates to establish a business in Kuwait, they need to have a Kuwaiti citizen partner, and the Kuwaiti partner must have the majority shareholder, which leaves the expatriate to have only 49 percent shareholding". Therefore, in essence, such businesses are qualified for financing from the KFN. However, as highlighted by an interviewee, "in most cases, Kuwaiti partner is sleeping partner, and therefore they do not engage with applications for financing, for example". It is also noted by an interviewee that "KNF does not accept applications in which there is a silent partners". Therefore, this directly results in the majority of the expatriate SMEs being excluded from KNF and including some specialised privileges customarily provided for the SMEs.

Regarding the operation of KNF, as stated by the interviewees, KNF does not have the capacity to evaluate SMEs financing applications made. Therefore, KNF outsources the process to four (two Islamic and two conventional) banks in return for a fee for the evaluation of each application. Thus, having such a coordinated effort to support SMEs should be considered a positive and integrated institutional arrangement.

It should be noted that since 2013, World Bank has been providing technical and institutional support for the implementation of KNF in "the development of its executive regulations, the strategy and action plan, and the organizational set-up of the Fund" (World Bank, 2016). As reported by World Bank (2016), it continues to support KNF in areas such as SME business environment, SME business development, developing a culture of entrepreneurship in the country, and supporting processes to performance evaluation in terms of its impact and monitoring its performance. However, considering the disbursement data, such support by the World Bank seems not to have contributed to the performance of KNF, which again comes back to the eligibility criteria. Therefore, as identified by the interviewees, the development of entrepreneurship culture is essential so that the KNF can proactively work with the young entrepreneur. It seems that KNF has been providing such training and project development support to the young willing Kuwaiti national as reported in the 2017 Annual Report. This will be useful as the Global Competitiveness Report (2019) data states that Kuwait lagged behind its GCC peers in the skills and innovation ecosystem. Considering SMEs play a vital role in innovation, KNF should expedite its activities in developing an entrepreneurship culture.

[19] *KNF, https://nationalfund.gov.kw/en/about-us/vision-and-mission/*

[20] *KNF, https://nationalfund.gov.kw/en/about-us/vision-and-mission/*

Other institutions for SMEs financing include Islamic and conventional banks as well as family and friends for raising financing for SMEs start-ups and operations. However, as stated by one of the interviewees specialised on the topic "95 percent of the business in the country consists of SMEs, while their share in the bank based financing is only 5 percent". This suggests the little importance given to SMEs development even though Kuwait Vision 2015 calls for economic diversification and private sector development.

Factors hampering the development of the SMEs sector

The SMEs face other challenges beyond financing challenges in Kuwait. As repeated in various sources, which came up in the interviews, the domination of the public sector in the economy seems to be the primary concern, limiting the opportunity spaces for business in the country. Kuwait Vision 2035 is expected to create a 'new Kuwait' where the private sector will have an equal share. However, the path dependence in the economic evolvement of the society has so far not allowed such a transformation. This is obvious from the fund allocation by KNF for SMEs so far. Despite the large size of its capital, KNF has only dispersed a small fraction of its capital.

In line with the overwhelming size of the government in the economy, "a tremendous amount of business opportunities depend on government contracts" (Alhabashi, 2015), which narrows the business opportunities for the private sector and creates inefficiencies. Similarly, "Government subsidies on special goods and facilities exclude the possibility for private sector competition in their production" (Alhabashi, 2015), which hamper the business opportunities. Furthermore, the attractiveness of public sector jobs with a very good package undermines the entrepreneurship culture, which "does not encourage the development of SMEs in Kuwait" (Alhabashi, 2015). Lastly, as this study has faced and as confirmed by interviewees, "lack of data and market information" remains a significant challenge.

Considering Kuwait Vision 2035 and the expressed economic diversity, entrepreneurship culture must be developed to create new opportunity spaces. Thus, "… a more holistic approach to reform in … economic sense is needed to open the private sector for innovation by a younger generation. Educational, social, and governmental practices must be challenged and upended because a piecemeal approach focused solely on SMEs will not be enough" (Al Sharekh, 2018, p. 14).

4.4.2. The Trajectory of Islamic Finance: Institutionalization, Legal and Regulatory Framework, and Financial Standing

The emergence of Islamic banking and finance can be traced back to the 1970s in Kuwait initially, with the conceptual engagements in the early 1970s leading to the establishment of the first Islamic bank in 1977 with the Kuwait Finance House. Thus, Kuwait is one of the initial embracers of Islamic banking, which has developed its Islamic finance offerings since then, including Islamic banks, financial institutions and *takaful* along with robust Islamic social welfare institutions such as waqf. The expansion and diffusion of Islamic banking were possible with the 2003 Law No. 33, which allowed the creation of new Islamic banks as well as non-lending Islamic financial institutions (Oxford Business Group, 2019). Since then, the Islamic finance sphere has witnessed the emergence and expansion of Islamic finance institutions and transactions.

Regarding the Islamic banking and finance industry regulation, the Central Bank of Kuwait (CBK) and the Capital Markets Authority (CMA) provide necessary directives for the operation and development of the industry, including governance. The legal provision is made through the 2003 Law No 30, while *sukuk* related regulation was issued in 2015 by the CMA (IFN Kuwait Report, 2020).

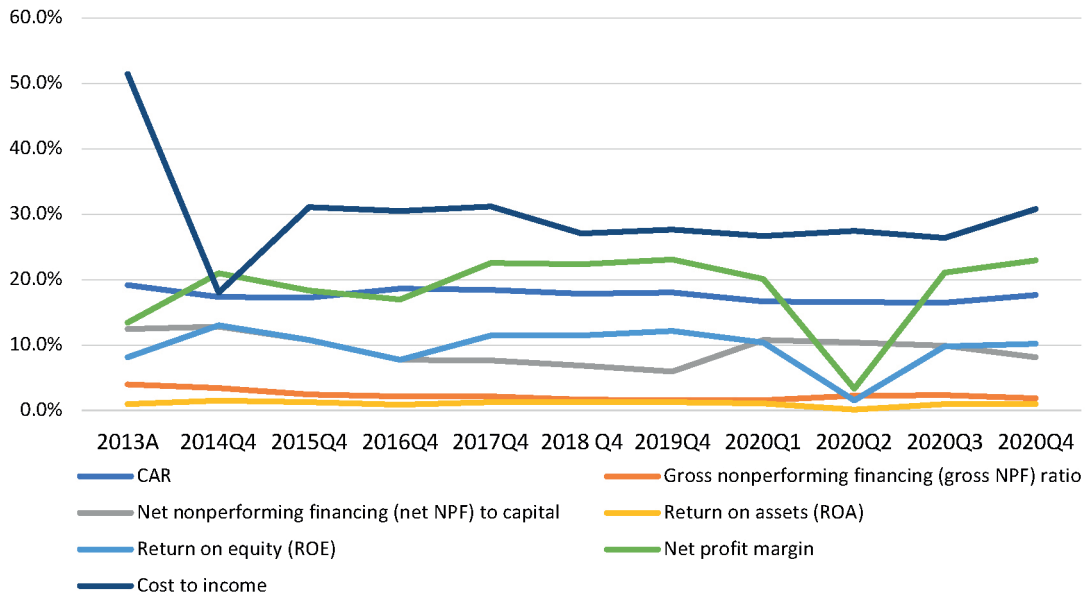
Table 27 and Figure 47 present the leading indicators and trends in those indicators for the Islamic banking sector in Kuwait, which covers 2020 also to detect the impact of COVID-19.

Table 27: Main Indicators of Islamic Banking Sector in Kuwait

Item	2013 A	2014 Q4	2015 Q4	2016 Q4	2017 Q4	2018 Q4	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4
CAR (%)	19.2	17.4	17.2	18.7	18.4	17.8	18.1	16.6	16.6	16.5	17.7
Gross nonperforming financing (gross NPF) ratio (%)	4.0	3.5	2.5	2.2	2.2	1.7	1.6	1.6	2.3	2.3	1.9
Net nonperforming financing (net NPF) to capital (%)	12.5	12.8	10.8	7.8	7.7	6.9	6.0	10.8	10.4	10.0	8.1
Return on assets (ROA) (%)	1.0	1.5	1.3	0.9	1.3	1.3	1.3	1.1	0.2	1.0	1.0
Return on equity (ROE) (%)	8.2	13.0	10.8	7.8	11.5	11.5	12.1	10.4	1.6	9.8	10.2
Net profit margin (%)	13.4	21.0	18.4	17.0	22.6	22.4	23.1	20.1	3.4	21.1	23.0
Cost to income (%)	51.4	18.0	31.1	30.5	31.2	27.1	27.7	26.7	27.4	26.4	30.8
Number of Islamic banks	6	6	6	6	6	6	6	6	6	6	6
Total assets (billion national currency)	22.6	25.8	26.4	26.9	28.9	30.7	35.3	37.0	37.6	38.1	38.9

Data Source: IFSB Database

Figure 47: The Performance of the Islamic Banking Sector in Kuwait



Data Source: IFSB Database

As can be seen in the statistics and trends, except for the second quarter of 2020, all the measures have progressed within their set trends from 2014 onwards with slight changes from one year to another. However, in particular, ROE and Net Profit Margin demonstrate a sharp decline in 2020 Q1, the initial lockdown. However, trends show that Islamic banks have developed the necessary

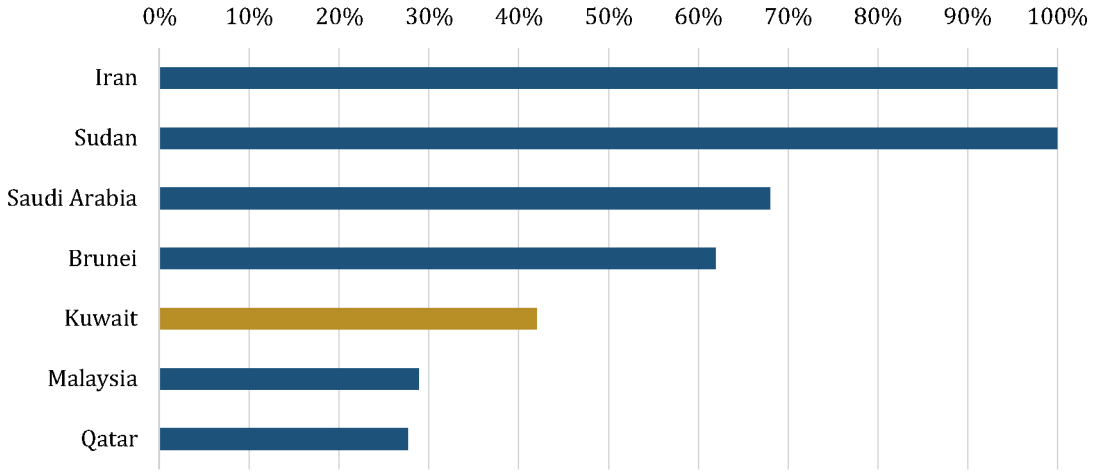
strategy to count for the adverse impact of COVID-19, therefore, trends went back to their pre-COVID-19 positions. In addition, as can be seen, the assets of the Islamic banks continued to grow despite the adverse impact of the economy. Hence, Islamic banks in Kuwait demonstrated resilience towards the COVID-19 impact, as it was the case with the 2008 Global Financial Crisis. However, this raises a critical issue as to how Islamic banks are not affected even though GDP and its growth was affected, as indicated in Figure 47, which may imply that Islamic banks are no longer fully relate to real economy and hence they are operating within disembedded reality. Their limited exposure to SMEs, as indicated by one of the interviewees, can lead us to such a conclusion. However, this is a general industry issue at the global level, as explained above.

In comparison to the conventional banks in Kuwait, while Islamic banks grew by 12 percent in 2018 in their assets size, conventional banks grew by 6 percent. have outperformed their conventional counterparts, with an average growth rate of 12% over the same period, compared to 6% for conventional banks. Moreover, as reported by Oxford Business Group (2019), the profit growth in Islamic banks was 22 percent as opposed to 17 percent for the conventional banks. Thus, despite the larger share of conventional banks in the economy, the growth pace of Islamic banks may result in convergence in the asset bases, as the share of Islamic banking in the national financial system is already around 40 percent (IFSB, 2020).

Islamic banks have continued to outperform conventional entities, reaching profit growth of 22% in 2018, compared to 17% for the latter. Conventional banks, however, dominate in terms of absolute value, taking in total profits of KD616m ($2bn) in 2018 versus KD268bn ($882.7m) for Islamic banks.

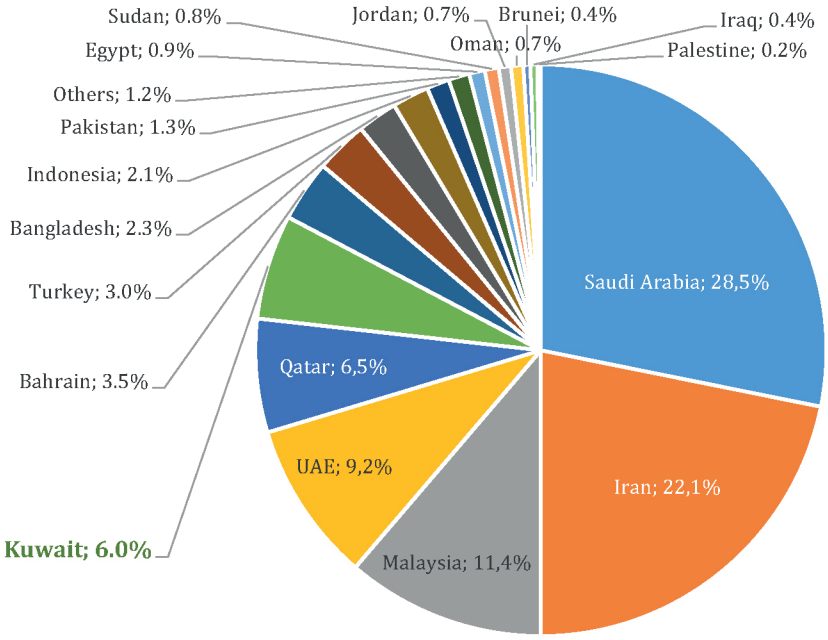
The growing strength of the Islamic banking sector in Kuwait is also evidenced by the international comparison of Islamic banking assets. For example, as shown in Figure 48, according to IFSB (2021), in 2020Q3, Kuwait's Islamic banking assets were 42 percent of all its banking assets. Similarly, as depicted in Figure 49, Kuwait is ranked fourth in global assets of Islamic banking.

Figure 48: Share of Islamic Banking Assets in the Domestic Banking Sector (3Q2020)



Source: IFSB (2021)

Figure 49: Share of Kuwait's Islamic Banking Assets in the Global the Islamic Banking Assets (%) (in 3Q20)



Source: IFSB (2021)

Overall, Kuwait is one of the leading countries in the development of Islamic banking and finance with growing asset size, Kuwait has established itself as the leading player in Islamic banking. Therefore, while caution is taken for the adverse impact of COVID-19, as explained above, it seems that Islamic banks managed to overt the initial distortions and have successfully caught up with pre- COVID-19 trends.

4.4.3. Islamic Financing Provisions for MSMEs: Institutions, Products, and Offerings

As mentioned above, the main SMEs funding body in the country is the KNF. However, KNF has not provided detailed data from their website to develop an advanced understanding of the extent and depth of their operations and funding. Along with KNF, conventional and Islamic banks are the remaining sources of SMEs funding.

While KNF does not openly operate in Islamic finance terms, as identified by the interviewees, the operation of KNF is basically Islamic: "KNF does not provide a pure Islamic solution. It provides debt-based financing similar to *qard al-hassan* plus 2 percent fees one time on the total amount of financing as a management fee. Then, the loan amortisation is for the principal and hence no interest or profits to be paid later. But KNF does not officially declare their operation as Islamic financing". As the explanation provided by all the interviews, the financing provided by KNF is akin to the *qard al-hassan* instrument of Islamic finance, as no return or profit-sharing is included in the operations. It is also important to state the *Shari'ah* compliance of the applications are ensured by Islamic banks, as the interviewees explained, "application for funding by the SMEs to KNF is evaluated by Islamic banks in the case of *Shari'ah* compliant funding is requested". Hence, banks, including Islamic banks, work in a coordinated manner with KNF by acting as the handler

of the applications for a fee from KNF for each evaluated application. This process supports the *Shari'ah* compliant nature, at least on the form.

While the latest data is not available as the last report provided by KNF is for 2017, the 2017 report, as reported by Markaz (2021), suggests that "The average loan size per borrower approved by The SME Fund in 2016-2017 for small businesses was KD 67,800 and for medium-size businesses was KD 392,920". Considering the financial size of KNF (USD6.5billion or KD2billion), such amounts are not highly significant in themselves to motive the SMEs sector. It should be noted that KNF has also "committed itself to involve the private sector in its approach, and it recently announced that it aims to include private capital in at least 60% of new loans until 2021" (TIGG, 2018).

The sluggish performance of KNF can be witnessed in the number of SMEs funded: "From 2016 until businesses suspension due to COVID-19, the KNF funded around 870 SMEs, at a cumulative cost of KD 151 million (or USD 498.5 million)" (Markaz, 2020). An interviewee updated that "until the emergence of COVID-19, exactly 1,449 SMEs benefited from the KFN with about USD700 million". Considering the financial size of KNF, which should be regarded as its mandate, the total amount dispensed so far is only 7.5 percent of its capital (Markaz, 2021) or, with the update from an interviewee, merely over 10 percent. Thus, regarding the stated objectives in Kuwait Vision 2035, KNF has not delivered its objectives yet. This is a concern raised by all the interviewees in this research project, who independently agreed that KNF has not been able to contribute to the development of the SMEs sector even though the economy needs diversification and new business opportunities. For example, in demonstrating the inefficiency of KNF, one of the interviewees suggested that "successful SMEs in Kuwait are not under the KNF. Mostly, they are the SMEs which raised financing from angel investors and venture capitalists".

Since all SMEs financing is operated through KNF, which is a public source, the other sources in Kuwait are conventional and Islamic banks, along with individuals utilising their own funds. In particular, individual, family and friends based business financing is an essential cultural factor in the GCC region. In the case of expatriates,, however, it is imperative to recourse to their own sources, as, for example, KNF would not provide financing for expatriates for their businesses, as they are not Kuwaiti citizens. For them, banks are a vital source as well. However, as the interviews pointed out, "*kafala* system means, the application must be made by the *khafil*", which reduces the appeal of banks to the expatriate businesses. Nonetheless, the main source is KNF, the banks including the Islamic banks, and family and friends.

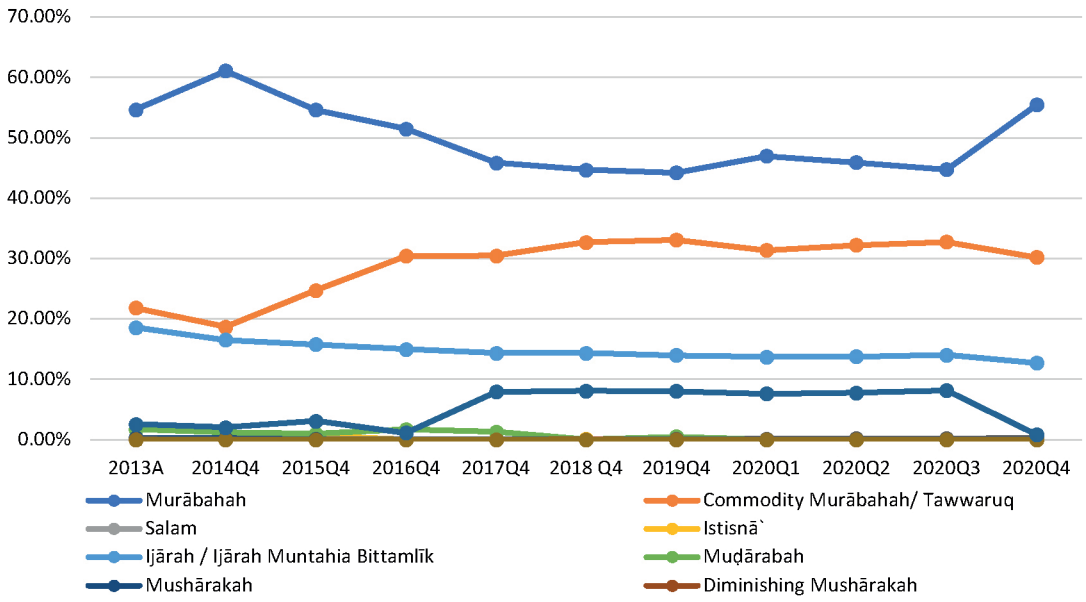
In addition to KNF, as the Financial Statements of the national conventional and Islamic banks indicate, banks have been providing financing for SMEs, and some of the banks have relevant SMEs department to finance and monitor the progress of their financing. This is verified by the interviews too. However, detailed data concerning financing provided by banks to SMEs could not be located. One of the interviewees, being a banker, stated that "the banks have not been proactive or eager in providing financing to SMEs either". It is, however, noted that, in particular, "expectations from Islamic banks are higher due to their underlying principles" (Interviewee).

