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**An investigation of the adoption of Islamic
financing instruments by
small and medium enterprises in the
Sultanate of Oman**

A thesis
submitted in fulfilment
of the requirements for the degree
of

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at

The University of Waikato

by

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Abstract

This PhD thesis investigates the intention of Omani small and medium enterprise (SME) owner-managers to adopt Islamic financing instruments (IFIs). Traditionally, when deciding how to finance their businesses, owner-managers of SMEs in the Sultanate of Oman have had to rely on the conventional financing instruments offered by the Omani banking industry. However, the recent emergence of Islamic banking and finance as a new offering within Oman's financial services industry has altered that situation. SME owner-managers in Oman can now choose between Islamic and non-Islamic finance options when making their financing decisions. Thus, gaining insight into which option they intend to choose is important, since the choice they make will change their enterprise's financial structure. The research undertaken in this thesis is, therefore, significant, because it investigates the part that Islamic financing instruments can play in both stimulating economic growth in Oman's SME sector and in encouraging a more equitable sharing of that growth.

Although capital structure theories grounded within the finance paradigm have enhanced our understanding of the capital structure puzzle, as Brealey, Myers, and Allen (2010) reveal, "how financial decisions are made" (p. 10) is a question that still needs to be answered. Finance researchers still need to be encouraged to continue their efforts to identify the missing pieces of the puzzle. To illustrate, such things as diverse nonfinancial and behavioural factors that influence capital structure decisions could be the missing elements of this puzzle.

Theoretical and empirical studies of capital structure have focused primarily on large listed firms; only a few studies have focused on the capital structure of SMEs. In addition, little is known about why financial choices vary among small businesses, especially how and why SME owner-managers make financial decisions. This gap in the literature is particularly evident when investigating the factors that influence the funding decision around Islamic financing in a country where Islamic finance represents a new banking sector offering.

Furthermore, the focus of the extant small business finance literature has centred primarily on the developed world. An assumption that its findings can be transferred to emerging economies is implicit, despite the fact that there are significant

institutional differences between small businesses in the developing and developed worlds. These differences warrant scholarly attention. In responding to that need, this thesis produces three research papers that examine three interrelated phenomena. Through the lens of Omani SME owner-managers, these papers provide additional insights into how SME owner-managers evaluate and select the Islamic financing options for their firms that have recently been introduced in the Omani context.

The first paper, entitled “Islamic financial decision-making among SMEs in the Sultanate of Oman: An adaption of the theory of planned behaviour (TPB)”, investigates SMEs’ Islamic financial decision-making by adopting the theory of planned behaviour (TPB). As such, it is one of the few global studies that seeks to propose and apply a theoretically modified model of Ajzen’s (1991) theory of planned behaviour to investigate SME owner-managers’ financial behaviour. As is already known, small firms are financed differently from large firms (Moritz, Block, & Heinz, 2016), because their financial reasoning is influenced by both economic and noneconomic motives (Gallo, Tàpies, & Cappuyns, 2004). Moreover, it is argued that small businesses not only behave and act differently from larger firms, but that they also utilise different financing mechanisms (Berger & Udell, 1995). In order to better understand the financing behaviour of SME owner-managers, particularly SME owner-managers’ Islamic financial decision-making, a conceptual model which borrowed from behavioural psychology was developed. The paper argues that nonfinancial factors such as SME owner-managers’ attitudes, subjective norms, perceived behavioural control, and behavioural intentions largely affect the financial decisions of SMEs. While this study found that religiosity showed a significant negative relation, and is not a predictor of SME owner-managers’ intention to adopt Islamic financial instruments, awareness did show a significant positive relation and was an important factor in predicting Islamic finance instrument adoption intention.

The second paper, entitled “Determinants of the decision to adopt Islamic finance: Evidence from Oman”, explores whether Omani SME owner-managers’ intention to adopt Islamic finance is influenced by their knowledge of Islamic finance, their own characteristics, and/or their firm’s characteristics. Here the literature indicates that a complex array of factors influences SME owner-managers’ financing decisions (Romano, Tanewski, & Smyrniotis, 2001). For example, entrepreneurial characteristics (Abdulsaleh & Worthington, 2013); business life cycle issues (La Rocca, La Rocca,

& Cariola, 2011); age and size of the firm (Cassar, 2004); and, industry sector (MacKay & Phillips, 2005) have all been shown to be influential. However, it appears that this literature has not made explicit those factors that influence SME owners' decisions on Islamic finance. Accordingly, this second paper explores whether or not SME owner-managers' Islamic financial knowledge of profit and loss sharing (PLS) instruments such as *musharakah* and *mudarabah*, and nonprofit and loss sharing (non-PLS) instruments such as *murabaha*, along with personal characteristics (gender and education) influence their intention to adopt Islamic finance. While it was found that such knowledge does influence their decision-making, their firm's characteristics were found to have no significant influence on SME owner-managers' Islamic financial decisions.

The third paper, entitled "Omani SME perceptions towards Islamic financing systems", investigates SME owner-managers' awareness, willingness, and perceptions concerning Islamic financing instruments as an alternative finance sourcing decision in Omani SMEs. Much research has been conducted to investigate consumer attitudes and perception towards conventional financing. Similarly, many studies have explored consumer attitudes and perception towards Islamic finance. However, only limited studies look at SME owner-managers' perception towards Islamic finance. In response to the important gap between the few empirical studies related to small businesses and their importance in the world economy (Zingales, 2000), this study explores SME owner-managers' financing perception and understanding of the newly available IFI options within Oman as an emerging context. The results show that SME owner-managers are aware of Islamic banking principles and have knowledge of Islamic financial instruments, despite Islamic finance's being new to the Omani banking industry. Interestingly, although the majority of the study's participants indicated their intention to adopt this new finance method, they were motivated by special requirements other than finance. Their positive perception of Islamic financing methods could, therefore, play a significant role in developing the Islamic banking industry.

In the main, these three papers employed quantitative methods. For instance, their primary data were gathered from 385 SME owner-managers via face-to-face interview, a method commonly used in SME research (Berger & Black, 2011). The interviews took place in Muscat, Oman's capital, between December 2016 and February 2017.

Additionally, follow-up interviews with 86 SME owner-managers probed their reactions more deeply in order to gain more detailed understanding of attitudes to the newly introduced phenomenon of Islamic finance in Oman (Creswell, 2013). The data from these interviews are used in the third paper. It is worth pointing out here that this study is the largest of its kind undertaken in Oman.

To check hypotheses relevant in this study, statistical techniques were used. Factor analysis and hierarchical multiple regression were used for the first paper and Kruskal-Wallis' one-way ANOVA nonparametric test and factor analysis were employed for the second paper. Descriptive and thematic analysis were used to analyse the data for the third paper.

Given the importance of the SME sector to the economic growth of Oman, it is believed that the findings of this research can assist policymakers who are targeting small businesses, because they need to recognise that the financing needs of small business are not constant, but rather change with the owner-managers' characteristics, and that they should match their policies to SME owner-managers' changing needs. Consequently, this study should enable Islamic banking to design financing programmes tailored to the specific needs of SME owner-managers, which will attract them to adopt the newly introduced phenomenon of Islamic finance, and which may, in turn, foster broader dissemination of Islamic financing.

Furthermore, this study will be important for policymakers concerned about SMEs' financing, Islamic financial institutions, and new entrants into the Islamic banking industry, as it provides empirical evidence of Omanis' views, and more specifically, those of Omani SME owner-managers, on the recent introduction of Islamic finance into the country. The insights this study offers should help them to develop the strategies required to attract SMEs and to construct policies and regulations to improve Oman's Islamic banking industry, which, it is hoped, will enhance Oman's economic development.

The three papers in this Ph.D. thesis have already appeared in a peer-reviewed journal.

Keywords: SMEs, Islamic finance decision-making; theory of planned behaviour; religiosity, awareness, willingness, perception, firm owners' Islamic financial knowledge, firm owners' and firm's characteristics, Oman.

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List of Abbreviations

ANOVA	Analysis of Variance
ATMs	Automated Teller Machines
CBO	Central Bank of Oman
CMA	Capital Market Authority
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
HMR	Hierarchical Multiple Regression
IBRF	Islamic Banking Regulatory Framework
IFAAS	Islamic Finance Advisory and Assurance Services
IFDI	Islamic Finance Development Indicators
IFI	Islamic Financial Instrument
IFIs	Islamic Finance Instruments
IFIs	Islamic Financial Instruments
IFSB	Islamic Financial Services Board
ILO	International Labour Organization
INCEIF	International Centre for Education in Islamic Finance
IPO	Initial Public Offering
ITC	International Trade Centre
MENA	Middle East and North Africa
MOCI	Ministry of Commerce and Industry
MSM	Muscat Securities Market
NIFIs	Non-Islamic finance instruments
Non-PLS	Nonprofit and loss sharing
ODB	Oman Development Bank
OHB	Oman Housing Bank
OMR	Omani Rail
PBC	Perceived Behavioural Control
PLS	Profit and Loss Sharing
SME	Small and Medium Enterprise
SQU	Sultan Qaboos University
SWOT	Strengths, Weaknesses, Opportunities and Threats analysis
TPB	Theory of Planned Behaviour
TRA	Theory of Reasoned Action
USD	US Dollar
VIF	The Variable Inflation Factor
WEF	World Economic Forum
WHO	World Health Organisation

Chapter 1

1.1 Introduction

This research investigates the intention of Omani small and medium enterprise (SME) owner-managers to adopt Islamic financing instruments. Traditionally, when deciding how to finance their businesses, owner-managers of SMEs in the Sultanate of Oman have had to rely on the conventional financing instruments offered by the Omani banking industry. However, the recent emergence of Islamic banking and finance as a new offering within Oman's financial services industry has altered that situation. Given that SME owner-managers in Oman, and elsewhere, can now choose between Islamic and non-Islamic finance options when making their financing decisions, gaining insight into which option Omani SME owner-managers intend to choose is important, because the option chosen will change the enterprise's financial structure. The research undertaken in this thesis is, therefore, important, because it investigates the part that Islamic financing instruments can play in both stimulating economic growth¹ in Oman's SME sector and in encouraging a more equitable sharing of that growth.

The Sultanate of Oman is a small, Middle Eastern country strategically positioned on the Arabian Gulf. Although the country is resource-rich and it has achieved impressive growth over the last 40 years (Chapter 2 provides a more detailed account of Oman's economy.), Oman's economy is highly dependent upon one natural resource: hydrocarbons. To illustrate, 84 per cent of Oman's revenue comes from oil and gas alone. This heavy reliance on hydrocarbons leaves the country's economy vulnerable to both slumps in domestic hydrocarbon production and to price volatility in international oil markets. Given its strong dependence on oil and gas, Oman has over the last four decades been striving to diversify the country's economy and to boost the role of the private sector in particular. To that end, Oman has paid particular attention to growing an effective SME sector.

¹ Carrying out the financial intermediation role by pooling and channeling funds to the productive investment.

The Omani government's emphasis on growing this sector is predicated on the wide understanding that SMEs, their formation, and the successful financing of both are not only critical components of the economy, but also vital for strong and sustainable economic growth (Kennickell, Kwast, & Pogach, 2015). Interest in the role of SMEs in the development process of most countries continues to be at the forefront of most policy debates (Abor, 2007) and Oman is not alone in its desire to lessen the reliance of its economy away from hydrocarbons and towards the SME sector.

The recent drops in oil prices have (second half of 2014), for instance, also affected other oil exporting countries such as the Gulf Cooperation Council (GCC) countries², and pushed them, along with Oman, into an era of austerity. In order to diversify away from oil, these countries have also recognised the importance of the SME sector's potential to support sustainable economic development and create jobs for their growing populations. It is no surprise, therefore, that in its efforts to shift economic growth away from the hydrocarbon sector by 2020, the Omani government has introduced a number of initiatives to further develop the role of the country's SME sector.

The Sultanate of Oman is the last Gulf Arab state to license Islamic banks to offer Islamic finance (i.e., Sharia-compliant products), a form of finance which is in its early stages of development. The introduction of Islamic banking in 2012 is a notable development in the banking sector and, according to Thomson Reuters (2016), the welcoming of Islamic finance in Omani banking is "a prominent signal that the country is keener on and now more open to new opportunities in terms of diversifying its economy" (p. 16). Until 1975, banks in Oman offered non-Islamic finance instruments (NIFIs) (Chapter 2 details Oman's banking industry.). Since then, new Islamic finance instruments (IFIs) have been gradually increasing. Islamic financing is growing in terms of its impact on the banking sector and its aims to promote growth in the economy and to promote financial inclusion³ and

² Gulf Cooperation Council (Oman, Bahrain, Saudi Arabia, Kuwait, Qatar, and the United Arab Emirates).

³ Financial inclusion measures the proportion of firms and individuals that use formal financial services (World Bank, 2015). Islamic financing promote financial inclusion through the Sharia-compliant microfinance programmes by removing people from poverty-line into becoming entrepreneurs.

diversity of banking services. Further, once the fully-fledged Islamic banks pass through the initial teething phase, they will have a bigger role to play and will boost the stability of the banking the sector⁴ (Central Bank of Oman, 2015). (Chapter 2 details the Islamic banking industry in Oman.).

According to the Supreme Council for Planning The General Secretariat Muscat (2016):

. . . it is hoped that the Islamic Banks and Windows⁵ play an important role in contributing to the economic development of the Sultanate of Oman and achieve substantial economic benefits by concentrating activities and products to invest in real economies, providing the necessary funding to promote investment opportunities in various projects, meeting the financial requirements for a large group of citizens and taking advantages of its various services and products. (p. 4)

Given that the Sultanate of Oman now has a dual financial system whereby conventional and Sharia-compliant products are available to its people, it is important to investigate Omanis' intention to adopt the new finance options that are now available to them and, more specifically, to investigate the adoption intention of SMEs. The financing decisions of SMEs have important implications for the economy (Cassar, 2004), given the role that the private sector plays as the engine of growth. Furthermore, as Romano, Tanewski, and Smyrnios (2001) argue, an enterprise's capital structure, opportunities for growth, profit performance, and long-term survival can all be impacted by that institution's financing decision or choice of finance; they also go on to point out that many of the factors that contribute to an enterprise's failure can be avoided through the proper management of financial decisions that drive growth and meet the organisation's objectives. Gaskill, Van Auken, and Manning (1993) emphasise that the main cause of business failure is the lack of financial planning. Therefore, understanding SMEs' financing decision is very important, as it can help them to develop further and, ultimately,

⁴ Through the nature of Islamic finance product e.g. asset-based and risk sharing.

⁵ A window within a conventional bank provides Islamic banking services.

will help them to play their crucial role in investment, growth, innovation, and employment.

Additionally, if Islamic financial institutions have a better understanding of the different financing needs and behaviour within the SME sector, having this knowledge will help them to target SMEs more effectively and to serve them better, because SMEs not only behave and act differently from larger firms, but also utilise different financing mechanisms. According to the World Bank (2015), “Islamic finance can play an important role in closing the financing gap for SMEs” (p. xi). Thus, in acknowledging the importance of the SME sector and Islamic financial institutions not only in the Omani context, but also in other contexts, this study is of specific and significant importance to policymakers who are targeting economic development through the development of the SME sector and the financial system.

According to Ardic, Mylenko, and Saltane (2011), it is difficult for policymakers to take decisions on expanding and strengthening the SME sector without reliable SMEs information. In light of the claim that a country case study would provide crucial investigation of small businesses (Beck & Demirguc-Kunt, 2006; Shaban, Duygun, Anwar, & Akbar, 2014), the focus of this study is limited to a single country, the Sultanate of Oman, and the objective of this doctoral study is to investigate the adoption of Islamic financing instruments by SMEs with the emergence of Islamic banking in the Sultanate of Oman. As the market for Islamic financial institutions (IFIs) in Oman is new, this country provides an interesting case context in which to analyse SME financial decision-making in an emerging economy. Furthermore, this thesis has produced three core research papers (See chapters 3, 4, and 5.) that contribute towards this aim. Each of these papers highlights its rationale and the key contributions that each study makes towards filling the gaps uncovered through the literature review.

1.2 Research Issue

The point of departure in this study is that small and medium enterprises, regardless of how they are defined, are widely recognised as engines of economic growth (Beck & Demirguc-Kunt, 2006; Beck, Demirgüç-Kunt, & Pería, 2011). The SME

sector has become significant to economists and policymakers who are making decisions on financial and economic development around the globe. In addition, the SME sector forms the backbone of economic development. There are many advantages to SMEs in that they provide job opportunities for both skilled and unskilled people, contribute to gross domestic product (GDP), promote economic diversification, and reduce poverty. Globally, SMEs constitute up to 95 per cent of the world's firms (International Trade Centre, 2015); according to International Labour Organization (ILO) (2015) estimations, there are 420 to 510 million SMEs worldwide, with the majority—365–445 million—being located in developing economies. Studies indicate that formal SMEs contribute up to 45 per cent of employment and 33 per cent of GDP in developing economies and nearly 64 per cent of the GDP and 62 per cent of employment in high-income countries (International Finance Corporation, 2013). The importance of SMEs is reflected in the fact that the World Bank Group's SME finance portfolio includes almost USD 4.8 billion in active lending. As of January 2018, this group was supporting 61 lending projects in 47 economies around the world (World Bank Group, 2018).

Despite their importance to economic output, SMEs are still inadequately supported financially, with inadequate access to finance being one of the main obstacles they face. Access to finance is a global challenge for both developed and developing countries. According to the World Bank (2015), the financing gap for micro, small, and medium enterprises (MSMEs) in developing countries is approximately USD 2.4 trillion. Thus, "Islamic finance can play a significant role in closing the financing gap for SMEs" (World Bank, 2015, p. xi), because Islamic financial products are founded mainly on asset-based transactions, together with equity-based sharing of risk and profit. The relevance of Sharia-compliant SME financing and its risk-sharing characteristics has, from an economic development perspective, been recognised by various policymakers in different countries and by international bodies (World Bank, 2015). Therefore, policymakers and stakeholders should seriously consider promoting asset-backed and equity-based financial instruments to leverage Islamic finance (World Bank, 2015).

Further, the World Bank (2015) emphasises that Islamic finance needs to be set in the context of the broader global agenda to support SME finance. Similarly, Ibrahim, Wohlmuth, and Knedlik (2003) emphasise that Islamic finance methods are better

suiting to satisfying the financial needs of SMEs. In this regard, the International Trade Centre (ITC) also emphasises the reasons why SME owner-managers should consider Islamic finance for their business stating that:

Islamic banking also advocates entrepreneurship and risk sharing. In the profit-sharing concept of a financed project, the financier and the beneficiary share the actual or net profit/loss, rather than leaving the risk burden to the entrepreneur. The principle of fairness and justice requires that the actual output of such a project be fairly distributed between the two parties. If a financier is expecting to make a claim on a project's profits, he or she is also expected to carry a proportional share of the loss of that project. (International Trade Centre, 2009, p. 50)

Backed by almost 494 Islamic financial institutions operating in more than 75 Muslim and non-Muslim countries, Islamic finance has become a growing force in global financial circles (Thomson Reuters, 2017). From insignificant beginnings, the industry had grown to USD 2.293 trillion in assets by 2016 (Dubai Islamic Bank, 2017) and is expected to reach USD 6.1 trillion by the end of the current decade (Grewal, 2013). There is no doubt that Islamic banking assets are growing rapidly. For example, between 1998 and 2005, Islamic bank assets grew at 111 per cent annually versus only a 6 per cent average annual growth rate for conventional bank assets (Bahrain Monetary Agency, 2006).

This expansion is taking place in various forms. Not only have local banks in Muslim countries adopted Islamic banking principles, but large multinational banks have also established Islamic windows. Bank of America, ABN Amro, Citibank, HSBC, the Union Bank of Switzerland, and Standard Chartered all either have Islamic banking subsidiaries or offer their customers Islamic financial products. In fact, "Islamic banking and finance has shown remarkable global success in terms of growth, expansion, and institutional and product diversification" (World Bank, 2015, p. viii). Islamic finance has clearly metamorphosed from being a little-known financial experiment into a notable player in global finance. Its growth also signals not only its financial importance, but also the increasing economic influence of the world's billion-plus Muslims, and, thus, the potential of this industry in the long term (World Bank, 2015). There is a clear recognition of Islamic finance and its significance in banking worldwide.

Iran, Malaysia, and Saudi Arabia are the established leaders in the Islamic banking industry. However, GCC countries such as the UAE, Kuwait, Bahrain, and Qatar have huge potential to become global players in the Islamic banking industry (Islamic Bankers Association, 2015). Islamic financial services are one of the important groups of banking services in the GCC region and they have experienced rapid growth (Srairi, 2010).

The following facts are significant and indicate that Islamic banking is systematically important to GCC countries:

- The leading Islamic banks are based in the GCC region; for instance, the Al Rajhi Bank, which is the world's largest Islamic bank, is based in Saudi Arabia.
- The first fully-fledged Islamic bank was established in Dubai in 1975.
- More than 65 per cent of global Islamic banking assets are in the GCC region and account for the largest proportion of Islamic financial assets (Qattan, 2015).
- At the end 2013, Sharia-compliant assets reached USD 490 billion. Saudi Arabia represents the dominant player in the region, with a 49 per cent share (Basu, Prasad, & Rodriguez, 2015).
- There was continued growth of Islamic banking assets in GCC countries from 2008 to 2014 (See Figure 1.).
- At the end of 2013, the largest Takaful⁶ market was in the GCC region, with an estimated total of USD 8.4 billion (Islamic Financial Services Board, 2015).
- In the first half of 2014 the banking assets in the GCC region were USD 564.2 billion, which outstripped those for Asia and the Sub-Saharan Africa regions (See Figure 2.).
- Islamic banking's growth rate is faster than that of conventional banking in GCC countries (See Figure 3.).

⁶ Islamic insurance

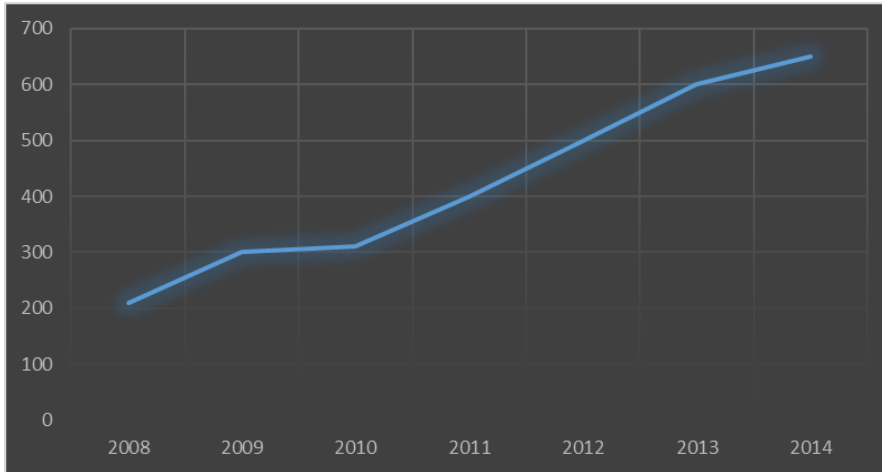


Figure 1. Growth trend of Islamic banking assets in GCC countries USD billion form 2008-2014.

Source: Qattan (2015)

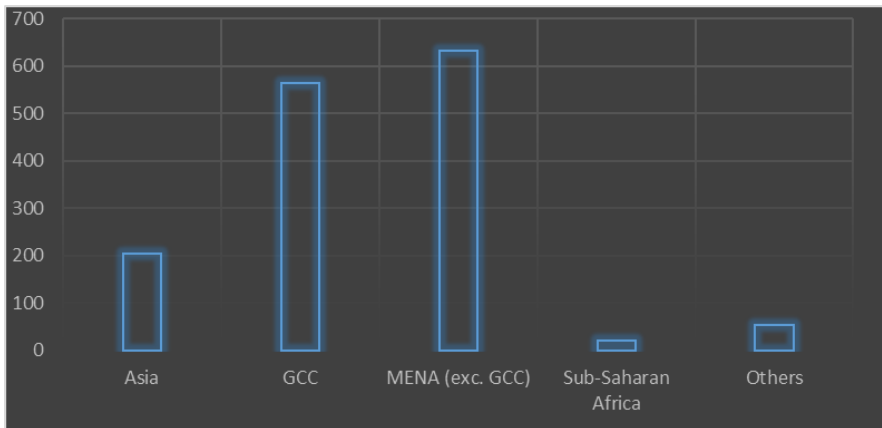


Figure 2. Islamic banking assets by region.

Source: Islamic Financial Services Board (2015)

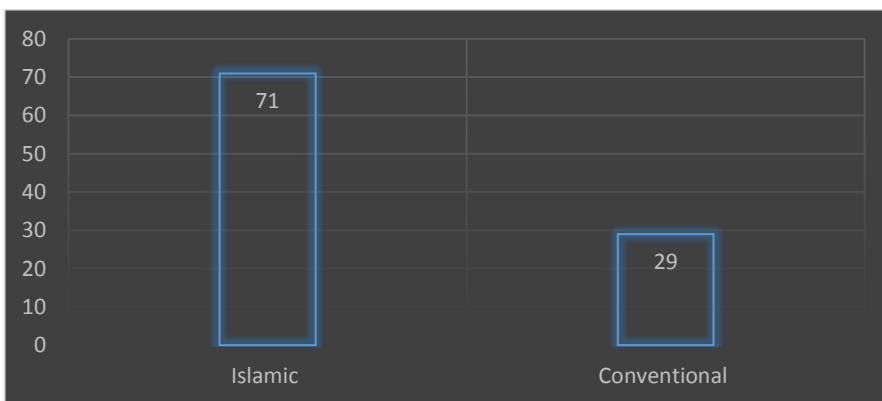


Figure 3. Growth of Islamic compared to conventional banking in the GCC region from 2009 to 2013.

Source: Qattan (2015)

The majority of the population in the GCC region is Muslim. The world's Muslim population has been increasing. Currently, one fifth of the world's people are Muslim and over the next two decades it is expected that the Muslim population will grow at twice the rate of the world's non-Muslim population. If this situation continues, the Muslim population will be 8.3 billion in 2030, that is, 26.4 per cent of the world's total projected population (TheCityUK, 2015). Given this context, there are golden opportunities for the Islamic finance industry to progress further. These include: (i) a growing Muslim population that will lead to increased demand for Sharia-compliant products; (ii) the active role played by scholars around the world to promote the development of Islamic banking; (iii) the superior performance of Islamic banking during financial crises; and, (iv) growing global interest in the Islamic finance industry (Mauro et al., 2013).

As shown above, there is, therefore, huge potential for the growth of Islamic banking in both Muslim and non-Muslim countries⁷. In order for Islamic banking to expand, it is crucial for Islamic financial institutions to understand not only the attitudes, awareness, preferences, and willingness of market participants to adopt Islamic banking, but also the reasons why they might decide to choose Islamic methods of finance and the factors that may influence that choice. More particularly, there is a pressing need to understand SMEs' perception towards Islamic methods of finance.

Numerous studies have discussed business firms' and individual consumers' attitudes and intention towards non-Islamic banking products and services. For example, levels of satisfaction, bank services, preferences, bank loyalty, and selection criteria for choosing financial institutions have been researched (Echchabi & Nafiu Olaniyi, 2012; Edris, 1997; Gait & Worthington, 2008). By the same token, there has also been much research on consumers' attitudes, perception of, and knowledge about Islamic banking in Muslim and non-Muslim countries (Al-Ajmi, Abo Hussain, & Al-Saleh, 2009; Gait, 2009; Jaffar & Musa, 2013). However, "Until recently, there has been very little work undertaken on business firms' attitudes towards Islamic methods of finance" (Gait & Worthington, 2008, p. 802).

⁷ Huge potential for the growth of Islamic banking in non-Muslim countries because of growth of Islamic banking, Muslim demands, globalisation and the Gulf influence.

In fact, many researchers (Abdesamed & Wahab, 2015; Badaj & Radi, 2017; Jaffar & Musa, 2013, 2016; Osman & Ali, 2008) have identified this gap in the literature.

Moreover, there are only a few published works that relate to SMEs' perceptions on Islamic banking (Abdesamed & Wahab, 2015; Gait, 2009; Jaffar & Musa, 2013; Jalaluddin & Metwally, 1999; Osman & Ali, 2008; Shaharuddin, Hamid, Safian, & Muda, 2005; Wahab & Abdesamed, 2012). These studies are not only interesting, but also confirm the significance of the SME sector's understanding of and desire to embrace Islamic finance methods. Since SMEs are key players in the global economy, according to Wahab and Abdesamed (2012, p. 3715), it is crucial to understand their financing practices, as these "serve as the foundation towards accelerating economic growth". While the majority of these studies have been conducted in Muslim and non-Muslim countries, i.e., in the context of a country with a predominately Islamic finance system and in a country with a dual-finance system), there are still many countries where Islamic finance is at an early stage of its introduction and where Islamic methods of finance need to be studied.

More particularly, the Sultanate of Oman is the last of the six-nation GCC countries to introduce Islamic finance, despite the fact that nearly all Omanis are Muslims. The first evidence of a move towards Islamic banking came in 2012 and represented a notable development in the Omani banking sector. A royal decree by Sultan Qaboos allowed the offering of Islamic finance products. Prompt action was taken by the Central Bank of Oman in 2012 to release the comprehensive Islamic Banking Regulatory Framework (IBRF). According to Thomson Reuters (2013), Washington-based scholar Muddassir Siddiqui, the president and chief executive of Sharia Path Consultants LLC, declared that "Oman came from behind but it is now among the very few jurisdictions to introduce such a comprehensive set of rules. I am sure it will inspire others to follow" (p. 1).