An important example provided by two Interviewees is the Kuwait International Bank (KIB), an Islamic bank, which used to be Kuwait Industrial Bank, which "has developed a positive attitude towards SMEs and therefore has attracted the businesses, which helps them to develop their corporate customer base". Similarly, another interviewee explained that Kuwait Finance House (KFH) has an important SMEs portfolio, which has the largest department in the country for SMEs. In addition, KFH has recently initiated microenterprise business as well". In addition,

another interviewee mentioned, "since KIB has focused on supply-chain financing, this appeals more to the SMEs"(Markaz, 2021).

As discussed at the beginning of the report, Islamic banks, theoretically, should be considered as the best institutions to provide funding to SMEs due to the PLS and risk-sharing nature of Islamic principles. However, as is the case for the global Islamic finance industry, "Islamic banks in Kuwait currently offers only debt-based financing to SMEs such as *tawarruq*, *ijarah*, and commodity *murabahah*. They do not offer equity-based financing" (Interviewee).

Figure 50: Distribution of Financing According to the Islamic Contracts



Data Source: IFSB Database

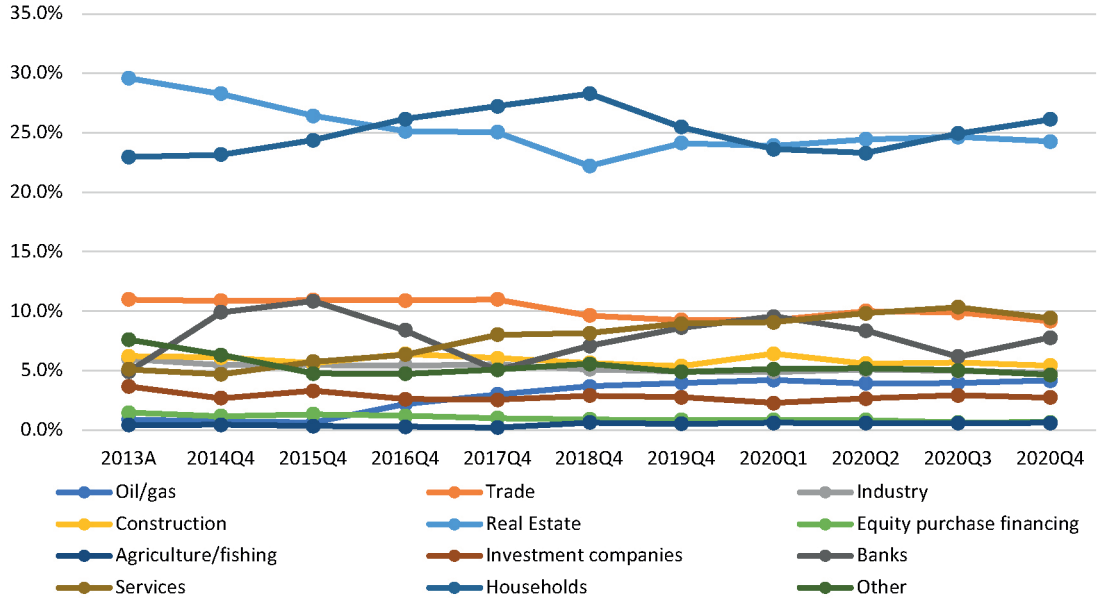
Figure 50 depicts the trends in the financing contracts used by Islamic banks in Kuwait, which can provide an indication of the financing extended to SMEs. As can be seen, the available financing is mainly debt-based *mudarabah*, and *musharakah* is hardly visible as *musharakah* is about 0 percent and *mudarabah* is around 0.3 percent in the entire Islamic financing options. As shown, *murabahah* and commodity *murabahah/tawarruq* has dominated the Islamic financing contracts in the Kuwaiti Islamic banks. For example, in the 2020-Q4, the total *murabahah* and commodity *murabahah/tawarruq* financing is about to 86 percent in the Islamic banking sector. It is also important to observe that *murabahah* financing has further increased during the COVID-19 period, which can be explained by avoiding any further risks. Thus, PLS and risk-sharing types of equity contracts are not available for SMEs in Kuwait, which an interviewee also confirms. Thus, *Shari'ah*-compliant debt-based contracts are used by SMEs in their operations, such as commodity *murabahah*, *tawarruq* and letter of credit *murabahah* are commonly used by Islamic banks.

In furthering the analysis, the distribution of the financing extended by Islamic banks is examined in relation to the economic sectors, which can provide an understanding of SMEs financing. Figure 51 depicts the trends in sectorial financing by Islamic banks.

As can be seen in Figure 51, the household and the real estate sector gets the lion's share from

Islamic banks. In 2020-Q4, the real estate sector, households, oil/gas, investment companies, and banks received about 65.2 percent of the financing extended by Islamic banks. This implies a maximum percentage of 35 percent left for sectors where SMEs are dominant, such as industry, agriculture/fishing, services and trade, as well as equity purchase. This has been the primary trend, as can be seen since 2013, with slight variation. Thus, using this as a proxy, it is possible to conclude that available financings for SMEs are somewhat limited within the system.

Figure 51: Distribution of Financing According to the Economic Sectors



4.4.4. COVID-19 Conditions and Islamic Financing Responses for MSMEs

COVID-19 conditions created uncertainties and volatility for the Kuwaiti government, society and the business, as elsewhere else in the world. Various packages have been developed to tackle the multiple consequences of the COVID-19, and the lockdown came with it. The restrictions and bans on people's movement as a result of COVID-19 implied that businesses, including SMEs, will face cash flow problems (Markaz, 2021) due to "loss of revenue, negative demand shock and temporary business closure" as well as income loss. Therefore, alternative economic and financial means had to be developed to mitigate the risks and moderate the consequences. As "limited cash reserves coupled with labour shortages in the SME segment due to COVID-19 lockdown is brewing the perfect storm" (Markaz, 2021) creating further uncertainties on the sustainability of SMEs.

As discussed above, COVID-19 emerged in such a period when the earnings from the oil sector had been declining due to the fall in the oil princes. Therefore, the budget deficit resulting from the gap between the planned oil price and the actual oil prices created strains on providing necessary financial means to meet the consequences of the economic and financial difficulties. Coupled with this, the institutional constraints in the country meant effective solutions to some of the problems could have to be delayed. Moreover, as expressed by one of the interviews, that requirement for additional support for SMEs may involve additional layers such as the Kuwaiti partners being sleeping partners has prevented many expatriates SMEs from applying for the rescue programmes (Interviewee).

The experience demonstrates that the Kuwait government was ready and motivated to support the SMEs, but "they did not have any data and information about the SMEs' size, segments and sectors to utilise in developing policies" (Interviewee). As all the governments were learning in the process, however, "to develop a stimulus package, such information is inevitable, which the government did not have" (Interviewee).

KES should be commended for undertaking the task of generating such vital information in the early weeks of COVID-19 to help the government with its policies through information generated from the field. Consequently, "KES focused on the consequences and impact in the sense where and which area there was a need (support for rent, or supply chain, cash and liquidity etc.) to develop effective measures. And therefore, conducted a survey over three months with the SMEs to gather detailed data" (Interviewee). It seems that sectorial associations were very helpful in the surveys. Based on the survey results, KES proposed a "two-way stimulus package. First, rescue plant to keep businesses floating; and secondly, creation of data centre for SMEs" (Interviewee). However, due to the concerns over budget deficit due to the declining oil prices, the government could not undertake the proposal on creating a data centre for SMEs.

In progression to develop a policy, as narrated by the interviewees, the policy development in relation to SMEs in Kuwait was then shifted to the Central Bank of Kuwait (CBK). "This is due to the fact that KNF stopped taking any new funding application in March 2020" (Interviewee) as a result of government policy. However, as asserted by the interviewees, "CBK could not assess the importance of SMEs, as for them it is an economic sector that contributes only to 3% of the country's GDP and carries high risk". In addition, "due to the health implications of the COVID-19, it seems that government's focus was on the health sector, and therefore policy making and developing rescue plans was left to the CKB" (Interviewee). However, in identifying the dilemma, one of the interviewees stated that "if the SMEs are not considered essential for the development of the economy and economic diversification, why KNF was created with such a large fund, which is one of the biggest specialised funds for SMEs".

With the given mandate, put forward some initiatives to ease the economic and financial consequences of the emerging COVID-19 conditions on the SMEs. "The initial stimulus package was not taken up by the public, as it was ineffective, and therefore, three months later, as new rescue plan was issued" (Interviewee). While SMEs needed any support to keep floating, the second rescue package did not get approval in the political process. For example, as reported by KPMG (2020), the Central Bank of Kuwait took up some immediate measures for SMEs, which included:

- "Discount rate reduced to a historic low of 1.5 percent
- Repo rates, overnight, one-week and one-month reduced to 1 percent, 1.25 percent, and 1.75 percent respectively
- Capital adequacy ratio lowered from 13% to 10.5%
- Risk weight for SMEs lowered from 75% to 25%"

In a similar fashion, "Kuwait Banking Association announced a moratorium period up to 6 months on bank loans including waiver of interest and charges (if any for postponement) for retail clients (citizens and expatriates) and SMEs" (KPMG, 2020).

As identified by the interviewees too, deferment of financing and restructuring financing/loans was immediately initiated at the bank and KNF levels through public policies and regulatory decisions.

Other measures offered to SMEs as identified by KPMG (2020) and the interviewees for this study are:

- "Providing loans on concessional and long term basis to SMEs, through joint financing from local banks and the Kuwait National Fund for SMEs
- Assisting SMEs and agricultural projects by postponing the instalments funded by the Kuwait National Fund for SMEs and the Industrial Bank of Kuwait
- Postponing social security contributions by business owners in the private and oil sectors (not fully owned by the state) for a period of (6) months
- Expediting work cycle to ensure that the government pays amounts due, to the private sector at the earliest
- Providing government exemptions to the affected economic institutions in the manufacturing sectors and the cooperative societies from some government fees and dues (if these exemptions are passed through to their clients)
- Exemption for self-employed Kuwaitis registered under Chapter Five of Social Security Law from contribution towards insurance for a period of (6) months".

The government's Stimulus Financing Package in early 2021 through CBK came with a ten-year horizon for repayment with a three-year grace period and a low return/interest rate. In addition, it included guaranteeing SMEs loans from the conventional banks and financing from Islamic banks up to 80 percent. However, the rescue package did not work, as "out of the 70,000 businesses/SMEs, only 1,000 of them applied, and 95 percent of the applications were rejected by Kuwaiti banks, Islamic and conventional alike" (Interviewee). As discussed before, one of the conditions is that Kuwaiti partners should not be silent. However, as discussed above, this excludes most of the potential applications.

In reflecting on the Stimulus Financing Package, one of the interviewees stated, "it was too little and too late. As most of the SMEs overcome the most difficult period of the COVID-19 period". Despite such a guarantee from CBK, "it seems that both the Islamic and conventional banks did not want to take any risks, even 20 percent of the risk, as banks were looking for 100 percent guarantee" (Interviewee). One of the interviewees associated banks' position with their size and portfolio; and therefore, suggested that "small banks are needed to support SMEs as in the SMEs successful countries in the West and South-east Asia evidence. The Kuwaiti banks are too large to consider SMEs while they can enjoy the corporate sector".

Furthermore, the Stimulus Financing Package, as can be seen, did not offer any grant, but rather debt-based solution through banks, in which the cost of the (conventional) borrowing, namely interest or (Islamic) financing cost is borne by the government, implying that it works as a subsidy.

At individual Islamic bank levels, various initiatives have been developed, too. For example, KFH (2021) reported that "As part of a strategic initiative in collaboration with the Ministry of Justice, Kuwait Finance House (KFH) is covering over KD20 Million in debts to release approximately 10,000 defaulting debtors and those whom the court ordered to be brought before it" in line with *Shari'ah* compliance. This measure also covers SMEs. In rationalising this measure, KFH, as the largest Islamic bank in Kuwait, framed it as corporate social responsibility (CSR) act. Thus, bringing CSR dimension to such a financial burden on the side of SMEs should be considered as a good practice. Furthermore, KFH (2021) announced the continuation of this programme

with a larger number of people and larger volume of debt as part of the continued effort for social welfare through increased effort towards CSR and sustainable development. Furthermore, KFH 2020 Annual Report mentions that they "have provided liquidity to markets and customers, postponed instalments for retail and corporate customers for 6 months as per CBK and Kuwait Banking Association instructions, set new finance lines to support companies, namely Small and Medium Sized Enterprises (SMEs) and provided support to the Kuwait Red Crescent Society and the Ministry of Interior efforts while performing their duties for the state and society".

Similarly, as informed by the interviewees, in responding to the Central Bank of Kuwait's Law No 2, 2021 to rescue the adversely impacted SMEs due to COVID-19, Ahli Bank of Kuwait launched SMEs Rescue Program. For this, the eligible SMEs are described according to the National Fund's set framework. Furthermore, Ahli Bank only included SMEs into the rescue programme, which was operating before the end of 2019 and also, they should not be in default before the same date, implying that they only considered COVID-19 related default. Furthermore, in the disbursement of new financing line as part of the rescue package, an interviewee stated that "CBK did not provide cash to the successful SMEs; but rather directly paid to the sources of need, namely paying rent to the landlord, paying the invoices for the supplied material and goods, etc.". This is believed to overcome the cash and liquidity needs of the financing granted SMEs.

Islamic banks have provided deferment and restructuring of financings and instalments for SMEs in difficulty. In doing so, CBK directives provided the necessary imperative. However, *Shari'ah* compliance of such actions is critical. As an interviewee explained, in the deferment of instalments and restructuring, "new *tawarruq* lines are opened; mostly *tawarruq* and commodity *murabahah* are used in the restructuring process". Hence, *Shari'ah* compliance is ensured in the process.

The proactivity of SMEs in responding to the changing nature is important also to consider, which includes the pandemic conditions. It seems that some delivery and retail-based SMEs in Kuwait turned the crisis into their chances by developing new ways of delivering their services, in particular in the food industry. The interviews provided engaging anecdotal experiences from the SMEs, which successfully show, in the expression of one of the interviews, "agile SMEs which were successful in changing their skin, gained better profits under the COVID-19 conditions by opting online platforms and fintech". This indicates the importance of adaptability to the new business environment, as the one created by COVID-19 implying that for some SMEs benefiting from technology could be a solution. Hence, the importance of innovation on the side of SMEs is originally marked, in general, for their innovation and adaptability. Developing such an innovation culture will be an essential contribution to Kuwait Vision 2035 and will fulfil the founding objectives of KNF. One of the interviewees mentioned that "Boubyan Bank has been an important leader in technological development in banking since 2014, which helps to capture the younger part of the population", which should be considered an important opportunity space for connecting with SMEs.

As regards the *zakat* fund and *awqaf* related SMEs financing, it should be noted that Kuwait has two important social welfare institutions: Kuwait *Awqaf* Public Foundation (KAPF) and Kuwait *Zakat* House (KZH). In some developing countries, such as the case study on Indonesia indicates, Islamic social welfare institutions proactively engaged in supporting SMEs through different impact areas. However, as the interviewees noted, since Kuwait has KFN, a substantial fund dedicated to SMEs, KAPF and KZH does not need to engage in SMEs areas. However, it is confirmed that they were proactively supporting particularly the workers from the SMEs, who fell into hardship due to redundancies led by the lockdown.

4.4.5. Best Practices: Lessons Learned

COVID-19 and the policies and strategies developed to tackle the adverse impact and consequences has provided entirely a new set of learning curve and tool kits. Each country has developed its own policies within its legal, regulative, and available resources framework and constraints along with the globally set and developed policies. The Kuwaiti government, together with the public and private sector, has acted in an integrated and coordinated manner to support SMEs in line with the Kuwait Vision 2035.

Kuwait has prioritised the development of special institutionalisation for SMEs financing as early as 1995, culminating in one institution, namely KNF. Thus, having a specialised institution should be considered a vital success factor for SMEs development. However, as discussed above, the effectiveness and efficiency of KNF is questioned in relation to developing the sector. An interviewee explains this with the management, as he stated that "since its establishment in 2013 until today, KNF has had five CEO, each of whom has come up with their own vision and strategies. However, none of them has the necessary time to implement". Indeed, the institutional instability as a result of such turnover, hence, has prevented this unique institution from fulfilling its objectives. Considering that it also aims to 'change mindset' to develop entrepreneurship culture in the society beyond only providing finance, its inability to achieve its novel objectives despite sitting on a considerable amount of resources constitutes a critical source to develop lessons. The invisibility of KFN during the COVID-19 process questions the entire rationale for such an institution, despite its stated novel objectives.

Having KNF working closely with Islamic and conventional banks to evaluate the applications rather than creating its own structures for this purpose should be considered a good practice. Such outsourcing overcomes additional transaction costs. In addition, the arrangement provides an integrated response, albeit it is partially integrated.

The government's efforts to develop rescue packages for SMEs should be considered a positive and proactive response. However, not having the essential information in terms of number, size and sectors, as well as the specific needs of SMEs, should be a source of concern. Therefore, as a lesson, necessary databases must be developed to create effective responses and develop efficient policies.

The government's resolution to shift the development and implementation of the Stimulus Financial Package to the CBK initially can be considered as a positive solution. However, the objective function of CBK does not include such tasks. Therefore, keeping the implementation of the package should have been with the relevant ministry such as the Ministry of Finance or Ministry of Commerce and Industry. As this would have provided coordinated policymaking in line with political will. As mentioned above through the views of the interviews, CBK does not prioritise SMEs in its portfolio compared to other portfolios.

Regarding the Islamic banks, this research demonstrates that each Islamic bank has undertaken various measures to support the SMEs within their SMEs portfolio. However, focusing only on shareholder interest and avoiding risk to the extent of rejecting 95 percent of the applications to the government guaranteed financing due to the remaining 20 percent risk questions rationale of Islamicity in Islamic banks. As one of the interviewees stated, "In line with the tradition and teachings of the Prophet (*saw*), every individual and institution is charged with the obligation of enhancing the world we live in. Therefore, Islamic banks, benefiting from such a philosophy, should have been more proactive in extending support to SMEs rather than rejecting the applications". Hence, the logic of Islamic banking must be reconsidered in particular in such a crisis time, and they should be re-directed to the foundational principles. Having stated that, as

explained above, one of the Islamic banks, paying off the financing (debts) of a certain number of people as part of social good or CSR should be considered a positive and good practice, which should be sustained beyond the COVID-19 period to reveal the determining nature of Islamic ethics on business.

Digitalization as part of the response to COVID-19 by innovative SMEs should be considered a positive response to creating new opportunity spaces by not surrendering the conditions. KNF's 'changing mindset' is very much related to the changing nature of business. Therefore, it is important that KNF and other funding bodies encourage innovation in technology in delivering their services and conducting their businesses. KNF and other bodies should also support technology start-ups and fintech. Similarly, as mentioned above, one of the Islamic banks mainly focusing on technology for banking and finance is a positive development, reducing transaction costs for SMEs.

4.4.6. Country-specific Policy Recommendations

Islamic banks provide debt-based financing for SMEs. However, in line with Islamic normative principles, equity-based financing should be taken up so that stakeholding can be developed in society. Considering the crisis period, *qard al-hassan* type of financing should be made available to uphold the Islamic moral imperatives.

In examining Islamic banking financing in terms of sectors, it is evident that most of their financing is devoted to the sectors where SMEs are not present. Those sectors getting higher shares also leads to financialisation. In line with the substantive morality of Islamic finance, real economy-related sectors where SMEs are present should also be prioritised in the financing decisions.

Bringing CSR rationality to paying off the debts of the SMEs is a positive moral imperative. Such good practices should be sustained for a non-crisis period as well.

KNF is a well-designed resource rich institution with an important mandate to contribute to the development of the private sector through SMEs. However, it has only utilised a very small fraction of its resources since its establishment in 2013. As explained, the institutional instability due to unprecedented turnover in its management should be one of the reasons for its shortcomings. Thus, KNF should be provided with a new mandate and strong leadership to effectively and efficiently utilise abundant resources for the development of the private sector through SMEs.

As discussed above, the lack of data on SMEs and their attributes has constrained the government's policy making. Therefore, it is an important that KNF should be tasked with collection and regular updating data on SMEs in all attributes to contribute to efficient policy making.

In order to contribute to the development of the private sector in line with economic diversification objectives, SMEs will play an essential role. For this, CBK and the Government should not consider SMEs only through their riskiness but should appreciate their contribution to value added, job creation and innovation. Hence, the current 3 percent value-added to GDP should not cloud the view of the economic and financial bureaucracy on the importance of SMEs for Kuwait.

In line with this, KNF, in serving its aim of 'changing mindset', should develop programmes to continue to entrepreneurship culture whereby should include the new generation into start-ups, in particular technological start-ups. This will help to overcome the job burden on the public

sector. This is particularly important given the declining oil prices.

Considering that Kuwaiti universities are graduating a large number of new generations of men and women, creating job opportunities in the public sector is not attainable. Hence, developing a road map for the employment of the new generation through SMEs will lessen the burden on the public sector and can also lead to innovation through the technology-oriented nature of youth will create new opportunity spaces for the development of the country.

COVID-19 vividly demonstrated that digitalization will be the central nature of our lives, including business conduct. Therefore, KNF should run training programmes to develop the new generation of SMEs with technological skills. In addition, Islamic banks should enhance their technological capabilities and Fintech for their own operations and also help with their financial conduct with SMEs.

Islamic logic require stakeholding institutionalisation so that Islamic banks should consider the well-being of other individuals and the welfare of the larger society. Hence, they are expected to proactively support SMEs through partnership by using PLS and risk-sharing financing methods. For this, the regulative environment should consider the distinctive nature of Islamic banking and finance rather than imposing conventional logic on Islamic banks. Such a development will pave the way for proactivity in supporting real economy sectors more than now, including the SMEs.

4.5. CASE STUDY: SENEGAL

4.5.1. Economic Structure and the Role of MSMEs

Senegal is one of the best performing economies[21] in sub-Saharan Africa. For several years now, the economy has recorded sustained growth of over 6%. Its long history of social and political stability and its constantly improving business environment make it a safe destination for domestic and foreign investments. In addition, Senegal has implemented reform programs such as the Plan Senegal Emergent (PSE) since 2012[22] for better competitiveness of the economy in key sectors such as agriculture, industry, tourism, transport infrastructure and extractive industries.

The PSE is a unique reference document for economic and social development policies, the vision of which is "Senegal, an emerging country by 2035, with a united society under the rule of law". It is based on three main strategic axes:

(i) Encourage the transformation of the structure of the economy by emphasizing the creation of wealth and employment.

(ii) Promote human capital, expand access to social perfection and preserve the conditions for sustainable development.

(iii) Respond to the requirements of good governance and regional integration.

Senegal is a member of ECOWAS, a regional bloc of 15 countries (around 360 million population) to promote economic integration in different sectors, including transport, energy, industry, agriculture, resources natural and trade. It is also a member of the West African Monetary Union (UEMOA), a regional organization of 8 countries and 112 million population, whose mission is to promote economic integration by strengthening the competitiveness of their economies within the framework of an open and competitive market and a harmonized legal environment. As an important member of such economic blocks, and thanks to its strategic position, Senegal is a point of access to a large market of over 300 million consumers located in Africa, a region with one of the highest growth rates in the world, 6.8 %% in 2016. Senegal also serves as an important gateway to major export markets in Europe, Asia and the Americas. Economic indicators have been improving steadily for several years.

With an average growth rate of over 6% over the past four years, Senegal is the second largest economy in francophone West Africa. As an open economy, the country is a preferred investment destination for several reasons. Senegal is also the beneficiary of several preferential trade agreements with several major economies worldwide, including the European Union, China and the United States.

In March 2020, the real economy (concerning the exchange of real goods and services between businesses and households) came to a halt because of the health containment and lockdown measures due to the pandemic of COVID-19. These have had a disastrous impact on the Senegalese economy, which is mainly based on the informal sector.

[21] *https://www.afdb.org/fr/countries/west-africa/senegal/senegal-economic-outlook*

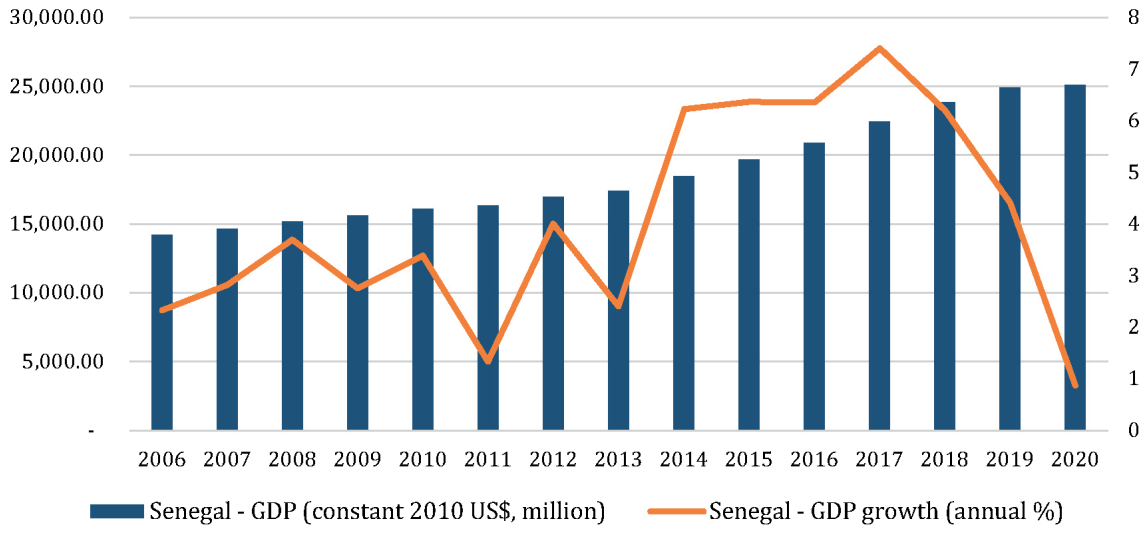
[22] *https://www.sec.gouv.sn/dossiers/plan-sénégal-emergent-pse*

Economic structure

COVID-19 has hit Senegal hard like almost every other world economy, plunging a once growing and stable economy into recession. As shown in Figure 52, After an increase of about 6.4% in 2018 and 4.8% in 2019, economic growth contracted by 0.7% in 2020 due to the closure of Senegalese borders and containment of populations. However, the economic recovery indications have been seen, as Senegal's real GDP rose by 0.9% in the first quarter of 2021 (National Agency for Statistics and Demography, ANDS).

In terms of comparing the impact of two different crises, as can be seen from Figure 52, due to the 2008 Global Financial Crisis, economic growth declined to 2.8% in 2009 from 3.7% in 2008. However, the economy experienced another decline in its economic growth rate in 2011 with 1.3%. However, as shown in Figure 52, the adverse impact of COVID-19 on economic growth has been more than the one led by the 2008 financial crisis.

Figure 52: Trends in Senegal's GDP and Economic Growth



Data Source: IFSB Database

ANDS notes that the Senegalese economy recorded a decline of 0.4% in final consumption compared to the fourth quarter of 2020. Growth is expected to rebound to 5.1% in 2021 and 6.0% in 2022, thanks to the resumption of public investments and the hydrocarbon sector, in parallel with the resumption of global growth. The fall in the growth rate in 2020 is caused by the slowdown in tourism (–17.0%), transport (–8.8%) and trade (–0.6%), as well as a decrease in investments and external demand due to the COVID-19 pandemic 19 (National Agency for Statistics and Demography, ANDS).

Table 28 depicts the composition of the GDP, which indicate the strong contribution of the tertiary sector.

Table 28: The Sources of GDP

Gross Domestic Product/Sector					
% Gross Domestic Product	Primary sector	Secondary sector	Tertiary sector	Public administration services	Taxes on goods and services
2014	13.4%	23.2%	48.5%	5.1%	9.9%
2015	14.3%	23.6%	46.4%	5.1%	10.7%
2016	14.4%	23.3%	46.8%	5.2%	10.3%
2017	15.0%	23.3%	47.0%	5.2%	9.6%
2018	15.0%	24.0%	46.6%	5.5%	8.8%
2019	15.0%	23.1%	45.7%	5.5%	10.7%
2020	17.0%	23.2%	44.3%	5.7%	9.8%
2021 prediction	16.9%	23.9%	43.6%	5.7%	9.9%

Source : ANSD Direction de la prévision et des études économiques

The analysis of GDP by sector in Table 28 shows that over the period 2014 to 2021, the tertiary sector remains the main dominant GDP with an average rate of 45% followed by the secondary sector with an average rate of 23%. Indeed, Senegal is characterized by underdeveloped agriculture and a fragile industry. The economy has moved more to the tertiary sector, having never experienced a significant industrialization phase. However, this trajectory is contrary to the classical stages of development, where a country should first move from an agrarian economy to a phase of intense industrialization before being dominated by the tertiary sector. A more detailed sectoral analysis shows that the growth rate of the primary sector is volatile while those of the secondary and tertiary sectors seem more stable, and the tertiary sector records stronger growth with a high share in the GDP. In Senegal, the primary sector generates less added value than other sectors and employs the majority of the workforce. The tertiary sector holds the highest share as a percentage of GDP and absorbs less labour force. By breaking down the tertiary sector, a predominance of trade appears to represent more than 13% of GDP between 2014 and 2021 and 30% of the tertiary sector and absorbs a large part of the employment. Despite their important role in wealth creation, posts and telecommunications, and real estate activities absorb very little labour.

Inflation increased from 0.9% in 2019 to 1.9% in 2020 due to restrictive measures containing the COVID-19 epidemic and the continued easing of monetary policy. The crisis also affected the budgetary situation in all its aspects. Tax revenues declined, and health spending increased, thus worsening the budget deficit, which increased from 3.7% of GDP on average in 2018 and 2019 to 6.0% in 2020. The decline in external demand has led to a deterioration in the current account deficit, which increased from 7.9% in 2019 to 10.3% of GDP, financed by donors due to the low level of foreign direct investment and the decrease in remittances. Remittances were also strongly affected by the containment measures in Europe as well as by the shutdown of the economy. The immigrants, as the family helpers, constitute many Senegalese households' essential source of monthly income. Before the pandemic, these transfers were estimated at an annual amount of EUR 2 billion (1,200 billion CFA francs or $ 2,159,077,301.38), which contributes to the economy greater than that of agriculture in the national GDP. When the 'African' markets where most of the exchange of goods takes place are closed, as well as transport, one can imagine the impact that this has on the lives of populations whose income, mainly daily, is based on the activities aforementioned.

Faced with this exceptional and unprecedented health crisis that has spared no economy in the world, Senegal has implemented emergency measures to reconnect with a growing economy. Thus, the government has put in place the economic activity recovery plan and has led to the revision of phase II of the Emerging Senegal Plan (PSE), which is the initial basic program for the development of SENGAL. In addition, the Senegalese government has put in place an Adjusted and Accelerated Priority Action Plan (PAP2A) for the period 2021-2023, whose main objective is to stimulate private investment by increasing and supporting the MSMEs, diversify growth engines and strengthen economic resilience to achieve an average growth rate of 8.7% over the period 2021-2023. Furthermore, Senegal has identified in the PAP2A five key sectors to revive its economy, hit hard by the coronavirus (economy contraction of 0.7% in 2020). These targets are 'promoting abundant, quality and resilient intensive agriculture', 'inclusive health', 'an efficient education system', 'development of a strong national private sector', 'strengthening of social protection' and 'industrial and digital transformation'. This program requires overall funding of FCFA 14,712 billion ($ 26.2 billion), of which FCFA 4,770 billion ($ 8.5 billion) comes from the national private sector and the remaining FCFA 9,942 billion ($ 17.7 billion) development partners.

Role of micro and small and medium enterprises in the Senegal economy

MSMEs make up the vast majority of Senegalese businesses (over 90% of businesses in Senegal) and represent a proven economic growth factor and a springboard towards economic emergence. MSMEs today represent the basis of the economic fabric of Senegal, contributing to 40% of the GDP (source General Directorate of Taxes and Domains) and constitute a significant source of unemployment reduction in the country. As in many African countries, they are the engine of growth and a powerful lever for the private sector. Thus, Senegal's economy is strongly dominated by MSMEs, that bring together enterprising, very small, small and medium-sized enterprises.

As regards the contribution of MSMEs, in addition to the economic growth contributions, the following should also be mentioned:

- Contribution to sub-regional economic integration (UEMOA) and their ability to form a subcontracting and partnership network with large companies,
- Participation in social cohesion,
- Positioning of Senegal within the framework of globalization and major axis of orientation and implementation of the objectives pursued by the New Partnership for the Development of Africa (NEPAD),
- Creation of wealth, jobs and workforce training.

The definition, size and distribution of MSMEs in Senegal

In Senegal, any independent natural or legal person, trader or producer of goods and market services, and whose annual turnover excluding tax does not exceed FCFA 2 billion (around USD3,622 million) is considered MSMEs, and the company must be legally declared and must keep regular accounts. The definitions are as follows:

Entrepreneur: any natural person exercising, on an individual basis, a professional, civil, commercial, craft, agricultural or service provider activity, whose annual turnover excluding tax does not exceed:

- FCFA 30,000,000 or $ 54,344 for commercial activities,
- FCFA 20,000,000 or $ 36,200 for craft and related activities; FCFA 10,000,000 for the provision of services, ie $ 18,000.

Very Small Enterprise (TPE): Any person other than a physical or legal entrepreneur, exercising a professional, civil, commercial, craft, agricultural, industrial or service provider activity, whose annual turnover declared net of tax is less than or equal to FCFA100,000,000 or USD180,000. The Very Small Company maintains, at least, a lean accounting system.

Small Business (PE): Any natural or legal person exercising a professional, civil, commercial, craft, agricultural, industrial or service provider activity, whose annual turnover excluding tax is greater than FCFA100,000,000 (USD180,000) and less than or equal to FCFA500,000,000 ($900,000). It keeps accounts either internally or by a Chartered Accountant or by a Chartered Management Center (CGA) or any other similar accredited structure.

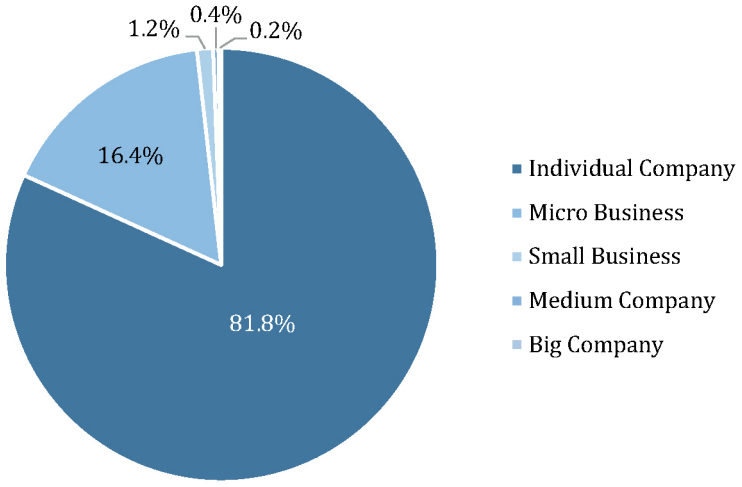
Medium Enterprise (ME): Any natural or legal person exercising a professional, civil, commercial, craft, agricultural, industrial or service provider activity, whose annual turnover excluding tax is greater than FCFA500,000,000 (USD900,000) and less than or equal to FCFA2,000,000,000 ($3,600,000). It keeps accounts according to the standard system and certified by an approved Chartered Accountant.

Table 29: Economic Definition of MSMEs in Senegal

Turnover	**Micro**	**Small Business**	**Medium Enterprise**
	180.000 $	180.000$->900.000 $	900.000$->3.600.000$
Activities	Professional, Civil, Commercial, Craft, Agricultural, Industrial or Service Provider		

The distribution of Senegalese companies in Figure 53 reveals in 2016 a strong predominance of entrepreneurs (81.8%). Next, come very small businesses (16.4%), small businesses (1.2%) and medium-sized businesses (0.4%). Finally, large companies only represent 0.2% (Recensement General des Entreprises or RGE, 2016).

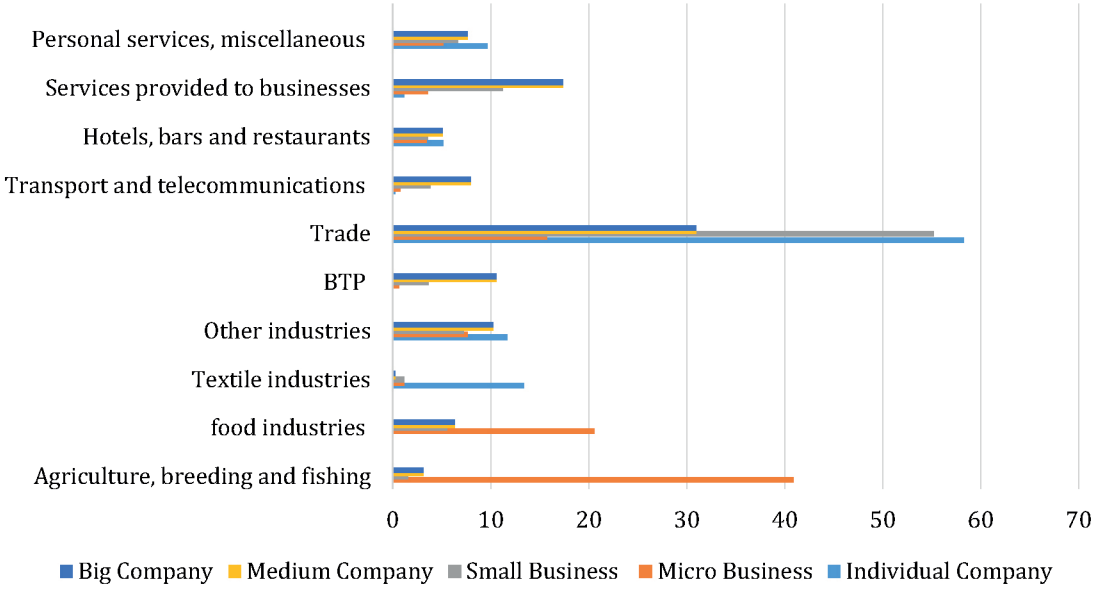
Figure 53: Distribution of MSMEs in Senegal



Source : ANSD/RGE 2016

Figure 54 depicts the distribution of MSMEs according to the sectors in 2016.

Figure 54: Distribution of Companies by Sector



Source : ANSD/RGE (2016)

The distribution of MSMEs by sector reveals that, in all categories, trade is the most represented. It dominates among entrepreneurs (58.3%) and covers more than half of Small and medium-sized enterprises. After the trade, agriculture is very representative in micro-business.

Table 30: Distribution of Companies by County

Industry	Individual Company	Micro Business	Small Business	Medium Company
Dakar	41,2	28	66,3	88,3
Ziguinchor	3,9	3,3	1,7	1,2
Diourbel	10,2	5,5	8,9	0,7
Saint-Louis	4,8	5,3	4,1	1,8
Tambacounda	4,6	5,4	1,2	0
Kaolack	6,3	5	3,1	1,3
Thiès	12,1	7,9	9,4	5,1
Louga	3,6	2,6	1,4	0,8
Fatick	2,4	2,1	0,7	0,2
Kolda	3,7	12,7	0,6	0
Matam	2,2	1,3	1	0,4
Kaffrine	2,5	3,1	0,8	0,1
Kédougou	1,1	0,9	0,2	0,1
Sédhiou	1,4	17,2	0,5	0
Total	100	100	100	100

Source : ANSD/RGE 2016

As depicted in Table 30, among the regions, Dakar (the capital city) and Thies are the most represented for all categories of businesses.

Financial challenges faced by MSMEs in Senegal

Despite the importance of the role of MSMEs in the Senegal economy, significant constraints hamper their development, particularly the difficulty of access to traditional bank credit for micro-small and medium-sized enterprises, as they are not always able to meet the eligibility criteria. Furthermore, considering the supply side, a weak microfinance supply is another critical barrier in the country.

These financial constraints led the Government of Senegal to take specific regulatory and legislative policy measures to support the development of MSMEs, namely, among others, the creation of MSME financing instruments: FONGIP (Priority Investment Guarantee Fund), FONSIS (Sovereign Fund for Strategic Investments), BNDE (National Bank for Economic Development) and National Program for the Promotion of Islamic Microfinance in Senegal (PROMISE). It should be noted that PROMISE is funded by the Islamic Development Bank, which should be considered as an important contribution to MSMEs development in developing countries.

FONGIP and FONSIS are financing instruments intended for priority public investments, while BNDE and PROMISE are open to any type of investment by MSMEs.

FONGIP has three missions:

- Guarantee bank loans to finance growth-promoting projects in priority sectors;
- Refinance microfinance institutions to enable them to grant loans to Micro Small and Medium Enterprises (MSMEs), women's and youth groups at subsidized interest rates;
- Set up a permanent support and monitoring system for project leaders throughout the territory.

The mission of FONSIS is to promote the role of the State of Senegal, as an investor, partner and complement of the private sector, with the aim of supporting direct investments to accelerate the economic and social development of the country by creating wealth and jobs for present and future generations.

BNDE and PROMISE contribute to the creation and development of Senegalese companies by offering them diversified and adapted products and services, with particular attention to all small and medium-sized enterprises.

The insufficiency of programs and projects related to the development of MSMEs with high potential for accelerating growth and strengthening the competitiveness of the Senegalese economy has prompted the Senegalese government to create institutions such as ADEPME (MSME development and supervision agency), which is a facilitator between the Senegalese State and MSMEs. ADEPME is the state's operational arm for promoting MSMEs by densifying the industrial fabric and strengthening the competitiveness of companies.

As a result of COVID-19 impact, MSMEs' contribution to wealth creation has declined. They now concentrate around 30% of jobs, 25% of turnover and 20% of national added value. To cope with the decrease in the growth rate, the government of Senegal has put in place solutions to support MSMEs. However, the COVID-19 impact has demonstrated that MSMEs need targeted support to

build resilience, formalize and contribute to the local economy.