Nevertheless, Oman's late entry provided an opportunity for the country's Islamic banking industry to take advantage of the experiences of other countries and to provide best practices (Islamic Finance News, 2015). As a result, Thomson Reuters' Islamic Finance Development Indicators (IFDI) report 2015 has declared Oman to be the world's third most developed Islamic finance market (Thomson Reuters, 2015). Moreover, the Sultanate of Oman is a member of the GCC countries where

Islamic banking plays a dominant role in the banking sectors. The Sultanate started with two fully-fledged Islamic banks and six Islamic windows banks, making a total of eight Islamic banking players. By comparison, the other countries started with only one fully-fledged Islamic bank.

“The Islamic banking industry in Oman is on the right trajectory and it is expected to accomplish many more milestones in the coming years” (Islamic Finance News, 2015, p. 99). In order for the Islamic banking industry in Oman to grow, some urgent areas need to be focused on: (i) training for staff in Islamic banks and institutions offering Islamic banking services; (ii) public awareness programmes on Sharia-compliant products and services; and, (iii) the provision of Sharia-complaint banking solutions for the SME sector, as suggested by Bilal Fiaz in the world’s leading Islamic finance news provider (Islamic Finance News, 2015) (The Islamic banking industry in Oman is elaborated upon in more detail in chapter 2.).

As mentioned previously, Oman’s economy is largely reliant on a single, finite resource base. Consequently, the government of Oman must diversify. However, achieving a diversified economy is not the only economic challenge for the Sultanate; it also faces a challenge from the other GCC countries, since they too rely primarily on the hydrocarbon sector. Furthermore, because the Sultanate of Oman is heavily dependent on dwindling oil revenues and a single-track development strategy, despite its commitment to multidiversification sources of income, Oman continues to depend on income from a single source to run the country and finance its projects.

In addition, the sharp fall in global oil prices over the past 3 years 2014, 2015, and 2016 has led to significant revenue shortfalls in many energy-exporting nations, including Oman. The scale of this shortfall can be seen in the fact that the Sultanate’s total government revenue declined by 16.1 per cent in 2016 due to a substantial fall in oil revenues; in the same year, the revenue from oil revenue fell 35.4 per cent, a figure which mainly reflected a steep decline in oil prices (Central Bank of Oman, 2017). Currently, the government of Oman is facing challenges to its economy as a result of low oil prices (Ministry of Oil and Gas, 2016). The collapse in the price of oil is a strong signal for the government to prepare for coming challenges. (Chapter 2 details Oman’s economy.).

In order to avoid a slowdown in the growth process, the government and Central Bank of Oman (CBO) are promoting economic diversification (Central Bank of Oman, 2017), as they wish to reduce the country's dependence on oil and grow its economy. The government and CBO are taking a number of initiatives aimed at developing the nonoil economy in areas such as the financial sector, infrastructure, tourism, enhancement of private sector involvement, and the investment climate (Central Bank of Oman, 2015).

According to Zahra (1999), "economic development can neither be achieved nor sustained if it does not promote or encourage human development" (p. 38). One of the key elements of Oman's Vision 2020 is to develop the SME sector. Oman recognises that the SME sector forms the backbone of economic development. Thus, encouragement of it complies with His Majesty's directive to support and develop SMEs as the future engines for the growth of the Omani economy. The government has intensified its efforts to promote SMEs, particularly in the context of economic diversification (Central Bank of Oman, 2017). Furthermore, as is the case in other economies, SMEs in the Sultanate of Oman contribute significantly to national gross domestic product (GDP) growth, job creation, and innovation (Public Authority for SMEs Development, 2014). (Chapter 2 provides further details about the SME sector in Oman.). As part of the effort to diversify Oman's economy, the authorities are keen to boost growth by welcoming the Islamic financial system into the Omani banking industry; this move represents a notable achievement in the Omani banking sector.

1.3 Thesis Aims and Research Objectives

While SMEs in Oman have traditionally had to rely on conventional financing, recent efforts by the Omani government have introduced Islamic banking in the Omani banking industry and, thus, provided SMEs with an opportunity to make use of newly available products that offer Sharia-compliant financing options. As mentioned above, while the main aim of this thesis is to investigate the adoption of Islamic financing instruments by SMEs in the Sultanate of Oman, three subaims were developed during the research; these are presented in the three papers that constitute the major part of this study. Two to three research objectives were drawn up to address each subaim. Table 1 shows these subaims and the corresponding research objectives for each paper, the paper's title, and its chapter number.

Table 1. *Thesis Aims and Research Objectives*

Thesis Aim	Research Objectives	Paper Title	Chapter Number
To investigate whether or not noneconomic variables and psychological factors influence SME owner-managers' Islamic financial decision-making.	<ol style="list-style-type: none"> 1. To explore nonfinancial and behavioural factors such as owner-managers' attitudes, subjective norms, and perceived behavioural control that influence financing decisions, specifically Islamic financing decisions. 2. To investigate if a) religiosity is an important factor in influencing the intention to adopt Islamic finance instruments (IFI) among owner-managers and b) whether religiosity offers improved prediction over theory of planned behaviour (TPB) constructs with regard to SMEs' intention to adopt Islamic finance instruments (IFIs). 3. a) whether awareness is an important factor in influencing the intention to adopt IFIs among owner-managers and b) whether awareness offers improved prediction over TPB constructs with regard to SMEs' intention to adopt IFIs. 	Islamic financial decision-making among SMEs in the Sultanate of Oman: An adaptation of the theory of planned behaviour (TPB).	Three
To investigate whether Omani SME owner-managers' intention to adopt Islamic finance is influenced by their knowledge of Islamic finance, their own characteristics, and/or their firm's characteristics.	<ol style="list-style-type: none"> 1. To explore if Omani SME owner-managers' intention to adopt Islamic finance is influenced by their knowledge of Islamic finance instruments such as <i>musharaka</i>, <i>mudarabah</i>, <i>murabaha</i>, and <i>ijarah</i>. 2. To explore if Omani SME owner-managers' intention to adopt Islamic finance is influenced by their own characteristics. 3. To explore if Omani SME owner-managers' intention to adopt Islamic finance is influenced by their firm's characteristics. 	Determinants of the decision to adopt Islamic finance: Evidence from Oman.	Four
To investigate SME owner-managers' awareness, willingness, and perceptions concerning Islamic financing instruments as an alternative sourcing decision in SMEs' businesses.	<ol style="list-style-type: none"> 1. Are SME owner-managers aware of Islamic banking principles? 2. Are SME owner-managers aware of Islamic finance instruments? 3. If they are aware of them, are SMEs willing to adopt Islamic finance methods? 4. How do SME owner-managers perceive Islamic methods of financing their businesses? 	Omani SME perceptions towards Islamic financing systems.	Five

1.4 Research Contributions

This study makes a number of contributions at both the paper level and thesis level. Paper one contributes to the SME finance literature in important ways. First, it broadens understanding of SMEs' financial decision-making by recognising unique SME owner-manager influences on financing decisions. Second, because most studies on SME finance focus on conventional financing, the paper obtains a more comprehensive perspective by analysing Islamic financing. Thirdly, this paper examines the factors that influence attitude formation towards Islamic finance from the perspective of SMEs' owner-managers, because all previous research omitted that perspective and because the research adopts the theory of planned behaviour as the basis of this investigation. Fourth, by testing the full TPB model, as described by Ajzen (2011), this paper provides the foundation for further research that aims to incorporate new developments into the model, thereby increasing our understanding of SMEs' intended behaviour around Islamic finance. Modifying the TPB model through the addition of variables like religiosity and awareness behind TPB constructs may help to maximise the predictive efficacy of the model (Moon & Kim, 2001). Lastly, this paper's investigation contributes to the wider research around SMEs, particularly that on SME financing, by showing that noneconomic variables, especially psychological factors, can influence financing behaviour decisions.

Paper two contributes to the literature on corporate finance in several ways. First, it emphasises the growing importance of Islamic finance not only as an effective financial tool around the globe, but also the importance of its key instruments: profit and loss sharing (PLS) and non-profit and loss sharing (non-PLS). Moreover, this paper's findings clarify whether an understanding of key instruments of Islamic finance affects SME owner-managers' financing decisions. Second, this study focuses on Omani SME owner-managers' Islamic finance knowledge, their own characteristics, and factors within their firms' characteristics that are important for decision-making regarding capital structure. Lastly, the focus of prior studies has been on large, listed firms; SMEs, however, significantly differ from such enterprises in terms of their financial decisions and behaviour (Abdulsaleh & Worthington, 2013); consequently, determinants of SMEs' capital structure are not well understood, especially as regards Islamic finance decisions.

Paper three responds to the increasing calls in the literature that encourage finance researchers to apply a more diverse approach to current research practices (Burton, 2007; Gippel, 2013; Kaczynski, Salmona, & Smith, 2014). For example, “imagine the benefits to finance if we expand our empirical source of data to include what people have to say” (Kaczynski et al., 2014, p. 1). Taking this line would motivate finance researchers to enhance current research practices through the use of a qualitative approach and would help us better understand social science issues. Burton (2007) has confirmed that there is a need for more research of a qualitative nature in finance, in order to generate important and novel empirical insights. Accordingly, for the third paper, the researcher generated face-to-face discussion on Islamic finance with 86 SME owner-managers, and in so doing advances the limited literature on perceptions of SMEs regarding Islamic banking in an understudied context (i.e., Oman). As this is the first study to comprehensively review SMEs’ willingness to adopt new financial instruments with the emergence of Islamic banking, this third paper generates new insights into that area.

The multiple theoretical and practical contributions at the research paper level combined in the thesis propose theoretical, methodological, and contextual contributions at a broader level. First, the overall study emphasises how small business owner-managers work out their capital structure decision, one of the most important research areas in corporate finance (Cassar & Holmes, 2003; Hall, Hutchinson, & Michaelas, 2000; Michaelas, Chittenden, & Poutziouris, 1999), particularly SMEs’ decisions around the adoption of Islamic finance instruments. The capital structure of SMEs is a major area of policy concern and so, as many research studies have proved, the failure to make the correct financial decision is a major cause of small business decline (Hall et al., 2000).

Second, the study responds to the increasing calls in the finance research literatures to incorporate nonfinancial influences on financing decision-making by firms (Barton & Gordon, 1988; Matthews, Vasudevan, Barton, & Apana, 1994). In other words, by examining SMEs owner-managers finance behaviour beyond the conceptual status, this thesis shows that noneconomic variables can influence financing behaviour and that the role of psychological factors can have an influence on financial decisions. Through the first two papers, it is argued that nonfinancial factors affect the financial decisions of SMEs. The first paper shows that the

influence of SME owner-manager attitudes, subjective norms, perceived behavioural control, awareness about Islamic financing, and behavioural intentions do largely affect their financial decisions, while religiosity is shown to negatively affect behavioural intention to adopt IFIs. The second paper shows the influence of SME owner-managers' Islamic financial knowledge and the effect that personal characteristics have on SME owner-managers' intention to adopt Islamic finance, while their firm's characteristics have no significant influence on SME owner-managers' Islamic financial decisions.

Third, the thesis addresses the limited research examining capital structure for developing economies. In this way, it moves beyond the many empirical research studies that focus on large, listed companies in the US and other developed countries (Ronoowah, 2004). This thesis attempts to supplement the existing literature by bringing forth new evidence regarding the determinants of capital structure by studying the case of SMEs in a developing economy, given that such economies have different institutional structures. In particular, the research examines a context that is rarely studied in the extant small business finance literature: Oman (Al Balushi, Locke, & Boulanouar, 2018). The unique characteristics of the institutional structures in this specific context generated new insights into SMEs' finance decision-making behaviour, and particularly the decision to adopt a newly available financing option being offered by the Omani banking industry—Islamic finance.

Finally, this study is a first attempt in the Omani context to investigate Omani SME owner-managers intention to adopt this new form of finance. Furthermore, given that this study surveyed 385 SME owner-managers, it is important to note here that it constitutes the largest and most representative evaluation in the area of SMEs and Islamic finance undertaken so far in the Sultanate. As such, this study has not only advanced our understanding and knowledge of alternative finance methods in the Omani banking industry—Islamic methods of finance—, but also specifically informed us about attitudes of SMEs that, compared to those to large firms, have rarely gained attention in the finance literature. From a policy position, when government is promoting a transition from one system to another, the stability of the regulatory framework is important, as regulatory framework is the momentum for change. Potentially unintended market failures may emerge, which result in

decision-making that is second best by participants in the market and results in less than optimal outcomes for the market from a national perspective.

In Summary, each paper in this thesis provides different insights in order to understand SMEs financing behaviour. In other words, if we combined insights from paper one and two, will provide better understanding of the topic, compared to insights from paper one and two individually. Further, if we combined insights from paper one, two and three will provide better insights to achieve the overall thesis objectives compared to insights to each individual papers.

1.5 Research Limitations

As with all studies, this research is subject to some limitations. These, however, indicate fruitful avenues that future research could follow. As this thesis focuses on a sample of SME owner-managers in Oman, its findings cannot be generalised to other countries or other entities such as large and public firms without caution. To achieve greater generalisability, further studies could consider other geographical contexts, and preferably draw upon cross-cultural samples. Finally, there is a need to investigate other factors, which were not explored in the present study, but which may influence SME owner-managers' Islamic financial decisions.

1.6 Outline of the Thesis

This thesis is structured into six chapters. Table 2 presents the details of each chapter

Table 2. *Thesis Structure*

Chapter Number	Chapter title	Description
Chapter 1	Introduction	This chapter provides an overview of the thesis, the research issue, aims, and research objectives, contributions for the three papers, research limitation and thesis structure.
Chapter 2	The research context: The Sultanate of Oman	This chapter gives an overview of Oman, Oman's SMEs and Oman's banking industry.
Chapter 3	Islamic financial decision-making among SMEs in the Sultanate of Oman: An adaption of the theory of planned behaviour (TPB).	The core of this thesis is presented in chapters 3, 4, and 5 which take the form of research papers. Although they produced as part of one overall project, they represent stand-alone papers. Each of these three chapters, therefore,
Chapter 4	Determinants of the decision to adopt Islamic finance: Evidence from Oman.	is a research paper that contains an abstract, introduction, literature review and theoretical development, method, results, and discussion,
Chapter 5	Omani SME perceptions towards Islamic financing systems.	conclusion and implications, and limitations and future research section.
Chapter 6	Conclusions	This chapter provides the conclusions for the overall PhD thesis. It summarises the overall research process and findings within the three core research papers. It revisits the thesis' research aims and interprets the findings, contributions, and implications for policy makers. It concludes with a reflexive account of the current study's research limitations and offers directions for future research.

1.7 Conclusion

Chapter 1 laid the foundation for this doctoral study. It presented an introduction to the study, the background of the research field, and identified the research issues, the research aims, the research objectives, and the limitations of the study. The contributions of the research were discussed with regard to prior research studies. An overview of the structure of the thesis concluded the chapter, along with a summary of the sections that follow. The next chapter will introduce the reader to the environment within which the current study's participants—SME owner-managers—function and operate, the Sultanate of Oman.

Chapter 2

Background of Sultanate of Oman

2.1 Introduction

As this study examines SME owner-managers' Islamic finance decision in the Sultanate of Oman, it is important to introduce the reader to the environment within which these businesses function and operate. This chapter is divided into three main sections, each with subsections. The first section presents a brief overview the Sultanate of Oman's strategic location, ruling system, political system, and economy. The second explores the SME sector in Oman and includes a definition of Omani SMEs, the challenges for SMEs, and the role of government in supporting and developing SMEs. The final section deals with the Omani banking industry. It explains the role of the Central Bank of Oman (CBO), the history of banking industry, the role of the banks in the economy, and specialised banks. An analysis of the strengths, weaknesses, opportunities, and threats (SWOT) of Oman's banking industry.

2.2 Sultanate of Oman: Background

Oman is a land with a rich history which dates back at least 5,000 years and which establishes Oman as an ancient civilization. The Sultanate of Oman is an Arab and an emerging country in the Middle East region. Historical documents indicate that Oman has been known by many names such as Magan (copper mines) and Mazoun (plentiful water). The country has an area of 309,500 square kilometres (119,500 sq. miles) and a population of 4,603,267, 2,577,730 (56 per cent) of whom are citizens. The remaining 2,025,537 (44 per cent) are expatriates (National Center for Statistics & Information, 2018). The Sultanate's religion is Islam. Arabic is the official language, while English used widely in the economic, business, trade, and education areas. Table 3 shows some key facts on Oman. The Sultanate has a reputation for having a stable political, economic, and social system (International Business Publications, 2013). Oman's excellent relations with neighbouring

countries has enabled it to play an active role in promoting regional, political, and economic cooperation.

The heart of the county's political, economic, and administrative system is Muscat Governorate. This is the site of Oman's capital city, Muscat. Muscat is the seat of government and the nerve centre of the state's administrative apparatus. Because of its strategic location, Muscat is famous as the country's trade, finance, and business centre; it is also known as a vibrant hub of local and international economic, commercial, and tourist activity. As per the most recent (2017) census, Muscat has the highest population density of all the provinces in the Sultanate, with a population of 1,441,622 residents, as indicated in Table 4.

Table 3. *Omani Key Facts Sheet*

Head of state	His Majesty Sultan Qaboos Bin Said Al Said
Land area	309,5500 square kilometres
Population	4,414,051
Density	9.2 inhabitants per square km
Capital	Muscat
Largest city	Muscat
Official language	Arabic (English widely used)
Religion	Islam
Currency	Rial Omani = USD 2.58 (OMR 0.387 = USD 1) (1 Rial = 1000 Baisa)
GDP (purchasing power parity, PPP)	USD 188 billion (2017)
GDP per capita (PPP)	USD 45,500 (2017)
GDP Real Growth Rate	0 (2017); slower than the 3 per cent in 2016
Unemployment rate	18 per cent
Inflation rate	2 per cent (2017)
Oil Production	860,000 barrels per day
Natural Gas Production	875 billion cubic feet/yards
Major Trading Partners	China, India, South Korea, Japan, United States, UAE, and Saudi Arabia.
Natural resources	Oil, copper, natural gas, marble, limestone, chromium, gypsum

Source: Central Bank of Oman (2017) and Katzman (2018)

2.2.1 Sultanate of Oman: Strategic location.

Oman occupies a uniquely important location. It is strategically located on the western shore of the Gulf of Oman which links the Arabian Sea to the Strait of

Hormuz, which is the world's most important transit point for crude oil (Figure 4). In 2011, the daily oil flow was almost 17 million barrels and between 15.5-16.0 million barrels per day in 2009-2010, which is about 35 per cent of all seaborne traded oil and 20 per cent of oil traded worldwide (U.S. Energy Information Administration, 2012). Oman shares land borders with three countries: The Republic of Yemen to the south-west, the Kingdom of Saudi Arabia to the west, and by the United Arab Emirates from the north and west. Oman is the third largest country in the Arabian Peninsula. The Sultanate's strategic location allowed it to become a bridge between the old and new worlds and but also to function as an active commercial route since ancient times. As a result of its strategic location, Oman has played a pivotal role throughout history, in political campaigns, regional conflicts, and for the access it offers to Asian, Arabic, and African markets (Ministry of Tourism, 2018).



Figure 4. Geographic location of Oman.

Source: U.S. Energy Information Administration (2012)

2.2.2 Sultanate of Oman: Ruling system.

The Sultanate is an absolute monarchy, and His Majesty, Sultan Qaboos bin Said Al Said is the country's current ruler. Sultan Qaboos came to power on 23 July, 1970 and his rule marked a turning point in the history and development of the

country. The period since that time has been recognised as the ‘Renaissance Era’ because of dramatic changes in the country’s development of the economic and social prosperity which have been effected. Before this period, Oman was considered poor in terms of its infrastructure, for example, conditions around education, health, and overall wellbeing. There was limited development in the country because of a closed international policy that isolated Oman from the world.

However, since Sultan Qaboos assumed power, all of the country’s sectors have begun to develop. The welfare of Omani citizens has become a priority. The quality of Omani citizens’ lives has improved and the country has been transformed from an impoverished Bedouin land into a prosperous nation (Owtram, 2004). Nowadays, Oman’s basic human development indicators are strikingly removed from what they were before Sultan Qaboos’ time. In 1997, Oman was ranked as first out of 191 countries in health care system performance and outcome and eighth best for its overall health system, according to the World Health Organisation (WHO). In 2010, the United Nations Development Programme recognised the Sultanate as having made the fastest progress in human development since 1970 (Phillips & Hunt, 2017).

Since the discovery oil and gas in 1967, the exploitation of these resources has increased the nation’s income and boosted its development. The hydrocarbon sector is currently one of the most important pillars of the Sultanate’s economy and oil is the main driver of Oman’s development process. However, the government of Oman is promoting nonoil products in order to diversify the economy (Ministry of National Economy, 2010).

2.2.3 Sultanate of Oman: Political system.

The major preconditions for economic growth and the sustainable growth of enterprises are peace and political stability. Under the rule of Sultan Qaboos the Sultanate’s political system has remained comparatively stable and it has provided a supportive environment for local and foreign businesses for over 30 years (Buckley & Rynhart, 2011). According to Phillips and Hunt,

Oman is one of the few Middle Eastern states that rarely features in the international headlines. Its politics are the least studied of any state in

the Arab Middle East presumably, in part, because of its stability, internal cohesion, relative prosperity, and ability to maintain genial diplomatic relations with its important neighbours. (2017, p. 645)

Oman has established friendly relations with all the countries around the globe. Oman has not been involved in conflict with either its it closer neighbours or the rest of the world. In his speech to the annual session of the Council of Oman on 4th November 2002, His Majesty confirmed this policy of peaceful coexistence stating:

Our foreign policy [is] known to all, we are always to the side of right, justice, friendship and peace. In addition, we call for peaceful coexistence among nations and to understanding between civilizations and to eradicate the causes of hatred and resentment generated in the hearts of those who suffer injustice and inequality. (Al-Maamari, 2014, p. 110)

Further, the Omani system of government is a hereditary one in which succession passes to a male heir. Sultan Qaboos bin Said is both the chief of state and the head of government. He acts as prime, foreign, finance, and defence minister. The central Government is located in the capital city Muscat. Sultanate is divided into 11 administrative areas called governorates, as indicated in Table 4. As Table 4 shows, each governorate has a governor who is a Representative of the Sultan. These governorates are divided into districts called *willaya* and there are 61 willayas in the country (National Center for Statistics & Information, 2018). Their main purpose is to stimulate economic development within the country and to facilitate the deployment of services across the Sultanate (Oxford Business Group, 2012).

Table 4. *Oman's Governorates*

Governorates/ Region	Number of willayas	Area Km2	Population
Muscat governorate	6	4,000	1,441,622
Al Batinah North governorate	6	8,000	727,148
Al Batinah South Governorate	6	5,323	400,967
Musandam governorate	4	2,000	43,959
Adh Dhahirah governorate	3	35,881	204,398
Ad Dakhliyah governorate	8	32,000	441,748
Ash - Sharqiyah South governorate	5	12,039	299,043
Ash - Sharqiyah North governorate	6	21,136	265,510
Al Wusta governorate	4	82,471	43,310
Dhofar governorate	10	99,062	434,952
Al-Buraimi governorate	3	8,068	111,394

Source: National Centre for Statistics & Information (2018)

2.2.4 Sultanate of Oman: Economy.

Over the past years Oman's economy has grown continuously due mainly to the increase in the oil prices and further improvements seen since the year 1999. The main source of Oman's income is oil, which accounts for more than 80 per cent of the country's economy. Oman's development programmes are mainly dependent on oil income and the country's economic and financial policies are largely linked to its main revenues.

Oil was discovered in Oman in 1967 and since then oil exports have been the mainstay of the country's economy, and oil exports have directly and indirectly helped to expand it. To illustrate, an increase in crude oil production and processing is the major direct effect of the oil boom while the impact of oil revenues on other sectors of the economy is its major indirect effect. Both effects have contributed to the country's economic development and growth.

As indicated in Table 5, Oman has witnessed remarkable development over the past four decades due to the revenues generated by petroleum products. The Omani economy continued to grow robustly, more specifically during 2010 to 2014, and enjoyed uninterrupted years of development mainly as a result, of oil prices.

However, after four decades of oil resource exploitation, Oman is now facing the challenge of reducing its dependency on oil revenue, as oil is a finite resource and one which fluctuates in price. Changes in the price of oil and the availability of this finite resource can thus have a significant impact on both the growth of the country's economy and other activities. For example, when the price of oil increases, government increases its spending on improving infrastructure facilities, while a reduction in the oil prices forces the government to cut back on its spending, a move which can affect the whole of the country's economy. Oman's dependence on oil weakens its economy. As a result, the country is facing many challenges in areas like public spending, unemployment, and infrastructure projects; the future loss of oil revenues will cripple the economy as a whole, leaving the Sultanate's economy vulnerable. In this scenario, planning is particularly important to the Omani government.

In recent years, more specifically since mid-2014, there has been a slowdown in the Omani economy due mainly to the fall in the price of oil. The sharp drop in the

price of oil shocked not only Oman's economy but also the economies of other countries like those in the GCC whose main revenue also comes from oil. The average price for Omani crude oil fell by 45.3 per cent to USD 56.5 per barrel in 2015; in 2014, the price of oil had been USD 103.2 per barrel. The sustained drop in global oil prices has affected Oman's economy and impacted not only on exports, but also Omani government revenue and economic activity overall. For instance, nominal gross domestic product (GDP) fell by 5.1 per cent in 2016. The decline in GDP was even more pronounced in 2015 when it saw a drop of 13.8 per cent, with the GDP component emanating from the petroleum sector registering a decline of 23.7 per cent. This was the largest deficit in the Sultanate's economy for more than a decade. Furthermore, the Sultanate recorded a 35.7 per cent revenue decline to OMR 9,067.5 million in 2015; the decline in the net oil revenues was also significant (OMR 4,549 million or 44.6 per cent).

Table 5. *Oman's Economic Indicators*

Item	1970	1980	1990	2000
Gross domestic product (OMR)	104.0	2185.0	4493.0	7478.5
Average annual growth rate (%)	-	35.6	7.5	5.2
Gross national income (OMR)	-	2098.0	4400.0	7156.5
Gross national income per capita (OMR)	158.0	1979.0	2708.0	2979.0
Gross national savings (OMR)	-	737.2	1029.8	2326.5
Total government revenues (OMR)	50.0	923.7	1876.3	2289.9
Total government expenditures (OMR)	46.0	949.8	1887.4	2656.2
Merchandise imports (OMR)	40.0	678.0	1075.9	1972.8
Merchandise exports (OMR)	88.0	1294.5	2116.4	4351.8
Trade exchange	128.0	1972.2	3192.3	6324.6
Relative share of oil sector (%)	69	60.5	47.7	50.1

Source: Ministry of National Economy (2010)

Therefore, it is crucial for Oman's government that it does not depend only on oil to finance development as this finite resource is expected to diminish over the next 20 years (Ministry of National Economy, 2010). Oman should adopt various diversification policies not only to reduce its dependence on oil as a main source of income, but also to protect the country from the risk of changes in oil prices. The Omani government has to boost the contribution to GDP of nonpetroleum activities within its plan to diversify the country's sources of income. To that end, Oman is

now pursuing a range of initiatives to diversify the economy such as promoting small and medium scale industries, improving agriculture and fisheries, infrastructure investment, and developing tourism.

2.3 Sultanate of Oman: Small and Medium-Sized Enterprises

The National Economy of a country is in fact based on small and medium industries ... these are the fundamentals, the foundations of all national economies ... (Sultan Qaboos Bin Said, Saih Al Shamikhat 27th January, 2013) (Riyada, 2013).

SMEs are now widely recognised as engines of economic growth (Beck & Demirguc-Kunt, 2006; Beck, Demirgüç-Kunt, & Pería, 2011). The SME sector has, therefore, become significant to economists and policy-makers who are making decisions on financial and economic development around the globe. In addition, the SME sector forms the backbone of economic development. Recently, SMEs in GCC countries gained importance because of the economic and social issues facing these economies, for example, diversification and privatisation of business, unemployment, and the dominance of expatriates within small business (Al-Kharusi, 2003). The SME sector is a key engine for the GCC economies.

There are many advantages to SMEs in that they provide job opportunities for both skilled and unskilled people, contribute to GDP and economic diversification and help to reduce poverty. SMEs contribute to the wellbeing of individuals, communities, and nations. According to Bilal and Al Mqbali (2015), Oman's SMEs are no different to their counterparts in other countries and they argue that the SME sector in Oman is also expected to be a leader in economic and social development.

In Oman, SMEs, whether micro, small, or medium, represent more than 90 per cent of the number of enterprises involved in economic activity. The latest information provided by the Central Bank of Oman is that 40 per cent of the workforce is employed in SME firms with fewer than 5 per cent of those employees consisting of Omanis. The contribution that SMEs make to the country's GDP ranges between 15 per cent and 20 per cent (Barwani, Jahwari, Saidi, & Mahrouqi, 2014). Given

these two key statistics, it is clear that SMEs in Oman are still in their infancy and there is significant potential for growth.

According to the Public Authority for SME Development (2013), there were approximately 132,735 SMEs in Oman at that time, the majority of which were located in the Muscat region. Table 6 shows the number of SMEs in Oman by governorate; 70 per cent of SMEs are micro enterprises, 25 per cent are small and 5 per cent are medium-sized (as shown in Figure 5) (Riyada, 2018).