It should be noted that the informal status of most MSMEs has also made it difficult for them to get support from the government to meet their short-term liquidity needs.

Mr Amine Lo, Senegal National director of the Central Bank of West African States (BCEAO) confirmed that "the measures taken by his regulatory body to instruct local banks including Islamic banks to extend payment delays for customers and restructure loans for them to cope with the COVID 19 crisis".

4.5.2. The Trajectory of Islamic Finance: Institutionalization, Legal and Regulatory Framework, and Financial Standing

The introduction of Islamic finance in Africa, especially in the UEMOA zone, began with an initiative of the Saudi financial group Dar Al Maal Al Islami, which, in the 1980s, signed agreements with the governments of the countries of the Sub-Saharan region for the opening of Islamic banks. This initiative paved the way for the establishment of the Banque Massraf Fayçal Al Islami of Senegal (MFIS) on 22 February 1983 (current Islamic Bank of Senegal), the Islamic Investment Company of Senegal (SIIS) on 9 March 1983, the Banque Massraf Fayçal Al Islami (MFIN) of Niger on 22 February 1983, the Islamic Investment Company of Niger (SIIN) on 9 March 1983.

Thanks to the African Institute of Islamic Finance (AIIF) chaired by Mouhamadou Lamine Mbacke, Senegal organized the 6th edition of the International Islamic Finance Forum West Africa on 7th June 2021 to position Senegal as a regional hub for Islamic finance in West Africa. Since 2010, AIIF has been co-organizing this event in cooperation with the Islamic Development Bank (IsDB) and the Government of Senegal. In 2021, the theme of the forum was 'Malaysia-West Africa: Building the Bridge of the Islamic Economy', which aimed at conveying the experience of Malaysia, which is a global hub in the field of Islamic finance, to West Africa to benefit from the best advantages offered by the Islamic economy as demonstrated by the Malaysian model.

After the 1st Islamic Finance Forum in 2010, Senegal's government has been promoting the development of an ecosystem conducive to Islamic finance. However, after taking into account the taxation of Islamic finance products (*murabahah* double taxation) in the tax reform of January 2013, the challenge of setting up the regulatory framework was taken up by the country's monetary authorities.

In this effort to promote the instruments of Islamic solidarity, the Government has also adopted a legal framework for the development of *waqf* institutions, which is a powerful Islamic economics institution for promoting a sustainable solidarity economy. This legal framework should host the first *waqf* intended for the modernization of Daaras (Quranic school) with the support of the IsDB.

In addition, as part of the diversification of its financing instruments, Senegal issued the first sovereign *sukuk* on the regional financial market worth FCFA 100 billion in 2014, which was a success and an innovative approach in the sub-region to the point of receiving the first African Prize of the Islamic Finance Awards. The second issuance of FCFA150 billion was made in 2016.

Islamic microfinance has not remained on the sidelines of this whole process with this important project to create an Islamic microfinance institution with a capital of FCFA5 billion in partnership

with the IsDB and local partners. In addition, with the support of the IsDB, Senegal has set up PROMISE with a financing line of FCFA 47 billion to provide Islamic finance based financing for the MSEMs.

In Senegal, even if there is an increasingly growing interest, Islamic finance remains at the embryonic stage in a country where the banking sector is growing with a total balance sheet of FCFA7,609.3 billion or USD13.7 billion in 2019 (BCEAO Annual Report)

Institutionalization

The efforts and resources deployed by the IsDB through its branch (Islamic Company for the Development of the Private Sector (ICD)) in support of the banking sector are bearing fruit for Senegal. To date, almost all the institutions present in Senegal have support from the IsDB.

Islamic finance institutions can be divided into there categories in Senegal: banks, insurance and microfinance

Islamic banks

Until 3 June 2019, the banking sector had twenty-nine (29) approved credit institutions and two financial holding companies, including three already operational (the Islamic Bank of Senegal and the Islamic branch of Coris Bank International of Senegal CBI Baraka called CBI Baraka, two pending approvals from BSIC(Sahelo-Saharan Bank for Investment and Trade) and the Islamic branch of BNDE (National Bank for Economic Development).

It should be noted that BIS is Senegal's first fully Islamic bank, which is a public limited company whose shareholders are as follows: Dar Al Maal Al Islami (DMI) 44.5%, the Islamic Development Bank (IsDB) 33.26%, the State of Senegal 22.18%, other shareholders (individuals) 0.06%. (Yabré, 2007)

BIS, apart from *mudarabah*, only offers products with cost plus margin. It does not offer the *musharakah* product, which is essentialised by Islamic economic philosophy in furthering PLS based economy. Nor does it offer *arbun* (or interest-free loan), which reflects the specificity of Islamic finance as well *as-salam* sales or hire-purchase.

These products should allow BIS to diversify its clientele better and have partnerships with small and medium-sized enterprises (SMEs) and small and medium-sized industries (SMIs) such as the *musharakah*.

The *murabahah* product is the most used at the BIS, which is explained by its commercial. Through murabaha, the BIS offers its clients a financing product which, while respecting their principles, allows MSMEs to finance both their operational needs (stocks, materials, intermediate products) and their investment. Among the risks facing the bank, it is the credit risk that is the most important. This is understandable because the main risk encountered by the *murabahah* product is the credit risk. To deal with this credit risk, BIS uses the following techniques: internal rating, financial analysis, assessment of pessimistic scenarios, choice of risk coverage tools (guarantees, etc.), monitoring of commitments, pre-litigation and litigation management.

Regarding the share of Islamic banking, as can be seen in Table 31, The share of the Islamic Bank of Senegal in the banking market in Senegal is on average 1.4%. Thus, the weight of the BIS

remains very low compared to the share of conventional banks. In 2021 due to a capital increase, the market share of BIS may be evaluated around 5% as they have become the third largest bank in Senegal in assets.

Table 31: Share of Islamic Banks in Senegal (in million FCFA)

	2017	2018	2019
Balance Sheet of Banks in Senegal	XOF 5,912,745 ($10 578)	XOF 6,428,658 ($11 500)	XOF 6,870,721 ($10 474)
Balance Sheet Islamic Bank of Senegal (BIS)	XOF 94,522 ($169)	XOF 92,275 ($165)	XOF 99,645 ($144)
Share of BIS	1.60%	1.44%	1.45%

Data Source : https://www.bceao.int/fr/publications/bilans-et-comptes-de-resultats-des-banques-et-etablissements-financiers-de-lumoa-2019

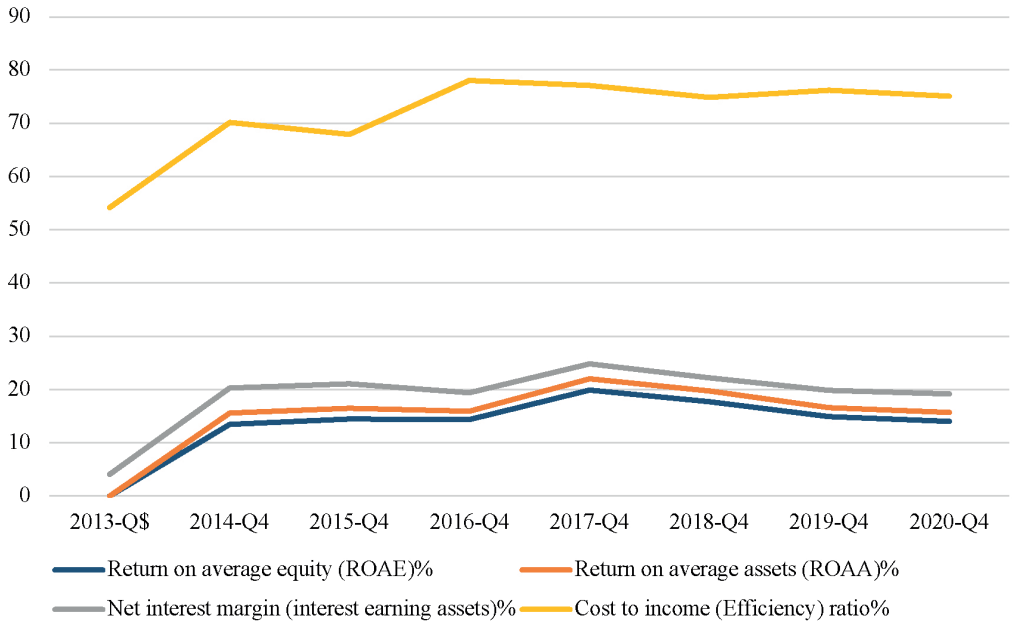
As regards to the performance of Islamic banking, Table 32 and Figure 55,

Table 32: Performance of Islamic Banking

Item	2013-Q4	2014-Q4	2015-Q4	2016-Q4	2017-Q4	2018-Q4	2019-Q4	2020-Q4
Return on average equity (ROAE)%	n.a.	13.51	14.53	14.35	19.91	17.77	14.95	14.03
Return on average assets (ROAA)%	n.a.	2.08	1.97	1.63	2.12	1.94	1.70	1.64
Net interest margin (interest earning assets)%	4.09	4.74	4.57	3.40	2.81	2.52	3.25	3.58
Cost to income (Efficiency) ratio%	50.12	49.83	46.88	58.69	52.31	52.68	56.30	55.91
Total capital adequacy ratio (as reported)%	n.a.	17.83	n.a.	n.a.	n.a.	n.a.	17.13	n.a.
Total assets (m XOF)	138,585	167,314	214,265	285,684	315,392	363,243	369,275	437,666

Data Source: IFSB Database

Figure 55: Performance of Islamic Banking



Data Source: IFSB Database

As can be seen in Figure 55 and Table 32, the performance of Islamic banking has been stable but in all the measures a slight decreasing trend is observed. This decreasing trend seems to have continued in 2020 which is the COVID-19's first year. As can be seen movements in the indicators follow the same pattern. A very close movement with similar level in ROAE and ROAA is particularly important note.

Islamic microfinance

The only fully-fledged Islamic microfinance approved institution in 2021 so far is TAYSIR FINANCE initiated by the African Institute of Islamic Finance (AIIF) of Mouhamadou Lamine Mbacke and other local stakeholders.

Senegal has set up with the support of the Islamic Development Bank (IsDB) a range of projects to promote Islamic finance, in particular Islamic microfinance, at the service of the poor population.

By way of illustration, the State of Senegal has established, through the Ministry of Women, Family and Gender, the Support Project for the Development of Female Entrepreneurship and Youth Employment (PADEF-EJ). The primary mission of this project is to enable women and young project leaders to have the possibility of accessing financing to develop income-generating activities, with a line of financing in the amount of FCFA 4 billion supported by the IsDB.

Alongside this project, the Literacy and Skills Training Program for the fight against poverty (PALAM / BID / SEN) should be mentioned. This program is, in fact, based on the promotion of endogenous know-how, through equitable access for rural youth and working women, to skills training programs and Islamic microfinance promoting self-development.

The Livestock Development Project in Eastern Senegal and Haute Casamance (PDESOC). The project to create an Islamic Microfinance Limited Company (Bouchra SA), led by UM-PAMECAS, the State of Senegal and private partners such as the ISDB should also be mentioned.

In addition, to consolidate its programs and have a framework favourable to the development of Islamic microfinance, a framework agreement was signed between the State of Senegal and the IsDB, establishing the National Development Program of Islamic microfinance in Senegal (PROMISE).

Like the other programs, the PROMISE is in perfect compliance with specific orientations of the Emerging Senegal Plan (PSE) 2, particularly the promotion of Islamic finance, which has so far been underexploited, the expansion of financial inclusion for the benefit of the poor, and support and financing of MSMEs. To this end, the program's main objective is to contribute to the socio-economic development of Senegal through the financial inclusion of MSMEs. The financial inclusion in favour of MSMEs would lead to more jobs and social advancement of vulnerable groups. According to the expected results, 50,000 micro-entrepreneurs could benefit from the financing that could be expended by PROMISE, which would create 25,000 new jobs by 2022 (PROMISE, 2018). This innovative mechanism is in line with the principles of *Shari'ah* and constitutes an attractive source of financing for populations and businesses on the fringes of the traditional financial sector.

Islamic insurance

There are currently only two Islamic insurance structures in Senegal: Sen Assurance Vie in Senegal, which in collaboration with the Islamic window of Um Pamecas, has set up Sentakaful, a counter entirely dedicated to *takaful* and the Islamic insurance branch of Salama Assurance.

Legal and regulatory framework

Senegal and Niger are the only countries of UEMOA (West Africa) which have revised their fiscal framework to take into account the specificities of Islamic finance. This constitutes a significant and positive development for Islamic banks in terms of competitiveness since their products have a higher cost.

In its framework law on banking regulations, the Central Bank of West Africa (BCEAO) places Islamic banks under the same supervision and regulatory regime as conventional banks while allowing UEMOA member states to grant them exemptions. In addition, it has started to put in place a regulatory framework intended specifically for credit institutions carrying out an Islamic finance activity through its instructions n ° 002-03-2018 and n ° 004-05-2018.

The BCEAO has made it possible to adapt tax laws and regulations at the national level to ensure that they do not penalize Islamic finance products compared to traditional financial products (double taxation). Likewise, the limitation of the duration of the right of usufruct granted to legal persons provided for by the applicable civil law is not always adapted to Islamic financial instruments, and the formalities of transfer of ownership of the underlying asset to the client is not systematized yet.

Finally, the principles of immunity from jurisdiction and execution as they apply to most African states can discourage investors in Islamic finance in the context of the issuance of corporate *sukuk*, as long as they do so.

Financial situation

The Islamic Development Bank remains the leading donor in Islamic finance in Senegal. From 1976 to the present day, the Islamic Development Bank (IsDB) has invested more than USD 3.7 trillion. Senegal has the privilege of being among the first beneficiaries of IsDB interventions, thus allowing it to benefit from all of its traditional and innovative intervention instruments.

The IsDB finances Senegal in health, hydraulics, sanitation, employment, energy, roads and agriculture sectors. In addition, Senegal was able to raise around EUR452 million thanks to the issuance of *sukuk* following resolutions at the 1st international forum on Islamic finance in Dakar organized by the African Institute on Islamic Finance (AIIF).

4.5.3. Islamic Financing Provisions for MSMEs: Institutions, Products, and Offerings

Faced with the virtual absence of financing for MSMEs by the traditional banking system, MSMEs resort to financing by Senegalese Islamic banks (BIS and Coris Bank Baraka), especially by financing programs set up Islamic microfinance (PROMISE, PAMECAS).

The financing methods of Islamic banking structures derive from the fact that they (BIS and Coris Bank Baraka) adopt support-based loan contracts. Likewise, they encourage risk-sharing to promote the enterprise's spirit, discourage speculative behaviour, and highlight the obligatory dimensions of contractual terms (for example, contracts, such as *musharakah*, *mudarabah*, *murabahah*, *istisna, salam,* etc.).

Table 33: Islamic Finance Products and Offerings

Institutions	Products	Offering
Banque Islamique du Sénégal	*Murabahah*, *Istisna*, *Ijarah*, *Mudarabah*	BIS and Coris Bank Baraka support MSMEs on different types of needs by offering them tailored Islamic products by intervening either: on risk capital, on investment, on operations, on cash
CORIS BANK BARAKA	*Murabahah, Istisna*, *Ijara, Mudarabah Musharakah, Qard al-Hassan*	
PROMISE	*Mudarabah*, *Ijarah, Musharakah*, *Qard al-Hassan*, *Salam, Murabahah*	Apart from the products offered, MSMEs do not have the possibility of having a current account at the PROMISE level.
PAMECAS	*Murabahah* (goods, equipment, real estate)	Unlike other Islamic financial institutions, Pamecas only offers *Murabahah* in goods, equipment and real estate. Therefore, their offer is very limited for MSMEs.

The complementary relationships between Islamic banks and microfinance institutions (MFIs) can also be crucial to meet the credit needs of MSMEs. For example, in Senegal, the difficulties encountered by MSMEs hamper their chance to obtain loans from banking and microfinance institutions. Currently, in the financing policy of Senegalese MSMEs, it is popular that microfinance institutions are faced with insufficient long-term resources to meet the financing demand of the majority of MSMEs. It emerges from this situation that second-tier banks, such as Ecobank, the Islamic Bank of Senegal (BIS), are intensely active in offering financing products intended for MSMEs to share this market niche with MFIs.

4.5.4. COVID-19 Conditions and Islamic Financing Responses for MSMEs

Mr. Ndiade, the Head of BIS Almadie branch in Dakar, stated that "COVID-19 delayed due loan payments as customers faced inability to meet their payment. To do this, the BCEAO had imposed on banking players to extend maturity periods to allow customers to repay their debt. He also said that they had to restructure many Islamic loans for customers to allow them to survive the crisis. Nonetheless, since a few months ago, according to the BIS manager, most of the customers were able to get back on track after these supports".

To better support, Senegal in the face of declining economic growth, the International Islamic Trade Finance Corporation (ITFC), a member of the Islamic Development Bank Group (IsDB), approved *murabahah* financing of EUR 8 million for the benefit of the Islamic Bank of Senegal (BIS) and aimed at supporting trade finance operations of the Senegalese private sector, in particular MSMEs. In Senegal, more than 407,000 MSMEs and micro-enterprises represent 90% of enterprises that will benefit from this financing.

The *murabahah* facility is expected to support around 1,000 jobs in the private sector, especially in the food and distribution sectors. In addition, the finance will contribute to intra-OIC trade, in line with ITFC's mandate in trade finance and development. To face the current crisis, the government of Senegal has put in place a major plan that includes medical and social measures. The rapid disbursement of these funds by ITFC has enabled local private companies to procure urgent staple foods and support the national effort to achieve food security.

The IsDB has also provided funding of FCFA 47 billion, or USD 85 million, aimed at helping young people and women entrepreneurs to invest in trade, agriculture, etc.

The promise is intended for young people, women and MSMEs, especially in rural areas, which the Senegalese government, in collaboration with the Islamic Development Bank (IsDB), has put on the baptismal font the national program for the development of Islamic microfinance in Senegal. This program is spread over five years. It aims to create a genuine sustainable Islamic microfinance industry in Senegal, a growth lever for the various economic actors. The government of Senegal intends to put in place a legal framework favourable to Islamic microfinance, to strengthen the capacities of participating microfinance institutions and targeted beneficiaries, to improve the quality of the offer of Islamic financial services and to develop channels of distribution in a sustainable way to meet national demand, to strengthen the structuring of demand for Islamic microfinance.

Another EUR12 million *Shari'ah* compliant funding agreement to support Senegalese MSMEs affected by the COVID-19 outbreak has been signed by the Islamic Corporation for the Development of the Private Sector (ICD), part of the Islamic Development Bank Group (IsDB), and the National Bank for Economic Development (BNDE) Senegal.

It should be noted that the IsDB, through its various Islamic financing facilities, remains one of the main actors for the revival of the Senegalese and West African economies.

4.5.5. Best Practices: Lessons Learned

The government of Senegal has taken important steps to improve the country's business environment in responding to the adverse impact of the pandemic.

Senegal is a land of opportunities where the business environment is favourable and constantly improving. With higher number of people included in the banking system and better evolution of Islamic microfinance while expanding training offers in Islamic finance, Senegal could be part of the global Islamic hub.

The evolution of the Islamic microfinance sector will make it possible to broaden the range of financial services to achieve a more inclusive financial intermediation system serving those excluded from the conventional banking system to give them a chance to participate in wealth creation. According to this principle, Islamic microfinance will be able to offer low-income segments of the population and microentrepreneurs opportunities to exercise productive activities and expand their activities through regular access to Islamic finance products.

According to recent data, the Senegalese microfinance sector has an overall loan portfolio and a total volume of deposits of FCFA 333 billion (USD 595 million) and FCFA 300 billion (USD540 million), respectively, for a clientele of 2,710 263 including 1,087,457 women, 1,418,949 men and 250,637 Legal Persons (DRS-SFD, 2017). These performances are considerable to make it possible to admit that microfinance structures constitute real effective instruments of poverty reduction.

Although many poor have seen their living conditions improved in recent decades, thanks to the products and services offered by conventional MFIs, the high interest rates due to the cost structure associated with the low amounts of loans and guarantees have been criticized by the clients. Islamic microfinance offers a range of products aimed at preventing events that may constitute a threat or risk observed in advance and according to terms and conditions defined in advance.

The IsDB PROMISE program of FCFA 47 billion (over USD80 million), in its inception phase, is expected to impact strongly and positively the MSMEs touched by the COVID-19. The start of operations of Taysir Finance, the first fully-fledged Islamic microfinance institution approved by the Central Bank of West African States (BCEAO) in the ECOWAS (West African Monetary Union of Eight countries), is expected to play a crucial role in poverty alleviation for MSME.

4.5.6. Country-specific Policy Recommendations

Positioned as a hub for Islamic finance in West Africa, Senegal has benefited in all areas of Islamic finance from IsDB's support. With COVID-19's colossal impact on MSMEs, where they account for 40% of businesses, Islamic finance is a strong tool in jumpstarting the impacted MSMEs for recovery in Senegal.

However, despite IsDB's strong support to boost that industry, BIS remains the only fully fledge bank of Senegal, and hence it is challenging for BIS to be able to respond to the increased liquidity needs of MSMEs. Despite the government's national support programs through banking loans, MSMEs are expected to fully benefit from the IsDB initiated PROMISE microfinance program to assist MSMEs through mudaraba facilities to survive and thrive.

The lack of Islamic finance product offering organizations for MSMEs beyond BIS and Islamic windows of some institutions (most of them in the course of being approved by the Central bank of Senegal) is a major hindering factor considering the strong demand for Islamic products from the population (bottom-up) and from the strong need of *musharakah* Islamic investments products from infrastructure financing to MSMEs' growth needs (top-down).

Recommendations, therefore, would be to encourage and strengthen the development of Islamic finance product offerings such as Taysir Finance newly approved fully Islamic microfinance institution, accelerate from the Central Bank the approval process and also push for the establishment of new Islamic banks, *takaful* institutions, waqf, and *zakat* fund and Islamic financing institutions. With bottom-up to and top-down strategies, considerable demand for Islamic finance products by MSMEs, more and better diversified Islamic finance product offerings on the market will undoubtedly help for MSMEs impacted by COVID-19.

4.6. CASE STUDY: RUSSIA

Russian Federation has the largest Muslim population in Europe. Muslims are mainly residing in its autonomous or semi-autonomous regions and states within the Federation. The official number of the Muslim population in the country is uncertain, and several estimates range from 15 million to 35 million, which constitutes %15-30 of all populations (Aleshin & Radchenko, 2018). With the increasing trend, the Grand Mufti of Russia Ravil Gainutdin, quoting from the experts, said that the Muslim population would be 30% of the total Russian population within 15 years (The Moscow Times, 2019). Although the official picture is not available, it can be said that Muslims are a significant part of Russia, and this trend will remain and even accelerate.

Beyond the main Russian cities where Muslims reside, there are eight recognized Muslim majority republics: Tatarstan, Bashkortostan, Chechnya, Ingushetia, Dagestan, Kabardino-Balkaria, and Karachay-Cherkessia. These republics are classified under the Volga Federal Region (Tatarstan, Bashkortostan), the North Caucasian Federal Region (Chechnya, Ingushetia, Dagestan, Kabardino-Balkaria, Karachay-Cherkessia), and Southern Federal Region (Adygeya) according to the administration of Russia (see Figure 56). Moreover, significant Muslim minorities live in Moscow, Saint Petersburg, Orenburg, Ulyanovsk, and Yekaterinburg cities (Cura, 2019; M. Hajjar & Habib, 2019).

Figure 56: Muslim Majority Republics in Russia Federation

Source: Authors (map was created by using mapchart.net).

Apart from the Muslim population, Russia has developed a close relationship with the Muslim world. President Putin declared this interest in his speech at the 10th OIC Summit in Malaysia in 2002 by stating that "Russia's participation will not only add to the rich spectrum of the

Organisation, it will also bring new possibilities to its work, and add the weight and voice of the large Russian Muslim community. A community which no longer separates itself from the international community of Muslims, and which is prepared for productive involvement in its spiritual, cultural and political life." (Kremlin, 2003). Consequently, Russia became the fifth observer state in OIC in 2005 with Bosnia and Herzegovina (1994), Central African Republic (1996), Kingdom of Thailand (1998), and Turkish Cypriot State (1979) (OIC, 2021).

The number of Muslim population and intention of Russia towards economic cooperations especially with Gulf countries makes Islamic finance important. Therefore Russia is selected as a non-OIC member case study for the report.

4.6.1. Economic Structure and the Role of MSMEs

SMEs are defined in Russia under three types: micro, small and medium. Two criteria as similar to in line with the international practices are used to classify the SMEs: the number of employees and the firm's total revenue. According to the law, the firms with lower than 251 staff and 2 billion RUB revenue are classified as SMEs (see Table 34). The individual enterprises are also reported separately, but they are included in the overall SMEs figures.

Table 34: Definition of SMEs in the Russian Federation

Type	Employees	Revenue (RUB million)
Micro	Up to 15	Up to 120
Small	16-100	Up to 800
Medium	101-250	Up to 2000

Source: OECD (2020)

The Federal Tax Service of Russia Federation updates the figures for SMEs monthly. According to the latest update on 10 August 2021, the total number of SMEs, including individual enterprises, is around 5.6 million in Russia. These firms create 14,646,503 employment and provide 8,627 different services and products. Individual entrepreneurs constitute 59.8% of SMEs, followed by the micro-segment with 36.5%. The small enterprises (16-100 employees) and medium-sized firms (1001-250 employees) have 3.3% and 0.3% share in the total SMEs in Russian Federation, respectively (Table 35).

Table 35: Distribution of SMEs in the Russian Federation based on Firm Size (employees) as of 10 August 2021

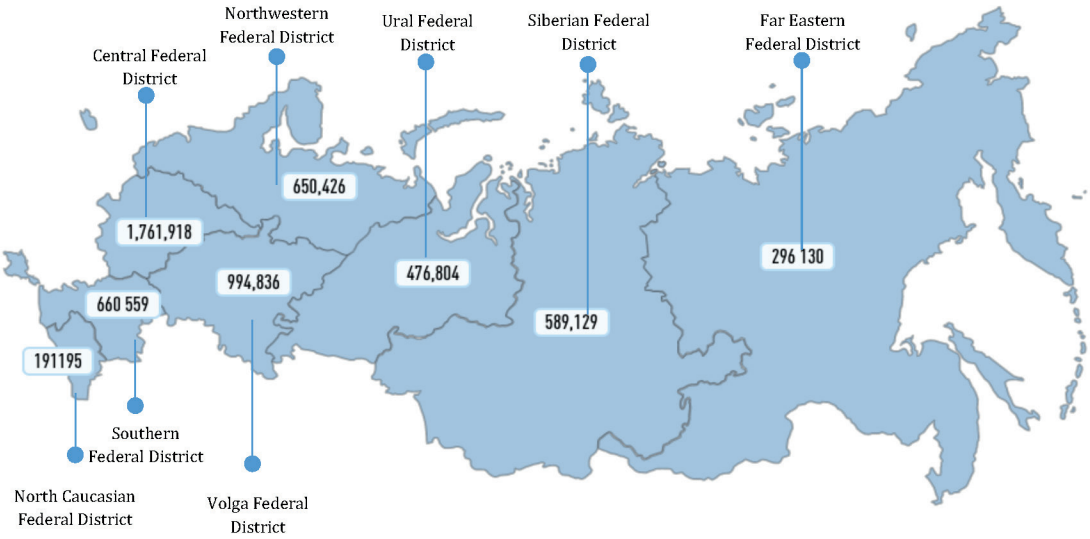
SMEs (up to 250)	# of firm	Share
Individual entrepreneurs	3,363,164	59.8%
Micro (up to 15)	2,053,528	36.5%
Small (16-100)	186,772	3.3%
Medium (101-250)	17,533	0.3%
Total	5,620,997	100.0%

Source: Compiled from the Federal Tax Service, https://ofd.nalog.ru/statistics.html, accessed on 11 August 2021.

Russia consists of eight different districts: Central Federal District, Volga Federal District, Southern Federal District, Northwestern Federal District, Siberian Federal District, Ural Federal

District, Far Eastern Federal District, and North Caucasian Federal District. Under eight districts, there are 85 federal subjects, including two internationally not recognized territories, Sevastopol and the Republic of Crimea. The Russian Federation includes these two subjects in their statistics under the Southern Federal District (Figure 57).

Figure 57: Distribution of SMEs in Eight Region of Russia as of 10 August 2021



Source: Federal Tax Service database, https://ofd.nalog.ru/statistics.html, accessed on 11 August 2021.

The Central Federal Region hosts 31% of all SMEs in the Russian Federation. Moscow city is the main contributor in this region, with 728,765 SMEs. Volga Federal Region, which includes the Tatarstan Republic, is the second-largest region having 994,836 SMEs. There are 660,559 SMEs in the Southern Federal District, which consists of the second largest city of Russia with around 5 million population, Saint Petersburg, the region's significant number of individual enterprises, i.e., 484,043. The region has a 14% share in total individual enterprises in overall Russia compared to its %8 shares in micro, small and medium enterprises (Table 36). The rest of the regions except the North Caucasian Federal District, where although the population density is high, the number of SMEs is very low (comprises 3% of all SMEs), have the lowest shares in all types of SMEs segments across the country.

Table 36: Micro, Small and Medium Enterprises Including Individual Enterprises by Regions

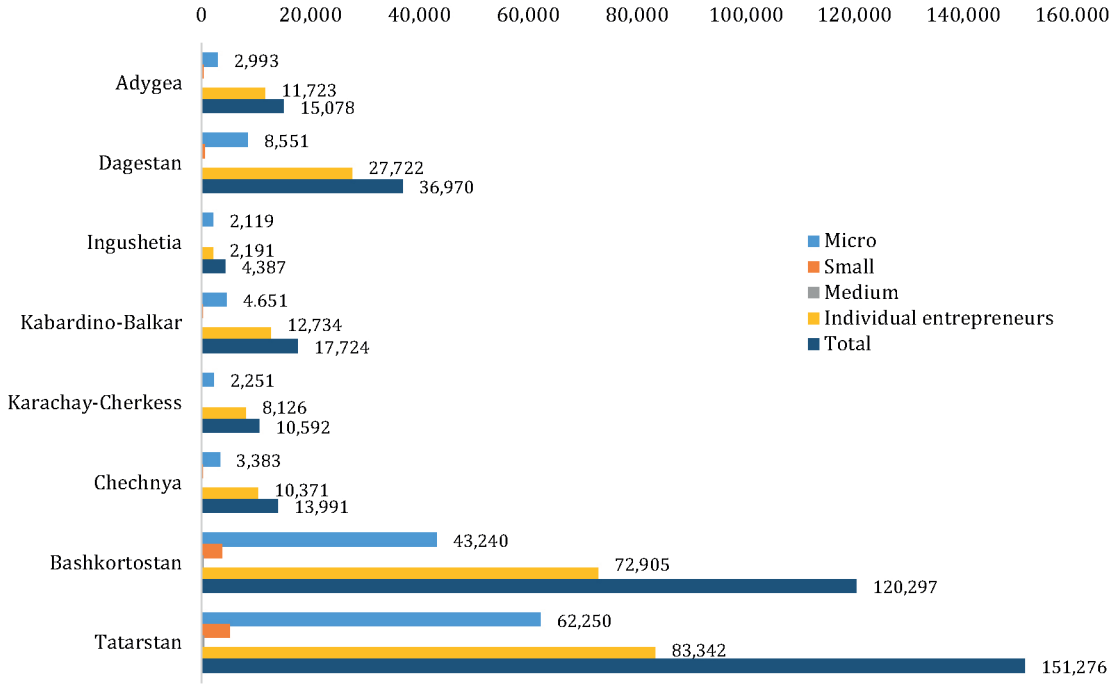
	Total	Legal Entities				Individual entrepreneurs
		Micro	Small	Medium	Total	
The Russian Federation	5,620,997	2,053,528	186,772	17,533	2,257,833	3,363,164
Central Federal District	1,761,918	702,005	66,743	6,807	775,555	986,363
	31%	34%	36%	39%	34%	29%

Volga Federal District	994,836	364,341	34,261	3,111	401,713	593,123
	18%	18%	18%	18%	18%	18%
Southern Federal District	660,559	160,449	14,665	1,402	176,516	484,043
	12%	8%	8%	8%	8%	14%
Northwestern Federal District	650,426	272,379	24,442	2,164	298,985	351,441
	12%	13%	13%	12%	13%	10%
Siberian Federal District	589,129	223,452	18,936	1,609	243,997	345,132
	10%	11%	10%	9%	11%	10%
Ural Federal District	476,804	179,794	15,305	1,392	196,491	280,313
	8%	9%	8%	8%	9%	8%
Far Eastern Federal District	296,130	106,365	8,579	639	115,583	180,547
	5%	5%	5%	4%	5%	5%
North Caucasian Federal District	191,195	44,743	3,841	409	48,993	142,202
	3%	2%	2%	2%	2%	4%

Source: Calculation of authors from Federal Tax Service database.

There is a heterogeneous distribution across Russia in terms of the number of SMEs. While some regions include companies from economically different sectors, some regions have a small number of SMEs. A similar situation is observed in the federal republics, where Muslims live in the majority (Figure 58). In the Volga Federal Region, which ranks second in terms of the total number of SMEs, there are two Muslim-majority republics: Tatarstan and Bashkortostan. Tatarstan is home to approximately 150 thousand SMEs. More than half of them are individual enterprises. Kazan, which is among the top crowded city of Russia and the capital of Tatarstan, has a significant contribution to the figure. In Bashkortostan, another republic in the Volga Federal Region, there are around 120,000 SMEs. More than half of them are, as similar to Tatarstan, individual entrepreneurs. The North Caucasian Federal District, which has the lowest share in Russia regarding SMEs, includes the remaining republics, excluding the Republic of Adygea. Chechnya and Dagestan are the Muslim majority republics with the highest number of SMEs. However, the number of SMEs is relatively low. There are 15,078 SMEs in the Republic of Adygea, which is located in the Southern Federal Region. On the other hand, as shown in the Figure 58, individual entrepreneurs and micro-enterprises constitute the majority of the SME segments in all mentioned republics. The number of small and medium-sized companies is very small.

Figure 58: Distribution of SMEs in Muslim Majority Federations (as of 10 August 2021)



Source: Calculation of authors from Federal Tax Service database.

Reaching financing is very important for SMEs to continue economic activities and to develop operations. According to the (OECD 2020)'s figures, the SME share in the total outstanding business loans has had a decreasing trend since 2014, and it was 13.08% in 2018. The non-performing loan ratio (NPL) for SME credits increased significantly from 7.71% to 13.64% in 2015. This deterioration in asset quality continued until 2018. In 2018, however, there was a slight recovery, and the NPL ratio was 12.38%. In the same year, the NPL ratio for all loans was 6.51%.

Table 37: SMEs Financing Figures

Indicator	Unit	2014	2015	2016	2017	2018
Outstanding business loans, SMEs	RUB billion	5,117	4,885	4,469	4,170	4,215
Outstanding business loans, total	RUB billion	27,785	29,885	28,204	29,219	32,229
Share of SME outstanding loans	% of total outstanding business loans	18.42	16.35	15.84	14.27	13.08
New business lending, total	RUB billion	38,530	34,236	35,580	38,453	45,005
New business lending, SMEs	RUB billion	7,611	5,460	5,303	6,117	6,816
Share of new SME lending	% of total new lending	19.75	15.95	14.90	15.91	15.15

Non-performing loans, total	% of all business loans	4.59	5.61	6.91	6.66	6.51
Non-performing loans, SMEs	% of all SME loans	7.71	13.64	14.23	14.93	12.38
Interest rate, SMEs	%	16.09	16.44	13.03	10.84	10.08

Source: OECD (2020)

Consequently, SMEs play an essential role in the Russian economy by constituting 22 percent of the total GDP and employing 30 percent of the country's labour force. In recent years, the government has introduced different support programs for SMEs, such as subsidizing the interest rates on commercial bank loans to SMEs (OECD, 2020). There are also differences in the distribution of SMEs across Russia, which has a very large area and diversity in terms of different religions, ethnic identities, and administration subjects. Except for Tatarstan and Bashkortostan, the number of SMEs in the federal republics is quite low. Most SMEs are micro and individual enterprises.

4.6.2. The Trajectory of Islamic Finance: Institutionalization, Legal and Regulatory Framework, and Financial Standing

The Islamic finance-related activities were affected by the collapse of the USSR (Union of Soviet Socialist Republics) in the 1990s positively. However, before the Soviet system, theoretical and practical efforts about the Islamic economy had occurred in the era of Tsarist Russia, especially in the Tatarstan region at the beginning of the 20th century. Leading scholars among the Muslims in Russia published a journal named *Iqtisad* (the Economics) from 1908 to 1913. Many issues related to the Islamic economy, including Islamic banking, were discussed (M. Hajjar & Habib, 2019). Apart from these theoretical endeavours, (M. Hajjar & Habib, 2019) assert that Muslims adopted the mutual banking model, which was practically available in Tsarist Russia. Although these initiatives taken at the beginning of the 20th century in the Tatar circle were important, there is a lack of information about how these mutual banks operated and their coverage.

The modern history of Islamic finance in Russia goes back to 1997 with the establishment of the Badr-Bank, which was the Islamic unit of Forte Bank. These two banks were merged in 2000, and the bank operated under the name of Badr-Forte Bank (Gabbasova, 2016). The Bank was operated in line with shariah. However, it did not use the "Islamic" prefix in its name because the Russian legislation has not allowed the establishment of Islamic banks. Badr-Forte provided a limited range of products to its customers (Kalimullina, 2020). This first and only fully Islamic banking experience was delicenced in December 2006 by the Central Bank of Russia due to them for alleged violation of the Federal Law On the Counteraction of the Legitimization (Laundering) of the Proceeds of Crime and the Financing of Terrorism (Gabbasova, 2016).

Badr-Forte Bank was a significant initiative for the trajectory of Islamic banking in Russia; however, there has not been any other fully Islamic bank. Nevertheless, there are other initiatives to provide *shariah*-compliant financing products to customers through "Islamic windows" by conventional banks. For instance, *ijarah* and *murabahah* based financing offerings were provided by the Ellipse Vostok Capital Bank branches in Nizhny Novgorod and Ufa [23] until the resolution of the bank in 2013 (Aidrous, Glavina, & Asmyatullin, 2020).

Several small banks were providing *shariah*-compliant products in Dagestan, where the share of the Muslim population is around 80%; however, their activities were terminated by the Central

[23] *Nizhny Novgorod is the sixth largest city of Russia with small muslim population. Ufa is the capital of Bashkortostan Republic.*

Bank of Russia during the recovery policy initiative in 2014 (Aidrous *et al.,* 2020). Moreover, according to Aidrous *et al.* (2020), Bank Express and AF Bank in Dagestan and Bashkortostan were also closed and reorganized in this process. It is noteworthy to mention the Moscow Industrial Bank, which had a wide range of branch networks and serving more than a million clients, offered *shariah*-compliant customer debit cards approved by Russian Mufti Council across Russia between 2015 to 2019 when the central bank reorganized the Bank (Churin & Nechaev, 2018). As summarised in Table 38, other big conventional banks such as Sovcombank and dedicated institutions offered several *shariah*-compliant products to the clients in Russia between 1997-2017, which were stopped due to either internal decisions or government interventions.

Table 38: Liquidated Islamic Financial Institutions/Terminated Islamic Financial Services During the Period of 1997-2017

Name (location)	Active years	Sharīʿah compliant product(s) and/or service(s)	Termination reason(s)
Badr-Forte Bank	1997-2006	Foreign trade operations support, corporate financing	Revocation of the license
AF Bank (Ufa-Bashkortostan)	2010-2014	Interest-free debit card: "Musulmanskaya karta"	Revocation of the license and bankruptcy of the financial institution
"Yumartfinans" (Tatarstan)	2009-2011	Investment deposits based on *mudarabah*, retail financing based on murabaha	Amal FH had acquired assets
Financial group BKS (Novosibirsk)	2007-2014	Unit trust *"Halal"*	Low demand
Moscow Industrial Bank (All Russian regions)	2015-2019	Payment card for the pilgrims	Reorganization of the bank by the CBR
Bank "Express" and its special separate branch (Islamic window) "Mudarib" (Dagestan)	2008-2013	Interest-free debit card "Specialnaya"	Revocation of the license and bankruptcy of the financial institution.
	2011-2013	*Murabahah*-based retail financing institution through credit card "Hayat" with a maturity from 6 months to 3 years	
Bank "Ellips" and its special separate branch (Islamic window) "Vostok-Capital" (Nijnyi Novgorod and Ufa)	2011-2014	Retail and corporate financing based on *murabahah* and *ijarah* facilities.	Revocation of the license and merge with another bank
AF Bank (Ufa-Bashkortostan)	2010-2014	Interest-free debit card "Musulmanskaya karta"	Revocation of the license and bankruptcy of the financial institution.
Islamic window of Tatagroprombank (Tatarstan)	2014-2017	Retail and corporate financing based on *murabahah*, asset management on *mudarabah*-basis, financial leasing, financing of foreign trade transactions	Revocation of the license.
Moscow Industrial Bank (All regions of Russia)	2015-2019	Payment card for the pilgrims in all Russian regions	Reorganization of the bank by the Central Bank of Russia
Sovcombank (Tatarstan, Bashkortostan, and some other regions)	2017-2019	Credit card based on *qard al-hassan*	Bank's internal decision

Sources: Compiled from Gabbasova (2016), Kalimullina (2020) and Aidrous et al. (2020)

Currently, different institutions range from fully-fledged Islamic financiers to conventional banks, offering various Islamic finance products across Russia (Table 39). As a conventional offering of Islamic finance-related products, AK BARS Bank operates in Tatarstan and is one of the most prominent *shariah*-compliant financing and investment products providers. In 2011, the bank provided $60 million in funding through the *murabahah* syndication facility in Islamic capital markets, which was announced as "the first public international *Shariah*-compliant deal in Russia" (AK BARS Bank, 2012). Besides, the bank has introduced Islamic mortgages based on *murabahah* contracts to its customers for homeownership without interest. On the other hand, AK BARS Bank established the LALE Islamic Investment Fund, which includes the shares traded on the Moscow Exchange in 2019 (Aidrous *et al.,* 2020), and AK BARS Capital manages the fund.