Table 6. *Number of SMEs in Oman*

Governorate	Total	%
Muscat	50359	38
Albatinah	26573	20
Musandam	1910	1
Aldhahra	6555	5
Aldakhliya	10250	8
Alsharqiya	18475	14
Alwusta	1446	1
Dhofar	10427	8
Alburaimi	6740	5

Source: Public Authority for SME Development (2013)

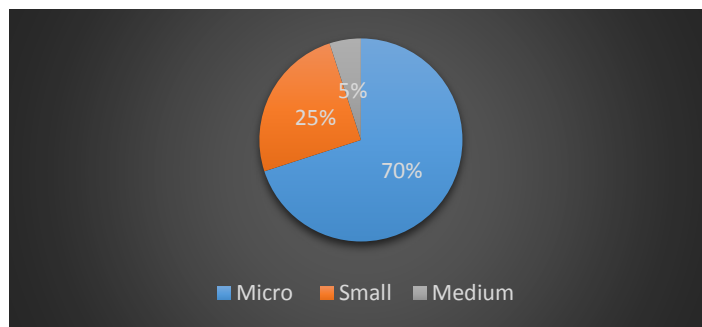


Figure 5. Number of SMEs in each sector.

Source: Riyada, (2018).

2.3.1 Defining SMEs.

Given that not all SMEs are the same, defining SMEs is important as regards resource planning for each category, because each category has specific needs and capacities. Medium-sized enterprises are often quite different from small and micro enterprises (Hertog, 2010). However, there is no global agreement on the standard definition of SMEs. The most common definition used by many countries is based on employee size, asset size, and annual turnover (Rahman, 2001). For instance, in the U.S. fewer an enterprise with fewer than 500 employees is considered to be an SME. Table 7 presents definitions of SMEs in different countries. Nevertheless, the definition of SMEs used by banks generally depends on average annual sales. For example, in Argentina the banks consider a business to be an SME when its average annual sales are approximately between 300,000 to 30 million USD; in Chile the figure is between 90,000 to 24 million USD, and from to 400,000 and 13 million USD in Colombia; in Serbia the banks consider a business to be an SME when annual average sales range from 500,000 to 10 million euros (de la Torre, Martínez Pería, & Schmukler, 2010).

The definition used in the GCC region also categorises SMEs on the basis of employee size, asset size, and annual turnover. Additionally, within GCC countries there is no unique, universally accepted definition for SMEs, due to the differences in the social and economic structures in each country. For example, the government of Dubai defines a SME as a firm that has turnover of less than 250 million UAE dirhams (USD 65 million) and with fewer than 250 employees (Department of Economic Development, 2011). In Bahrain, SMEs with up to 10 employees are consider micro enterprises, those with up to 50 are seen as small enterprises and medium-size those with up to 150 employees, according to the Ministry of Commerce and Industry (MOCI). In Kuwait, the number of employees is not used as the size criterion. SMEs are defined according to the Kuwait Small Projects Development Company. It considers projects with capital of up to 150,000 Kuwaiti Dinar (USD 520,000) as small and those with less than 500,000 Kuwaiti Dinar (USD 1.7 million) as medium-size. In Saudi Arabia, there is no consist definition of SMEs; each institution has a different definition. For example, small enterprises those with less than 5 million Saudi Riyals (USD 1.3 million) of capital, while medium-size ones have capital between 5 and 20 million Saudi Riyals (USD million)

(Hertog, 2010). In Qatar, SMEs are defined as a company with a workforce that does not exceed 250 employees, and its annual revenue doesn't exceed 100 million Qatari rial (USD 28.24 million) (The Peninsula, 2015).

While, SMEs in Oman are defined by the Ministry of Commerce and Industry on the basis of the number of employees and annual sales, according to a circular issued by Commerce and Industry Minister Ali bin Masoud Al Sunaidy. The breakdown of the SME segment is presented in Table 8. However, in 2016 Ministry of Commerce and Industry, revised SMEs definition Table 9, because it was not in line with international definitions and this action has been taking after receiving input from various bodies. According to Redha Juma, vice-chairman at the Oman Chamber of Commerce and Industry the new definition of SMEs is “more realistic” (Times of Oman, 2016).

Table 7. *Definitions of SMEs*

Country by SMEs size	Maximum number of employees
Vietnam	300
Belarus	250
Moldova	250
Switzerland	250
Australia	200
Morocco	200
Peru	200
Thailand	200
Bangladesh	100
Brazil	100
Ghana	100
Nicaragua	100
Norway	100
Egypt	50
Malawi	50
Pakistan	50
Tanzania	20

Source: Gibson and Van der Vaart (2008)

Table 8. *Definition of SMEs in Oman*

Type	Number of Employees	Annual Sales (OMR)
Micro or Very Small Enterprises	Less than 5	Less than 25,000 (about USD 65,000)
Small Enterprises	5 to 9	25,000 to 250,000 (about USD 650,000)
Medium Enterprises	10 to 99	250,000 to 1.5 Million (about USD 3.9 million)

Source: Ministry of Commerce and Industry (2012)

Table 9. *Revised Definition of SMEs in Oman*

Type	Number of Employees	Annual Sales (OMR)
Micro or Very Small Enterprises	1-5	Less than 100,000 (about USD 260,000)
Small Enterprises	6-25	Between 100,000 and less than 500,000 (about USD 1300,000)
Medium Enterprises	26-99	Between 500,000 and less than 3 Million (about USD 8 million)

Source: Ministry of Commerce and Industry (2016)

2.3.2 SMEs' challenges.

Despite SMEs' importance in terms of to economic output, they still have inadequate support. For example, inadequate access to finance is one of the main obstacles and it is the main challenge for SMEs in Oman according to a Central Bank of Oman (2014) report. The report shows that 56 per cent of SMEs were self-funded—individually or jointly by family—and only 13 per cent borrowed from banks and financial institutions. According to the World Economic Forum's (WEF) executive opinion survey, 13.5 per cent of the participants indicated that financing is one of the most problematic factors when it comes to doing business in the Sultanate (Buckley & Rynhart, 2011).

In addition, the main reasons that hamper Omani SMEs' ability to raise funds are high rate of interest, lack of securities, and a lack of a business plan (Al-Kharusi, 2003). The high risk that SMEs pose and their lack of collateral are the main reasons why banks in Oman hesitate to finance this sector, according to Salah bin Hilal Al Maawali, ex-director-general of the Directorate General for Development of SMEs. However, he stated that "if banks do not tap this market now, they will find it difficult to get a share in future", and emphasised that the best way to promote the economy is to provide new financing plans and to make the lending mechanisms easier for the SME sector (Al bawaba Business, 2012). This type of thinking indicates the importance of financial institutions in enhancing the growth of the SME sector in Oman.

In order to grow and stay competitive, SMEs of all sizes and types require financial support, whether to create new business or expand an existing business. Government and the Central Bank of Oman (CBO) have introduced many policy

initiatives to encourage banks to support SMEs. For example, all banks that are operating within the country are expected to make the lending option to SMEs commercially attractive and to formulate a liberal lending policy for them. The Sultanate's financial sector is highly competitive, consisting as it does of local and foreign banks, specialised banks, nonbank finance and leasing companies, and local money exchanges.

Alongside financing obstacles, SMEs in Oman face many other challenges. For example, the investment environment, the capabilities of the owner, marketing, and legislation and regulations (Bilal & Al Mqbali, 2015). Moreover, a study conducted by the CBO in 2014 uncovered several of the challenges that SMEs faced in Oman. These included: a lack of business knowledge on the part of the owner, difficulty finding customers, unfair competition, the high cost of capital, the high cost of production (wages and rent), a lack of skilled and experienced staff and managers, and regulations and administrative burdens (Barwani et al., 2014). Along the same lines, Christina, Neelufer, and Al Amri (2014) studied the challenges encountered by SMEs owners in Muscat. The major findings from their study indicated that policy and administrative challenges are the main barriers for SMEs. Al Bulushi and Bagum (2017) argued that financial management, marketing management, operations management, and human resource management constraints have a negative impact on growth strategies of Oman's SMEs.

2.3.3 The role of government in supporting and developing SMEs.

Since the early 2000s Oman's government has had a policy of encouraging private sector growth. The government views private companies as the primary engines for economic development and growth. In an effort to promote the SME sector, the Omani government established policies, and guidance, and provided training for its management in order to help this sector to grow and strengthen the economy. It is difficult for SMEs to run successfully without support from the government. The government of Oman has, therefore, shown an increasing interest in the development and support of SMEs. This encouragement complies with His Majesty's directive to support and develop SMEs as "the future engines for the growth of the Omani economy". The Royal Decree NO.19/2007, established the

Directorate General for Development for SMEs within the Ministry of Commerce and Industry; its mission is to create and enhance a private sector that would be able to add value to Omani economy.

The Omani government makes constant attempts to develop and support the SMEs sector. On 31 May 2013, a Royal Decree was issued to establish the Public Authority for Small and Medium Enterprises, a move which indicates the growing importance attached to the SME sector in Oman. The main aim of the Public Authority is development and support for the growth of SMEs. Further, the Public Authority is helping SMEs to add value to the economy and create economic diversification (Public Authority for SME Development, 2013).

In addition, the government provides many programmes to support its nationals in starting and running their own businesses as indicated in Table 10. Likewise, the private sector provides many programmes to develop and support the SMEs sector (see Table 11). A number of other bodies are charged with supporting SMEs, for example, the Public Authority for Investment Promotion and Export Development, the Ministry of Tourism, The Research Council, Grofin Oman, the Towell Group, and the Saud Bahwan Group–Toyota. More information about these bodies is provided by the Public Authority for SME Development (Public Authority for SME Development, 2013).

Table 10. *Government Programmes Supporting SMEs*

Government programmes	Aim
Oman Development Bank	Is a leading institution in financing of the SME sector.
Riyada	A governmental authority for the development of SMEs. It provides support such as business advisory services and training programmes.
Al Raffd Fund	A governmental financial institution aimed at providing financial support to Omani youth to establish their own projects.
Sanad (Self-Employment and National Autonomous Development)	A governmental financial institution aimed at providing financial support to unemployed and newly graduated Omani youth to establish their own projects.
Sharakh	A governmental authority aiming to provide the necessary expertise and funding needed to develop SMEs. It offers a number of services to SMEs. It, for example, reviews SMEs' business plans, assists SMEs in preparing their cash flow, conducts a risk assessment for the business, and assists SMEs to develop their annual marketing. These services are provided only to SMEs that get financial support from Sharakh; otherwise, they have to pay a fee for these services.
Public Authority for Craft Industries	It aims to improve and develop craft industries and craftsmen. It also provides all necessary and accessible capabilities and resources in order to support all aspects of marketing, and the financial and administrative needs of these industries.
National Business Centre	It aims to develop and support Omani entrepreneurs by providing services such as preparing feasibility studies, a financial and legal advisory service, business advisory services, and coaching and mentoring.

Table 11. *Private Sector Programmes Supporting SMEs*

Private sector programmes	Aim
Zubair Small Enterprises Centre	A corporate social responsibility initiative, which aims to support SMEs by providing various services such as business advice, training, and funding.
Intallaqah	A Shell social initiatives; which aims to create an entrepreneurial environment and help SMEs to grow and succeed. Intillaqah provides services such as workshops, training courses, and business development and counselling services for SMEs and potential entrepreneurs.
INJAZ Oman	Part of "Junior Achievements Worldwide", the world's largest nonprofit organisation. Which aims to provide many programmes to encourage the Omani youth to start their own companies and begin their careers with confidence.

Further, the CBO is making concerted efforts to develop the SME sector, for instance, capacity building of prospective entrepreneurs and finding key methods for SME financing. The CBO is aiming to increase its contribution to SME development by enhancing the engagement of banks in the financing and development of SMEs. All licensed banks in Oman should allocate 5 per cent of their total credit to SMEs. In other words, lending to SMEs should not fall below 5 per cent of the bank's total credit portfolio. However, this is only a minimum target and the CBO may consider increasing the limit beyond 5 per cent.

The CBO recognised that the high cost of capital is affecting the ability of SMEs to succeed, so all licensed banks must reduce interest rates and other costs when lending to SMEs. All banks operating in the Sultanate need to provide a return on SME lending on a monthly basis, starting from June 2013 and a quarterly return should contain all the loan applications received and processed from the quarter ending September 2013 onwards.

In addition, the CBO is guiding banks towards nonfinancial inputs in the following areas:

1. When providing loans to SMEs banks should not be guided by collateral.
2. When providing financing to SMEs banks need to prepare themselves in a systematic way⁸.
3. Infrastructure/ process requirements:
 - Policy: According to the government's vision and CBO initiatives to support SMEs segment, all boards of directors of the banks and the management of foreign banks need to have a liberal lending policy.
 - Separate department: All local banks that are operating within the country should have a discrete department to meet the needs and requirements of SMEs; this department should be headed by a senior management member. Moreover, the foreign banks that are operating within the country need to have a person who is qualified in SMEs' developments in order to cater for the requirements of

⁸ Acting according to a fixed plan or system set up by CBO to provide smooth channelling of credit to SMEs.

the SME segment. The staff member of the bank who is responsible for SME finance should have relevant training so as to be aware of SMEs' requirements.

- Delegation: There should be a well-defined process when providing loans to SMEs with a specific time limit.
- Credit flow: There needs to be a timely flow of credit to the SME segment.
- Other assistance: Banks should provide easier access to finance for SMEs. They should facilitate SMEs by offering technical support, sourcing of raw material, marketing, and business management.

Compared to large enterprises, SMEs are different. By their very nature, they are risky, weak, and unable to handle setbacks. They require adequate policies to help them to grow by getting their ideas off the ground; in addition, they require tailor-made support services. Once SMEs are provided with all these essential requirements, they can play an active and unique role in economic development. A strong SME sector is the foundation for a healthy economy.

2.4 Sultanate of Oman: Banking Industry

One of the main functions of the banking industry is to systematically fund and support the most profitable and efficient projects. For this reason, economists have long recognised the vital role that banks play in the proficient functioning and growth of any country's economic development. As banks are the most dominant financial institutions in any country, the role of government then is to ensure that financial institutions serve these vital functions efficiently. Oftentimes, a government carries out this responsibility by establishing regulatory and supervisory bodies to oversee and enhance the solvency and stability of the banking sector. The current section will, therefore, examine the banking industry in the Sultanate of Oman, specifically the role of the Central Bank of Oman, the history of the banking industry in the Sultanate, and the role of the banks including conventional, specialised and Islamic banks in the economy.

2.4.1 Role of Central Bank of Oman.

The Central Bank of Oman was established in early 1974 by Royal Decree No 114/2000. Before that time, there was no national authority responsible for controlling the banking system in the Sultanate of Oman. In fact, there were a limited number of banks and their activities were limited in scale. Two monetary authorities, Muscat Currency Authority in 1970 and the Oman Currency Board in 1972, paved the way for the establishment of the CBO.

Oman's financial services industry is regulated and supervised by the CBO. Its vision is “to be recognized as an effective, efficient and dynamic value driven Central Bank fostering macroeconomic, price and financial stability and enhancing economic welfare of the country”(Central Bank of Oman, 2007, p. 1) and its mission is “to proactively provide a stable framework for economic development of Oman through the effective, efficient and transparent implementation of monetary and exchange rate policy and management of financial sector” (Central Bank of Oman, 2007, p. 1). The CBO’s primary objective is to provide a stable framework for the economic development of Oman and an efficient financial sector.

As stated by the Central Bank of Oman (2016), the institutional framework of the financial sector in Oman consists of the Central Bank of Oman, commercial banks, Islamic and Islamic windows specialised banks, nonbank finance and leasing companies, and money exchange houses. In addition, public and private sector pension funds, insurance firms, brokerage firms, and the Muscat Securities Market (MSM) are also included as part of Oman’s broad financial system.

Notwithstanding the challenges the Omani government is facing due to decline in crude oil prices, the CBO is still contributing its support to economic diversification and growth⁹. To illustrate, the total assets of the CBO increased by 16.8 per cent in 2016, from OMR 7,588.8 million as at the end of December 2015 to OMR 8866.3 million at the end of December 2016; however, there was a marginal drop in its total assets at the end of December 2017 to OMR 7,178.4 million, as shown in Figure 6

⁹ Good monetary policy, financial stability, and efficient payment systems all contribute to economic growth and development.

While foreign assets made up the major portion of the total assets at 87.9 per cent, and increased by 15.5 per cent compared to the previous year 2015, foreign assets stood at OMR 6,186.3 million at the end of 2017. CBO capital stood at OMR 760 million in 2016, the same as for the previous year 2015; at the end of 2017, CBO enhanced its capital to OMR 1 billion through a transfer of OMR 240 million in April 2017 from its general reserve to its capital reserve. It then stood at OMR 1000 million. (Central Bank of Oman, 2018). The CBO's profit for the year 2016 amounted to OMR 49.83 million compared to OMR 49.65 million during 2015, a rise of 0.4 per cent over the previous year's profit. However, there was a dramatic increase of 50.2 per cent in the CBO's profit at the end of 2017, amounting to OMR 74.82 million.

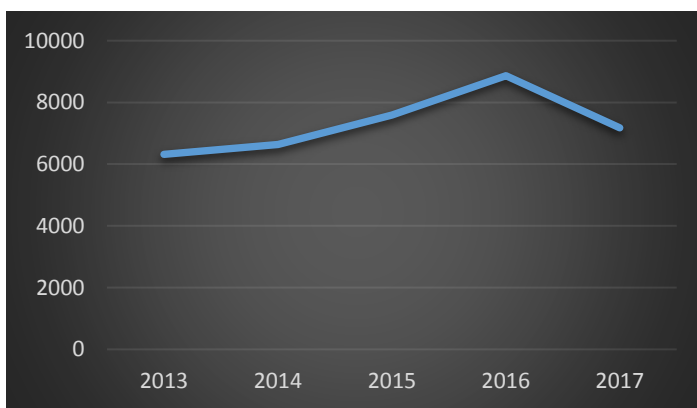


Figure 6. Total assets of the Central Bank of Oman (OMR million).

Source: Central Bank of Oman (2018)

2.4.2 History of the banking industry in the Sultanate.

The first commercial bank in Oman—a branch of the British Bank of the Middle East—was established in 1946 in Oman's capital city, Muscat. Since then, banking activities in Oman have grown significantly. There have, for example, been many significant developments in branch networking, asset growth, capital employed, and the variety of financial products and services (Central Bank of Oman, 2000).

The following subsection provides the history of commercial banking in the Sultanate of Oman up to 1990. In 1970, there were only three commercial banks, with seven offices operating within the country, around the capital area. From 1970-

1973, the number of bank branches increased to 27. This indicates slow growth but steady expansion. However, in 1974, there was rapid growth in bank branches, with 11 new branches being opened. This expanded growth was also seen in the following year, 1975, when 17 additional branches started operation (Central Bank of Oman, 2000).

By the end of 1975, 55 banks were operating within the country, with 13 commercial banks, 11 foreign and 2 local banks, as seen in Table 12. During 1970-1975, there was a significant expansion in the number of banks operating within the country. Significant growth in banking activities continued during the second half of the 1970s. For example, the number of operating banks rose from 18 to 20 banks. In fact, the expansion in the banking industry continued during the period 1981-1990, with an additional four banks (see Table 13).

Table 12. *List of First Established Commercial Banks in the Sultanate of Oman*

Name of the Banks	Establishment Date
Local Banks	
1. Bank of Oman, Bahrain & Kuwait	1974
2. National Bank of Oman	1973
Foreign Banks	
3. Arab African Bank	1975
4. Arab Bank	1973
5. Bank of Credit & Commerce, Intl	1974
6. Banque de Paris et Des Pays Bas	1975
7. Bank Melli Iran	1974
8. British Bank of the Middle East	1948
9. Chartered Bank	1968
10. First National City Bank	1975
11. Grindlays Bank	1969
12. Habib Bank Overseas	1972
13. Habib Bank A.G. Zurich	1973

Source: Central Bank of Oman (2000)

Table 13. *List of Commercial Banks in the Sultanate of Oman During 1975-1990*

Name of the Banks	Establishment Date
Local Banks	
1. Al Bank Al Ahli Al Omani	1976
2. Commercial Bank of Oman	1976
3. Union Bank of Oman	1976
4. Bank of Oman & Gulf	1977
5. Oman Overseas Trust Bank	1981
6. Bank Dhofar Al Omani Al Fransi	1990
7. Omani European Bank	1990
Foreign Banks	
8. Bank of Baroda	1976
9. Bank Saderat Iran	1976
10. National Bank of Abu Dhabi	1976
11. Banque du Liban et D'outre-mer sal	1981

Source: Central Bank of Oman (2000)

In the early half of the 1990s, mergers¹⁰, acquisitions, and amalgamations¹¹ took place within the banks¹². This was a significant development in the banking industry. As a consequence, 18 commercial banks were then operating within the country—7 were local and 11 were branches of foreign banks—at the end of 1995 (Central Bank of Oman, 2000).

During 1996-1999, the Omani banking industry continued its growth phase, despite the international financial crises and the decline in the oil price. In other words, the banking industry was not much affected, according to Central Bank of Oman (2000). In addition, during the same period, more mergers took place, making a total of 16 commercial banks, 7 local and 9 foreign banks, which were operating within the Omani banking industry.

From 1975 to 2000, the commercial banks in Oman have shown a significant development in the banking industry in terms of overall economic development. Since the 1990s, the Sultanate has had several mergers and, as a result, the number of banks authorised by the CBO at the end of 2017 stood at 28 licensed: i.e., local (7), foreign (9), specialised (2), fully-fledged Islamic banks (2), and Islamic windows of conventional banks (6), as indicated in Table 14. The number of

¹⁰ A merger is where two or more banks combine to create a new bank.

¹¹ An amalgamation is where one bank acquires one or more banks.

¹² Five mergers took place.

banking units in Oman is “considered sufficient” and “proportionate” to the size of the nation’s economy, according to Al Zadjali, Executive President of the Central Bank of Oman (Thomson Reuters, 2015). Historically, as we have seen, there was no Islamic banking in the Omani banking industry; its first emergence in the country began only in 2012.

Table 14. *Licensed Banks in the Sultanate of Oman (as of 31 December, 2017)*

Name of the Banks	Establishment Date	Authorised Office	Operating Offices
Local Banks			
National Bank of Oman	1973	63	61
Oman Arab Bank	1973	59	59
HSBC Bank Oman	1975	71	47
Bank Muscat	1981	140	134
Bank Dhofar	1990	59	59
Bank Sohar	2007	30	29
Al Ahli Bank	1997	14	13
Foreign Banks			
Standard Chartered Bank	1968	2	1
Habib Bank Ltd	1972	8	6
Bank Melli Iran	1974	1	1
National Bank of Abu Dhabi	1976	9	7
Bank Saderat Iran	1976	2	2
Bank of Baroda	1976	5	4
State Bank of India	2004	1	1
Bank of Beirut	2006	6	6
Qatar National Bank	2007	6	6
Specialised Banks			
Oman Housing Bank	1977	5	5
Oman Development Bank	1977	18	18
Islamic Banks			
Bank Nizwa	2012	12	12
Alizz Islamic Bank	2013	10	10
Islamic windows			
Bank Muscat -Meethaq	2013	19	19
NBO - Muzn	2013	6	6
BD - Misara	2013	10	10
OAB - Al yusr	2013	7	7
AHB - Al hilal	2013	7	7
BS - Sohar Islamic	2013	5	5
Total		573	535

Source: Central Bank of Oman (2018, p. 157)

Further, as at the end of 2017, Oman’s conventional commercial banks (excluding Islamic banking windows) had 1,288 automated teller machines (ATMs), (620 of which were off-site); 225 cash deposit machines (22 of which were off-site); and, 13 on-site banking facilities. Out of seven only, six local banks are listed in the Muscat Security Market. In fact, all commercial banks are privately owned, and the Government of Oman has minority stakes in a few of them. Aggregate foreign

ownership in locally incorporated banks is limited by law to a maximum equity share of 70 per cent, with prudential sublimits imposed on the shareholding pattern. Twelve conventional banks and one fully-fledged Islamic bank had approval to engage in specific investment banking activities on a tiered licensing system, at the end of 2017.

2.4.3 **Role of the banks in the economy.**

Any market economy requires a well-developed financial sector in order to ensure mobilisation of savings and then efficient allocation of these resources among productive users who need financial support. The costs of moving funds between borrowers and lenders are reduced by financial intermediaries. This system produces an efficient way to allocate resources and to make for faster growth of the economy. Economists have described banks as intermediaries between savers and users of capital. According to Bossone (2001, p. 2240), banks are special intermediaries and play a unique role in the economy, “because of their unique capacity to finance production by lending their own debt to agents willing to accept it and to use it as a money.” Thus, the banking system plays an important role as a financial intermediary in the economy of any nation.

The purpose of financial intermediation in the economy is valuable. In general, financial intermediaries have four important functions: (i) the bank serves as a channel between economic units with excess and deficient financial resources; (ii) the bank borrows on a short-term basis to lend on a long-term basis; (iii) it consolidates saving in the form of deposits and other liabilities, transforming them into loans; and, (iv) it acts as risk aversion, providing valuable information for operations and investment decisions (De la Cuesta-González, Muñoz-Torres, & Fernández-Izquierdo, 2006).

Oman’s financial sector is dominated by the banking system and the domestic banks are the leading players (see Figure 7). The banking system in Oman has helped in promoting financial inclusion and financial deepening in the economy, according to the Central Bank of Oman (2018). To illustrate this, during the recent 5-year period, there was:

- ✓ Constant growth in the ratio of banks' credit to nominal GDP: 51.9 per cent in 2013, 57.1 per cent in 2014, 75.9 per cent in 2015 and 86.1 per cent in 2016 and a marginal decline in 2017 of 84.3 per cent.
- ✓ Constant growth in the ratio of banks' credit to nonoil GDP: 94.8 per cent in 2014 ,104.7 per cent in 2015 ,112.4 per cent in 2016, and 115.1 percent in 2017.
- ✓ Constant growth in the ratio of banks' deposits to GDP, which increased by 47 per cent from 2013 to 2017.
- ✓ Constant growth in the ratio of market capitalisation to GDP; this indicates the magnitude of the size of the stock market and the market value of investors' wealth.

Table 15 shows a few selected monetary and banking indicators over the most recent 5-year period.



Figure 7. Structure of Omani financial sector.

Source: Central Bank of Oman (2015b)

Table 15. *Monetary and Banking Indicators, as at 31 December 2016*

	2013	2014	2015	2016	2017
Monetary Indicators					
Reserve money (OMR million)	2652	3302	5612	4061	3765
Currency with public (OMR million)	1039	1188	1395	1299	1266
Banking Indicators					
Number of conventional commercial banks	16	16	16	16	16
Number of branches of conventional commercial banks	493	469	468	470	436
Conventional commercial bank ATMs	1071	1053	1088	1109	1288
Capital adequacy ratio	16.2	15.4	16.1	16.8	17.4
Financial deepening indicators					
Bank credit to GDP (%)	51.9	57.1	74.4	86.8	84.3
Bank credit to nonoil GDP (%)	90.8	94.8	104.7	112.4	115.1
Bank deposits to GDP (%)	52.4	57.1	73.3	79.5	77.2
Currency with public to GDP (%)	3.5	3.8	5.3	5.1	4.5
Currency with public to reserve money (%)	39.2	36.0	24.9	32.0	33.6
Stock market capitalisation to GDP ratio (%)	47.1	46.3	58.4	67.8	64.3

Source: Central Bank of Oman (2018)

According to the Central Bank of Oman (2018), the Omani economy has recently faced many challenges which are associated with: i) a slowdown in economic activities globally and regionally; ii) a fall in crude oil prices during the second half of 2014; iii) deficits in the fiscal and current account; and, (iv) greater risk aversion influencing investors' concerns and capital flows. Despite such challenges, the banking sector has shown a continued positive growth trend and is supportive to economic diversification. For instance, during the most recent 5-year period, the banking industry showed a notable growth in the main banking aggregates (see Figure 8), such as

- I. Assets growth saw a 3.2 per cent increase in total assets of conventional banks from OMR 27.1 billion in year 2016 to OMR 27.9 billion in year 2017.
- II. Deposits saw an increase of 2.1 per cent in deposits held with conventional banks to OMR 18.3 billion in December 2016 as compared to 17.9 billion in December 2015; there was a modest increase of 1.9 per cent to OMR 18.6 billion as at the end of December 2017.

- III. Total credit increased by 4.1 per cent from OMR 19704.6 million in 2016 to OMR 20511.5 in year 2017. The growth in credit was mainly driven by credit to the private sector.
- IV. There were significant increases in the conventional banks' core capital and reserves which went up by 14.3 per cent to OMR 4651.0 million at the end of 2017.
- V. Profit saw a marginal decline from OMR 379.3 million in 2015 to OMR 376.9 million in 2017, a marginal drop of 0.6 per cent over the year in the net profits of banks after earmarking provisions and taxes. Of the total profits, 97.1 per cent represent local banks' profits and 2.9 per cent represents foreign banks' profits.

As a matter of fact, the financial health of the Omani banking industry in terms of: assets quality, provision coverage, capital adequacy and profitability remained strong. Given the fact that banks in Oman are well capitalized and comply with the international regulatory prescriptions such as Basel III capital and liquidity standards, there is not much concern regarding the likely impact of NPLs on the capital adequacy of banks. (Central Bank of Oman, 2016, p. 12)

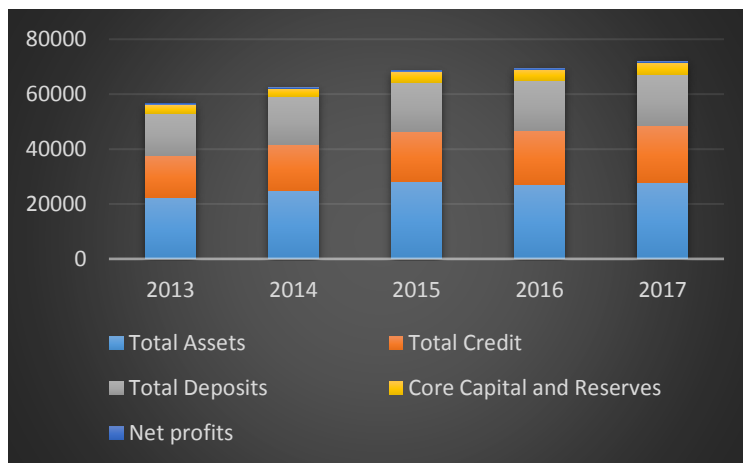


Figure 8. Main banking aggregates of conventional banks (OMR million).

Source: Central Bank of Oman (2018)

2.4.4 Specialised banks.

The government owns two specialised credit banks, namely the Oman Housing Bank (OHB) and Oman Development Bank (ODB), with a network of 23 branches, as at the end of 2017. The former bank specialises in providing soft finance to

mainly low- and middle-income Omani nationals to enable them to build or purchase residential property. In fact, at the end of 2017, total mortgage loan accounts were at OMR 476.2 million compared to OMR 420.8 million a year previously, a rise of 13.2 per cent (Central Bank of Oman, 2018).

The latter bank, the ODB, is the leading development financing institution specialised in the financing the development projects of large, small and medium enterprises such as fisheries, agriculture, livestock, information technology, industrial resources, education, professional activities, tourism, workshop, and traditional craftsmanship. The bank offers soft loans at interest rates of not more than 3 per cent per a year, and the interest charged to customers is subsidised by the government¹³, which provides interest-free loans up to OMR 5,000 to small investors and craftsmen. Figures 9 and 10 show the total assets and asset structure of the specialised banks in the Sultanate.

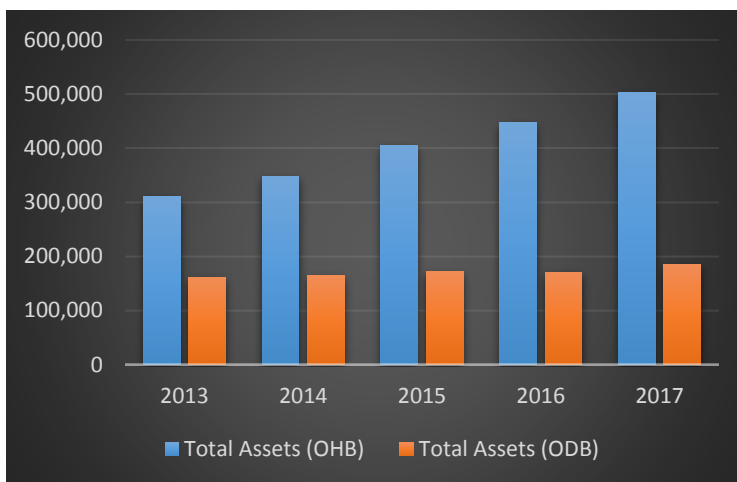
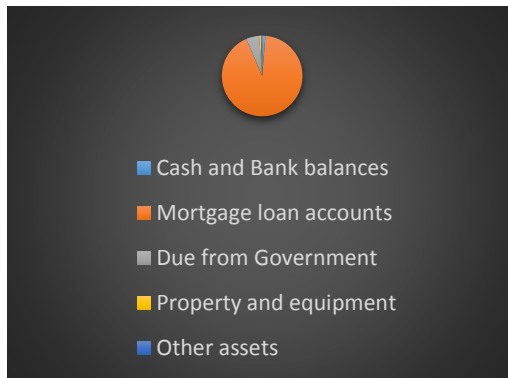


Figure 9. Total assets of specialised banks in Oman (OMR thousands).

Source: Central Bank of Oman (2014, 2015a, 2016, 2017, 2018)

¹³ Government provides support to the extent of 6 per cent p.a.

OHB



ODB

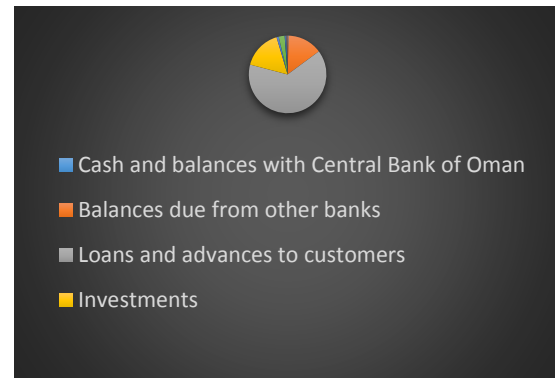


Figure 10. Banking assets structure.

Source: Central Bank of Oman (2016)

Further, the ODB's main objective is to contribute to the diversification of the national economy through financing SMEs and corporations. Since its inception, the bank has been supporting the promotion of economic and social development in the Omani economy by financing SMEs which are in need of financial support in order to start up new projects or expand existing ones. The bank's mission is "to commit necessary long and short term financial resources that are required to support the development activities of Large, Medium and Small Enterprises in line with the Government goals to diversify the sources of national revenue" (Oman Development Bank 2011, p. 1). Figure 11 shows the ODB's disbursement of loans for the past 5 years. Furthermore, in 2016 the ODB financed 5327 projects with loans worth OMR 51,29969,1 an increase of 19 per cent when compared to the loans approved during the same period in 2015. Figure 12 shows total disbursement of loans provided to permitted sectors¹⁴.

¹⁴ For example, fisheries, agriculture, livestock, information technology, industrial resources, education, professional activities, tourism, workshop, and traditional craftsmanship.

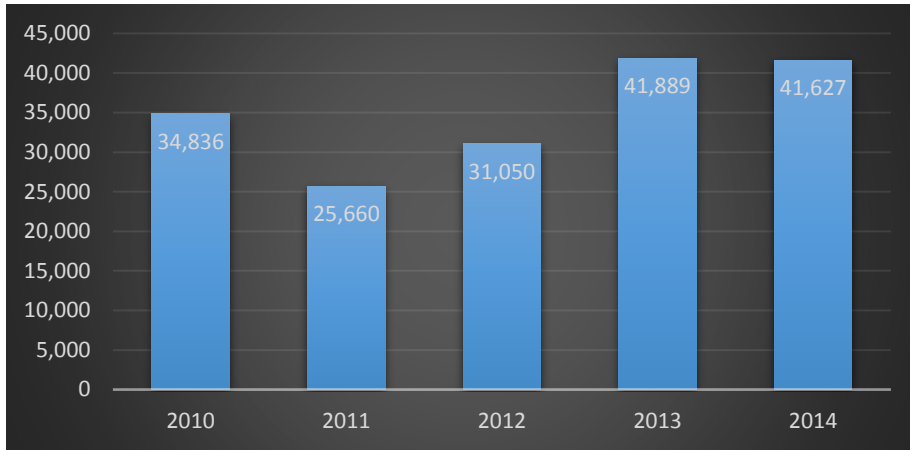


Figure 11. Disbursement of loans (OMR thousands).

Source: Oman Development Bank (2014)

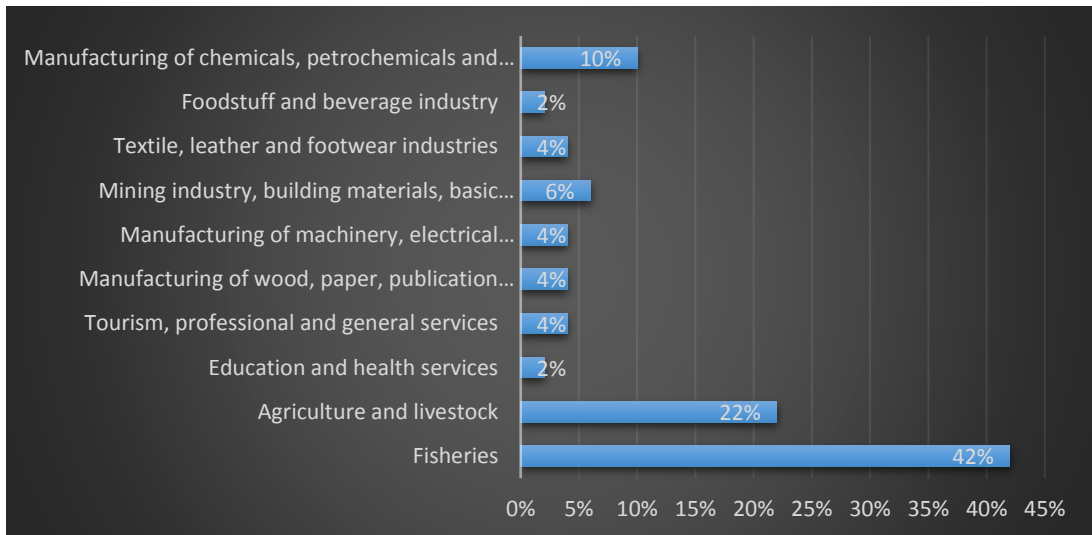


Figure 12. Percentage of loan approvals to each economic sector 2014.

Source: Oman Development Bank (2014)

2.4.5 Islamic banking industry.

The Sultanate of Oman was the last Gulf Arab state to license Islamic banks to offer Islamic finance (Sharia-compliant products), which is in its early stages of development. The introduction of Islamic banking in 2012 is a notable development in the banking sector. It is growing in terms of its impact on the banking sector and aims to promote growth in the economy, and promote financial inclusion and diversity of banking services. Further, once the fully-fledged Islamic banks pass

through the initial teething phase, they will have a bigger role and boost the stability of the banking sector (Central Bank of Oman, 2015b). In addition, the Sultanate has all the ingredients in order to establish a successful Islamic banking industry, such as “strong economic growth projections, significant government expenditure on infrastructure projects and a young, sharia-sensitive population” (Thomson Reuters, 2016, p. 7).

A royal decree by Sultan Qaboos allowed the offering of Islamic finance products. Prompt action was taken by the CBO in 2012 to release the comprehensive Islamic Banking Regulatory Framework (IBRF), “one of the most comprehensive regulatory frameworks in existence in the Islamic banking industry the world over,” according to Mr. Sulaiman bin Hamed Al Harthy, a group general manager of Meethaq Islamic Banking (Thomson Reuters, 2016, p. 38). The IBRF includes different aspects of Islamic banking such as Islamic bank licensing requirements, rules and regulations governing sharia supervisory boards, and comprehensive guidelines on Islamic transactions.

Currently, there are two fully-fledged Islamic banks. The Bank Nizwa was granted a licence from CBO in May 2011 to establish the first Islamic bank and started operations in January 2013 with two branches. It raised OMR 60 million in an initial public offering (IPO) of 40 per cent of its shares in May 2013. Bank Alizz was granted a licence in August 2011 to operate as a fully-fledged Islamic bank; it has 40 per cent capital from public investors and 60 per cent from other promoters and started with OMR 100 million. In addition, six of the seven Omani conventional banks¹⁵ listed in Table 4 above offer Islamic banking through their Islamic windows. For example, Ahli Bank (Hilal Islamic), Bank Muscat (Meethaq), National Bank of Oman (Muzn) launched their Islamic banking operations in January 2013, Bank Dhofar (Maisarah) was granted a licence from the CBO in February 2013, and Bank Sohar (Sohar Islamic) and Oman Arab Bank (Yusr) launched their Islamic banking operations in July 2013. Islamic and window banks establish their own sharia supervisory boards in order to provide a guide for Islamic law methods.

¹⁵ HSBC Bank Oman is not offering Islamic banking services.

The door is now open both for Islamic and conventional banks to post high growth. By the same token, Omani consumers have the benefit of choosing between conventional and Islamic banking products.

We should bear in mind that Islamic banking is not just a new addition to the traditional banking or a competitor that offers the same products and services. They are rather financial to provide ideal solution for those who have been waiting for long for banking products and services that are compatible with the tenets of Sharia. (Batainah, 2014, p. 1)

In fact, 74 per cent of Omani consumers are encouraged to deal with Islamic banking due to Islamic rules (Thomson Reuters, 2016) and 55 per cent cite religion as the main concern when dealing with Islamic banks. In light of this finding, Islamic banks in Oman must prove that they are different from traditional banking in order to better position themselves in the eyes of the public.

In addition, a study published by the Islamic Finance Advisory and Assurance Services (IFAAS) in December 2011 found that 85 per cent of Omani consumers expressed an interest in Islamic finance products (Thomson Reuters, 2013). This study is the first of its kind to provide the perspective of the Omani consumer towards Islamic finance products. Its results indicate a strong preference to Islamic products. Similarly, according to a consumer banking survey conducted by Thomson Reuters (2016) in Oman in May 2014, a high demand for Sharia-compliant products among Omanis. For example, 40 per cent of the respondents indicated that conventional finance should be replaced completely by Islamic finance. Also, the report shows that 93 per cent of Omani consumers may still be interested in Sharia-compliant products, despite possibly higher fees, and are considering moving their transactions to an Islamic bank. These findings indicate that the growth prospect of Islamic banking within the Omani market is high.

The late entrance of Sharia-compliant banking in Oman, compared to its presence in other GCC countries (see Table 16), provides an opportunity for Oman to learn from other markets' experiences and achieve best practice within the banking industry. According to Abdullah Salim Al-Salmi, the executive president of the Capital Market Authority (CMA):

being new entrants to the Islamic finance industry, we have had the opportunity to learn from the experience of other jurisdictions. We have tried our best to avoid mistakes done elsewhere and this gives a

positive signal to the Omani market. (Islamic Finance News, 2016, p. 5)

Al Zadjali, the Executive President of the CBO, also noted that late entrance to the market had meant Oman benefitted immensely from the experience of other markets: “the hallmarks of our approach have been adopting of accounting standards of Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and guidance by Islamic Financial Services Board (IFSB) standards in the beginning itself” (Times of Oman, 2016a, p. 1)

Table 16. *History of Islamic Banking in the GCC Market*

Country	Year
United Arab Emirates	1975
Saudi Arabia	1975
Bahrain	1978
Kuwait	1977
Qatar	1982
Oman	2012

Source: Al-Ajmi, Abo Hussain, & Al-Saleh, (2009); Central Bank of Oman, (2014); Kuwait Report, (2012); Institute of Islamic Banking and Insurance, (2008); Qatar Islamic Bank, (2016)

Within a short time span, Islamic banks and windows have shown robust growth, with the value of gross assets amounting to OMR 3.81billion, as at the end of December 2017 (see Figure 13), with this sum constituting about 10 per cent market share of the total banking industry, as shown in Figure 14. We compare these percentages with other older and more established Islamic finance sectors, as in Table 17.

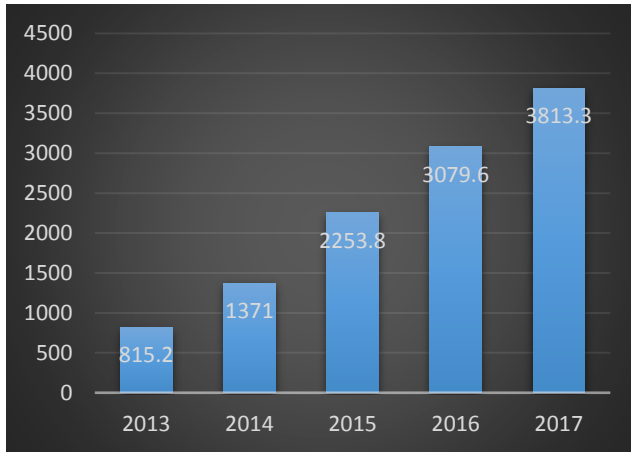


Figure 13. Total assets of Islamic banks and windows (OMR millions).

Source: Central Bank of Oman, (2014, 2015a, 2016, 2017, 2018)

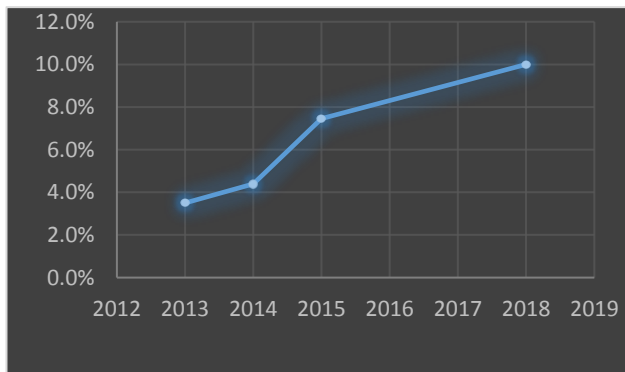


Figure 14. Market share of Islamic banks and windows of the country's total assets

Source: Thomson Reuters, (2016); Times of Oman, (2016b)

Table 17. Islamic Banks' Market Share, by Total Assets

Country	Total Islamic banking industry	First evidence of Islamic banking
Egypt	5%	1996
Pakistan	5%	1980
Turkey	5.6%	1985
Indonesia	5%	1992

Source: Okumuş (2005), Hussain, Shahmoradi and Turk (2015), Saeed (2012) and Ismal (2011)

Oman’s Islamic banking industry is even more impressive (Thomson Reuters, 2016). In fact, by the end of 2018, it is expected that Islamic banks and window operations in the best-case scenario will ramp up this market share to 10 per cent of the entire banking industry according to Thomson Reuters (Times of Oman, 2016b). On the other hand, under a base scenario, total banking assets could reach OMR 5 billion, which is a 7 per cent share of estimated total assets, which is still higher than that in above mentioned countries. Growth has also been strong on a year-on-year basis with total investment, total finance, total deposits, and core capital and reserves with two dedicated Sharia-compliant lenders and six commercial banks with registered Islamic window banking (see Table 18). According to Thomson Reuters (2016), this continued growth in Oman’s Islamic banking sector is mainly supported by six Islamic windows of strong conventional banks in the Sultanate. In addition, “such robust growth in Islamic institutions indicates that Sharia-compliant banks have been able to establish themselves in the market and are able to overcome teething problems,” according to Ali Hamdan Al Raisi, vice-president, Central Bank of Oman (Times of Oman, 2016a, p. 1).

Table 18. *Islamic Banking Performance Indicators*

Banking indicators	2013	2014	2015	2016	2017
Fully-fledged Islamic banks	2	2	2	2	2
Windows banks	6	6	6	6	6
Islamic banking entities’ ATMs	29	43	50	72	79
Number of branches of Islamic banking entities	32	46	60	70	76
Total investment	104.2	44.9	145.3	159.9	228.7
Total assets (OMR million)	815.1	1371.0	2253.8	3079.6	3813.3
Total finance (OMR million)	433.9	1049.5	1781.3	2425.9	3033.0
Total deposits (OMR million)	171.9	688.9	1539.4	2169.8	2968.2
Core capital and reserves (OMR million)	328.1	350.6	391.3	433.0	458.0

Source: Central Bank of Oman, (2014, 2015a, 2016, 2017, 2018)

Despite growth in the sector and fruitful performance of Islamic banking in the Sultanate, the standalone Islamic banks showed the largest losses in the first year of their operation (see Figure 11). For example, Bank Nizwa reported OMR 12,304,780 losses, due to net expenses of OMR 3,921,119 prior to the bank’s

starting operations, and the operating expenses were OMR 11,083,168 for the period from 19 December 2012 to 31 December 2013, as stated by Al Busaidi, the chairman of Bank Nizwa (Bank Nizwa, 2014). Also, due to preoperating costs, Alizz Islamic bank reported OMR 3,232,132 losses; this loss was in line with the expected forecast, as mentioned by Al Said, the chairman of Alizz Islamic Bank (Alizz Islamic Bank, 2014). In fact, the losses of fully-fledged Islamic banks continued for 2014 and 2015 but with smaller losses (see Figure 15).

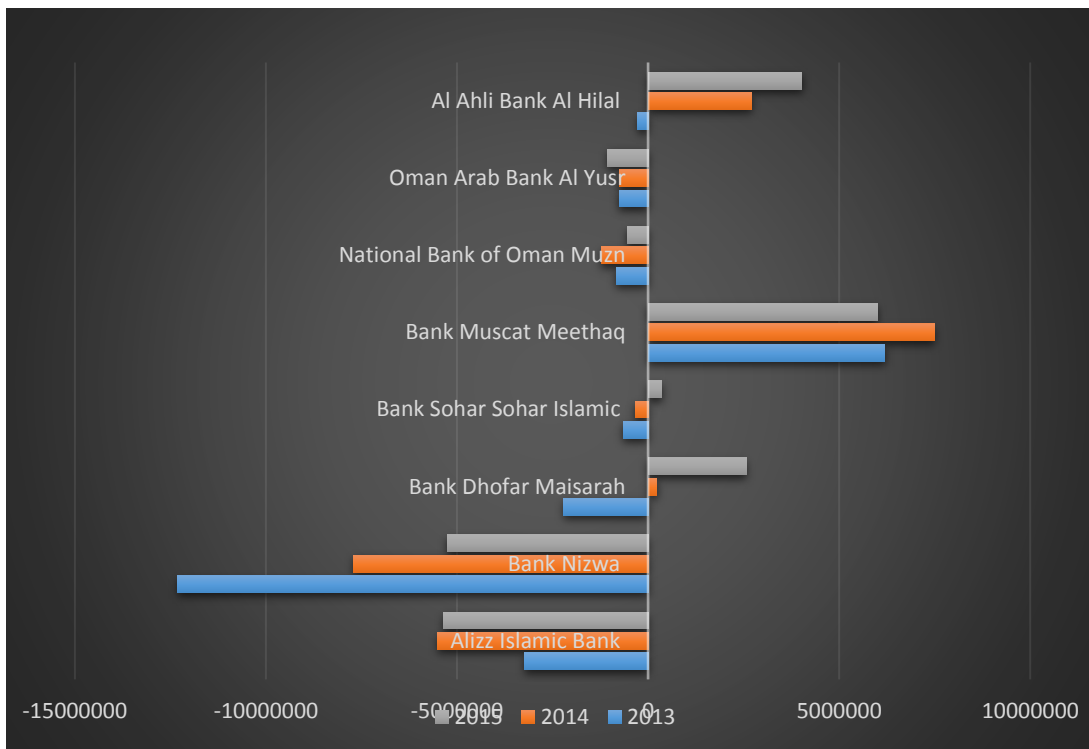


Figure 15. Islamic banking net profit/loss

Source: (Al Ahli Bank, 2014, 2015, 2016; Alizz Islamic Bank, 2014, 2015, 2016; Bank Dhofar, 2014, 2015, 2016; Bank Muscat, 2014, 2015, 2016; Bank Nizwa, 2014a, 2015, 2016; Bank Sohar, 2014, 2015, 2016; National Bank of Oman, 2014, 2015, 2016; Oman Arab Bank, 2014, 2015, 2016)

Notes:

- * Alizz Islamic Bank net losses for the period 2 November 2012 to 31 December 2013.
- * Bank Nizwa net losses for the period from 15 August 2012 to 31 December 2013.
- * Bank Dhofar Maisarah net losses before taxation for the period from 3 March 2013 to 31 December 2013.
- * Bank Sohar Sohar Islamic net losses for the period from 30 April to 31 December 2013.
- * Oman Arab Bank Al Yusr net losses for the period from 14 July 2013 to 31 December.

On the other hand, all six commercial banks with registered Islamic windows banking also reported net losses for the first year of their operations, with the exception of Bank Muscat Meethaq, which was the only Islamic banking service to report net income, that is, OMR 6.2 million. In fact, the majority of the Islamic banking windows reported net income for 2014 and 2015 (see Figure 15). This situation is not surprising, since two dedicated Sharia-compliant lenders could not leverage the existing technology and network that conventional banks had while they set up their Islamic banking services (Thomson Reuters, 2016).

Despite the economic challenges the Omani government is facing from the crude oil prices and the performance of Islamic and windows banking at the early stages, the years 2016 and 2017 saw improved performance for both the Islamic and window banks. To illustrate, by the end of September 2017, Oman's Islamic banks and window operations had shown a robust year-on-year growth of 31.82 per cent—OMR700 million in financing at OMR 2.9 billion, as against OMR 2.2 billion in the same period last year. This improvement not only indicates robust growth in the Islamic banking industry within the country, but also that Sharia-compliant banks have been able to establish themselves in the Omani market and overcome their teething problems.

Specifically, the performance of both the two fully-fledged Islamic banks—Bank Nizwa and Alizz Islamic bank—was positive and more efficient. The former bank's total assets grew by 35 per cent to reach OMR 697 million in 2017, compared to OMR 516 million in the previous year. Its gross financing portfolio grew by 41 per cent to reach OMR 568 million, while its total customer deposit portfolio reached OMR 526 million, recording a significant growth of 50 per cent year-on-year. Operating income for the year 2017 increased by 29 per cent, while operating expenses increased by only 4 per cent. Consequently, the bank achieved a net profit OMR 3.8 million (Bank Nizwa, 2018).

The later bank witnessed solid growth in all the core business areas, which resulted in an increase in financing receivables of 47.13 per cent, to reach OMR 460.20 million from OMR 312.79 million at the end of 2016. Revenue from financing and investing activities increased by 68.88 per cent, to OMR 21.15 million from OMR 12.53 million compared to 2016's revenue. Net operating loss before provisions

and tax reduced by 55.86 per cent, to OMR 1.62 million, while the bank achieved an operating profit of OMR 283,000 in the fourth quarter of 2017. Net loss reduced by 36.59 per cent, to OMR 2.99 million from OMR 4.72 million and the net profit grew to OMR 154,000 in the fourth quarter of 2017 (Alizz Islamic Bank, 2018).

By the same token, the six window banks' performance was positive. During the years 2016 and 2017, all the window banks had a net profit, as indicated in Table 19, with the exception of the National Bank of Oman - Muzn in 2017 and Oman Arab Bank - Al yusr 2016 had a loss. The performance of these window banks is a good indicator of the significant growth that is expected in the near future, despite the challenging economic environment in the Sultanate. The progress which Islamic banks and window operations have achieved within 5 short years and in various areas has been remarkable. This progress has been achieved thanks to the effort that these institutions have made to build a strong network of branches across the country and to raise awareness on Sharia-compliant products and services. Despite its relative youth, the Islamic banking has grown exponentially. Continuous innovation, better products, and good customer service have all helped the industry to gather momentum. Moreover, Islamic banking's level of penetration is around 14-16 per cent in Oman, compared to an average penetration level of 20 per cent in the Gulf, which leaves ample room for Omani institutions to grow, in the interior towns away from the country's capital, Muscat. In other words, there is still room for further expansion of Islamic banks, despite the challenges ahead (Times of Oman, 2017).

Table 19. *Financial Performance of Window Banks*

Window banks	Net profit/loss OMR	Net profit/loss OMR
	2016	2017
Bank Muscat - Meethaq	8.950 million	8.255 million
National Bank of Oman - Muzn	255,000	(57,000)
Bank Dhofar - Misara	3.18 million	3.19 million
Oman Arab Bank - Al yusr	(253,000)	153,000
Al Ahli Bank - Al hilal	4,433,000	4,958,000
Bank Sohar - Sohar Islamic	663,000	853,000

Source: Al Ahli Bank (2018); Al yusr (2018); Bank Dhofar (2018); Bank Muscat (2018); Bank Sohar (2018); National Bank of Oman (2018)

Despite the fact that Islamic banking in Oman has grown and performed very well over the last few years, there are some limitations which could handicap the achievement of interest-free banking. The following outlines some of the key challenges that Omani interest-free banking faces and some initiatives that could have been taken to reduce these challenges:

- Awareness: Lack of awareness of Islamic banking among Omani consumers is the key challenge. For this reason, as stated by Ehab Hashish, the deputy general manager of wholesale banking at Alizz Islamic Bank (Islamic Finance News, 2016), it may be difficult to make progress. Nevertheless, awareness has increased and improved quickly among Omani consumers, which can be seen in the growth performance in Islamic banking. The Sultanate of Oman ranked at the top of the table regarding awareness efforts in the form of campaigns or seminars, conferences, and news articles, as mentioned in the ICD – Thomson Reuters Islamic Finance Development Report 2013 (Thomson Reuters, 2013).

In addition, Oman's first fully-fledged Islamic bank, Bank Nizwa has instituted a number of initiatives such as a series of lectures and workshops, in order to raise and enhance awareness of Islamic banking within the country (Global Islamic Economy, 2015). It also organised a conference, the first of its kind in Oman, for students and the staff of Sultan Qaboos University (SQU), with the objective of raising awareness of the advantages of Islamic banking regarding economic development. In order to spread knowledge of Islamic finance in the Sultanate, the bank collaborated with the Malaysia-based International Centre for Education in Islamic Finance (INCEIF) (The Global University of Islamic Finance), to develop of its employees (World Finance, 2014).

- Human capital: Oman's Islamic industry lacks local talent in Islamic banking. In other words, Oman is heavily dependent on foreign expertise to establish the country's new Islamic finance industry. This point is mentioned in the Islamic Banking Regulatory Framework (IBRF) established by the CBO in December 2012 (Central Bank of Oman, 2012). However, both the Government of Oman and the private sector play critical roles in developing

the Islamic banking industry. For example, in 2015 Bank Nizwa provided over 700 training and development opportunities designed to nurture the next generation to become leaders in Islamic banking. Also, many initiatives such as training sessions, a series of interactive workshops, and conferences in strategic, leadership, and Islamic banking disciplines were provided for 190 bank employees in order to build human capital (Al bawaba Business, 2016).