Table 39: Existing Islamic Financial Institutions and Islamic Windows in Russia (in 2021)

Name	Locations	Institution or product inception date	Islamic financial services
Amal Finance House	Tatarstan and some other cities.	2010	Retail and corporate financing based on *murabahah*, leasing *(ijarah), salam, istisna'*, *mudarabah* and asset management on *mudarabah*-basis. Current accounts, saving accounts on *qard al-hassan* basis
IFC "Ash-Shams Capital"	Moscow	2010	Asset management for corporate and individual clients based on *mudarabah* brokerage services based on *wakalah*
TIIC – Tatarstan International Investment Company	Tatarstan	2010	Project financing for projects with the minimum total amount of $3 mln. on *musharakah*-basis
LaRiba Finance	Dagestan	2011	Investment deposits based on *mudarabah*; corporate and retail financing with *murabahah* and *musharakah*
Ak Bars Bank	Tatarstan	2011	Providing Islamic mortgage and recently started
Eurasian Leasing Company	Tatarstan	2012	Leasing (*ijarah*) services for corporate clients
Barakat	Chechenya	2012	Providing small *shariah*-compliant financing to the poor people through *qard al-hassan* and *murabahah*
Masraf Finance House	Dagestan	2013	Investment deposits based on *mudarabah*, corporate and retail financing with deferred payment
Fincity	Chechnya	2017	*Murabahah* financing
Nur Finance	Tatarstan and Moscow	2020	Investment deposits based on *mudarabah*; corporate and retail financing with *murabahah*
SHOOKRU	Moscow	2021	Serving as an online payment platform to clients in Moscow. It is based on the *murabahah*.

Sources: Gabbasova (2016); Kalimullina (2020) and interviews by authors

Another important conventional bank interested in Islamic finance is Sberbank which is the biggest bank in Russia. The bank is state-owned, and its interest in Islamic finance makes it more significant to understand the central government's approaches to developing Islamic finance in Russia. For example, Sberbank has used *shariah*-compliant instruments in trade finance to export Russian wheat to Egypt with the participation of the International Islamic Trade Finance Company in 2020. As a result, the USD13 mln deal was successfully completed (Sberbank, 2020). Moreover, the bank applied for a license to operate in United Arab Emirates (UAE) through an Islamic finance subsidiary, and it was approved in September 2020 by the authorities. The international trade deals and starting Islamic finance operations in the UAE show the bank's objective to become a significant partner in all future deals between Russia and Middle East countries (DOMAT, 2021). Apart from the initiatives taken directly by Sberbank, some other Islamic finance providers also benefit from the bank distribution channels. For instance, Barakat, which provides financing to low-income families in Chechenya, informs the borrowers how to pay instalments through Sberbank mobile application [24].

When we look at the geographical distribution of Islamic financial institutions in Russia, it is seen that they are generally concentrated in Tatarstan, Dagestan, and Chechnya. It can be said that Tatarstan and especially its capital Kazan are the leading locations. One of the interviewees, the upper manager of one Islamic financial institution in Kazan, emphasized that Kazan follows Moscow and St. Petersburg in terms of economic development, and the surplus generated in Kazan is sent to the central government's budget so that the expenses of other regions are covered in this way.

On the other hand, Kazan hosts the most prominent Islamic finance summit in Russia. 12th Russia-Islamic World: Kazan Summit 2021 was held on 28-30 July in Kazan with academics, entrepreneurs, company representatives, professionals, government officials from different regions of Russia and Muslim worlds. Besides Islamic finance-related programs, workshops and trainings were organized for various sub-sectors of the *halal* economy (*see*; Kazan Summit, 2021). The Republic of Tatarstan as the centre of Islamic finance in Russia and Kazan, the capital of this region, can be shown. In addition, small-scale Islamic financial institutions operate in Dagestan and Chechnya. These organizations are usually located in the capital cities, ie. Makhachkala and Grozny.

Several organizations in Moscow offer financing and investment products in accordance with the principles of Islamic finance. Moscow has the potential of Islamic finance to be the most developed region, having a significant number of the resident Muslim population. An Islamic finance company manager; stated that their customers in Moscow have high savings; therefore, they offer investment products to them. On the other hand, he notes that they channel these funds as financing to the customers in other cities. Moreover, new Islamic financing initiatives using financial technology have been coming to the customers in Moscow. SHOOKRU is one of the recent initiatives that provide clients with an online platform where they can pay the costs with a mark-up in four instalments (Shookru, 2021).

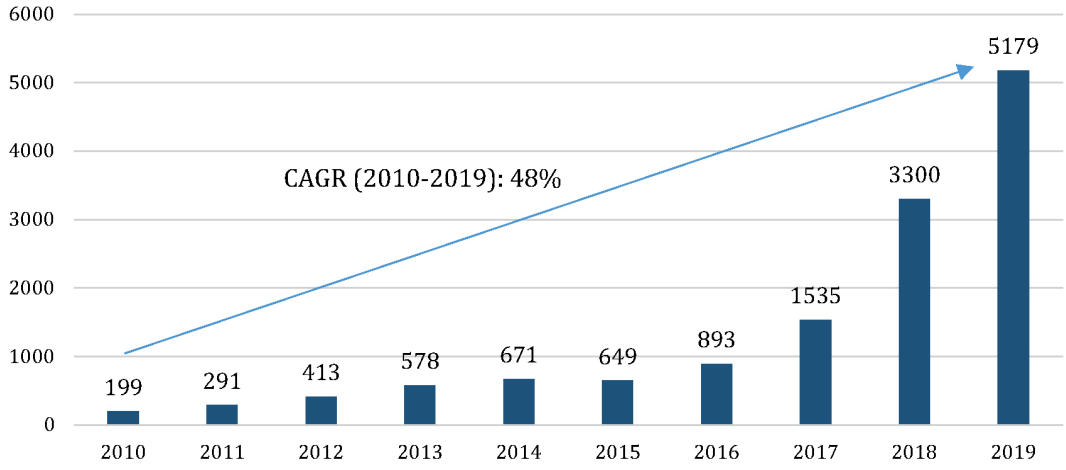
As shown in Table 39, Islamic financial services are offered within different institutional structures, albeit in limited numbers, in various regions of Russia. While most of them have murabaha-based financing products, there are also mudaraba-based investment instruments. For example, the newly established Nur Finance raises funds through mudaraba and extends them to the customers based on *murabahah*. Most of the organizations that offer Islamic financial services outside of conventional banks are limited liability companies. Therefore, there

[24] *Please see: "Repayment of an interest-free loan, via the Sberbank mobile application online (Возврат беспроцентного займа, через мобильное приложение Сбербанк онлайн)": https://www.youtube.com/watch?v=EsW34GIgh9w, accessed: 15.08.2021*

is no emphasis on Islamic financial institutions in their names. As an example of this approach, the working groups of the Central Bank and the State Duma use the partnership concept while mentioning the Islamic finance sector (Aidrous *et al.,* 2020). However because Russian does not have legislation for Islamic financial instruments and financial services, these organizations implement various contracts as limited liability companies following legal regulations.

Regarding the Islamic capital markets and the investment instrument offered by Ak BARS Capital and international trade finance transactions by SberBank. No *sukuk* has been issued so far. Besides, Islamic insurance (*takaful*) is not available in Russia. Kalimullina (2020) states that the absence of *takaful* products is a limiting factor for the activities of existing Islamic financial institutions in Russia.

Figure 59: Islamic Finance Assets in Russia (million RUB)



Source: Kalimullina (2020)

Although Islamic finance is huge potential in Russia, this is not realized yet, and the development level of the sector is in infancy level. Kalimullina (2020) indicates that the size of the sector's total assets has significantly increased in recent years and reached 5,179 million RUB (Figure 59). According to her latest estimate, while the number of employees of Islamic finance institutions in Russia is at least 150, the total number of clients is around 40,000. This consequent number in terms of the Islamic finance industry's customer base is very far from the 500,000 clients estimates (Juravliov, 2013).

4.6.3. Islamic Financing Provisions for MSMEs: Institutions, Products, and Offerings

Islamic finance in Russia is quite an incipient level. In this sense, although there is no financial institution that specifically targets the SME segment, it can be said that this segment is among a significant part of the customers of some Islamic financial institutions. The foremost of these is Amal Finance House, based in Tatarstan/Kazan. The organization, which started its operations in 2010, merged with the Kazan-based Yumart Finance Islamic Financial Company in September 2011 and acquired most of the personnel and customer portfolio (Juravliov, 2013). Amal focuses on corporate financing, and therefore the majority of clients are SMEs and individual entrepreneurs (IslamNews, 2019).

Amal Finance House operates as an Islamic finance company. It offers both financing and investment products to its customers. While *murabahah* and *ijarah* contracts are used on the financing side, the company collects funds on *mudarabah*-basis. In this sense, although it has a similar scope to Islamic banking in many countries globally, it is not operating as a bank. According to the regulations of Russia, the bank must have interest; therefore, Amal is not an Islamic bank; it only uses certain elements of Islamic banking (IslamNews, 2019). Nevertheless, Amal Finance is an important experience in showing that Islamic finance can be realized in Russia, although there is no place for Islamic banks in the legal framework.

The maximum amount in *murabahah* financing is 40 million rubles, and the maturity is up to 3 years (Amal Finance, 2021a). Amal Finance buys the goods and sells them in a deferred payment by marking up a profit. It also takes responsibility for the delivery of the goods. They do not follow the common practice of Islamic banks in some countries, which appoints the customer as an agent based on the *wakalah* contract in *murabahah* financing. Another financing instrument is the *ijarah*. In this product, which is offered with a maximum maturity of 3 years, Amal Finance purchases the vehicle and leases it to the customer. At maturity, the vehicle is usually sold to the customer at the agreed price (Amal Finance, 2021c). Different products based on *mudarabah* (profit and loss sharing) are offered to invest customers' contributions. Accordingly, there are products with 3, 6, 12, 24, and 36 maturities, and the partnership ratio varies according to the amount invested. Investments can only be made in rubles (Amal Finance, 2021b). Amal Finance pays attention to the following to minimize the risk in the investments of its customers' funds: high portfolio diversification; an effective system of analyzing solvency; the use of pledges and surety instruments (Garifullin, Daryakin, & Galeeva, 2018).

Other initiatives related to SMEs are located in Chechnya. The first of these institutions is the Barakat microfinance institution. It provides microcredit to low-income people in accordance with Islamic finance principles. Barakat cooperates with Islamic Relief, which carries out humanitarian aids and programs in different parts of the world. The company operates as an official microfinance institution subject to the regulations of the Central Bank of Russia. It provides *qard al-hassan* and *murabahah*-based financing to support micro-entrepreneurs. Since Islamic microfinance institutions are not recognized in the legislation, fees received from *qard al-hassan* financing are considered interest by the law (Kalimullina, 2020). However, it is appropriate to receive a fixed fee for expenses from *qard al-hassan* financing. Therefore, Barakat operates in *shariah*-compliant as well as in line with the Central Bank of Russia's regulation.

Another organization in Chechnya is the Zayed Fund for Entrepreneurship and Innovation, which was established in 2017 with the support of the UAE. The fund's primary purpose is to support the economic activities of those in the low-income group through financial and non-financial instruments. In this context, it provides *murabahah* and *musharakah* financing as well as conventional financing. As of the end of 2019, 3% of the provided funding from the fund is conventional loans, 82% is *murabahah*, and 15% is *musharakah* (Kalimullina, 2020). To be eligible to obtain financing from the fund, applicants must be between the ages of 18-60 and a resident of Chechnya. Consumer loans are not provided; instead, applicants are required to use funding in income-generating activities (Zayed Fund, 2021). According to the speech of the representative of the Fund at the 12th Kazan Summit, the success of the *musharakah* financing is low because the beneficiaries have difficulties reporting the business activities.

Lastly, two Moscow-based *zakat* funds can be mentioned as supportive Islamic social finance institutions, although they are unrelated to MSMEs. The first fund is the Charity Fund "ZAKYAT," which was established by Muslims of the European part of Russia in 2011 to organize the collection and distribution of *zakat*. The Foundation primarily supports the poor, orphans, and patients. They operate in Russia, and Zakyat has support programs for orphans in Palestine, Syria, and Lebanon. So far, 167,412 people have supported Zakyat with various tools, including cash, cloth, and meat supports (Zakyat, 2021). Another *zakat*-related initiative is Pay*Zakat*, a Moscow-based online platform that collects, distributes, and monitors *zakat* and *sadaqah*. The fund, which operates in partnership with Sberbank, shares the projects that can be supported on its website and directs the *zakat* or *sadaqah* deposited to the account in Sberbank to these projects (Pay*Zakat*, 2021). Pay*Zakat* platform won the Global Islamic Finance Awards, and its total number of members reached 4,000 (Sberbank, 2020).

The majority of Islamic financial institutions in Russia offer investment products based on profit-loss sharing and products for housing and vehicle financing. In addition, there are a limited number of Islamic financial institutions that support SMEs and individual entrepreneurs. Some of them are for-profit companies, while others are charitable organizations. There is a need to increase the number of institutions offering Islamic finance products in order to ensure access to finance, especially for SMEs in Russia that stay away from interest (riba).

4.6.4. COVID-19 Conditions and Islamic Financing Responses for MSMEs

The first official COVID-19 cases in Russia were recorded in January 2020, and the first peak was seen in May, with the number of cases over 10,000. COVID cases, which were somewhat under control during the summer months, started to rise towards the end of the year, and in December 2020, the number of daily cases exceeded 30,000 and deaths exceeded 600. With the introduction of the vaccine and the effect of the containment measures, the daily new cases decreased until June 2021 and reached below 10,000. Recently, with new variants and increased social mobility, the number of daily confirmed cases has exceeded 20,000. According to the World Health Organization figures, there have been 6,642,559 confirmed cases of COVID-19 with 172,110 deaths between January 3, 2020 and August 17, 2021, in the Russian Federation. As of 9 August 2021, a total of 66,245,526 vaccine doses have been administered (WHO, 2021b).

In addition to the effects of COVID-19 on the people's lives and health system in Russia, it has also had a negative impact on the economy as happening over the world. A six-week nationwide shutdown took place in the spring of 2020 to prevent the spread of the coronavirus. Besides, the Russian government has not resorted to further lockdowns despite the rise in the number of new cases and increased criticism brought towards the government for not taking the rise in the cases seriously (APNews, 2021). Although there was only a one-time closure, a 3% contraction was occurred in the economy in 2020. The decline in oil prices in 2020 was also effective in this negative GDP growth. According to the IMF's July 2021 forecasts, Russia is expected to grow by 4.4% in 2021 and 3.1% in 2022 (Table 40). Growth expectations in the world output in the same periods are 6.0% for 2021 and 4.9% for 2022.

Table 40: Selected Economies Real GDP Growth (percent change)

			Projections	
	2019	2020	2021	2022
World Output	2.8	-3.2	6.0	4.9
Brazil	1.4	–4.1	5.3	1.9
China	6.0	2.3	8.1	5.7
Germany	0.6	–4.8	3.6	4.1
Kazakhstan	4.5	–2.6	3.2	4.0
Russia	2.0	–3.0	4.4	3.1
United States	2.2	–3.5	7.0	4.9

Source: International Monetary Fund, World Economic Outlook, July 2021 Update.

SMEs and individual entrepreneurs are among those most affected by the pandemic in Russia. In particular, the six-week shutdown and other restrictions had a negative impact on some areas of the service sector. The government has announced support packages for SMEs and families, and their primary aim is to secure employment. For this purpose, it was stipulated that the companies that did not lay off workers in this process should benefit from the support packages.

As previously mentioned, there are a limited number of Islamic financial institutions in Russia, and they only operate in several country regions. Therefore they have played a limited role in supporting SMEs during COVID-19. The manager of Amal Finance House, interviewed, stated that they called customers during this period. Some of them had problems due to the lockdown and slowdown in the economic activities for a few months. To those who are in a difficult situation were given time for delays in their instalment payments. He also stated that with the recovery in the economy, customers in this situation began to pay their instalments regularly. Also, one of the staff of a unit that supervises food companies in Kazan and provides halal certificates also confirmed that some companies in the food sector had problems during the closure period, but later they recovered.

Apart from the effects of the COVID-19 on the demand side, it can be said that Islamic finance suppliers that offer Islamic finance products are not adversely affected by the COVID-19. At this point, the Islamic finance expert interviewed stated that he called his contacts from the companies offering Islamic finance services to ask how they were affected during the COVID-19 pandemic and learned that all of them continued their activities without any problems. The fact that there are new players (Nur Finance and SHOOKRU) entering the Islamic finance sector in Russia despite the COVID-19, confirms the situation.

4.6.5. Best Practices: Lessons Learned

In addition to being among the largest economies in the world, Russia is a country that has a vast territory, more than eighty units in its federal structure, and diverse administrative structures. A high number of the Muslim population mainly live in the North Caucasus and Volga Region and Moscow and Petersburg in Russia. In the history of Russia, there were sometimes severe tensions between the Muslims and the state, according to the political conjuncture of the period. It can be said that there is a more balanced situation now. The same is true of the recent approach to Islamic finance. However, Islamic finance is not recognized by the Russian relevant laws. In such an environment, it is noteworthy that Islamic finance is successfully implemented, albeit

in a narrow scope, by adapting to the existing legal regulations under different institutional structures. Again, the methods found and the attention on the supply side provide examples for places where Muslims are in the minority, and Islamic finance is just being implemented.

On the other hand, the sensitivity in the implementation of Islamic finance is remarkable. For example, in Amal Finance, unlike the general practices in the world in *murabahah* financing, the goods are bought by the company and sold to the customer again. The company bears the risk. On the other hand, the company has an Internal and External Shariah Control Department to ensure Islamic corporate governance.

It is observed that Islamic finance providers in Russia try to follow international rules on standardization. For example, while it is stated in the brochure of Ak BARS Bank's Islamic mortgage product that it complies with AAOIFI standards, Amal Finance House gives the names of its *Shariah* advisors on its website. It highlights the expertise of the person working there as follows: "*Sharia* is carried out by the first specialist in Russia who passed the international financial Sharia certification at AAOIFI (Bahrain), as well as a specialist in the field of Arabic language and Sharia sciences." (Amal Finance, 2021d). On the other hand, AAOIFI Standards were translated into Russian by experts in the country in 2017, following English, Arabic, French, Russian, Turkish, Urdu, and delivered to officials as well as Islamic financial institutions (AAOIFI, n.d.). These developments and approaches show that Islamic finance in Russia takes international good practices as an example in its attempt to progress institutionally.

Another good practice that can be revealed from the Russia case is that in the financing of SMEs during the COVID-19 period, institutions that provide some Islamic finance products have called their customers and offer the opportunity to postpone the instalments of those in difficult situations. Undoubtedly, the small number of customers is also a factor here, but it also shows that local initiatives establish a closer relationship with society. As Islamic financial institutions grow, this relationship weakens and becomes more mechanical.

Moreover, the Kazan Summit took place for the 12th time in 2021 despite the COVID-19. Thousands of visitors from both Russia and different countries of the world participated in the international summit. Various programs are held with many parallel sessions, and companies present their products in the fairground. Hosting such a large organization and successfully completing 12th-time show both the high level of interest and the attractiveness of Kazan and the institutional and human capacity of Tatarstan to organize such an event.

Lastly, one of the best practices in Russia's approach to information disclosed about the SME segment, although it is not directly related to Islamic finance. Statistics on SMEs and individual entrepreneurs are published every month, including breakdowns by regions and firm sizes. Following this good practice by other countries will enable the sector, which is the backbone of the economy, to be closely monitored and policies developed more effectively. From this standpoint, Russia offers an excellent example of data sharing.

4.6.6. Country-specific Policy Recommendations

The lack of legal regulation is one of the main obstacles to developing Islamic finance in Russia. In 2014, due to the economic sanctions on Russia, Islamic finance started to be seen as an alternative sector by the government, and a working group was formed within the Central Bank. SberBank, the largest state bank, also has started to offered *shariah*-compliant trade finance products. However, the government's interest later weakened, and it was seen by the Central

Bank of Russia that the current regulations were sufficient for Islamic finance (Aidrous et al., 2020).

Roadmaps containing concrete proposals and examples from world practices should be prepared and presented to the government authorities in order to retake their attention to make regulations that will pave the way for the Islamic finance sector. At this point, international Islamic financial institutions such as Islamic Development Bank should take a role. The IsDB can provide capital support for establishing an Islamic bank as it did in several other countries. Thus, he will convince the Russian government that Islamic finance will provide capital inflows to the country.

Another issue is the need to increase Islamic financial literacy and awareness of financial institutions in society. A study revealed that Islamic finance literacy among finance sector employees in Moscow is relatively low (Hidayat, Rafiki, & Svyatoslav, 2020). An SME owner who participated in Kazan Summit emphasized in our interview that he had heard of Islamic finance institutions once but had no idea about it. A self-employed Muslim person reported the same situation in Moscow, and he stated that he had to take conventional loans unintentionally due to the lack of Islamic finance institutions. Therefore, there is a need to increase public awareness of Islamic finance through social media and conferences, especially in Muslim majority republics and big cities where a significant number of Muslims reside.