- Managing the liquidity: As Sulaiman Al Harthy, group general manager, Islamic Banking window¹⁶, Bank Muscat (Thomson Reuters, 2014, p. 1) stated

Islamic banks are facing significant challenges in managing their own liquidity. Lack of a developed global Islamic money market is one of the key hurdles. The industry also suffers from the shortage of short-term to long-term, or highly tradable, investment instruments with limited capital risk and, ideally, predictable returns.

To conclude, the Omani banking industry has been developing significantly and promisingly since its establishment. Its operations have so far been very robust, contributing to diversification of Oman's economy, especially with the emergence of Islamic banking, which has spurred competition for market share. Despite its short history, Sharia-compliant banking in Oman shows significant growth. Table 20 below presents a SWOT analysis of Oman's banking.

¹⁶ Meethaq

Table 20. *Oman's Banking Industry SWOT Analysis*

Strengths:	Weaknesses:
<ul style="list-style-type: none"> ➤ Oman is known for its strong economic growth with increasing diversification of the economy that enhance lending opportunities. ➤ Oman's banking industry is well regulated, with a high level of bank capitalisation. The industry has a low ratio of nonperforming loans, while credit growth is funded largely by deposits. 	<ul style="list-style-type: none"> ➤ Oman's domestic market size is small which could limit top line growth within the industry. ➤ The Omani rial (OMR) is pegged to the USD which limits monetary policy flexibility, as is the case in other GCC regions. ➤ The regulatory caps imposed on personal loan in 2013 have affected the attractiveness of the retail lending customers. ➤ Deposit growth and lending opportunities will remain constrained by low oil prices. ➤ Pressure on the state finances will continue to force the Omani government to tap into its bank deposits, which will tighten bank liquidity.
Opportunities:	Threats:
<ul style="list-style-type: none"> ➤ There is an opportunity for continued banking services to expand by, for example, increasing in the number of branches and ATMs and expanding into overseas markets, which could lead to further growth within the industry. ➤ Oman's banking industry is growing faster compared to other parts of the economy. ➤ Introducing Islamic finance within the banking industry has opened up the chance to reaching previous 'unbanked' populations. 	<ul style="list-style-type: none"> ➤ Nonoil export sector could be affected heavily by a global downturn. ➤ Risk appetite is still low regardless of a relatively resilient growth picture, and low loan growth will affect profitability going forward. ➤ The pressure of currency pegging is increasing and devaluation could affect the banking industry.

Source: BMI Research (2016)

2.5 Conclusion

Chapter 2 provided background information about the Sultanate of Oman in terms of its strategic location, ruling system, political system, and its economy. The researcher then provided background information about SMEs in Oman. It defined and explored the challenges they face and the role of the Omani government and private sector in supporting them. Supporting the SME sector is one of the Omani government's priorities as it attempts to diversify the country's oil-based economy. The final section provided information on Oman's banking industry. It explained the role of the CBO, the history of the banking industry, the role of Omani financial

institutions in economic development, specialised bank, Islamic and windows banks and provided a SWOT analysis of the Omani banking sector.

The next three chapters, which constitute the core of this thesis take the form of three research papers. These three papers appear as chapters 3, 4, and 5, although produced as part of one overall project, they represent stand-alone papers. Each of these three chapters, therefore, is a research paper that contains an abstract, introduction, literature review in addition to sections devoted to theoretical development, method, results, and discussion, conclusion and implications, and limitations and future research section as per the requirements of related target journals. Although the content of each paper reflects its online version, the numbering of the tables and figures in these papers follows the sequencing of the overall thesis, and so their numbers differ from those that appear in the published articles.

The thesis' questionnaire survey and ethical approval are provided in Appendixes 1 and 2.

Chapter 3

Islamic financial decision-making among SMEs in the Sultanate of Oman: An adaption of the theory of planned behaviour

Declaration about the role and contribution of authors

I (Yasmeen Ali Al Balushi) am chiefly responsible for the conceptualisation, review of literature and empirical analysis as well as the writing of this research paper. Stuart Locke supervised each step of this process. In particular, Stuart Locke gave conception advice on this work and commented on all versions of the research paper. Susanna Lu and Zakaria Boulanouar gave conception advice and edited the final research paper.

This paper was accepted for publication and available online

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Abstract

Adapting the theory of planned behaviour to the area of Islamic financial decisions among SMEs, we argue that nonfinancial factors such as SME owner-manager attitudes, subjective norms, perceived behavioural control and behavioural intentions largely affect the financial decisions of SMEs. A hierarchical multiple regression with a sample size of 385 SMEs supports this study's behavioural approach to understanding financing decisions. While the factors mentioned above acted as stimuli for SME decision-making, religiosity was shown to negatively affect behavioural intention to adopt Islamic financial instruments (IFI). Implications of financial decisions, specifically around Islamic finance and ideas for future research, are discussed.

Keywords

SMEs, Islamic finance decision-making; theory of planned behavior; religiosity.

3.1 Introduction

Smaller firms are financed differently from larger firms (Moritz et al., 2016) because both economic and noneconomic motives influence their financial reasoning (Gallo et al. 2004). Furthermore, López-Gracia and Sogorb-Mira (2008) and Berger and Udell (1995) confirm that SMEs not only behave and act differently from larger firms but also utilise different financing mechanisms. However, despite their distinctive approach to financing policy (Gallo et al., 2004), most research into SME financing employs traditional capital structure theories – principally trade-off theory or pecking order theory – as a framework for analysis (Serrasqueiro et al., 2011).

While capital structure theories grounded in the finance paradigm have increased our understanding of capital structure decision-making (Matthews et al., 1994), from a managerial choice perspective that includes nonfinancial and behavioural factors (Barton and Gordon, 1988; Matthews et al., 1994), they fail to address the complexities around capital structure decision-making in privately owned firms. Additionally, research shows that traditional capital structure approaches either fail to account for the importance of small businesses' preferences and norms (Pearson et al., 2008) or ignore managerial preferences. Thus, capital structure decision theories neither explain actual financing decisions adequately nor deliver financial theories or empirical studies that incontrovertibly explain critical factors that affect owners or managers' financing decisions (Myers, 1984; Norton, 1991). As Zellweger, Frey, and Halter conclude: “We need to accept that financing in most privately held companies cannot be fully explained with traditional financial theory based on the paradigm of pure rationality” (2005, p. 20).

By using a noneconomic rationale and incorporating insight from social psychology to research Islamic financial decisions, our study answers calls in the literature to expand financial choice models to research financial decisions in privately held firms (Barton and Gordon, 1987, 1988; Beattie et al., 2006; Matthews et al., 1994) and to investigate how behavioural factors affect financial structure decision-making processes (Romano et al., 2001).

Borrowing from behavioural psychology to develop a conceptual model for understanding Islamic financial decision-making, our study conducted a face-to-face survey in the Sultanate of Oman among SME owner-managers because, as Matthews et al. (1994) note, cognitive psychology research supports taking the individual approach to understanding capital structure decisions in privately held firms. To gain better understanding of factors that influence small business owners' funding decisions, we framed our study around Ajzen's (1991) theory of planned behaviour (TPB).

TPB has been successfully applied in the small business research domain (Brettel et al., 2009; Ghouri et al., 2016) where it fits particularly with understanding privately held firm financing decisions (Brettel et al., 2009; Kelley and Buultjens, 2003). Brettel et al. (2009) also supports TPB's empirical validity in the finance context, specifically SMEs' financing decision behaviour. While TPB has been widely used to evaluate a range of individual behaviours in the finance and investment context (Koropp et al., 2014; Sudarsono, 2015), its suitability for use in evaluating decisions in an organisational context is arguable because of the nature of the dynamic and complex "multiphase, multiperson, multidepartmental and multiobjective" decision processes in organisations (Johnston & Lewin, 1996, p 1). Consequently, the predictive capacity inherent in TPB may well have relevance to evaluating decision-making within the small business field (Southey, 2011), especially as financial decisions are at least partially the outcome of owners' personal preferences (Brettel et al., 2009). Adopting this focus, therefore, allows us to establish the role of managerial beliefs, attitudes, and experience in influencing capital structure decisions.

This study contributes to the SME's finance literature in important ways. First, we broaden the understanding of SMEs' financial decision-making by recognising unique SME owner-manager influences on financing decisions. Second, because most studies on SME finance focus on conventional financing, we obtain a more comprehensive perspective by analysing Islamic financing. Thirdly, we examine the factors that influence attitude formation towards Islamic finance from the perspective of SMEs' owner-managers because all previous research omitted that perspective and because we adopt TPB as the basis of our investigation. Fourth, by

testing the full TPB model, as described by Ajzen (2011), we provide the foundation for further research that aims to incorporate new developments into the model, thereby increasing our understanding of SMEs' intended behaviour around Islamic finance. Modifying the TPB model through the addition of variables like religiosity and awareness behind TPB constructs may help to maximise the predictive efficacy of the model (Moon and Kim, 2001). Lastly, we contribute to the wider research around SMEs, particularly on SME financing, by showing that noneconomic variables, especially psychological factors, can influence financing behaviour decisions.

3.2 Literature review and theoretical development

Many early capital structure studies assume that managers behave rationally, for instance, by selecting financial sources according to cost minimisation (Myers and Majluf, 1984) or by using tax benefit and cost of debt to balance their firm's debt level (Modigliani and Miller, 1963). Furthermore, Barton and Gordon (1987, 1988) indicate not only that the traditional finance theory of capital markets asserts that financial decisions are affected by fundamental variables such as stock price, profitability and volatility but also that managerial choice and nonrational elements of decision-making are important aspects that need to be considered to understand capital structure decision-making. SME behaviour, regarding financing decisions, is unique due to the specific properties these firms possess. For example, SMEs engage in conservative financing strategies: they try to retain the generational influence; managerial succession impacts their financial plans (López-Gracia and Sánchez-Andújar, 2007); and they often avoid external equity in order not to lose control over their business, a strategy which could affect their business growth opportunities (Michaelas et al., 1998).

Together, this evidence suggests that financial choices are not homogeneous and vary among small business owner-managers (Moritz et al., 2016) because small firms are highly dependent on a single decision-maker, typically the owner-manager (Gibcus et al., 2004). We also know that SME owners self-select to run businesses that best match their own areas of expertise (Wiklund et al., 2004), so

financing behaviour in small firms may be the result of owner-managers' personal attitudes. These attitudes are embedded into SMEs (Michaelas et al., 1998). Hence, SME's financing decisions are highly complex because they rest on myriad social, behavioural and financial factors (Romano et al., 2001). Thus, we argue that small businesses are likely to engage in a financial logic based on not only rational economic motivation but also nonfinancial and behavioural factors that have received relatively little attention from finance researchers (Michaelas et al., 1998).

Consequently, to better understand SME's financial decision-making, we need to explore nonfinancial and behavioural factors (Baker and Ricciardi, 2014; Matthews et al., 1994) such as the owner-managers' attitudes, subjective norms, and perceived behavioural control that influence financing decisions, specifically Islamic financing decisions. Furthermore, financial literature has ignored how religiosity may affect the financing decisions of SME owner-managers (Baker and Ricciardi, 2014). Finally, in a country where Islamic finance is in its infancy, ways in which awareness about Islamic financing may affect financing decisions among small business owners need to be understood.

3.2.1 TPB and small business financing

The theory of reasoned action (TRA) (Ajzen and Fishbein, 1980; Fishbein and Ajzen, 1975), of which TPB is an extension, has received considerable support in empirical studies of consumer behaviour and social psychology (Albarracin et al., 2001). TRA's ability, however, to predict behaviour and behavioural intentions when individuals cannot voluntarily control their behaviour is limited (Ajzen, 1991; Taylor and Todd, 1995). By adding the influence of perceived behavioural control on behavioural intentions and behaviour, TPB proposed to remedy the model's limitations (Ajzen, 1985, 1991).

We use Ajzen's (1991) TPB to study Islamic financial decision-making behaviour in SMEs. This theory explains and predicts human behaviour that is not fully under volitional control (Ajzen, 2002b) where behavioural decisions and the proximate behaviour are seen as determined primarily by the decision-maker's behavioural intentions. Behavioural intentions, in turn, arise from three determining factors: attitudes, perceived norms, and perceived behavioural control. Attitudes refer to either favourable or unfavourable evaluations of the likely consequences or

attributes of a behaviour. Norms refer to the decision-maker's beliefs about the expectations of significant others (e.g., family or friends) regarding whether to perform, or not perform, a behaviour. Behavioural control refers to the perceived ease or difficulty of performing a behaviour based on the decision-maker's belief about the presence of behaviour-limiting factors.

In SMEs a single decision-maker, typically an owner-manager, usually makes the financial decisions (López Salazar et al. 2012); his/her values and beliefs are also significant drivers in strategy making tasks (Heck, 2004). Our model, elaborated on in the next section, is displayed in Fig. 16. It extends previous research on SMEs' Islamic financing (Abdesamed and Wahab, 2015; Gait and Worthington, 2008; Gait, 2009) by analysing the impact of attitudes, subjective norms, perceived behavioural control, religiosity and awareness factors on Islamic financial decisions among SMEs. Thereafter, we develop the respective hypotheses in detail.

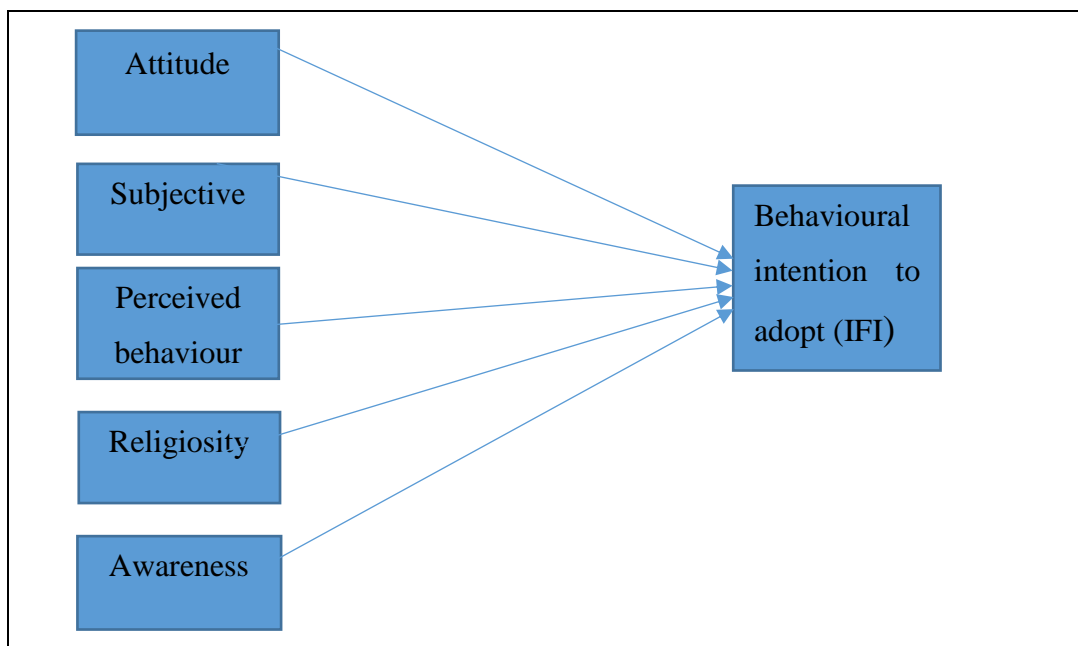


Figure 16. Hypothesis model of Islamic financial decision-making among SME owner-managers.

3.2.2 Attitudes

Although very important, research on the finance gap often neglects the attitudes of small business owners (Landström and Winborg, 1995). The small business owner's decision to use a particular source of finance is not shaped purely by access

to the sources on offer. It is shaped as much by the entrepreneur's wishes and desires (Read, 2002) as by any constraints imposed by finance suppliers (Hughes and Storey, 1994).

To illustrate the importance of SME owner-managers' attitudes on the influence on capital structure decisions, Borgia and Newman (2012) empirically test whether positive or negative attitudes influenced firms' willingness to borrow externally.

Hence, we hypothesise that more favourable attitudes toward Islamic finance will affect the behavioural intention to adopt IFI.

Hypothesis 1: An owner-manager's favourable attitude towards Islamic financing will be positively associated with his or her behavioural intention to adopt IFI.

3.2.3 Subjective norms

Research shows that social norms significantly impact entrepreneurial decision making (Chang et al., 2009). Anderson et al., (2005), for instance, show that family is an important source of encouragement and support to entrepreneurs. Greve and Salaff (2003) argue that entrepreneurs use close contacts like family members to help them during all stages of their business decisions. According to Miller (2015), head of Small Business, Bank of America, "we know small business owners are inherent self-starters making significant personal sacrifices on behalf of their businesses, but what's fascinating is this dimension of family, friends and community that they see as core to their success" (p. 1).

Fishbein and Azjen (1975) suggest subjective norms are a direct determinant of behavioural intention, as under significant social influence and social pressure individuals would perform an unfavoured behaviour if they believed one or more important referents think they should do so, and if they are sufficiently motivated to comply with the referents (Venkatesh & Davis, 2000). Thus, if family or friends favour Islamic finance, these norms should affect financial choices via behavioural intention. Hence, we hypothesise the following:

Hypothesis 2: Perceived subjective norms toward Islamic financing will be positively associated with the owner-manager's behavioural intention to adopt IFI.

3.2.4 Perceived behavioural control (PBC)

PBC indicates people's view of their ability to perform a given behaviour. According to East (1993), if people believe that they have control over an action they will be more confident of achieving that action's outcome/s. Our study defines PBC as the decision-maker's perception of the degree of control he or she has regarding adopting IFI as a form of financing. Ajzen (2002b) claims that a high level of perceived behavioural control should generally correspond to greater behavioural intention and increased efforts and perseverance to realise the intended behaviour.

PBC was found to be one of the most influential factors that play an important role in enhancing performance in entrepreneurship and in determining financial decisions. Research reveals that PBC accounts for considerable variance in intention and behaviour, and that there is a positive relationship between PBC and intention (Taylor and Todd, 1995), highlighting the importance of psychological traits such as PBC in explaining financial decision-making (Farrell et al., 2016). However, investigation into the association between PBC and financial behaviour is limited (Farrell et al., 2016). Accordingly, we hypothesise the following:

Hypothesis 3: Higher owner-manager's perceived behavioural control will be positively associated with the intention to adopt IFI.

3.2.5 Behavioural intentions and Islamic financial decisions

Behavioural intention is defined as the subjective probability that an individual will perform a certain behaviour (Fishbein & Ajzen, 1975). Because it is depicted as a function of three basic determinants—attitudes, subjective norm, and perceived control—factors that influence each of these determinants should result in a change in the behavioural intention, according to the theory (Ajzen, 1991). TPB provides support for a positive correlation between each of these determinants and the

behavioural intention. In other words, the more favourable the attitude and subjective norm and the greater the perceived control, the stronger the person's intention to perform the behaviour (i.e., adopting IFI).

Further, despite the success of previous TPB research, scope remains for improving the prediction of both intentions and behaviour, with Ajzen (1991) describing the model as open to further elaboration: "the theory of planned behaviour, in principle, [is] open to the inclusion of additional predictors if it can be shown that they capture a significant proportion of the variance in intention or behaviour after the theory's current variables have been taken into account (p. 199)." Thus, the present study tests the impact of two additional variables—religiosity and awareness—as predictors of adopting IFI among Omani SME owner-managers. If Ajzen's (1991) assertion is correct, then we would expect to find an increase in the variance explained.

3.2.6 Religiosity

As an influential social institution, religion often significantly influences people's attitudes, values and behaviours at both the individual and societal level. Hence, it is important to study this cultural factor (Mokhlis, 2009). Much research shows that religion is the principal motivation for SMEs to, potentially, use Islamic banking (Gait & Worthington, 2009). While some studies agree that religiosity, along with profit, plays a significant role in an individual's choices, it is not necessarily the sole or main motivating factor (Alam et al., 2012).

Nevertheless, other studies indicate that religion is either not an influencing factor when choosing between Islamic and conventional banks or is not the main reason for adopting Islamic finance (Dusuki & Abdullah, 2007). Edris (1997) finds this to be true in Kuwait, a predominantly Muslim country; similarly, Abdesamed and Wahab (2015) find religion is not an influencing factor on SMEs' preferences for adopting Islamic banking over conventional bank loans.

Shakona (2013) provides further evidence that religiosity may be an additional primary external and internal factor exerting influence on behaviour; religiosity has also been shown to be a consistently strong predictor of future behaviour (Amin, Abdul Rahman, & Abdul Razak, 2014). Amin et al.'s (2014) study on acceptance

of Islamic home financing demonstrates that measures of religiosity improve predictions regarding TPB constructs.

As this paper explores a) whether religiosity is an important factor in influencing the intention to adopt IFI among owner-managers and b) whether religiosity offers improved prediction over TPB constructs of SMEs' adopting IFI, we hypothesise the following:

Hypothesis 4a. There is a positive relationship between SMEs' owner-managers' religiosity and their intention to adopt IFI.

Hypothesis 4b. Religiosity adds a unique variance in predicting SMEs' intention to adopt IFI above and beyond that predicted by TPB.

3.2.7 Awareness

Awareness refers to consciousness or knowledge. The data people select for processing and the type and amount of information they receive influence their awareness. Individuals interpret information differently and their knowledge, feelings, and attitudes towards others influence their interpretation of information (Wanyana, 2011).

Awareness is critical because one cannot develop an attitude towards something about which one has no knowledge. Thus, this paper examines SME owner-managers' awareness about Islamic financing in terms of: its existence, differences with conventional financing, Sharia law, and the profit-and-loss-sharing model, because awareness determines their adoption intention.

Empirical studies have firmly established that consumers' awareness significantly influences their attitude and intention to use Islamic banking (Thambiah, Eze, & Ismail, 2011). The better the knowledge, awareness and understanding of Islamic finance, the greater the intention to use Islamic banks (Kewuyemi, 2015; Wahyuni, 2012). Further, according to Wahyuni (2012), the knowledge variable must be considered in building a model of the behaviour around selection or use of products, including Islamic banks.

As this paper explores a) whether awareness is an important factor in influencing the intention to adopt IFI among owner-managers and b) whether awareness offers improved prediction over TPB constructs of SMEs' adopting of IFI, we postulate the following:

Hypothesis 5a. Awareness of Islamic banking has a positive relationship with an individual's intention to adopt IFI.

Hypothesis 5b. Islamic banking awareness adds unique variance in predicting SMEs' intention to adopt IFI above and beyond that predicted by TPB.

3.3 Method

3.3.1 Sample and procedure

We gathered the primary data for our study via a face-to-face interview survey—a method commonly used in the SME and finance context (Berger & Black, 2011)—in Muscat, Oman's capital between December 2016 and February 2017. Face-to-face surveying enables the researcher to reduce any potential respondent confusion over the questions asked, and produces high quality data (Szolnoki & Hoffmann, 2013). The market for Islamic finance in Oman is new—the first evidence of Islamic banking emerged only in 2012—and Islamic finance institutions for SMEs are a relatively new development. Choosing Muscat, where the majority of Oman's SMEs are located, therefore, offered an interesting context in which to analyse SME financial decision-making.

The sample was drawn from the Oman Chamber of Commerce and Industry (OCCI) database, as all companies operating in Oman must be registered under the OCCI; this database, therefore, guarantees almost full and unbiased coverage of the Sultanate's business landscape. Thus, all SMEs registered on the OCCI database were regarded as the population size (P).

We randomly selected 385 firms, since “The random sample is the best because it's most representative of the entire population. It's least likely to result in bias” (Alreck & Settle, 2004, p. 71). To ensure that 385 represented a sufficient sample size, we used the following assumptions (Waters, 1994): (i) proportion (π) equals to 0.5. This is the safest possible assumption; (ii) a confidence level of 95% which

corresponds to a Z-value of 1.96; and (iii) an error or precision (E) of 0.05. Given the above assumptions, the sample size N is estimated by

$$N = \pi (1-\pi) Z^2 / E^2 = (0.5) (0.5) (1.96)^2 / (.05)^2 = 384.16$$

We contacted SME owner-managers by phone call and asked if they would be willing to participate in the study. If they agreed to take part, we set up an interview date, time and place. Some of those we approached were either unwilling to participate or did not respond to our phone call. When that happened we then attempted to contact the next SME owner-manager on the same list in order to avoid missing any potential respondents.

3.3.2 Measurements of variables

A questionnaire using a Likert point scale was employed to collect the data for the research model's constructs, as Fishbein and Ajzen (2010) suggest doing when constructing TPB questionnaires. All the research model's latent variables were measured by adapting versions of previously validated scales related to TRA and TPB. That adaption left the wording of the individual scales largely unchanged; however, we adapted the scales to the specific context of Islamic finance and SMEs finance.

Our dependent variable was the intention to adopt IFI. Intention reflects an individual's likelihood of performing a particular behaviour in the future (Ajzen, 1991). We measured the strength of the SME owner-managers' intention towards adopting Islamic finance for their business using three 7-point items commonly used in studies assessing behavioural intentions (Madden et al., 1992).

Attitude is commonly assessed with items related to the overall favourableness or unfavourableness of the behaviour in question, which is captured by dimensions such as good-bad, beneficial-harmful, or likeable-dislikeable (Ajzen, 2001). We used four items, measured with 7-point bipolar adjective scales, adapted from Kraft et al. (2005).

In the TPB context, a global measure for the behavioural norm is generally obtained by asking respondents to indicate the extent to which important others would approve of the performance of a certain behaviour (Ajzen, 1991). Following this rationale, two items with 5-point scales adapted from Ajzen and Madden (1986) we

used to assess perceived social norms towards Islamic finance. Here, owner-managers indicated the extent to which they thought social pressure (a) supports or (b) agrees with their intention to adopt Islamic finance

We used four items with 5-point scales adapted from previous research (Kraft et al., 2005) to measure the degree of control that SME owner-managers believe themselves to have over financial decision-making around adopting Islamic finance in their business.

Broadly speaking, religiosity is a wide-ranging sociological term which encompasses various aspects of religious activity, dedication and belief. We used five items with 5-point scales adapted from previous research (Obeid & Kaabachi, 2016) to measure religiosity. Awareness signifies a person's understanding and knowledge about something. Thus, we used six items with 5-point scales adapted from previous research (Faisal, Akhtar, & Rehman, 2012) to measure SME owner-managers' awareness about Islamic banking.

Content and internal validity were assessed in a pilot study with SME owners-managers. Reliability analysis on the final constructs indicated that all measurement scales exceeded the 0.7 threshold for Cronbach's alpha, thereby, demonstrating a satisfactory internal validity (Nunnally, 1978). As Table 21 shows, all items had loading greater than 0.4 as recommended by Costello and Osborne (2005) and were retained in the model. One item—the subjective norm construct—was removed from the model because of a cross-loading above 0.5 (Costello & Osborne, 2005; Pallant, 2007). Consequently, the final constructs demonstrate acceptable internal consistency and reliability. Next, we present our results.

Table 21. *Measurement Constructs and Reliabilities*

Items		Factor 1	Factor 2	Factor 3	Factor 4	Factor 5	Factor 6	Communality
Attitude	A1. Using Islamic banking and financial services is 7 = Good 1= Bad	.862						.815
	A2. Using Islamic banking and financial services is 7 = Beneficial 1= Harmful	.921						.868
	A3. Using Islamic banking and financial services is 7 = Useful 1= Worthless	.880						.852
	A4. Using Islamic banking and financial services is 7= The right thing to do 1= The wrong thing to do	.873						.809
Subjective Norm	SN1. Most people who are important to me support me taking Islamic banking.		.737					.712
	SN2. Most of my friends/colleagues who have taken Islamic banking agreed that Islamic finance is better than conventional.		.763					.753
Perceived Behavioural Control	PBC1. For me to adopt Islamic financing in business would be appropriate.			.591				.673
	PBC2. If I wish to I could adopt Islamic financing in business.			.750				.724
	PBC3. I do have better control over adopting Islamic financing in business.			.837				.792
	PBC4. It is mostly up to me whether or not I adopt Islamic financing in business.			.673				.578
Awareness	AW1. In practice Islamic banking is different from conventional banking.				.551			.618
	AW2. Islamic banking is based on Sharia (Islamic Laws).				.694			.607
	AW3. Islamic banking is a banking system for people of all faiths/religions.				.626			.636
	AW4. If I put my money in Islamic banks, I am content that my money will not be invested in unethical ventures like alcohol, gambling etc.				.727			.713
	AW5. Islamic banking is strictly based on a risk-sharing model (profit and loss).				.734			.708
	AW6. Islamic banks are more regulated forms of banking as they are governed by regulatory bodies as well as by Sharia boards.				.687			.704
RI	RI. I try to follow Islamic injunctions in all matters of my life.					.697		.729

	R2. I always try to avoid minor and major sins as told by my religion.						.830	.811
	R3. I have firm belief in all basic ideological dimensions of Islam.						.847	.823
Religiosity	R4. I know the basic and necessary knowledge of my religion.						.818	.782
	R5. I feel sorrow and dissatisfaction when I do something against my faith.						.774	.730
Islamic	IFIA1. I intend to adopt Islamic banking services in the future.						.838	.849
Financial	IFIA2. I predict that I will frequently use Islamic banking services in the future.						.838	.875
Instrument	IFIA3. I will strongly recommend others to use Islamic banking services.						.782	.790
Adoption								
	Eigenvalue	4.23	1.02	1.34	2.00	8.27	1.06	
		8	8	2	1	9	7	
	Variance explained	17.6	4.28	5.59	8.33	34.4	4.43	
		58	5	1	7	94	2	
	KMO measure of sampling adequacy			.859				
	Bartlett's test of sphericity			Chi-square 6767.887 (df, 276; p =				
				0.000)				
	Cronbach's alpha (α)	.933	.800	.825	.864	.908	.912	

3.4 Results

3.4.1 Descriptive results

The profile of the respondents and characteristics of the respondents' businesses are summarised in Table 22. Most of the respondents (68.8%) were males; females made up 31.2% of the sample. This gender disposition is relatively consistent with Oman's business environment where more men than women own businesses (Riyada, 2018). With regard to their educational level, 36.9 % of the participants had achieved a secondary certificate, 31.7% had a bachelor's degree, 28.1% held a higher diploma and 8% had only primary education. The majority of participants (46.2%) were in the age category 31-40 and 40.8 % were in the 20-30 category. With regard to their businesses' sector operation, the majority of the SMEs (45.2%) were in trade, 35.1% were in service industries and 19.7% were in the manufacturing sector. In Oman, the trade sector is the largest of all the sectors and majority of firms there are operated by small businesses (Alkharusi, 2003). The majority (59.7%) of the firms sampled employed 1-5 workers; firms employing 6-25 workers constituted 37.4% of the sample, with 2.9% employing 26-99 workers these figures are also consistent with Omani SME categories where the majority (70 %) are micro businesses, 25% are small and 5% are medium-sized (Riyada, 2018).

Table 22. *Respondent Profile*

Description	Frequency	Percentage
Gender		
Male	265	68.8
Female	120	31.2
Educational level		
Primary	3	0.8
Secondary	142	36.9
Higher diploma	108	28.1
Bachelor's	122	31.7
Master's	10	2.6
Age in years		
Under 20	4	1.0
20-30	157	40.8
31-40	178	46.2
41-50	42	10.9
Over 50	4	1.0
Nature of business		
Manufacturing	76	19.7
Service	135	35.1
Trade	174	45.2
Number of employees		
1-5	230	59.7
6-25	144	37.4
26-99	11	2.9

Tables 23 shows a summary of the means, standard deviations and correlation matrix for the independent variables and the dependent variable. All variables had a modest to high mean. As a rule of thumb, a correlation coefficient of 0.7 or more suggests the possibility of multicollinearity. As the table indicates, the correlation coefficient between each pair of variables is less than 0.7. This result was confirmed by the variable inflation factor (VIF) test shown in Table 24, which suggests that multicollinearity was not an issue.

Table 23. *Descriptive Statistics and Correlation Matrix*

	Mean	SD	1	2	3	4	5	6
1- Attitude	18.47	3.64	1					
2- Subjective norms	7.55	1.72	.089	1				
3- Perceived behaviour control	14.95	2.87	.125*	.569**	1			
4- Religiosity	19.82	3.75	.092	.402**	.447**	1		
5- Awareness	22.94	4.19	.082	.533**	.569**	.627**	1	
6- Intention to adopt IFI	12.52	3.64	.570**	.309**	.319**	.166**	.310**	1

Note: Significance at: *p < 0.05 and **p < 0.01

3.4.2 Hierarchical multiple regression (HMR) analyses

HMR models (Wong & Mullan, 2009) were used to examine a) the extent of TPB's ability to predict SME owner-managers' intentions to adopt IFI and b) if the religiosity and awareness constructs add unique variance in predicting SMEs' intentions to adopt IFI above and beyond that predicted by the three TPB constructs. The predicting variables i.e., attitudes towards Islamic banking and finance and subjective norm TRA constructs were added in the first model; perceived behaviour control TPB constructs were added in the second model, as suggested by TPB; religiosity constructs were added in the third model; and, awareness constructs were added to the final model. At each stage, an additional explanatory variable was added to the model and the change in R² was noted.

Table 24. A Summary of HMR Analyses

Model	Variables	R	R ²	R ² Δ	R ² adj.	B	SE	β	t	VIF	Tolerance
1		.626	.392***	.392***	.389						
	Attitudes					.483	.035	.547***	13.66	1.008	.992
	Subjective norm					.551	.085	.261***	6.51	1.008	.992
2		.639	.408***	.016**	.404						
	Attitudes					.473	.035	.535***	13.48	1.016	.984
	Subjective norm					.370	.101	.175***	3.65	1.479	.676
	Perceived behavioural control					.194	.061	.153**	3.18	1.491	.671
3		.639	.409***	.001	.403						
	Attitudes					.474	.035	.536***	13.48	1.018	.983
	Subjective norm					.383	.104	.181***	3.70	1.541	.649
	Perceived behavioural control					.205	.064	.162**	3.22	1.623	.616
	Religiosity					-.027	.044	-.028	-.63	1.304	.767
4		.654	.428***	.019***	.420						
	Attitudes					.475	.035	.538***	13.73	1.018	.982
	Subjective norm					.291	.105	.137**	2.76	1.640	.610
	Perceived behavioural control					.140	.065	.110*	2.14	1.762	.568
	Religiosity					-.110	.049	-.114*	-2.26	1.688	.593
	Awareness					.175	.049	.201***	3.56	2.115	.473

Note: Statistical significance: *** p < 0.001, ** p < 0.01, * p < 0.05

In the first model, the TRA constructs were entered as a whole and they explain 39.2% of the variation in the dependent variables; the model was statistically significant at $F(2,382) = 123.39, p < .001$, which indicates that TRA performed well and explained the intention to adopt IFI among SME owner-managers. Most of the predictive accuracy was shown by attitudes rather than subjective norm, which indicates that attitude is an important predictor of Islamic financing decisions.

In the second model, TPB as a whole explains 40.8% of the variation in the dependent variables $F(3,381) = 87.587, p < .001$. Attitude ($\beta = .535, p < 0.001$), subjective norm ($\beta = .175, p < 0.001$), and perceived behavioural control ($\beta = .153, p < 0.01$) are statistically significant predictors, and confirm the results of previous research. The introduction of the perceived behavioural control explained an additional 1.6% of variance in SME owners' intention to adopt IFI after controlling for attitudes and subjective norm ($R^2 \Delta = .016 F(1,381) = 10.103, p < .01$). Thus, these results show not only that TPB can be determined to be a better model than TRA (Alleyne & Broome, 2011; Beck & Ajzen, 1991) but also that SME owner-managers' perception of how much control they have regarding adopting IFI as a form of financing is a significant factor when making financing decisions.

While the third model, which added the religiosity variable into the TPB variables, is as a whole significant at $F(4,380) = 65.684, p < .001$, religiosity does not add unique variance in predicting SMEs' intention to adopt IFI above and beyond that predicted by the TPB variables ($R^2 \Delta = .001 F(1,380) = .392, p > .1$).

However, in the final model, awareness adds a significant and unique variation in predicting SMEs' intention to adopt IFI above and beyond that predicted by the TPB variables ($R^2 \Delta = .019 F(1,379) = 12.671, p < .001$). All predictor variables were statistically significant, with attitudes recording a higher Beta value ($\beta = .538, p < .001$) than awareness ($\beta = .201, p < .001$), than subjective norm ($\beta = .137, p < 0.01$), than religiosity ($\beta = -.114, p < 0.05$), and finally than perceived behavioural control ($\beta = .110, p < .05$). Table 24 presents those results.

3.5 Discussion

Worldwide, financial decision-making poses the main challenge in small business (Koropp et al., 2014). To better understand this phenomenon, we investigated the Islamic financial decision-making process within SMEs from an owner-manager perspective. We argued that Islamic financial decisions in small businesses are affected by nonfinancial and behavioural factors such as attitudes of SME owner-managers, subjective norms, and perceived behavioural control. We showed that these factors have direct significant positive relationships with behaviour intention to adopt IFI among owner-managers, which aligns with both TPB (Ajzen, 1991) and previous studies (Ajzen, 2002a; Amin et al., 2014). Furthermore, consistent with previous studies in accounting and finance areas, Islamic finance and SME contexts (Alleyne & Broome, 2011; Cucinelli et al., 2016), the current study provides strong support for TPB as a model for financing decisions among SMEs.

In line with TPB and previous studies (Amin et al., 2014; Koropp et al., 2014; Warsame & Ireri, 2016), we found SME owner-managers' attitudes towards Islamic banking and finance have the greatest predictive influence on uptake and are positively associated with intentions to adopt IFI. The significance of the positive coefficient provides support for Hypothesis 1, which supports the crucial role managers' attitudes play in influencing their decisions towards the intention to adopt IFI (Amin et al., 2014). These findings support previous studies that identified the crucial importance of SME owner-managers' perceptions and preferences in shaping financial decisions in the SME context (Brettel et al., 2009; Matthews et al., 1994).

The positive and significant coefficient on subjective norms also supports Hypothesis 2 and is consistent with previous research (Koropp et al., 2014). As East (1993) suggests, financial products appear to be influenced mainly by family, friends and relatives' opinions, which indicates the importance of the social norms variable as a factor affecting SMEs' financing behaviour (Brettel et al., 2009).

By the same token, there was evidence to support Hypothesis 3's supposition that PBC is significantly related to SME owner-managers' intention to adopt IFI; these findings support Koropp et al.'s (2014) and Amin et al.'s (2014) studies. We find that SME owner-managers' control motives influence their financing decisions (re

Islamic finance). The majority of the business decisions, specifically the financial decision-making processes (López Salazar et al., 2012), in a small business are taken by the owner, as he/she has complete control and decision-making power over the business.

Surprisingly, there is lack of support for Hypotheses 4b, in that religiosity does not add unique variance in predicting SME owner-managers' intention to adopt Islamic finance above and beyond that predicted by the TPB model, which is in line with previous research (Ahmad & Haron, 2002; Dusuki & Abdullah, 2007). In fact, there was a statistically significant negative relationship between religiosity and SME owner-managers' intention to adopt Islamic financing, providing lack of support for Hypotheses 4a, which is in line with Osoba (2003). These outcomes could be explained in two ways: 1) that adhering to Islamic rules not being a main concern for SMEs in adopting Islamic finance and 2) that religious SME owners may not fully believe that the Islamic finance products on offer truly adhere to Islamic principles and this perception might explain their reluctance to take up these products. This finding is a clear signal to Islamic banks when targeting small business owners that the religious factor is not the primary influence on firms' adopting Islamic finance.

However, awareness adds unique variance in predicting SME owner-managers' intentions to adopt IFI above and beyond that predicted by the three TPB variables' support for Hypotheses 5b. In fact, we find awareness positively associates with intentions to adopt IFI; the significant and positive coefficient provides support for Hypothesis 5a. These findings corroborate Buchari, Rafiki, and Al Qassab (2015) and clearly highlight the importance of awareness in decision-making, especially financial decision-making. Since Islamic finance is new to the Omani banking sector, SMEs' understanding is crucial in order for them to adopt IFI. Insufficient understanding of how Islamic banks operate may make small business owner-managers hesitant about adopting IFI.

3.6 Conclusion and implications

This study investigated TPB's efficacy in predicting SME owner-managers' intentions to adopt IFI using a sample of 385 participants. The empirical analysis supports TPB and prior research in the field of finance and other domains by confirming that attitudes, subjective norms and perceived behaviour control are significant predictors of SMEs' intention to adopt IFI. Although religiosity showed a significant negative relation and is not a predicting factor of SME owner-managers' intention to adopt IFI, awareness did show a significant positive relation and was an important factor in predicting IFI adoption intention.

Our results emphasise the importance of the noneconomic variables and psychological factors that influence SME owner-managers' financial decision-making processes and are important because little is known about why financial choices vary among small businesses, especially how and why SME owner-managers make financial decisions, especially Islamic finance decisions. This study, therefore, provides additional insights into how SME owner-managers evaluate and select financing options for their firms.

Our research also contributes to the theoretical and empirical work on the uniqueness of small business (Ang, 1991) and will help private and government agencies involved in the funding of SMEs to develop better policies. Policymakers should be aware of how decision-makers' personal characteristics (attitudes, perceived norms, and perceived control) impact on the development of SMEs when devising mechanisms to support them. Consequently, this study should enable Islamic banking to design financing programmes tailored to the specific needs of SMEs' owner-managers which attract them to adopt IFI, and may, in turn, foster broader dissemination of Islamic financing.

3.7 Limitations and future research

This study's results are based on a sample of SME owner-managers in Oman. However, its findings are not generalisable to other contexts. Validating the findings of this study, therefore, requires further studies in other geographical contexts, and preferably with cross-cultural samples. Finally, a number of gaps in our knowledge around SMEs' Islamic finance decisions remain. For instance, research that explores the effect of demographic factors on SMEs' intention to adopt Islamic finance and, more specifically, investigates whether firm owners' and firms' characteristics and awareness of Islamic finance types (Mudarabah, Musharaka, & Murabaha) affect SMEs Islamic financing decisions, is needed.

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Chapter 4

Determinants of the decision to adopt Islamic finance: Evidence from Oman

Declaration about the role and contribution of authors

I (Yasmeen Ali Al Balushi) am chiefly responsible for the conceptualisation, review of literature and empirical analysis as well as the writing of this research paper. Stuart Locke supervised each step of this process. Particularly, Stuart Locke gave conception advice on this work and commented on all versions of the research paper. Susanna Lu and Zakaria Boulanouar gave conception advice and edited the final research paper.

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Abstract

Purpose – Small and medium enterprises' (SMEs) capital structure and financial policies are important areas of policy concern. Only a limited number of studies on capital structure have, however, been conducted on SMEs, and this deficiency is particularly evident when investigating what influences funding decisions around Islamic finance. This paper accordingly aims to investigate whether Omani SME owner–managers' intention to adopt Islamic finance is influenced by their knowledge of Islamic finance, their own characteristics, and/or their firms' characteristics.

Design/methodology/approach – The authors administered a questionnaire survey via face-to-face interviews to 385 SME owner–managers operating in Muscat, Oman's capital city. The Kruskal-Wallis one-way Analysis of Variance (ANOVA) non-parametric test was used to analyse the questionnaire survey data.

Findings – The findings indicate that while SME owner–managers' Islamic financial knowledge and personal characteristics do influence their intention to adopt Islamic finance, their firms' characteristics have no significant influence on SME owner–managers' decisions to accede to Islamic financing.

Research limitations/implications – The research's first limitation is that it gathered data from SME owner–managers in Muscat only. Future studies could survey a wider sample of Omani SME owner–managers. Secondly, the study's findings cannot be generalised to large and public firms, as the sample includes owner–managers of SMEs only. Finally, there is a need to investigate other factors such as non-financial and behavioural factors, which were not explored in the present study, but which may influence SME owner–managers' Islamic financial decisions.

Originality/value – Theoretical and empirical studies on capital structure have focused primarily on large listed firms. Only a few studies have paid attention to the capital structure of SMEs, particularly in the context of an emerging market such as Oman. This gap in the literature is mostly evident when investigating the factors that influence the funding decision towards Islamic financing in a country, such as Oman, where Islamic finance represents a new banking sector offering.

Keywords Islamic financial decisions, SMEs, Oman, firm owners' Islamic financial knowledge, firm owners' and firm's characteristics

Paper type Research paper

4.1 Introduction

One of the most important decisions that a firm has to make relates to its capital structuring. Consequently, the strategies that firms follow when financing their operations have been widely discussed and examined (Haron, 2016), and several theories have been developed to explain the ways in which financing preferences can influence the capital structuring decision. Each of these theories explains corporate financing differently and is predicated on particular conditions, assumptions, and propositions. Modigliani and Miller (1958) pioneered the development of capital structure theories, while subsequent theoretical frameworks have aimed mainly at explaining the capital structure decisions of firms.

Initially, most theoretical and empirical studies of capital structure focused on public corporations due to the accessibility of data on them (Rajan and Zingales, 1995); more recently, however, researchers have begun to give more attention to small and medium enterprises (SMEs). In Oman and other Islamic countries, SMEs can choose between Islamic and non-Islamic finance options when making their financing decisions. Deciding which option to choose is, therefore, important, as the option chosen will change the financial institution's structure. Given that SMEs are widely recognised as engines of economic growth, the SME sector has become significant to economists and policymakers around the globe in their decisions on financial and economic development. In addition, the SME sector forms the backbone of socio-economic development. They provide job opportunities for both skilled and unskilled people, contribute to the gross domestic product (GDP), promote economic diversification, and reduce poverty. Consequently, SMEs' capital structure and financial policies are major areas of policy concern (Michaelas *et al.*, 1999).

Only a limited number of the studies on capital structure have, however, been conducted on SMEs, and this deficiency is particularly evident when investigating what influences funding decisions around Islamic finance. In light of the rising

importance and potential of Islamic finance, it is, therefore, essential to understand what factors influence the adoption of this new financing option. This paper attempts to contribute to the process of filling this gap.

A review of the extant interdisciplinary literature indicates that a complex array of factors influence SME owner–managers’ financing decisions (Romano *et al.*, 2001). These include: entrepreneurial characteristics (Abdulsaleh and Worthington, 2013); entrepreneurs’ prior experience with capital structure and firm owners’ attitudes (Romano *et al.*, 2001); business life cycle issues (La Rocca *et al.*, 2011); age and size of the firm (Cassar, 2004); and industry sector (MacKay and Phillips, 2005). However, it appears that this literature has not made explicit those factors that influence SME owners’ decisions on Islamic finance.

Hence, this study investigates the influence a firm owner–manager’s Islamic finance knowledge of profit and loss sharing (PLS) financing, for example, *mushārah* and *muḍārah* financing, and of non-profit and loss sharing (non-PLS) financing, such as *murābahah* and *ijārah*, has on SMEs’ Islamic financing decisions. Financial knowledge plays an important role when taking effective financial decisions (Robb and Woodyard, 2011). The current study identifies whether it is the characteristics of a firm’s owner–manager or the firm itself that influence SMEs’ intention to adopt Islamic finance. To the best of the authors’ knowledge, no other paper has yet addressed these issues in Islamic finance within the context of small firms, specifically in Oman.

The remainder of this paper is organised as follows. The next section provides a brief overview of Islamic finance and Omani SMEs, followed by the literature review and hypotheses. The research method and characteristics of the study sample are then presented. Next, the results and discussion are delineated. The final section provides a summary and conclusion of the paper.

4.2 Islamic finance and SMEs in Oman

Oman has achieved remarkable socio-economic development. However, Oman's economy is still largely reliant on a single resource base—that is, oil revenues—and a single-track development strategy; thus, the government is taking a number of initiatives to develop the non-oil economy in areas such as the financial sector.

The Omani banking sector's welcoming of Islamic finance is “a prominent signal that the country is keener on and now more open to new opportunities in terms of diversifying its economy” (Thomson Reuters, 2016, p. 16). The market for Islamic finance in Oman is new—the first evidence of Islamic banking emerged only in 2012—and Islamic financial institutions that provide financing to SMEs are a relatively new development. However, the door is now open for both Islamic and conventional banks to post higher growth and to extend financing facilities to small and medium projects. The Central Bank of Oman has established rules for all banks—Islamic and conventional—to support enterprises in the SME sector by increasing their loans and financing (Central Bank of Oman, 2017).

One of the key elements of Oman's Vision 2020 is to develop the SME sector. Oman recognises that this sector forms the backbone of economic development. Thus, its encouragement complies with His Majesty's directive to support and develop SMEs as the future engines for the growth of the Omani economy. The government has intensified its efforts to promote SMEs, particularly in the context of economic diversification (Central Bank of Oman, 2017). Furthermore, similar to those in other economies, Oman's SMEs contribute significantly to the nation's gross domestic product (GDP) growth, job creation, and innovation (Public Authority for SMEs Development, 2014). For example, Omani SMEs make up 90 per cent of all companies, contribute 15-20 per cent to GDP, and employ 40 per cent of the Sultanate's workforce (Central Bank of Oman, 2016), and thus contribute in boosting national economic growth.

4.3 Literature review and hypotheses

Myers (1984) characterises capital structure decision-making as a puzzle. Both theoretical and empirical studies of capital structure generate many viewpoints to explain the capital structure enigma; however, neither theory nor empirical research

has been able to suggest a comprehensive justification of precisely what factors affect financing decisions (Matthews et al., 1994; Myers, 1984). Attempts to theorise SMEs' financial behaviour have revealed a number of different financing patterns followed by SMEs. For example, the financial growth paradigm proposed by Berger and Udell (1998) suggests that financial need and the financing options which are available for SMEs alter during the various phases of a firm's life cycle; thus, a number of empirical studies have used the life cycle model to understand the financial behaviour of SMEs (Barton and Gordon, 1987; La Rocca et al., 2011). However, this model has been criticised by many researchers for its failure to offer a complete picture of SMEs' financial decisions and behaviour (Abdulsaleh and Worthington, 2013).

Further, SMEs' financing patterns, as explained by Berger and Udell (1998), contrast with the hypothesis behind Myers' (1984) pecking order theory (POT). POT suggests that the capital structure decision of a firm is a function of the firm's age, and that a firm prioritises internal sources of funding rather than external sources. In other words, when seeking funds, firms adhere to a hierarchy of financing preferences: internal equity to external debt; short-term debt to long-term debt; and, external debt to external equity. Many studies have applied POT to explain the financial structure of SMEs, even though the theory was developed for large corporations (López-Gracia and Sogorb-Mira, 2008; Zoppa and McMahon, 2002), and have proved that the financial choices of SMEs clearly fit the POT. On the other hand, Holmes and Kent (1991) argue that application of the POT to SMEs is constrained; first, because SMEs are usually not in a position to issue equity to the public, and secondly, because their owner-managers tend to be deeply opposed to anything that weakens their ownership interest and control.

A number of other theories are relevant to the financial behaviour of SMEs. These include: trade-off theory, agency theory, market timing theory, signalling theory, and information asymmetry. Different theories suggest different approaches. Commenting on the extent to which existing financing theories can explain the financial structure of businesses, Pettit and Singer (1985, p. 54) state: "Business firms of all sizes select their financial structure in view of the cost, nature, and availability of financial alternatives. For a number of reasons, our understanding of this decision for large and small firms is deficient." Furthermore, they emphasise

that the “level of debt and equity in a smaller firm is more than likely a function of the characteristics of the firm and its managers” (p. 58). Given that SME owner–managers hold the dominant position in their role as the firm’s primary decision–taker, the firm’s financing structure is their personal choice; the decisions that owner–managers take can, therefore, depend on the owners’ characteristics and the firms’ characteristics (Michaelas *et al.*, 1999).

As it is generally agreed that the characteristics of both the firm and the firm’s owner affect the financing methods chosen and employed by SMEs (Abdulsaleh and Worthington, 2013), this study details how those characteristics and the firm owner–manager’s Islamic financial knowledge impact the capital structure decisions vis-à-vis Islamic finance in small firms. Thus, this is one of the few studies that investigates Islamic financing decisions among SMEs’ owner–managers. Figure 17 delineates the relationship between the demographic variables and SME owner–managers’ intentions to adopting Islamic finance within their capital structuring decisions.

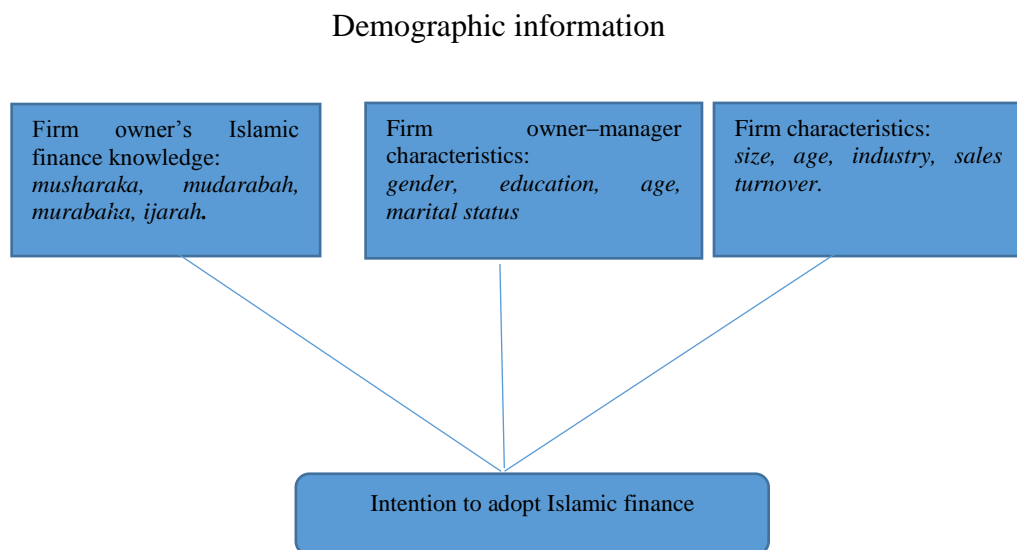


Figure 17. Relationship between demographic variables and intentions

Source: Authors’ Own

4.3.1 Factors influencing the adoption of Islamic finance

As Sayani and Miniaoui (2013) show, customer preferences vary not only according to geographical location but also from segment to segment, for example, in Muslim-majority versus Muslim-minority countries. In their investigation into the factors that motivate consumers to adopt Islamic banking, Erol and El-Bdour (1989) find that, while peer group influence, awareness about profit/loss, and economic and social development are the main factors that influence the adoption of Islamic banking, religious motivation does not appear to be the main justification when selecting Islamic financing.

The nine core markets for the Islamic banking industry are: Bahrain, Qatar, Indonesia, Saudi Arabia, Malaysia, the United Arab Emirates, Turkey, Kuwait, and Pakistan. According to Ernst & Young (2016), these countries will remain the industry's key driving markets. Together, they account for 93 per cent of industry assets, which in 2015 were estimated at over US\$920 billion (Ernst & Young, 2016). As shown below, a number of studies have investigated customer preferences for Islamic finance in these markets:

Malaysia: Using the theory of planned behaviour (TPB) model, Ibrahim et al. (2017) find that there is a significant relationship between attitude, subjective norm, perceived behavioural control, level of knowledge or awareness, and religiosity and a customer's intention to select Islamic home financing. According to Ibrahim et al. (2017), religiosity is the most influential factor in selecting Islamic financing. In another Malaysian study, Selvanathan et al. (2018) identify religion, bank reputation, and cost-benefit factors as the factors that influence Malaysian customers' selection of Islamic banking products and services, while convenience is not seen to be a significant factor.

Pakistan: Using the theory of reasoned action (TRA) model, Ali et al. (2017) investigate factors affecting intentions to select Islamic credit cards and find that attitude and subjective norms are positive and significant factors in choosing an Islamic credit card, while perceived financial cost has a negative effect. In addition, Akhtar et al. (2016) find that religion, awareness regarding Islam's teachings on finance, awareness of Islamic banking products and services, advertising, and

networking are the most important factors which affect customer perception regarding Islamic banking.

Indonesia: Usman et al. (2017) state that religious norms play an important role in the relationship between religiosity and choosing Islamic banks. More specifically, they show that religiosity does not always play a critical role in selecting Islamic banks, as only people with a higher degree of religiosity tend to prefer Islamic banks. According to the authors, their results aligned with previous studies they examined which showed inconclusive findings on the relationship between religiosity and the selection of Islamic banks. For customers of conventional banks, their results found that religiosity is not a determinant for choosing an Islamic bank.

Turkey: Genç et al. (2016) find that household and corporate customers adopt Islamic banking because of staff friendliness; the other factors that motivate them to use Islamic banking include: the availability of interest-free financial institutions, efficient service, and financial counselling offered by staff.

Qatar: AlBaker (2017) finds that Shari'ah-compliance and family/friends are the most influential factors that attract customers to adopt Islamic banks, while factors like quality of services and corporate social responsibility (CSR) activities have less influence on customers.

Kuwait: AlHunnayan and AlMutairi (2016) find that quality of service and low service charges offered by Islamic banks are the most important factors that motivate customers to deal with them, while banks' mass media advertising is the least important factor.

The United Arab Emirates: Shome et al. (2018), targeting university students, find that students' Arabic language skills and their expectations in terms of the conformity of a bank's operations with Islamic principles are the main factors that affect their decision to open an account with an Islamic bank. On the other hand, factors such as students' nationality, gender, education, and familiarity with Islamic banking are not seen to have any effect on the decision to open an account with an Islamic bank.

Bahrain: AlHadrami et al. (2017) identify the criteria that customers consider to be important when selecting Islamic banks; they find that religion is the major factor, followed by service quality.

Saudi Arabia: Alanazi and Lone (2016) show that people in Saudi Arabia prefer to invest in Islamic banks rather than conventional banks and that they are satisfied with Islamic banking operations. This study emphasises that Islamic values are more important for Saudis than anything else. Similarly, Lone et al. (2017) conclude that Saudi Arabian customers are satisfied with Islamic banking and that customer satisfaction is the key element contributing to the success (or failure) of Islamic banking institutions.

As indicated above, the literature on Islamic banking and finance produces mixed results when it comes to identifying factors that influence a customer's decision to adopt Islamic banking. Nevertheless, most studies do indicate that an Islamic bank's conformity to the *Shari'ah* (Islamic law) or Islamic banking principles is a major factor influencing consumers' choice to adopt Islamic finance (Ullah and Lee, 2012) and that both religious and functional beliefs clearly shape consumer attitudes towards Islamic banks globally (Butt and Aftab, 2013). A review of the literature reveals, however, that only a limited number of studies consider personal characteristics as an influencing factor affecting the Islamic financing decision. For that reason, in this study it is further investigated whether the characteristics of small firms and of their owner-managers' Islamic financial knowledge impact on their capital structure decisions to adopt Islamic finance. In view of the fact that there are very few studies that investigate SMEs preferences' regarding Islamic finance, this paper attempts to contribute to the process of filling this gap by investigating factors that influence the adoption of this new financing option within the context of Oman.