In order to support SMEs in Russia with Islamic finance principles, cooperation with the ICD of the IsDB should be developed. In this way, financing can be offered to SMEs through existing Islamic finance providers thereby, both the support of SMEs and the development of the institutional structures of Islamic finance providers can be achieved.

5. CONCLUSION AND POLICY RECOMMENDATIONS

The world is marked by VUCA (volatility, uncertainity, complexity and ambiguity) characteristics, and the last of such consequences has been the emergence of COVID-19, which plunged the entire world into VUCA. In addition to having catastrophic consequences on human lives, the survival of human beings and human society has come under threat. The lockdown policies pursued by governments and health authorities all over the world created unprecedented economic and business challenges while securing human lives.

As part of the real economy and providing the backbone to economies all over the world, MSMEs faced financial (liquidity and cash), supply chain, sales and labour challenges. To overcome some of the economic and financial challenges, governments have developed policies within their means. Expansionary fiscal and monetary policies aimed at easing the consequences and adverse impact of the COVID-19, which were necessary for the survival of the MSMEs. However, the effectiveness and efficiency of such policies on MSMEs are disputed and in any jurisdictions, in particular in developing countries, MSMEs were left to their own means and the provisions by the banking system.

Since the banking system is constituted in line with the profit logic, social consequences are not considered, which was evident during the COVID-19 conditions. As explained above, Islamic banks and financial institutions are theoretically shaped under the Islamic logic by essentialising substantiative morality. Therefore, they are expected to demonstrate distinct organisational behaviour consistent with Islamic logic. While we acknowledge the criticism raised against Islamic finance in terms of its dissembeddedness from Islamic norms and the real economy, this study was motivated to examine the performance of Islamic banking to support the MSMEs, which were challenged by the COVID-19 conditions.

The research process proved fruitful to explore sampled countries with different Islamic finance and banking presence and different levels of Islamic finance ecosystem in their economies and regulative environment. As was expected, such distinctions can be useful to understand the performance of Islamic banks in responding to the challenges faced by MSMEs.

As the findings show, Indonesia has a better established Islamic finance ecosystem, which is also embedded in civil society. Therefore, Indonesia could mobilize various Islamic banking, finance, and social finance responses to the COVID-19 challenged MSMEs. On the other hand, oil-rich Kuwait has a more considerable asset holding the Islamic finance industry with a larger share in its financial system but a limited Islamic ecosystem and a substantial fund directly for SMEs. In Kuwait, it seems that Islamic banks have operated within the public policy, and also they developed some institution specific measures. With SMEs' limited size and extend yet larger *Shari'ah* compliant liquidity, Kuwaiti Islamic banks could have developed a more proactive response.

Furthermore, Jordan, being an emerging economy, has a bourgeoning Islamic finance industry, which is much smaller in its assets base and institutionalisation compared to Indonesia and Kuwait. As the analysis suggests, Islamic banking demonstrated some positive initiatives to support the MSMEs, as Jordan has a very large number of MSMEs, which stands as the foundational base for the economy. Furthermore, as a developing economy in Africa, Senegal can be considered an emerging Islamic finance country. While Islamic finance is minimal, the history of the emergence of Islamic banking institutionalisation can be traced back to the early 1980s. Within limited financial means and liquidity provided only limited space for action for

Islamic banking in the country. Lastly, Russia was selected on the ground of a larger Muslim population as part of the Russian federation. Therefore, mainly civil society based Islamic financing initiatives have demonstrated an embedded response with the available financial means. Thus, this research examined countries with different economic levels, structures, and MSMEs presence and different Islamic finance and banking presence. Accordingly, the research findings show the differences in the responses developed for the challenges faced by the MSMEs under the COVID-19 conditions. However, what remains a general conclusion is that Islamic finance and banking have too much embedded into market logic despite and through *Shari'ah* compliant process. Therefore, its responses are mainly constrained by shareholder maximisation concern rather than Islamic logic's stakeholding and sharing economy paradigm. As the latter would have resulted in proactive responses to the challenges of MSMEs. After all, as one of the interviews mentioned, "Islamic institutions and Muslims are expected to make the world a better place as par the tradition of the Prophet Muhammad (*saw*)", and therefore Islamic banks and financial institutions should develop such an objective function. In line with this, as in the case of Indonesia, the contribution of the institutionalised version of Islamic social welfare institutions fills the gap left by the public policy and the financial system, including Islamic banks and financial institutions.

Based on this discussion on the conclusions drawn from the study, this section provides policy recommendations that are designed in the form of a roadmap from which the OIC member countries to benefit from in their efforts to support MSMEs during and post COVID-19 era.

As explained above, each of the OIC member countries has different approaches and implications of Islamic finance. As a result, these differences are considered while proposing policy recommendations for the OIC member countries.

The policy recommendations are developed in terms of short-term and long-term recommendations. Short-term recommendations will be heavily based on the findings of the results, while long-term recommendations will be structural in their form and will be reflective of the findings.

Short-term recommendations:

1) Need for a Generally Accepted Definition of MSMEs for OIC Member Countries

There is not any globally accepted definition for MSMEs. Countries define MSMEs through two parameters: the number of employees and the total turnover of the company. Each country defines micro, small and medium-sized firms separately based on these parameters with different thresholds. Even in some countries, there is not any definition available for MSMEs. The limitations caused by the lack of a general or any definition of MSMEs are also emphasized by international organizations. The obscurity in the definition of MSMEs make the comparison between countries difficult, and therefore appropriate policy measures to support MSMEs are not to be introduced effectively.

On the other hand, the European Union has worked to define MSMEs, used in support programs for member countries and updates when necessary. Thus, supports for MSMEs in member countries are determined more effectively according to these definitions. However, the lack of a standard definition for MSMEs is also valid for OIC member countries. Therefore, a generally accepted definition should be determined for MSMEs in OIC member countries.

i) To have an inclusive and reflective definition, the situation of each member country should be examined, and a comprehensive report should be prepared. The EU's definition methodology can be benefitted in the process.

ii) An international and experienced organization or research centre, such as SESRIC, can prepare the report. A final definition to be used within the OIC should be decided by taking the opinions of the member states in a workshop. The agreed definition could be updated, if necessary, by following the methodological process. Finally, the adjustments based on the new definition should be made for the historical data.

iii) Support programs for MSMEs, prepared by the OIC and other relevant OIC institutions, should be determined according to this accepted definition.

iv) In the development of a common definition, however, field, capital and habitus of each society and their political economies must be considered.

2) An important conclusion of this study is the lack of effective and efficient data. Without an effectively organised and developed data set, it is impossible to develop policies, including public policies. In order to develop programmes at the Islamic bank level and policies at the governmental level, it is critically vital that quality data in defining, classifying, need assessment, financial evaluation, and social impact measurement is essential. During the COVID-19 process, the data requirements of MSMEs emerged as the main hurdle to develop the necessary rescue packages, as information on their presence, positions, and challenges were in need to develop effective solutions. However, data development and provision remain the most challenging issue in the OIC countries. Therefore, public policy should consider developing relevant departments and enhance the operation of these departments to provide data in every aspect of life, including MSMEs related matters. For this, OIC organisations such as IsDB Institute and SESRIC should develop collaborative projects to generate, organise and make available the databases. For example, annual surveys of MSMEs would provide much needed data for policymaking, strategy development, academic and professional research.

3) Since lack of data and shortcomings of the existing datasets are still a serious issue in Islamic banking and finance, OIC institutions such as IsDB Institute and SESRIC should also work with local institutions, as well as multilateral institutions such as IFSB, AAOIFI and CIBAFI to ensure the availability and quality of data. This will enhance the research and policy in Islamic banking and finance institutionalisation and contribute significantly to product development, including innovation and operation.

4) SMEs are the backbone of any economy globally, and their success in contributing to value-added in many countries and creating jobs is evidenced. Their specific contribution to the innovative process is notably recognised. OIC countries should develop their MSMEs sector in a planned manner to benefit from their value-added. Specific strategic sectors have emerged as essential as demonstrated by the COVID-19 experience, including health and related sectors and technology. Thus, OIC member countries should develop such sectors to gain a strategic competitive advantage.

5) The development of MSMEs requires financing from start-up to exit strategies. Considering their essential contributions, specialised funds should be developed, and those countries having such specialised institutions must ensure their effectiveness in responding to the development of the MSMEs sphere. This requires effective planning and leadership.

6) Considering that the OIC countries have a large youth population, developing an entrepreneurship culture is critical to developing a dynamic society through the technological friendly nature of the new generation. Hence, startups-oriented financing and developing such a culture will be vital as some Islamic banks have initiated.

7) Islamic banking and finance should be an essential source for financing the MSMEs sector due to the underlying normative principles. However, Islamic banks and financial institutions have provided so far limited opportunity space for the development of the MSMEs sector in their portfolios. The objective function of Islamic banks and financial institutions must internalise the importance of this business segment rather than attaching stigma about their riskiness. In line with the long-term recommendation below, the SMEs sector as part of the real economy should be supported by equity financing, which requires a change in the institutional logic of Islamic banks and financial institutions (see below).

8) In line with the above, the sectorial distribution of financing by Islamic banking leaves very small room for MSMEs. As evidenced in this report, Islamic banks prefer sectors such as the real estate sector, banking and finance and customer financing, as these sectors get the lion's share in their financing. However, sectors such as agriculture, manufacturing, services and other locally essential sectors are left much lesser share from Islamic banking financing. These sectors are where MSMEs are mainly located and operated. Therefore, rather than shareholder profit maximisation attitude, contribution to the larger society through allocating more financing opportunities and increasing MSMEs portfolio in Islamic banks will fit their theoretical philosophy better and contribute to the development of the OIC countries. Therefore, incubator development projects should also be supported by Islamic banks and financial institutions to contribute to the entrepreneurship culture for empowering youth.

9) The experience under COVID-19 has demonstrated the importance of digitalisation and online service delivery. Those MSMEs which have immediately developed technological processes for their service delivery and financing have converted 'crisis into opportunity'. Therefore, MSMEs should be provided training sessions in technology use and should be financed by MSMEs-specialised financing bodies to develop the necessary infrastructure for digital production and service delivery. The new entrepreneurship culture must include digital knowledge and practice development. Islamic banks should come forward to financially support their MSMEs clients and customers for the digitalisation process and training them to develop the necessary practical skills to use technology.

10) Islamic fintech capabilities should be developed within Islamic banks as well as by the MSMEs. New research demonstrates a positive link between fintech literacy and use and Islamic banking stability and profitability. Hence, MSMEs and other customer base having practical skills using the Fintech developed by their respective Islamic banks will be an essential contribution to the Islamic bank performance and also to the operations of MSMEs.

Such short-term policy recommendations need meaningful and existential long-term structural change and institutional transformation. In particular, Islamic banking and finance must move to the next development phase to be able to fulfil a more MSMEs friendly financing paradigm. The emergence of Islamic finance in the first phase was in the 1950s in civil society in the form of *musharakah* and *mudarabah* project financing. The second stage came with Mith Ghamr (Egypt) as a social financing institution and *Tabung* Hajj (Malaysia) as an Islamic investment company.

The third stage emerged with Islamic commercial banking (Dubai Islamic Bank) in 1975. The fourth stage of Islamic finance emergence has been through the Islamic capital markets, hence, the *sukuk* market since 2001. The next phase of Islamic banking and finance has to refer to the foundational principles and Islamic *logic* to serve sustainable development, impact investment, and socially responsible financing to serve the development objectives of the Islamic moral economy in creating an *ihsani* society. Therefore, the following *long-term recommendations* are made, which requires political will. However, the emergence and development of Islamic banking and finance was a product of political will in the first place. Now that political will has to be shown to move from transaction-oriented paradigm to transformation (*islah*) paradigm of Islamic moral economy.

1) The regulative environment must provide an opportunity space for the development and sustainability of Islamic finance within Islamic logic. As institutional grafting by forcing Islamic banks to operate with the same operational principles of shareholder maximization limits the authenticity of Islamic banks and financial institutions. An Islamic ecosystem must be provided as an additional regulative environment for the Islamic banks and financial institutions to operate towards the social impact, including increasing their support for MSMEs. The dual banking system as a concept, hence, should not be limited to the institutional presence, but the operational distinctions of Islamic banks and financial introductions must be recognized. In the market-based logic, Islamic banks have avoided PLS and risk sharing or equity-based financing, as the regulative environment would consider Islamic banks in the same position as the conventional banks.

2) The policy-making by the regulators should consider developing a proper dual banking system to pave the way for the Islamic identity should be demonstrated through the consequences. Since the current dual banking method forces conventional logic on Islamic banks and financial institutions, this limits their capacity of delivering on development issues, including extending support to MSMEs.

3) Consequently, rather than considering Islamic banks within the competition in the dual banking system, they should be provided with a specialised institutional set-up consistent with their objective function, which can facilitate the process of extending financing to the MSMEs.

4) As regards to the long term paradigmatic change in relation to corporate governance, the regulative environment in the OIC member countries should consider moving from Anglo-Saxon governance model in Islamic banks to stakeholder governance system of Islam or at least to stakeholder enhanced European model of stakeholder governance so that the interest of all the stakeholders, including MSMEs, can be recognised.

5) In a broader sense, 'changing the minds' of all the stakeholders must be aimed at so that shareholders, depositors, and clients could adequately understand the operational nature of Islamic logic in Islamic banking and finance, which should pave the way for stakeholding corporate governance. This will help get Islamic banks and financial institutions from competing with conventional banks, as their distinctions mean outcomes and performances require different measurements and tools. As in an Islamic ecosystem, the performance will be measured by equity and not by efficiency, as the *ihsani* governance or stakeholder governance model essentialises.

6) Among the stakeholders, standard setting bodies, such as AAOIFI and IFBS, have made immense contributions to the development of the Islamic banking and finance industry.

However, their standards and regulations result in grafting these institutions to further embedded into the market logic. Therefore, for the next stage of Islamic banking and finance, the standard-setting bodies must consider Islamic logic esentialised paradigms, which goes beyond merely a *fiqhi* approach in standard and regulation development. Such an approach will respond to development needs of society within sustainability paradigm, which includes MSMEs.

These policy recommendations can also be classified into institutional setup, incentive mechanism, public policy and governance, legal and regulative provision, regional and international cooperation beyond short term and long term related policy recommendations, as follows:

Institutional Setting

- There is an urgent need to develop a alternative and specialised institutional set-up consistent with the Islamic banking's main objectives to facilitate the process of extending financing to MSMEs and ensuring collaboration with the public and private agencies (joint fund) to overcome the constraints of the market logic through such as synergy.

- Islamic banks should consider moving out of reverse engineering based financial engineering and financial development into the authentic product development stage, including for MSMEs, through which ideals in the emergence of Islamic finance can be actualised.

- Specialised institutional settings should be considered to educate and train MSMEs in their accounting and management skills and processes, which will help them have a stronger position in securing financing from Islamic banks.

- Through an effective institutional setting, MSMEs should cooperate with other market-supporting institutions and agencies and other risk-management tools to enhance their robustness in terms of institutional and financial stability.

- A specialised institutional setup for every aspect of MSMEs from their start-up stages to their exit stages should be considered an efficient solution being a single-window point for MSMEs.

- Developing the necessary technological infrastructure for MSMEs to initiate new business models and promoting Fintech based solutions with a view to actualize next stages of Islamic financing institutional development.

- The next stage of Islamic financing institutional development must be through digitlisation such as Fintech, and therefore Islamic banks and the finance sector must develop the necessary infrastructure to move into Fintech provisions, including MSMEs, and public agencies should provide the required training to MSMEs.

- A specialised institutional setting should also be tasked with collecting regular data concerning every operational and financial aspect of MSMEs in a longitudinal manner so that cross-sectional and time-series data regularly should be available to develop policies.

Incentive Mechanisms

- Several OIC member countries have utilised financial incentives and tax relives to helping o develop their Islamic banking and finance sector, such as the *sukuk* market. Similar incentive mechanisms for Islamic banks and Islam capital markets should be considered. This will provide a substantive level playing field for the Islamic banks and financial institutions beyond the usual meaning of level playng field.

- The incentive mechanism towards Islamic banks and financial institutions must also include contract preference that specific Islamic banking and finance instruments such as PLS, risk-sharing type, and *qard al-hassan* financing can be encouraged.

- R&D in Islamic banking and finance should be encouraged through incentive mechanisms such as tax relieves so that authentic product development for Islamic banks and financial institutions can be possible through knowledge development. This process can help to develop more MSMEs friendly financing products and mechanisms.

- Islamic Fintech for Islamic banks and financial institutions and FinTech development in MSMEs should be developed through various incentive mechanisms, including technological support related financial incentives and tax incentives. This will be an essential contribution for preparing Islamic banks and financial institutions as well as MSMEs for the new business environment.

*Public and Private Policy Settings, and Governanc*e

- The regulative environment in the OIC member countries should consider moving from Anglo-Saxon governance model in Islamic banks to stakeholder governance system of Islam or at least to stakeholder enhanced European model of stakeholder governance so that the interest of the all stakeholders, including MSMEs, can be recognised.

- Rather than considering Islamic banks within the competition in the dual banking system, they should be provided with a specialised institutional set-up consistent with their objective function, which can facilitate the process of extending financing to the MSMEs.

- Islamic banks should voluntarily consider sustainable development as an objective function in serving the communities rather than the markets even if the regulative environment does not facilitate, including willingness to enable financing for MSMEs, among others. As such, a proactive and voluntary action will locate Islamic banks with their raison *d'etre*.

- Public policy and private development strategies should consider developing a strategic planning framework for MSMEs development and their financing through Islamic banking and finance. Such national strategy should also consider coordination of the efforts through various agencies.

- Collaborative institutional development between the private and public sectors helping the MSMEs reach the necessary domestic and international markets will allow them to develop a robust financial and economic position, putting them in a better place to get financing from Islamic banks.

- Technology has proven essential in converting the crisis into an opportunity, as witnessed during the COVID-19 period. Therefore, OIC member countries should develop the necessary technological infrastructure for MSMEs, covering from the start-up stage to operations and exit strategies.

- Encouraging MSMEs to cooperate with other market-supporting institutions and agencies and other risk-management mechanisms to enhance their institutional and financial stability.

- Entrepreneurship culture among the OIC youth should be developed through education and training by the private and public sector through the necessary institutional arrangement, and Islamic banks should consider developing particular projects towards such an end.

Legal and Regulative Environment

- The dual banking system should be effectively operated to create an opportunity space for Islamic banks and financial institutions to operate within its (Islamic) objective function to operationalise its essentialised features such as risk-sharing and PLS, which will help supporting MSMEs.

- Specialised Islamic banking and finance law in the OIC member countries which have not issued yet will provide an opportunity space for the emergence and operation of the distinctive nature of Islamic banks.

- The regulative environment should recognise the importance of PLS and the risk-sharing nature of Islamic banking in operations rather than only on the deposit side so that Islamic banks and financial institutions can demonstrate distinctions in their financing side.

- Regulative environment, therefore, should avoding forcing Islamic banks into operational mechanism alien to Islamic logic (such as Basel regulation's de facto imposition), which strips Islamic banks from operating within the Islamic logic, as such capital efficiency based regulations negate the Islamic logic's economic and social imperative, such as willingness to extend financing to MSMEs, beyond financial logic.

- New regulations for FinTech, as the next development stage of Islamic banking and finance, will help them move into a new paradigm of outreach and impact, including Islamic financing for MSMEs.

- A proper legal environment as part of MSMEs ecosystem must be provided for MSMEs, which should also recognise its connnections to the financial and insurance system.

Regional and International Cooperation

- Various agencies have emerged in the OIC member countries concerning MSMEs financing and operational aspects. Some of these institutions have developed valuable acumen in good practice. OIC based cooperation will help disseminate such good practices among the member countries to benefit from each other's learning curve. Experience sharing facilitation will be essential among the OIC member countries.

- OIC organisations such as IsDB and its relevant organs and agencies and OIC's relevant organisations, such as COMCEC and SESRIC, should develop joint projects to develop policies concerning MSMEs in the member countries, which can be a standing working group.

- Considering the particularities of the regional differences within the OIC, regional cooperation on aspects of MSMEs should be regarded as within particular regions.

- Increased trade between OIC member countries is essential for the long-term sustainability of MSMEs so that they can reach out to different markets to sustain their operations and hence financial stability, which can reduce their financing gap.

- The ecosystem and financial architecture relating to Islamic banking and finance in some OIC member countries are well developed, which should be considered good practices for the other OIC member countries.

- A well-developed Islamic finance ecosystem does not imply preferences given to MSMEs in the financing sphere, as the experience in some countries demonstrate. Therefore, good practices for MSMEs financing through Islamic finance and banking should be considered good case studies for the other OIC member countries.

- Harmonization of the definition of MSMEs should be considered among the OIC member countries as similar regional and political groupings have done so far, such as OECD and the EU. In this, country-based specifics should also be recognised. However, considering IsDB and OIC based initiatives to develop MSMEs and providing them, financing requires some definitions. Therefore, such an effort will make a positive impact.