4.3.2 Firm owners' Islamic finance knowledge

As Robb and Woodyard (2011) point out, it is important to investigate the relationship between financial knowledge and corresponding financial behaviour because financial knowledge plays an important role when taking effective financial decisions. Borden et al. (2008) too suggest that greater financial knowledge may improve intentions towards more responsible behaviour.

The influence of personal familiarity with Islamic financial products and services on consumers' behaviour has been examined in various research studies. Husin and Rahman (2016), for example, state that individual factors such as awareness, knowledge, and exposure have an impact on consumer intention to participate in *takāful* (Islamic insurance). Jaffar Rahman (2017) indicate that, although the majority of Indians who participated in their study lacked an understanding of how Islamic banking works, they were willing to consider using it if properly informed and offered a better customer experience. Osman and Ali (2008), who investigate Muslim entrepreneurs' knowledge of Islamic financing, also find that entrepreneurs understand the importance for their business of practising and applying Islamic financing.

In effect, however, some people find it hard to differentiate between Islamic and conventional financing. As a result, they fail to understand the differences between these two types of financing. Some, for example, believe that Islamic finance is just a change in name without other special features. They argue that the profit rate used under Islamic finance is merely a substitute for the interest rate under conventional financing. Such misunderstanding may prevent SMEs from adopting Islamic finance. However, distinguishing the differences between Islamic and conventional financing, and understanding how Islamic financial types relate to SMEs' financing are important in terms of SMEs' adoption and acceptance of this new phenomenon in Omani banking. Therefore, in this study, it is hypothesised that SMEs with higher awareness of Islamic finance are more likely to adopt it as a way to finance their firms.

H1. There is a significant difference between SMEs' awareness level of Islamic finance types and their intention to adopt Islamic finance.

H1a. There is a significant difference between SMEs' awareness level of mushārakah and their intention to adopt Islamic finance.

H1b. There is a significant difference between SMEs' awareness level of muḍārabah and their intention to adopt Islamic finance.

H1c. There is a significant difference between SMEs' awareness level of murābahah and their intention to adopt Islamic finance.

H1d. There is a significant difference between SMEs awareness level of ijārah and their intention to adopt Islamic finance.

4.3.3 Firm owners' characteristics

4.3.3.1 Gender

The gender of the small business owner plays a significant role in financing decisions which may affect the capital structure choice of the firm (Abor, 2008). Powell and Ansic (1997) indicate not only that males and females adopt different strategies in financial decisions but also that they differ in the way they finance their businesses (Verheul and Thurik, 2001). Research indicates that females favour stable and easy-to-manage financial investments (Prudential Financial, 2015).

Studies of financial decision-making also identify that females are less confident in making decisions. Researchers have found women generally have a lower risk preference and are more anxious when taking financial decisions than men are (Fisher and Yao, 2017; Neelakantan, 2010). In fact, variations in risk preferences between males and females may lead to different outcomes in financial decision-making (Yao *et al.*, 2011).

For the purpose of this paper, the authors focus on the difference between male and female owner–managers in adopting the new financing options that are now available in the Omani banking sector. The second hypothesis, therefore, relates to:

H2. There is a significant difference between males and females in adopting Islamic finance.

4.3.3.2 Education

There is a general assumption that those who are better educated are better able to weigh risk and return than their less well-educated counterparts. Researchers have shown a positive correlation between educational attainment and financial behaviour; indeed, Cole et al. (2014) provide evidence showing that a person with higher education will engage in smarter financial decision-making.

In the case of SMEs' finance, Green *et al.* (2007) show that the owner's level of education appears to have an important positive impact on the financing behaviour of small enterprises, while Storey (1994) indicates that more highly educated entrepreneurs demonstrate greater confidence in dealing with external funds providers when seeking additional funds for their businesses. Similarly, Abor (2008) finds that the level of education of SME owners is a significant factor in determining capital structure in Ghanaian firms.

Furthermore, there is also a growing body of literature that supports the idea that there is a positive relationship between an individual's rationality or decision-making power and his/her education level (Fan, 2017). In this study, it is hypothesised that SME owner-managers with higher education levels are more likely to adopt Islamic finance than are those with lower education levels.

H3. There is a significant difference between SME owner-managers' education levels in adopting Islamic finance.

4.3.3.3 Age

In terms of SMEs' characteristics, the small business finance literature suggests financial decisions vary with age. For example, older people tend to make worse financial decisions, because they take less information into account before reaching a decision (Mather, 2006) and because they have greater difficulty with rather complex decision-making (Bruine de Bruin et al., 2012) than younger individuals do.

Both younger and older decision-makers make mistakes; however, they do so for different reasons. In terms of financial decision-making specifically, Bangma et al. (2017) find no significant effect of age on financial decisions. As financial decision-making is the main factor for business success, especially for SMEs' development

and expansion, in this study the differences between younger and older SME owner–managers in their financing decision to adopt Islamic finance are investigated. Accordingly, H4 relates to:

H4. There is a significant difference between younger and older owner–managers in adopting Islamic finance.

4.3.3.4 Marital status

As is generally believed, and as supported by research, married couples make financial decisions differently when compared to single individuals; married couples are more cautious in their financing decisions because they have more responsibilities than a single person has. Kannadhasan (2015) suggests that, due to financial commitments, married people are more averse to high financial risk and are less risk tolerant than single people are. However, the findings in this area are mixed. For instance, Yao et al. (2005) find that single people are more risk tolerant than married individuals, while Grable and Joo (1997) find that there is no significant relationship between marital status and risk tolerance. The authors of this paper, however, believe there will be a difference in perceptions between married and single SME owner–managers as regards adopting a new method of financing. Consequently, it is suggested that H5 stands for:

H5. There is a significant difference between being single and married when adopting Islamic finance.

4.3.4 Firm characteristics

4.3.4.1 Firm size (number of employees)

Numerous studies demonstrate links between firm size and financial structure (Berger and Udell, 1998; Michaelas et al., 1999). The literature on SME finance suggests that SMEs' capital structure decisions differ from those of large corporations and that this difference gives rise to correspondingly different financial behaviours (Cassar and Holmes, 2003). For example, small and young firms are less likely to apply for financing (Berger and Udell, 2002) due to information asymmetries or agency costs (Berger et al., 2001). Accordingly, it is hypothesised that variation in SMEs' size affects their financing preferences.

H6. There is a significant difference between firm sizes when adopting Islamic finance.

4.3.4.2 Firm age

Financing preferences and the nature of an SME's specific financial choices vary according to the firm's life cycle (La Rocca et al., 2011). In other words, firms employ different financing strategies at different stages of the growth cycle. For instance, during the start-up stage SMEs depend heavily on internal funding. Klapper et al. (2002) note that younger enterprises (less than four years old) are more reliant on informal financing than on bank financing. Younger firms are also characterised by information opacity (Berger and Udell, 1998), a lack of information on past trading performance (Cassar, 2004), and the high likelihood of failing (Huyghebaert and Van de Gucht, 2007).

SMEs tend to adopt different financing strategies as they progress, and these affect their firms' financing behaviour. Therefore, it is hypothesised that SMEs differ according to their age and their willingness to adopt Islamic finance.

H7. There is a significant difference between firms' ages when adopting Islamic finance.

4.3.4.3 Industry

Numerous studies have discussed the idea that the industry sector in which firms operate could explain their capital structure and financial decision (MacKay and Phillips, 2005; Smith et al., 2015). For example, Abor (2007) argues that industry effect is important in explaining the capital structure of SMEs; he found some differences in the funding preferences of Ghanaian SMEs across industries. Degryse et al. (2012) reveal that different industries exhibit different degrees of leverage among small unlisted firms, because most are unitary firms. For example, as manufacturing industries require more assets than services industries do, their financing needs and choices may differ. Consequently, it is hypothesised that the adoption of Islamic finance as a method of finance will vary among industries.

H8. There is a significant difference between industries in their adoption of Islamic finance.

4.3.4.4 Sales turnover

The corporate finance literature is not very clear on the effect of sales turnover and the choice of finance. According to POT (Myers, 1984), firms with higher turnover or healthy sales can be expected to prefer to use their earnings and to borrow less. However, the tax model suggests a contrary prediction; in that model, profitable firms should borrow more to gain tax advantages. In fact, Eriotis et al. (2007) find no consistent relationship between profitability and capital structure. Therefore, the authors of this research expect SME owner–managers’ financing behaviour to vary with their firms’ turnover when adopting a new form of finance.

H9. There is a significant difference between firms’ turnover in the adoption of Islamic finance.

4.4 Research methods and sample characteristics

4.4.1 Data collection method

In this paper, primary data have been gathered via a face-to-face interview survey in Muscat, Oman’s capital, between December 2016 and February 2017. Face-to-face surveys enable the researcher to reduce any potential respondent confusion over the questions asked and produce high quality data (Szolnoki and Hoffmann, 2013), specifically in understanding SMEs’ knowledge of Islamic finance.

The sample was drawn from the Oman Chamber of Commerce and Industry (OCCI) database, as all companies operating in Oman must be registered under the OCCI; this database, therefore, guarantees almost full and unbiased coverage of the Sultanate’s business landscape. From this database, only SMEs were selected. The chosen SMEs were located in the Muscat region and represented three main industries in Oman: manufacturing, services and trade.

A total of 385 firms were then randomly selected, since “The random sample is the best because it’s most representative of the entire population. It’s least likely to result in bias” (Alreck and Settle, 2004, p. 71). To ensure that 385 represented a

sufficient sample size, the following assumptions were used (Waters, 1994): (i) proportion (π) equals to 0.5, as this is the safest possible assumption; (ii) a confidence level of 95 per cent, which corresponds to a Z-value of 1.96; and, (iii) an error or precision (E) of 0.05. Given the above assumptions, the sample size N is estimated by

$$N = \pi (1-\pi) Z^2 / E^2 = (0.5) (0.5) (1.96)^2 / (.05)^2 = 384.16$$

The survey comprised three sections: Section 1 included demographic questions; Section 2 measured adoption; and Section 3 questioned firm owners on their Islamic finance knowledge. The dependent variable was the intention to adopt Islamic finance. Intention reflects an individual's likelihood of performing a particular behaviour in the future (Ajzen, 1991). The strength of the SME owner-managers' intention to adopt Islamic finance for their business was measured using three 7-point items commonly used in studies assessing behaviour intentions (Madden et al., 1992). Table 25 explains the factor loadings on the dependent variable.

Table 25. *Factor Loading (Dependent Variable)*

Items	Factor Loadings
<i>IFIA 1.</i> I intend to adopt Islamic banking services in the future.	.926
<i>IFIA 2.</i> I predict that I will frequently use Islamic banking services in the future.	.942
<i>IFIA 3.</i> I will strongly recommend others to use Islamic banking services.	.901
Eigenvalue	2.555
Variance explained	85.179
KMO measure of sampling adequacy	.742
Bartlett's test of sphericity	Chi-square 818.563 (df, 3; p = 0.000)
Cronbach's alpha (α)	.919

Note: IFIA = Islamic Financial Instrument Adoption

4.4.2 Characteristics of the sample

Table 26 details the descriptive statistics of the SME firm owners and their firms' characteristics.

Table 26. *Respondent Profile*

Description	%
<i>Gender</i>	
Male	68.8
Female	31.2
<i>Educational level</i>	
Primary	0.8
Secondary	36.9
Higher diploma	28
Bachelor's	31.7
Master's	2.6
<i>Age in years</i>	
Under 20	1.0
20-30	40.8
31-40	46.2
41-50	11
Over 50	1.0
<i>Marital status</i>	
Single	39.7
Married	57.1
Other	3.2
<i>Number of employees</i>	
1-5	59.7
6-25	37.4
26-99	2.9
<i>*Sales turnover (OMR)</i>	
Less than 100,000	76.4
Between 100,000 and less than 500,000	22.3
<i>Firm age in years</i>	
0-1	13.2
2-3	47.8
4-5	23.2
Over 5	15.8
<i>Nature of business</i>	
Manufacturing	19.7
Service	35.1
Trade	45.2

*Notes: Turnover does not add up to 100 per cent because a few participants were reluctant to provide this information.

4.4.3 Statistical analysis

Non-parametric model Kruskal-Wallis one-way ANOVA was conducted to test the hypotheses (Noulas, 2001; Urionabarrenetxea and Rodríguez Castellanos, 2009; Uyar and Guzelyurt, 2015). Because of the nature of the data obtained from the survey, the results are not required to comply with the assumptions of normality or homoscedasticity that variance analysis requires (Urionabarrenetxea and Rodríguez Castellanos, 2009).

4.5 Results and discussion

4.5.1 Firm owners' Islamic finance knowledge

Table 27 shows the influence of firm owners' Islamic finance knowledge on their intention to adopt Islamic finance. There is support for *hypotheses 1a, 1b and 1c*, indicating that SME owner-managers' knowledge of PLS such as *mushārah* and *muḍārah* and non-PLS such as *murābahah* influences their intention to adopt Islamic finance. For example, SMEs' intention to adopt Islamic finance shows a statistically significant difference in the mean scores between SMEs' awareness level of *mushārah*, *muḍārah*, and *murābahah*, at ($p < 0.01$), ($p < 0.01$), and ($p < .05$) respectively. It is clear from Table 27 that SMEs with full awareness of Islamic finance are more likely to adopt Islamic financing compared to those that are not aware. This finding is not surprising, as SMEs with higher knowledge of Islamic financial products understand the advantages of these financial instruments, and, thus, it is easier for them to make an informed and confident decision; in addition, they are ready to accept this newly available financing option in the Omani banking industry.

This finding suggests that awareness of financial knowledge can help in improving SMEs' Islamic financial decision-making. While this finding is consistent with Jaffar and Musa's (2013) and Khattak's (2010) previous research findings, there was a lack of support for hypothesis 1d, i.e., SMEs' owner-managers' intention to adopt Islamic finance does not vary with their awareness level towards *ijārah*.

Table 27. *Kruskal-Wallis Results for SME Owner-Managers' Knowledge about IFIs*

	Mean Rank	Kruskal-Wallis X^2	Hypotheses
<i>Awareness of musharaka</i>			
Fully aware	208.03	8.252*	Supported
Somewhat	194.80		
Not aware	158.93		
<i>Awareness of mudarabah</i>			
Fully aware	207.11	8.044*	Supported
Somewhat	195.90		
Not aware	159.93		
<i>Awareness of murabaha</i>			
Fully aware	209.77	9.603**	Supported
Somewhat	195.06		
Not aware	158.08		
<i>Awareness of ijarah</i>			
Fully aware	204.34	1.787	Not supported
Somewhat	190.92		
Not aware	183.34		
Notes: *, ** Significant at 0.05 and 0.01 level, respectively			

4.5.2 Firm owners' characteristics

4.5.2.1 Gender

Table 28 shows the influence of gender on the adoption of Islamic finance. A statistically significant difference in the mean scores between male and female SME owner-managers on their intention towards adopting Islamic finance ($p < .01$) offers support for hypothesis 2. As is clear from Table 28, male owner-managers have a higher mean score (202.79) for adopting new financing options that are available in Omani banking compared with a score of 171.38 for their female counterparts. This finding suggests that females are more cautious and less confident in their abilities to make financial decisions involving the adoption of the Islamic financing options that are available in the country's banking sector.

Other studies attribute the causes of such difference to sexual stereotyping whereby, when confronted with risky decisions, females choose low-risk alternatives, and males choose alternatives with higher risks. This conclusion may be interpreted as females being more risk-averse than males in adopting Islamic finance in their business. The stereotype has important implications as it is consistent with the previous research findings of Abor (2008), Schubert (2006), and Powell and Ansic (1997).

Throughout history, men in the Arab world have possessed the right to make decisions in all aspects of life. Women's participation in the decision-making process has been limited (Said-Foqahaa and Maziad, 2011). However, this trend is changing; for example, in Oman, women are allowed to participate in politics, society and the workforce, while at the same time keeping their main responsibility towards their family. However, in Omani culture it is still men who wield the dominant power in decision-making, indicating that gender inequality has not been eliminated completely within the culture. Additionally, as men are considered to be the family's main breadwinners, they are prioritised over women (Al-Lamky, 2007), which could be the reason why male owner-managers are more confident than female owner-managers when it comes to making decisions regarding the adoption of new finance opportunities currently on offer in Oman.

4.5.2.2 Education

Table 28 also shows support for hypothesis 3 in that intention to adopt Islamic finance varies with the SME owner-managers' education level. Intention to adopt Islamic finance among SMEs is significantly different at ($p < 0.05$), with mean scores being higher for those with master's level education (248.90). This finding suggests that SME owner-managers with higher education are more likely to adopt Islamic finance than those with lower levels of education such as only primary education (91.50). This result may indicate that educated SME owner-managers are more confident because of their knowledge and understanding of the benefits of Islamic finance as a method of financing their businesses. Furthermore, this result indicates that education has important effects on financing decisions among SMEs. This finding confirms the results of Cole et al. (2014), who find that a wide range of financial outcomes are causally impacted by education.

In fact, because awareness about Islamic banking in Oman was the main challenge when Islamic banking was first introduced, the country's policymakers later introduced a number of measures to increase people's awareness. For example, some universities have begun to introduce courses such as Islamic finance and Islamic insurance into their academic curricula. According to Thomson Reuters (2014), Oman ranks fifteenth for Islamic finance education in terms of the Islamic Finance Development Indicator (IFDI) education sub-indicator, which indicates

that knowledge has spread within the country. Similarly, this study finds that SME owner–managers with higher education are more likely to adopt Islamic finance.

On the other hand, there is a lack of support for *hypotheses 4 and 5*—the *age and marital status* of SME owner–managers. Thus, it is to be concluded that age and marital status are not associated with SMEs’ financing decisions. This finding is consistent with those of Bangma *et al.* (2017) and Grable and Joo (1997).

Table 28. *Kruskal-Wallis Results for Firm Owner’s Characteristics*

	Mean Rank	Kruskal-Wallis X^2	Hypotheses
<i>Gender</i>			
Female	171.38	6.936**	Supported
Male	202.79		
<i>Education</i>			
Primary	91.50	17.699*	Supported
Secondary	208.82		
Higher diploma	202.34		
Bachelor’s	164.24		
Master’s	248.90		
<i>Age in years</i>			
Under 20	203.50	6.303	Not supported
20-30	192.14		
31-40	185.45		
41-50	218.04		
Above 50	289.25		
<i>Marital status</i>			
Single	197.06	2.901	Not supported
Married	192.97		
Other	141.71		

Notes: *, ** Significant at the 0.05 and 0.01 level respectively

4.5.3 Firm characteristics

Table 29 shows that in terms of the firms’ characteristics, there are no substantial differences in adopting Islamic finance (indicating a lack of support for hypotheses 6, 7, 8, and 9) when the following variables are considered: (i) firm size: this is consistent with market efficiency hypotheses that the firm’s size does not affect the capital structure, as per Modigliani and Miller’s (1958) theory; (ii) firm age: the growth cycle paradigm does not fit all SMEs (Berger and Udell, 1998); (iii) industry:

this is consistent with Myers' (1984) argument that a firm's capital structure is not directly determined by the industry sector in which it operates; and, (iv) turnover seems to have no significant impact on SMEs' financing decisions, this finding is consistent with Eriotis et al.'s (2007) conclusion that profitability does not significantly influence financing decisions in SMEs.

Studies on developing countries show no agreement on the basic factors that affect small businesses financing decisions. In addition, different countries have different institutional arrangements, differences in social and cultural issues and even in their levels of economic development (Abor, 2008). It is important to note that, as part of the effort to diversify the country's economy, the Omani authorities recognise that the SME sector forms the backbone of economic development. Oman is developing programmes to set up new units and to achieve overall successful development of the SMEs sector. Currently, that sector is relatively underdeveloped; hence, it can make only a limited contribution to the country's economy overall (Central Bank of Oman, 2016). The SME sector needs time to become a driver of economic growth and the mainstay of the Omani job market. The fact that Oman's SMEs are still at the development stage may account for the finding that the characteristics of a firm do not significantly influence finance decisions in SMEs.

Table 29. *Kruskal-Wallis Results for Firm Characteristics*

	Mean Rank	Kruskal-Wallis X^2	Hypotheses
<i>Firm size: number of employees</i>			Not supported
Micro	193.79	1.243	
Small	194.48		
Medium	157.14		
<i>Firm age in years</i>			Not supported
0-1	192.49	.036	
2-3	193.29		
4-5	194.16		
Above 5	190.88		
<i>Sales turnover OMR</i>			Not supported
Less than 100,000	191.34	.081	
Between 100,000 and less than 500,000	187.62		
<i>Nature of business</i>			Not supported
Manufacturing	211.77	3.567	
Service	194.36		
Trade	183.75		
Notes: *, ** Significant at 0.05 and 0.01 level respectively			

4.6 Summary and conclusion

The financing decisions that a firm makes are critical for its financial welfare; making the wrong decision with regard to the firm's capital structure may, therefore, result in financial difficulty and ultimately bankruptcy (Eriotis et al., 2007). Although there is as yet no specified methodology that financial managers can follow in order to achieve optimal financing decisions, this paper has shed some light on the determinants of the capital structure of SMEs. More specifically, this paper investigated whether the intention of Omani SME owner-managers to adopt Islamic finance was influenced by their knowledge of Islamic finance, by their own characteristics, and/or by their firms' characteristics. Thus, it is one of the few studies that investigates Islamic financing decisions among SMEs.

The authors adopted a questionnaire survey methodology for this research. A questionnaire was administered via face-to-face interviews between December 2016 and February 2017 to 385 SME owner-managers operating in Muscat, Oman's capital city. The Kruskal-Wallis one-way ANOVA non-parametric test was used to analyse the questionnaire survey data. The findings reveal that Omani SME owner-managers' intentions to adopt Islamic finance are strongly influenced by (i) the firm owner's knowledge of Islamic finance, specifically knowledge of PLS such as *mushārah* and *muḍārah* and non-PLS such as *murābahah*; and, (ii) by the firm owner's personal characteristics. While knowledge of *ijārah* does not influence their Islamic financial decisions, factors such as gender and education do affect SME owner-managers' Islamic financial decisions. Age and marital status are not associated with SMEs' financing decisions. Nor did firm characteristics such as firm size, firm age, industry, and sales turnover show any significant effect on SMEs' intention to adopt Islamic finance as a financing option.

The study contributes to the literature on corporate finance in several ways. First, it emphasises the growing importance of Islamic finance not only as an effective financial tool around the globe but also of its key instruments, PLS and non-PLS. Moreover, the study's findings clarify whether an understanding of key instruments of Islamic finance affects SME owner-managers' financing decisions. Second, this study focuses on Omani SME owner-managers' Islamic finance knowledge, their own characteristics, and factors within their firms' characteristics that are important

for decision-making regarding capital structure. Lastly, the focus of prior studies has been on large listed firms; SMEs, however, significantly differ from them in terms of their financial decisions and behaviour (Abdulsaleh and Worthington, 2013). Consequently, determinants of SMEs' capital structure are not well understood, especially as regards Islamic finance decisions.

This finding has important implications for Islamic banks and for window operations in a predominantly Muslim country. In order to compete with established conventional banks in the Omani banking sector, Islamic financial institutions need to understand what it is that affects Omanis' uptake of the new financial instruments that have recently become available in the Omani banking sector. Given the importance of the SME sector to the economic growth of Oman, it is essential that these institutions understand the factors that govern the adoption intention of SME owner-managers in particular.

It goes without question that the more SME owner-managers know and understand about Islamic finance, the easier it will be for them to make an informed and confident decision to adopt Islamic financing. It is, therefore, critical that Islamic banks in Oman increase Omanis' awareness and understanding of the principles, the advantages, the terminology, and the ways in which Islamic financial institutions operate, as ensuring increased consumer knowledge and understanding will enable Islamic banks to increase their activities and services.

Knowing which demographics affect SME owner-managers' financing decisions would be of use to Islamic banks and windows and to new entrants into the Islamic banking industry. This knowledge would also be of particular use to policymakers who are targeting small businesses. That is because they need to recognise that the financing needs of small businesses are not constant but, rather, change with the owner-managers characteristics, and that they should match their policies to SME owner-managers' changing needs.

This study has some limitations which need to be considered. The research's first limitation relates to its geographical location, as the study focused on SME owner-managers in Muscat only. Secondly, the study's findings cannot be generalised to large and public firms, as the sample includes only SME owner-managers. Future studies could survey a wider sample of SME owner-managers in locations beyond

Oman's capital city, Muscat. Finally, the findings are limited to SME owner-managers' knowledge of Islamic finance, their own characteristics, and their firms' characteristics only. Consequently, more research should be carried out to determine what other factors affect the intention of Omani SME owner-managers to adopt Islamic finance.

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Chapter 5

Omani SME perceptions towards Islamic financing systems

Declaration about the role and contribution of authors

I (Yasmeen Ali Al Balushi) am chiefly responsible for the conceptualisation, review of literature and empirical analysis as well as the writing of this research paper. Stuart Locke supervised each step of this process. In particular, Stuart Locke gave conception advice on this work and commented on all versions of the research paper. Susanna Lu and Zakaria Boulanouar gave conception advice and edited the final research paper.

This paper was accepted for publication

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Abstract

Purpose – This paper aims to investigate SME owner–managers’ awareness, willingness and perceptions concerning Islamic financing instruments as an alternative sourcing decision in SMEs’ businesses.

Design/methodology/approach – The research employed mixed methods to gather data. A questionnaire survey was conducted via face-to-face interviews with 385 SME owner–managers operating in Muscat, Oman’s capital city, along with face-to-face discussion on Islamic finance with 86 SME owner–managers. Descriptive and thematic analysis were used to analyse the data.

Findings – The findings indicate that SME owner–managers are aware of Islamic banking principles and have knowledge of Islamic financial instruments, despite Islamic finance being new to Oman. Interestingly, although the majority of the participants indicated their intention to adopt this new finance method, they were motivated by special requirements other than finance. Their positive perception of Islamic financing methods could play a significant role in developing the Islamic banking industry.

Research limitations/implications – The research is limited in that its data came only from Omani SME owner–managers in Muscat. Future research could investigate wider samples. Secondly, the study’s findings lack generalisability to larger and public enterprises, because only SME owner–managers were surveyed.

Originality/value – The research is significant as it is the first study to investigate the awareness, willingness, and perceptions of Omani SMEs regarding Islamic banking in Oman. Even though all Omanis are Muslims, Oman was the last of the six-nation Gulf Cooperation Council countries to introduce Islamic finance. Thus, this emerging market provides an important basis from which to extend future research on Islamic finance to other potential Islamic finance markets.

Keywords Islamic finance, Awareness, Willingness, Perception, SMEs, Oman.

Paper type Research paper

5.1 Introduction

According to Warde (2000), one significant reason for writing about Islamic finance is its sheer size. The Islamic banking and finance industry is one of the fastest growing industries in the international financial system. Current global Islamic financial assets were estimated at USD 2.293 trillion at the end of December 2016 and they are expected to exceed USD 4.362 trillion by 2020 (GIFR, 2017). Ernst & Young (2014) estimate that between 2009 and 2013 Islamic banking assets grew at an annual rate of 17.6%, and anticipate this trend will continue to grow until 2018 by an average of 19.7%. Islamic banking operates in more than 50 countries worldwide (Chong and Liu, 2009) and there is still huge potential for Islamic banking to grow.

In order to expand, it is crucial that Islamic financial banking institutions understand why would-be customers would decide to adopt Islamic finance methods. More particularly, it is important to know more about SMEs' attitudes, awareness, preference and willingness to embrace Islamic financing. Myriad studies have discussed the attitudes and intentions of businesses and individual consumers towards conventional banking (Echchabi and Nafiu Olaniyi, 2012; Edris and Almahmeed, 1997; Gait and Worthington, 2008). Similarly, there is much research on consumers' attitudes, perceptions and knowledge towards Islamic banking (Al-Ajmi et al., 2009; Gait and Worthington, 2008; Jaffar and Musa, 2013, 2016).

However, "Until recently, there has been very little work undertaken on business firms' attitudes towards Islamic methods of finance" (Gait and Worthington, 2008, p. 802). In fact, in their review paper on attitudes, perception and knowledge of Islamic financial products and services Gait and Worthington (2008) identified this area as a gap in the literature. Other researchers have also noted this gap; for instance: "There have been [more] substantial literatures on attitude towards Islamic finance among individual segment than business firms" (Jaffar and Musa, 2013, p. 136); "Few studies have been conducted in terms of the Islamic mode of financing to the SMEs" (Osman and Ali, 2008, p. 11); "no adequate studies have been conducted on the attitude of firms toward Islamic banks" (Abdesamed and Wahab, 2015, p. 3258); and, "Little empirical work has been done for examining

the attitude towards Islamic banking and finance from the perspective of business firms” (Badaj and Radi, 2017, p. 2).

Furthermore, only a few studies that relate to SMEs’ perceptions on Islamic banking have been conducted (Abdesamed and Wahab, 2015; Gait, 2009; Jaffar and Musa, 2013; Jalaluddin and Metwally, 1999; Osman and Ali, 2008; Shaharuddin et al., 2005; Wahab and Abdesamed, 2012; Badaj and Radi, 2017). These studies are, however, interesting and confirm the significance of the SME sector’s understanding of and attraction towards Islamic finance methods. Since SMEs are key economic players, it is crucial to understand their financing practices, which, according to Wahab and Abdesamed (2012, p. 3715), “serve as the foundation towards accelerating economic growth.” It should also be noted that while the majority of these studies were conducted in a wide variety of contexts including Muslim countries and non-Muslim countries, a country with a predominately Islamic finance system, and a country with a dual-finance system which had established Islamic banking practices, there are still many countries where Islamic finance is at an early stage of its introduction and where Islamic methods of finance need to be studied.