In concluding, as assummed by Islamic moral economy, necessary environment must be created for Muslim individuals to achieve their emancipation and empowerment potentials. For this, MSMEs should be considered an instrumental institution, which contributes to wealth generation, job creation, value added creation, resource mobilisation, and innovation.

Islamic banking and finance emerged from an ontology (Islamic ontology) that aims to emancipate and empower human beings. Hence, Islamic banking and finance and MSMEs combination can be a vital and critical solution achieving Islamic economics' promised development in the OIC member countries. In its fourth institutional development stage (from social bank to commercial banks, and to capital and financial markets), Islamic banks can be grafted towards its main objective of development orientation which also require financing MSMEs. This will help to actualise *maqasid al-Shari'ah* in its Islamic substantive morality form.

Efforts for *ihsan* should be expedited so that *tawfik* (success) may be granted by Allah (*swt*).

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APPENDICES FOR THE INDONESIAN CASE STUDY

Appendix 1. List of Bank Wakaf Mikro

No	Name	Number of Customers (cum)	Number of Customers (out)	Amount of Financing (cum-million IDR)	Amount of Financing (outstanding-million IDR)	Product	Number of Products
1	LKMS Bankwakaf Alpansa	459	0	499	0		
2	LKMS Amanah Berkah Nusantara	1,200	219	2,400	262		
3	LKMS Ranan Indah Darussalam	1,700	331	2,100	257	Snacks	8
4	LKMS Berkah Bersama Baiturrahman	831	255	1,100	185	Mineral water	1
5	LKMS Buntet Pesantren	900	119	1,500	124	Chips	1
6	LKMS Denanyar Sumber Barokah	1,700	305	2,400	240	F&B	5
7	LKMS Almuna Berkah Mandiri	2,100	473	2,800	421	Clothes; snacks	4
8	LKMS Berkah Rizqi Lirboyo	2,000	222	2,800	264	Snacks	4
9	LKMS Khas Kempek	900	183	1,200	71		
10	LKMS Pesantren An Nawawi Tanara	1,200	232	1,800	257	Cake and Snacks	3
11	LKMS Amanah Makmur Sejahtera	1,000	193	1,500	222	Clothes; snacks	3
12	LKMS Assa Berkah Sejahtera	1,000	255	2,000	423	Clothes; snacks	39
13	LKMS El Manahij	1,100	173	2,300	182	Food	3
14	LKMS Al Ihya Baitul Auqof	676	169	769	53	Food, snacks, coffee	7
15	LKMS Lan Taburo	1,300	371	2,500	528	Snacks	3
16	Al Manshur Barokahing Gusti	1,300	222	2,500	243	Handicraft	3
17	LKMS Nahdlatul Wathon Cijantung	665	77	1,000	58	Snacks; handicraft	5
18	LKMS Tebuireng Mitra Sejahtera	1,000	208	1,600	261	Snacks, handicraft	5
19	LKMS Bahrul Ulum Barokah Sejahtera	1,000	197	2,000	240	F&B Snacks, handicraft	7
20	Lembaga Keuangan Mikro Syariah Al Fithrah Wava Mandiri	516	90	709	132	Snacks and beverages, handicraft, clothes	8
21	LKMS BWM Kariman Birajuda Al Karimiyyah	424	214	608	140	Handicraft	4
22	LKMS Pondok Pesantren Modern Al Kautsar	1,100	306	1,600	193	Food, Snacks, handicraft	13

23	LKMS Usaha Mandiri Sakinah (LKMS UNISA)	100	276	1,700	344	Food, Snacks, handicraft, clothes	20
24	Lembaga Keuangan Mikro Syariah Bank Wakaf Mikro Ponpes Futuhiyyah	800	325	1,300	348	Handicraft	5
25	LKMS Sinar Sukses Bersama	1,000	310	1,400	186	Snacks	1
26	Lembaga Keuangan Mikro Syariah Bankwakaf Imam Syuhodo	849	256	1,300	165	Snacks and clothes	8
27	LKMS Alpen Barokah Mandiri	878	182	1,500	312	Snacks, handicrafts and services	5
28	LKMS Berkah Umat Ciganitri	555	153	780	127	Snacks and F&B	14
29	LKMS Ummul Mukminin Aisyiyah	546	216	606	149	Snacks and handicrafts	5
30	LKMS BWM Taawun Mitra Ummat Pondok Pesantren Al Mujahidin Balikpapan	131	75	184	89	Snacks, fruit, and handicrafts	8
31	Lembaga Keuangan Mikro Syariah Pondok Pesantren Minhadlul Ulum	545	223	651	185	beverages and handicraft	14
32	LKMS Al Azhar Jember	1,000	366	1,700	472	Snacks and handicrafts	5
33	LKM Syariah AL-Falah	2,000	900	2,900	1,000	beverages and handicraft	6
34	LKMS Pondok Pesantren Mawaridussalam	320	90	489	107	snack and f&b	6
35	Lembaga Keuangan Mikro Syariah Sinar Mandiri Sejahtera	613	198	717	118	snack and handicraft	4
36	LKM Syariah-Bank Wakaf Mikro Sunan Pandan Aran	708	269	900	229	Clothes, food, snacks, handicraft, detergent & soap	23
37	LKMS Pondok Pesantren As'ad	781	261	1,100	287	clothes, handicraft and snack	7
38	Lembaga Keuangan Mikro Syariah Sunan Gunung Jati Ba'alawy Semarang	390	191	545	214	fruits, snacks, and clothes	3
39	LKMS Barokah Pesantren Al-Masthuriyah	709	255	1,100	311	food, snacks, shoes	13
40	LKMS Amal Dana Bergulir	354	163	389	66	snacks	3
41	LKMS Minhajut Thullab	798	295	1,000	244	Snacks	6
42	Ponpes Minhajut Thulab	363	112	603	99	Handicraft, shoes, snacks	12
43	LKMS Al Anshor Peduli	495	190	690	178		

44	LKMS Fajar Pelita Harapan	350	0	350	0		
45	LKMS Alhidayah Rokan Hulu	1,000	523	1,200	302	F&B, snacks	4
46	Lembaga Keuangan Mikro Syariah APIK Kaliwungu Kendal	900	325	1,600	494	F&b, snacks, and handicraft service	5
47	LKMS Mantenan Aman Makmur	577	204	1,000	277	food and handicrafts	3
48	LKMS BWM Ahmad Taqiuddin Mansur (ATQIA)	1,100	739	1,500	352	handicraft	5
49	Ponpes Al-Manshuriyah Ta'limusshibyan	499	221	748	175	snacks, handicraft, tabletennis equipment, brick	11
50	LKMS Pesantren Hidayatulloh Trenggalek	614	380	774	299	snack, beverages, scraping for trash	3
51	LKMS Bita Amanah Ummat	210	161	245	130		
52	LKMS BWM Bangkit Nusantara	204	89	254	40	handicraft	2
53	LKMS BWM Babul Maghfirah	265	164	359	119	snack and handicraft	5
54	LKMS BWM Aulia Cendekia Palembang	227	121	295	112	food, snack, handicraft, beauty products	8
55	LKMS BWM Al Hijrah Cindai Alus	354	198	502	195	snacks	2
56	BWM Al Mushoffa	100	100	100	84	clothes, beauty products, snack, handicraft	8
57	Koperasi Jasa Lembaga Keuangan Mikro Syariah Bank Wakaf Mikro Al Fadlu Kendal	210	210	210	74		
58	BWM Al Muayyad	60	60	60	46		
59	BWM Nurul Huda	110	110	110	84	snack and beverage	4
60	LKMS - BWM PKP	73	73	73	63	clothes, snacks, vitamin	3

Appendix 2. List of Businesses Funded by Equity Crowdfunding – Santara

No	Business Name	Category	Sub-category	Total Funding (in billion IDR)	Dividend Period (in months)
1	PT Persada Pangan Prakasa	F&B Provision	Nams Kopi	2	6
2	PT Kamo Group Sejahtera	Retail and Wholesale	Kamo Petshop Group	3	6
3	PT Ace Jaya Indo Realty	Retail and Wholesale	SPBU Shell	4	6
4	PT Surya Abadi Garmindo	Retail and Wholesale	Surya Abadi	2.2	6
5	PT Hamada Logistik	Transportation, Warehouse, and Communication	Hamada Logistik	3	6
6	PT Marlin Brothers Indonesia	Livestock	Marlin Brothers	2.8	12
7	PT Baja Utama Makmur	Retail and Wholesale	Baja Utama Tegal	3	6
8	PT Anugrah Peternak Gemilang Indonesia	Livestock	APG	3	6
9	PT Libra Corporindo Investama	Retail and Wholesale	Libra Online Store Group	3	6
10	PT Syarif Durian Indonesia	Retail and Wholesale	Syarif Durian	2.5	6
11	PT Gupo Jaya Petindo	Retail and Wholesale	Gupo Petshop	1.7	6
12	PT Ayam Broiler Nusantara	Livestock	Jaya Farm Poultry	8	6
13	PT Nada Damai Indomakmur	Retail and Wholesale	ND Fresh	0.057	6
14	PT Delta Gemilang Abadi	Retail and Wholesale	Delta Gemilang	19	6
15	PT Tirta Mina Radhika	Livestock	Surya Kencana Farm	0.85	6
16	PT ASPAL POLIMER EMULSINDO	Processing Industry	PT ASPAL POLIMER EMULSINDO	4.711869	6
17	PT Sei Sapi Kana	F&B Provision	Sei Sapi Kana	30	6
18	PT Giri Gemilang Persada	Retail and Wholesale	Gemilang Petshop Group	1	6
19	PT Mitra Kelola Abadi	Livestock	Mitra Broiler	1.6	6
20	PT Akang Amanah Makmur Bersama	F&B Provision	Baso Aci Akang	15	6
21	PT Mentari Timur Sentosa	Retail and Wholesale	ListrikKlik.com	3	6
22	PT Tirta Agrapana Semesta	Retail and Wholesale	H2in	0.6	6
23	PT Kandang Pintar Indonesia	Livestock	Smart Kandang	1.7	6
24	PT Kopi Loer Jaya	F&B Provision	Kopi Loer	1.5	6

25	PT Parahita Mugi Sejahtera	F&B Provision	Nasi Peda Pelangi	1.6	6
26	PT Rositama Baja Prima	Retail and Wholesale	Rosteel	3	6
27	PT Rhaka Jaya Farm	Livestock	Rhaka Jaya Farm	2.5	6
28	PT Milenial Kolaborasi Bisnis	F&B Provision	Kolektif CollaborAction Space	2.5	6
29	PT Bersama Surabaya Bisa	F&B Provision	Jokopi	25	6
30	PT Inovasi Makanan Indonesia	F&B Provision	Fried Id	6.5	6
31	PT Graha Barcode Mandiri	Retail and Wholesale	Barcode Barbershop	8	6
32	PT Boga Sinar Salam	F&B Provision	Kue Balok Mang Salam	1.3	6
33	PT KAMPUNG INGGRIS INDONESIA	Education Services	KAMPUNG INGGRIS BANDUNG	4.5	6
34	PT GST MITRA UTAMA	Society, individual, and other services	Fajar Citra Jaya	1.7	6
35	PT Tahooe Pranata Indonesia	F&B Provision	Tahooe & Ladybee	11	6
36	PT Kalis Damai Sejahtera	F&B Provision	Kalis Donuts	25	6
37	PT Soni Saktie Sejahtera	Society, individual, and other services	AHASS Soni Saktie Motor Group	20	6
38	PT Sintesa Karya Boga Sejahtera	F&B Provision	Brix Coffee & Kitchen	5	6
39	PT Layar Sentuh Lestari	F&B Provision	Warung Layar Sentuh	15	6
40	PT Salad Nyoo Indonesia	F&B Provision	Salad Nyoo	25	6
41	PT Maha Karya Sinergi Indonesia	F&B Provision	Goebog Resto dan DAyam Crispy	12	6
42	PT Indobat Nandhana Prima	Health and Social Services	Apotek Indobat	3	6
43	PT Indonesia Berkah Kulina	F&B Provision	Ayam Geprek Mang Soetta	5.5	6
44	PT Oasis Laju Sentosa	F&B Provision	Oasis Bubble Milktea and Dessert	7	6
45	PT Kopi Sembilan Delapan Indonesia	F&B Provision	Kopi 98 & Syndicate Koffie	2	6
46	PT Amberly Karya Indonesia	Retail and Wholesale	Amberly Fashion	0.6	6
47	PT Promosia Cipta Utama	Processing Industry	Hadi Sukirno dan Promosia.com	20	6
48	PT Reka Cipta Bangsa	Leasing and Company Services	Reka	0.35	12
49	PT AZFASA KULINARI INDOTAMA	F&B Provision	Mas JaC dan BOBA KOE	0.048	6
50	PT Muda Bangun Semesta	F&B Provision	Bento Kopi	20	6
51	PT Momen Jaya Abadi	F&B Provision	Moment Coffee & Space	17	6
52	PT Jali Merah Nusantara	F&B Provision	Jali Merah Koffie	6	6

53	PT Felice Gelato Nusantara	F&B Provision	Felice Gelato	11	6
54	PT Samudera Limpah Artha	F&B Provision	The Crabbys	6	6
55	PT Sambel Rintis Kuningan	F&B Provision	Kedai Sambel Rintis	11	6
56	PT Ramen Hits Kekinian	F&B Provision	Waroenk Ramen	11	6
57	PT Dimsum Jagoan Indonesia	F&B Provision	Dimsuming	0.013	6
58	PT Sinar Palagan Baru	F&B Provision	Nasi Uduk Palagan	14	6
59	PT Naura Global Indonesia	Retail and Wholesale	Nutrishe	7.021568	6
60	PT Adhi Trindo Bogatama	F&B Provision	Bean Me Up	0.01	6
61	PT Handal Selaras Medika	Health and Social Services	Kosambi Maternal & Chicken	0.0015	6
62	PT Mitra Usaha Grup	F&B Provision	MUG Authentic Coffee Atjeh	0.014	6
63	PT Bima Jaya Mukti	F&B Provision	Warung Cak Muk	3.6	6
64	PT Kenyang Puas Selalu	F&B Provision	Steak Addict	9	6
65	PT Cerita Hidup Sehat	F&B Provision	Kraveformore	12	6
66	PT Harum Prasama Kopi	F&B Provision	Aromia Coffee	10	6
67	PT Teto Cita Rasa Otamah	F&B Provision	Mr. Teto Sate & Soto	12.5	6
68	PT Adaf Safeer Indonesia	Retail and Wholesale	Adaf	0.0025	6
69	PT. Aldan Sembada Rasa	F&B Provision	Lesehan Aldan	15	6
70	PT Buma Cipta Rasa Otamah	F&B Provision	Nasi Bebek Buma	6	6
71	PT Esteboo Manis Indonesia	F&B Provision	Esteboo	0.005	6
72	PT Beautylux Gemilang Indonesia	Health and Social Services	Beautylux	18	6
73	PT Rahajeng Bersama Unggas	Livestock	PT Rahajeng Bersama Unggas	0.005	6
74	PT Taman Boga Sejahtera	F&B Provision	Chicken Crush	6.6	6
75	PT Sumber Rejeki Berkah Lautan	Fisheries	PT Sumber Rejeki Berkah Lautan	60	6
76	PT Kembar Cipta Boga	F&B Provision	PT Kembar Cipta Boga	0.01	6
77	PT. Megah Lautan Utama	Fisheries	PT. Megah Lautan Utama	0.015	6
78	PT Bhisma Chakti	F&B Provision	Fello BnB	0.26037	12
79	Cakekinian Yogyakarta	F&B Provision	Cakekinian Yogyakarta	0.176	6
80	PT. Ardigu Makmur Bersama	Real Estate	Kampung Tahfidz Indonesia	0.1532	18
81	Tambak Udang Vaname	Livestock	Tambak Udang Vaname #2	0.055994	4
82	Tambak Udang Vaname	Livestock	Tambak Udang Vaname #3	0.055974	4
83	PT. Milichem Indonesia	Livestock	Domba Milichem Tahap 2	0.153529	12
84	Tambak Udang Vaname	Livestock	Tambak Udang Vaname #1	0.05598	4

85	PT. Piring Baja Sinar Anugrah	F&B Provision	Plate-O	0.1114	6
86	PT. Milichem Indonesia	Livestock	Domba Milichem Tahap 1	0.110492	12
87	PT. Bebek Prima Nusantara	Livestock	Bebek	0.124541	6
88	PT. Manggala Karya Bangun Sarana	Agriculture, Hunting, and Forestry	Pepaya	0.05	16
89	YAMIE PANDA	F&B Provision	YAMIE PANDA	0.112598	6
90	PT. Kembar Cipta Rasa	F&B Provision	PT. Kembar Cipta Rasa	0.115234	6
91	PT. Cipta Agrinusa Mandiri	Agriculture, Hunting, and Forestry	Durian	0.376737	12
92	Mayasi	F&B Provision	Mayasi Resto	2.653386	6

Appendix 3. List of Businesses Funded by Equity Crowdfunding – Bizhare

No	Business Name	Category	Investment Value (in billion)	Number of Investor	Business Value (average-in billion IDR)	Profit Sharing Period (in months)	Dividend yield (%)	BEP (in months)
1	Alfamidi	Retail	5,145	436	4,860	3	20-25.5	55-60
2	Parahyangan Green Resort	Property	6,953	6	6,953	3	15-28	24
3	Salsa	Retail & Wholesale	1,358	75	1,358	1	20-32	37-45
4	Tihama	Health Product and Services	10,000	61	10,000	1	17-30	36-48
5	Dr Metz Skincare	Beauty Clinic	0	0	2,308	3	25-34	29-37
6	BAM Cargo	Cargo	602	296	2,058	3	16-22	60-72
7	Djakarta Streetfood and Baberjek House	F&B	234	89	600	3	40	48
8	Lets Toast	F&B	1,179	381	2,000	12	20-30	24-36
9	Bakmi Gili	F&B	0	0	20	6	25	40
10	Ternak Pintar	Livestock	0	0	10,000	6	15-26	44-77
11	Penyetan Cok	F&B	0	196	1,000	3	30-35	40
12	Travelbook Tours and Travel	Tour and Travel	0	0	7,000	3	20-30	3-4
13	Golden Lamian	F&B	0	0	2,500	3	20-30	48
14	Sour and Sally	F&B	1,228	453	1,300	3	25-30	10-13
15	Gulu Gulu Cheese Tea	F&B	0	0	350	3	30-35	7-10
16	Lamak Coffee	F&B	550	116	550	3	20-30	60
17	Ternak Kambing	Livestock	391	161	1,700	6	9	24
18	AutoClean Waterless Indonesia	Automotive	0	0	700	3	12-20	24-36
19	KJV Motorsport	Automotive	0	0	7,000	3	15	48
20	Kopi Oey	F&B	2,325	553	800	3	15	36
21	Eghili Kost	Accommodation	0	0	3,960	3	30	120
22	Akila Dental	Dental	0	0	1,385	1	20-30	12-18
23	Djakarta Café	F&B	1,460	234	2,290	1	20-30	18
24	Apotek Indobat	0	0	1,300	3	20-30	32-40	
25	Thai Street	F&B	602	141	2,000	3	25-30	36-44
26	Isla	Clothing Line	500	29	1,500	6	30	27
27	Holycow Steakhouse By Chef Afit	F&B	0	0	2,000	1	25-30	15-24
28	Donburi Ichiya	F&B	1,640	145	2,000	3	25-35	24-36
29	Capital Bakery	F&B	0	0	2,000	1	25-35	24-36
30	Chir chir	F&B	2,565	61	3,000	1	30-35	34-50
31	Burger Klenger	F&B	0	0	500	3	20-25	30-40
32	Refit	Gym	0	0	2,000	1	25-35	36-45
33	Chapayom	F&B	0	0	300	1	30-35	30-35

34	Straps	Retail	0	0	1,000	1	25-35	30-40
35	Stella Maris	Education	0	0	5,000	12	10-15	60-80
36	Lakoe Desert	F&B	264	52	400	3	25-35	25-30
37	Odysen Barbershop	Barbershop	680	66	200	3	10-20	50-60
38	Flip Burger	F&B	2,010	162	1,500	1	20-30	50-60
39	Rumah Makan Padang Sederhana Lintau 88	F&B	4,390	261	2,500	1	15-20	50-60
40	Smokey Kontainer Kebab Baba Rafi	F&B	520	40	250	1	10-15	50-60
41	Fishstreat	F&B	1,904	14	1,000	1	20-30	40-50
42	Tambak Udang Vaname	Shrimp Farm	2,080	133	250	4	15-30	30-60
43	Gerai Indosat Ooredoo	Telecommunication	0	0	300	1	15-25	30-40
44	Foreshthree Coffee	F&B	865	77	400	1	20-30	36-48
45	Kebab Turki Baba Rafi	F&B	260	15	250	1	10-15	50-60
46	Laundry Klin by KliknKlin	F&B	210	43	250	3	25-30	48-60
47	Alfamart	Retail	6315	367	700	3	20-30	36-48