More particularly, Oman was the last of the six-nation Gulf Cooperation Council (GCC) countries to introduce Islamic finance (as a response to public demand), even though all Omanis are Muslims. This research uses a single country study because a country case study can provide crucial investigation of small businesses (Beck and Demircug-Kunt, 2006; Shaban *et al.*, 2014). The first evidence of the development of Islamic banking in Oman appeared in 2012 and constituted a notable development in the banking sector. Oman now has a dual-banking system with Islamic banking operating side by side with conventional banking. Omani SMEs can, therefore, deal with both systems.

However, the introduction of Islamic finance in Oman is not without a number of challenges, specifically public awareness. In order for Oman’s Islamic banking industry to grow, there is an urgent need for public awareness programmes that focus on Shariah-compliant products and services, and for the provision of Shariah-compliant banking solutions for the SME sector, as Bilal Fiaz suggested in the world’s leading Islamic finance news provider (Islamic Finance News, 2015).

These challenges are the most significant challenges a country faces when newly introducing Islamic banking.

Thus, this study aims to examine the level of SMEs' awareness of and willingness to adopt Islamic methods of finance and SMEs' perceptions of them. It goes without saying that success of this form of finance is strongly dependent on the eagerness of customers to accept and adopt this new finance offering. This study attempts to answer the following questions:

RQ1. Are SME owner–managers aware of Islamic banking principles?

RQ2. Are SME owner–managers aware of Islamic finance instruments (IFIs)?

RQ3. If they are aware of them, are SMEs willing to adopt Islamic finance methods?

RQ4. How do SME owner-managers perceive Islamic methods of financing their businesses?

The next section of the paper provides a literature review, followed by the methodology. The research results and discussion are then presented. The final section provides a summary of the research's findings and conclusion.

5.2 Literature review

5.2.1 Islamic financing to SMEs

The business world is constantly changing; consequently, innovative financial instruments to suit that environment are constantly being offered. Traditional finance models with their fixed/variable rates of interest do not currently provide SMEs with flexibility, nor are they particularly well-suited to SMEs where starting up a new business or new idea is seen as riskier than financing established businesses. In traditional financing, borrowers, including SMEs, must pay back the stipulated interest on their loan, irrespective of the prevailing economic conditions; they are also legally liable for repaying the capital with interest, irrespective of whether or not they are making a profit or incurring a loss. In other words, borrowers must pay as per contract regardless of heavy losses on a project. Since earnings fluctuate because of market uncertainty, competition, and lack of business experience, financial instruments that enable SMEs to start new businesses where

they can share the risk with a finance provider are needed to motivate and encourage the development of new SME enterprises.

Islamic banks, as predominantly risk-taking institutions, act as partners with their clients, spread the risk, and share the business' profit and loss at a predetermined percentage rather than committing the borrower to fixed interest charges (Mills and Presley, 1999). According to Iqbal *et al.* (1998, pp. 15-16), "The most important feature of Islamic Banking is that it promotes risk sharing between the provider of funds (investor) on the one hand and both the financial intermediary (the bank) and the user of funds (the entrepreneur) on the other hand.... In conventional banking, all this risk is borne in principle by the entrepreneur." The concept of risk sharing is, therefore, a key feature that distinguishes Islamic from conventional banking.

The International Monetary Fund stresses the importance of Islamic finance in supporting SMEs: "Islamic Finance's emphasis on asset-backed financing and risk sharing feature means that it could provide support for small medium-sized enterprises" (Kammer *et al.*, 2015, p. 6). Profit-and-loss sharing (PLS) "is at the core of Islamic Banking" (Zaher and Kabir Hassan, 2001, p. 6). Thus, "Islamic banks are supposed to act as venture capital providers, investing in worthy firms and financing promising ideas in exchange for a share of the profits, rather than lending on the basis of cash-flow and collateral, and forcing firms into liquidation to recover loans that had gone bad through no fault of the borrower" (Khan, 2010, p. 87).

Further, a study by the World Bank (2008) reveals that not all traditional financial products are attractive simply because they go against the religious beliefs of some customers. Thus, customers who eschew traditional financial products on religious grounds need to be offered alternatives. According to the IFC (2014), 32% of SMEs in the Middle East and North Africa (MENA) are excluded from the formal banking sector due to lack of Shariah-compliant products. Alternative, Shariah-compliant financial products could, therefore, meet the financing and investment needs of Muslims (World Bank, 2008). The main differences between the Islamic financial system and the conventional system include the fact that: (i) the prohibition of interest in the Islamic financial system results in the elimination of debt and avoids

exploitation; and (ii) the risk and PLS feature in the Islamic financial system help to enhance the productivity of business ventures (Iqbal and Mirakhor, 2011).

Indeed, SMEs demonstrate substantial demand for Islamic banking. For instance, 90% of SMEs in Saudi Arabia indicate a strong preference for Shariah-compliant products. However, large numbers of SMEs are not participating in the lending market because they are not open to non-Islamic finance. SMEs in Morocco and Yemen have also shown a similar interest in Shariah-compliant products (54% and 37% respectively) (IFC, 2014). As illustrated by Demirguc-Kunt et al. (2014), adults in the MENA region express a strong hypothetical preference for Islamic banking products, despite their higher costs. These results indicate a potentially significant demand for Islamic finance in the MENA area, where 35% of businesses are excluded from formal banking financing because of a lack of Shariah-compliant products (IFC, 2014).

In brief, business firms contribute to the success of the banking industry in many economies and, by the same token, banks represent an important business partner for business firms, because banks facilitate many functions for them. Therefore, it is critical that businesses are cautious when choosing between banks, particularly given the emergence of Islamic banks. As Abdesamed and Wahab (2015) note, by working in partnership with entrepreneurs Islamic banking can produce a superior outcome, as such collaboration leads to better business decisions than can be produced by working in isolation. Therefore, it is important to understand entrepreneurs' attitudes towards Islamic finance, as SME owner-managers' attitudes and perceptions about Islamic banks are important when they consider future expansion and development (Abdesamed and Wahab, 2015).

5.2.2 SMEs' perceptions of Islamic finance

Edris and Almahmeed's (1997) study in Kuwait was the first to investigate firms' attitudes to Islamic finance. They note that, although Kuwait has a dual-banking system, the majority of Kuwaiti firms prefer to deal with commercial banks rather than Islamic or specialised banks. Furthermore, despite being a predominantly Muslim country, the majority of Kuwaiti firms do not consider Islamic banking practices as the main factor when selecting a bank; rather, the main factor is the size of the bank's assets. Similarly, Abdesamed and Wahab (2015) confirm that religion

is not a factor that influences SMEs' preferences for adopting Islamic banks, because SMEs that have used conventional financing show less preference for Islamic financing than SMEs that have used informal loans (Abdesamed and Wahab, 2015). This finding indicates that firms that are dealing with conventional banks have strong relationships with them, and, consequently, such firms are less inclined to use Islamic banks.

On the other hand, Gait (2009) finds that in Libya potential business users of Islamic banking are motivated primarily by religion. Their second motivation is profitability, followed by the business support and unique services Islamic banking offers potential business users. Gait (2009) shows that most Libyan businesses have some knowledge about Islamic finance. In fact, 72.3% of the firms in this study were interested in adopting Islamic finance, because the risk-sharing feature of Islamic finance is attractive. Similarly, in the context of Malaysia, Osman and Ali (2008) find that 85% of entrepreneurs would choose Islamic finance on the grounds of religious beliefs or because it is a Shariah-based system. In fact, entrepreneurs believe that Islamic banks are more profitable than conventional banks.

Moreover, in the Malaysian context, Jaffar and Musa (2013) show that the majority of Halal-certified micro and small to medium enterprises indicate that, as a Halal business, they should use Islamic financing. However, only 40% of the participants are using and borrowing Islamic finance, with the remaining 60% being non-users of Islamic finance. In fact, 50% of the participants had limited to no knowledge about Islamic financial systems, which could explain why they are not borrowing from Islamic banks.

Ahmad and Haron (2002) note that Malaysian corporate customers perceive economic factors such as the profitability and quality of services as being more important than religious considerations when selecting banks. They emphasise that for Islamic banks to be attractive to business customers, they have to provide a lower cost product than a product which is available in conventional banking. Likewise, in the Malaysian context, Shaharuddin et al. (2005) find that the majority of SMEs do not fully utilise or accept Islamic products, nor do they consider Islamic banks as the most desirable financial institutions for their financing and daily business transactions.

In the case of Pakistan, Rustam et al. (2011) show that Islamic banking products and services have good potential and the majority of corporate sector customers perceive religion and economic factors as important in selecting Islamic banking. Islamic banking is 30 years old in Pakistan; nevertheless the majority of Pakistan's corporate sector customers still have little knowledge of Islamic banking products and services, according to Rustam et al. (2011), and they claim that Islamic banks in Pakistan have not marketed their products and services well.

Turning now to a country which is predominantly non-Muslim, Jalaluddin and Metwally (1999) investigate SMEs' views on Islamic finance methods and test the attitudes of 385 small Australian business firms towards PLS methods of finance. The majority of the respondents agreed to try PLS methods of finance, and 59.6% agreed to borrow money for their business using PLS methods. The findings of the study reveal five factors that motivated small firms to use PLS financing systems. These were: the sharing of risk between lenders and borrowers; motivation for business expansion; cost of borrowing; suitability of PLS; and, risk of default in the traditional finance system. However, the reasons small firms gave for not using PLS methods included: terms and conditions of borrowing; management intervention; and, high cost of borrowing. Their study, therefore, confirms that religion is not the only factor that encourages small businesses in Australia to adopt PLS methods of finance.

To conclude, despite empirical evidence pointing to the importance of its religious aspect regarding the proliferation in Islamic financing across Muslim countries, as well as non-Muslim countries, many of researchers (Ahmad and Haron, 2002; Jamaludin, 2013) argue that Islamic banks should not rely heavily on religious factors as a strategy for capturing businesses' attention, because it is not the primary reason that influences firms to use Islamic banks. In addition, as noted, SMEs' views and perceptions towards Islamic finance methods are actually contradictory. For example, in the context of Arab countries with similarities in language, religion, and culture, SMEs' attitudes towards Islamic banking are different. Possible reasons for those differences are offered next.

First, the availability of Islamic banks differs from country to country. For instance, while Kuwait is well-served with Islamic banking, Libya, which is also a Muslim-

majority country, presently has no Islamic banking. Second, the contradictory results found for Muslim and non-Muslim countries may be due to sample size, period, stage of SMEs' growth, the target groups, and cultural differences between regions. Finally, although all the studies cited above used quantitative methods such as self-administered questionnaire surveys, they employed different analysis techniques. This lack of consistency might be one reason for their contradictory research results. Moreover, none of these studies used a mixed methods approach to investigate SMEs' perceptions and knowledge towards new methods of finance. For this reason, we believed that adopting mixed methods would offer an interesting approach through which to examine SMEs' views. Additionally, employing a qualitative lens would enable us to explore SME owner–managers' views about Islamic banking through directly sharing their stories and so enable us to understand their perceptions of Islamic methods of finance, rather than gauging those through prior literature and the results of other studies (Creswell, 2013).

Furthermore, all of the above studies were conducted either in countries such as Malaysia which have an established Islamic banking industry alongside conventional interest-based banking, or in countries which have no Islamic financial institutions at all such as Libya. Indeed, it can be said that differences in the existence of Islamic financing institutions and business model between countries have normalised the perception that the decision for business financing is driven by the type of business and scale. None of those studies, however, has investigated SMEs' views in a country such as Oman where Islamic finance is in its infancy.

5.3 Methodology

5.3.1 Data collection method

This study examines SME owner–managers' awareness about the principles behind Islamic banking and their knowledge and understanding about IFIs; SMEs' adoption intention towards Islamic method of finance; and, SME owner–managers' perceptions towards Islamic finance. Primary data was collected through a face-to-face interview survey in Muscat between December 2016 and February 2017 with 385 SME owner–managers. Face-to-face interview was chosen as the main tool for collecting primary data for two main reasons: first, because of the lack of a database

on SMEs in Oman (Neelufer and Al Amri, 2014) and the lack of comprehensive data on Islamic banking (Gheeraert, 2014) and secondly, because face-to-face interviewing allowed the lead researcher to gather valuable information from SME owner–managers about newly introduced finance in Oman. Thus, it was possible to address the study’s research aims and objectives.

Every company that operates in Oman must be registered on the Oman Chamber of Commerce and Industry’s (OCCI) database. Therefore, as that database provided a full picture of the SMEs operating in the Sultanate, the sample for this study comprised all the SMEs registered on the OCCI database. Only SMEs, SMEs in the Muscat region and SMEs operating in the three main industries in Oman—manufacturing, service, and trade—were selected from this database.

According to Alreck and Settle (2004), “The random sample is the best because it’s most representative of the entire population” (p. 71) and the least likely to result in bias. This research, therefore, randomly chose 385 firms from the OCCI’s SME database. The following assumptions were used to guarantee that these 385 SMEs represented an adequate sample size: (i) proportion (π) equals to 0.5, as this is the safest possible assumption; (ii) a confidence level of 95% which corresponds to a Z-value of 1.96; and, (iii) an error or precision (E) of 0.05 (Waters, 1994). On these assumptions, the sample size (N) was estimated as follows:

$$N = \pi (1-\pi) Z^2 / E^2 = (0.5) (0.5) (1.96)^2 / (.05)^2 = 384.16$$

The interview schedule covered four areas. Section 1 asked demographic questions. Because one cannot develop an attitude towards something about which one has no knowledge, Section 2 measured SME owner–managers’ awareness about Islamic banking principles (Table 31). Here the researchers used six items with 5-point scales adapted from previous research (Faisal *et al.*, 2012), with 5 indicating strongly agree and 1 strongly disagree. SME owner–managers’ awareness about Islamic financing was measured in terms of: knowledge of its existence; its differences from conventional financing; Shariah law; and, the PLS model. Section 3 questioned SMEs owner–managers’ Islamic finance knowledge of PLS and non-PLS finance (Table 32). The options here were fully aware, somewhat aware, and not aware. Section 4 asked SME owner–managers if they intended to adopt Islamic banking services in the future using 7-point items ranging from 7 definitely true and

1 definitely false. Section 5's open-ended question asked SME owner-managers if they wanted to add anything on Islamic financial institutions in relation to SMEs; 86 of the participants chose to respond to this question, which involved 5-10 minutes of discussion.

5.3.2 Characteristics of the sample

Table 30 details the descriptive statistics of the SME firm owner and firm characteristics.

Table 30. *Respondent Profile*

Description	%
<i>Gender</i>	
Male	68.8
Female	31.2
<i>Educational level</i>	
Primary	0.8
Secondary	36.9
Higher diploma	28.1
Bachelor's	31.7
Master's	2.6
<i>Age in years</i>	
Under 20	1.0
20-30	40.8
31-40	46.2
41-50	10.9
Over 50	1.0
<i>Number of employees</i>	
1-5	59.7
6-25	37.4
26-99	2.9
<i>Nature of business</i>	
Manufacturing	19.7
Service	35.1
Trade	45.2

5.3.3 Analysis methods

This research employed a mixed methods approach to explore, examine, and discover new and detailed understanding of SME owner-managers' attitudes to the newly introduced phenomenon of Islamic finance in Oman (Creswell, 2013)

because “in a qualitative study, you are interested not only in the physical events and behaviour that are taking place, but also in how the participants in your study make sense of these, and how their understanding [about Islamic finance] influences their behaviour [towards the adoption of Islamic method of finance] (Maxwell, 2013, p. 30).

However, one of the challenging aspects of qualitative research lies in analysing qualitative data (Kaczynski *et al.*, 2014). Qualitative data analysis involves creativity, intellectual discipline, and analytical rigour, and a great deal of hard work (Patton, 2002). In order to achieve the aim of this research, descriptive analysis were used to analyse the data for research questions 1, 2, and 3, and thematic analysis for research question 4.

As research question 4 was open-ended, thematic analysis was used since it is one of the most commonly used methods for qualitative analysis (Roulston, 2010). Thematic analysis is an independent qualitative descriptive approach defined as “a method for identifying, analysing and reporting patterns (themes) within data” (Braun and Clarke, 2006, p. 6). Thematic analysis has many advantages such as flexibility, identifying core features of large data, identifying similarities and differences with large data, and providing thick description for the large data (Braun and Clarke, 2006). Following Braun and Clarke (2006), this research used six analytical processes. First, the authors read the transcriptions to familiarise themselves with the data. Second, a list of initial codes were established. Third, the authors looked for themes (Themes were not determined prior to analysis but rather emerged from participant responses) and assigned all relevant data to each theme. Fourth, the themes were reviewed to ensure that all codes were relevant, and subsequently named each theme. Finally, the authors began writing up the analysis. NVivo software program was used to ensure rigour in the analysis process (Davies and Hughes, 2014).

5.4 Results and discussions

5.4.1 SMEs awareness towards Islamic banking principles

The results in Table 31 clearly indicate that SME owner–managers are aware of the basic principles of Islamic banking, for example, how it differs from conventional banking, and the fact that Islamic banking works on a risk-sharing model and is

regulated by Shariah boards, indicating they have knowledge and understanding of Islamic banking. This awareness could be a reason why the Omani public are demanding that their government allows Islamic banking in Oman. Furthermore, this finding may indicate either that Oman’s Islamic financial institutions have successfully spread awareness of their products within a short time span, or that SMEs have got this information from other GCC countries where Islamic finance has been available for over 40 years.

This finding indicates that SMEs are keen to know about Islamic finance, which is a new form of finance in Omani banking. Moreover, understanding the basic principles of Islamic banking may lead SMEs to adopt Islamic finance, because awareness determines their adoption intention (Abduh and Omarov, 2013). Having established a clear picture of SME owner–managers’ knowledge about IFIs, findings on SME owner–managers’ intention to adopt Islamic finance is presented next.

Table 31. *SMEs Awareness*

Items	Factor Loadings	Mean	Median	Std. Deviation
AW1. In practice Islamic banking is different from conventional banking.	.551	3.808	4.00	.915
AW2. Islamic banking is based on Shariah (Islamic Laws).	.694	3.805	4.00	.911
AW3. Islamic banking is a banking system for people of all faiths/religions.	.626	3.829	4.00	.894
AW4. If I put my money in Islamic banks, I am content that my money will not be invested in unethical ventures like alcohol, gambling etc.	.727	3.862	4.00	.949
AW5. Islamic banking is strictly based on a risk-sharing model (profit and loss).	.734	3.816	4.00	.916
AW6. Islamic banks are more regulated forms of banking as they are governed by regulatory bodies as well as by Shariah boards.	.687	3.821	4.00	.846
*Cronbach’s alpha (α)	.864			
*Minimum	1.50			
*Maximum	5.00			
*Mean	3.82			
*Median	4.00			
*Std. Deviation	.699			
Note: AW= Awareness				

* The items were combined to form an average score.

5.4.2 SMEs awareness towards IFIs

To measure the level of awareness and understanding among the SMEs' owners, a number of Islamic financing instruments such as musharaka, mudarabah, ijarah, and murabaha were identified and used in the questionnaires survey. The purpose for including these Islamic financing instruments was to ascertain whether the managers are familiar with Islamic financing methods.

Table 32 shows SME owner-managers' awareness and understanding towards IFIs. It is apparent from the findings that the majority of managers do understand and are familiar with Islamic financing instruments. For example, 29 % of SMEs are fully aware of *musharaka* and *murabaha*, the most common IFIs, and 28% and 27% respectively are fully aware of *mudarabah* and *ijarah* financing.

Table 32. *SMEs Awareness about IFIs*

IFIs	Fully aware %	Somewhat %	Not aware %
Musharaka	29	55	16
Mudarabah	28	55	17
Murabaha	29	54	17
Ijarah	27	54	19

However, it is interesting to note that, as Table 32 shows, even though Islamic finance is a new form of finance for SMEs in Oman's banking industry, most participants know about and understand the main PLS and non-PLS Islamic methods of finance and have good knowledge and understanding of these financial terminologies. Their level of awareness could be because the original Arabic is used to describe these financing terms and Arabic is Oman's national and official language.

Indeed, familiarity with Arabic appears to play a part in recognition and understanding of the terminologies of Islamic banking. The study's results are, for instance, consistent with Bley and Kuehn (2004) which found that Arabic-speaking United Arab Emirati respondents were significantly more knowledgeable about Islamic banking products and services than were respondents who were not Arabic-

speakers. Similarly, Gait and Worthington (2008) found that most Libyans understand Islamic finance terminologies. Although Islamic banking and finance have not yet become established in Libya, their study shows that most businesses have some knowledge about Islamic finance because IFIs such as *musharakah* and *quard hassan* are used informally among Muslims in Libya.

On the other hand, this study's results contradict Ahmad and Haron's (2002) findings on Malaysian corporate customers' attitudes towards Islamic banking products and services. They note that more than 65% of their participants have limited knowledge of Islamic finance, even though Malaysia's Islamic banking system has been operating since April 1983 (Chong and Liu, 2009). Moreover, in the Malaysian context, Jaffar and Musa (2013) show that 50% of the country's micro and small to medium enterprises have limited to zero knowledge of Islamic financial systems.

These results clearly indicate that non-Arabs/non-Arabic-speakers may be confused by the Arabic terms used by Islamic financial institutions to introduce or construct Islamic finance products and services in non-Arab countries/contexts. This lack of language familiarity may be a major impediment in the promotion of Islamic financial products, especially when the target consumers are not native speakers of Arabic.

This issue is a concern for policy makers in Malaysia. To illustrate this concern, Mohd-Karim (2010) points out that in 2002 Malaysia's Islamic banking practitioners agreed to mandate that all Malaysian Islamic banks add "i" at the end of generic product names, for example, "house financing-i" or "current account-i". These terms were to be used in all publications, including brochures. The aim here was to minimise confusion among product users because, prior to this agreement, some products were designated through Arabic terminology only.

As Dar and Presley (2000) make clear, having knowledge and understanding of Islamic finance is the most important prerequisite if customers are to engage with it. We, therefore, explored Omani SME owner-managers' knowledge and understanding of Islamic banking principles and IFIs. Having ascertained their level of understanding and knowledge, we then investigated SME owner-managers' readiness to accept this new financing option.

5.4.3 Adopting Islamic methods of finance

Viewing Islamic banks as business entities designed solely to fulfil religious obligations is no longer appropriate; rather, they should be viewed as business entities operating and competing alongside conventional banks. The door for both Islamic and conventional banks in Oman’s banking sector to post high growth and to extend financing facilities to small and medium projects is now open, even though Islamic finance is in its infancy in Oman’s banking sector when compared to conventional and long-established finance providers. Given that situation, we sought to discover whether Omani SME owner–managers are ready to adopt this new finance method.

Further question was asked to investigate whether the SMEs’ owner–managers intended to espouse Islamic banking services in the future. As the findings shown in Figure 18 indicate, 37% of Omani SME owner–managers are ready to adopt Islamic methods of finance in the future. However, 39 % are unsure and are, therefore, likely take a wait and see attitude while they see how the Islamic banks develop, and, in the interim, intend to maintain their relationships with conventional finance providers.

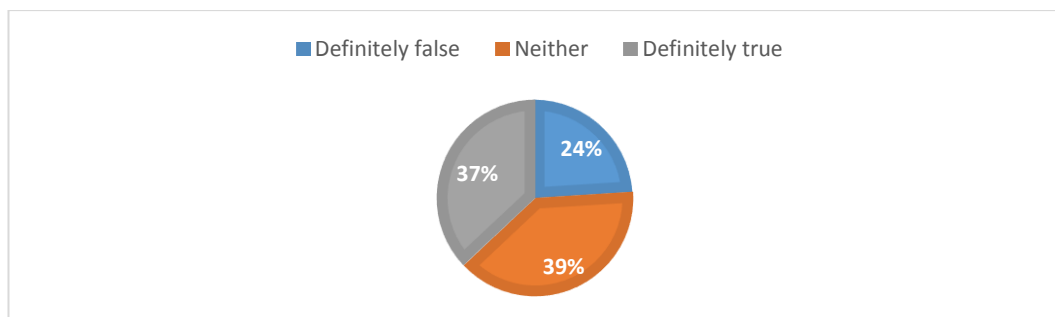


Figure 18. SMEs’ intention adoption towards Islamic financing

Overall, the findings suggest that some Omani SME owner–managers are considering adopting Islamic finance methods, because they are aware of it and are knowledgeable about its various elements. Abdesamed and Wahab (2015) drew the same conclusion. They found that 90.9% of the SMEs in their study were motivated to adopt Islamic finance, with that figure indicating a high preference for Islamic finance methods among SMEs. Indeed, Osman and Ali (2008) reveal that Muslim entrepreneurs understand the importance of applying Islamic financing in their business, as the majority of the participants in their study are using Islamic modes

of financing. That finding indicates that Muslim entrepreneurs have a positive view of Islamic financing.

Furthermore, the findings from our face-to-face discussions with 86 SME owner-managers confirmed both their interest in Islamic methods of finance and also their reasons for hesitating to adopt Islamic financing. Analysis of the interview transcripts revealed two main themes related to SME owner-managers' views towards the Islamic method of financing businesses and these are presented next.

Theme 1. SMEs' perception of Islamic finance

As discussed previously, Islamic finance is a newly available financing option in Oman's banking sector. Discussion with SME owner-managers revealed that SMEs are aware of the existence of Islamic finance for Omani SMEs and that they are ready to adopt Islamic finance methods. Interviewee G, for example, noted that he was "prepared to apply Islamic methods of finance", while interviewee A stated that he was "Happy to try [the] new financing option in the country".

The findings are consistent with the findings of the Islamic Finance Advisory & Assurance Services (2011), the first independent market study on Islamic finance in Oman. That study was conducted before the introduction of Islamic banking into Oman, and it reported the following: 85% of Omanis expressed their interest in Islamic finance products; 59% were very interested; and, the remaining 26% were quite interested. Further, the report indicated that 77% of Omani consumers were expecting to take up Islamic-style financing. Similarly, Al Ghammari and Ahmed's (2017) more recent study noted that more than half of Omanis are willing to join the newly introduced Islamic banks because of the attractive offers available, and 56% are ready to switch to Islamic banking for future financial requirements.

Furthermore, while the face-to-face discussion with SMEs revealed their interest in Islamic methods of finance, the majority are actually hungry for greater business support. The analysis showed that the majority of SME owner-managers are looking for the following (Table 33): finance services, non-financial services, and banking operations.

Table 33. *List of Areas and Issues Raised by the Participants*

Finance services/lending processes	Non-financial services	Banking operations
<ul style="list-style-type: none"> • Quick finance applications with minimal requirements. • Simple finance processes. • Flexible monthly instalments. • Fast funding approval. • Less expensive finance/low profit margin. • Increased finance limit, so SMEs will be able to work effectively and successfully on their project. • Dismiss or flexible collateral requirements. 	<ul style="list-style-type: none"> • Help in creating a business plan. • Help with marketing strategies. • Finance advice and planning. • Consulting and advisory services on IFIs. 	<ul style="list-style-type: none"> • More branches. • Branches outside the capital region, Muscat. • Enhanced finance departments. • A stand-alone department that deals exclusively with SMEs. • ATM services.

Further, discussion with SME owner–managers emphasised that Islamic banks should support SMEs, and that there should be collaborations between Islamic banks and government. The following comments illustrate that point: “Government and Islamic banks must work together to support SMEs”: and, “Government must support Islamic banks in financing SMEs”.

This finding seems to support Huda’s (2012) idea that government should be active as a “strategic partner” for Islamic banks in order to solve the financing problems faced by SMEs. In other words, the Omani government has an important role to play in creating a favourable environment within which Oman’s Islamic banks can operate and flourish.

The findings clearly indicate that finance is no longer SME owner–managers’ sole expectation when they consider a finance provider. They also want advice on wider business_matters. Islamic banks must go beyond the traditional services which are already available in Oman’s banking industry, as these do not align with SMEs’ current needs and expectations. This finding is consistent with Al Ghammari and Ahmed (2017) which found that Omanis are looking for low interest rates, easy access to loans, innovative products, quality services, variety in products/services, Islamic banking, and problem-solving.

The main challenges faced by Omani SMEs is a lack of finance, experience, and management capabilities (Ministry of Commerce and Industry, 2012) and they are hoping that Islamic banking can offer them these facilities. Small businesses rely heavily on banks as they are essential for their survival through, for example, the provision of finance and management services (Trayler *et al.*, 2000). In order for Islamic banks to compete successfully with conventional banks and other new market entrants, Islamic banks must give extremely high consideration to the special needs and requirements of SMEs. In addition, government involvement would definitely enhance the ability of SMEs to meet their financing needs and requirements.

Theme 2. Partnership financing

As Huda (212) noted, debt-based financing dominates the operations of most Islamic banks. Consequently, SMEs have limited access to financing because they are unable to provide sufficient collateral, and cannot provide an adequate track record, and because banks require high profit payment (Berger and Udell, 1998). Hence, a number of previous studies have considered how musharakah financing could offer a viable alternative form of financing for SMEs. Musharakah financing's risk-sharing principles could not only offer one way of overcoming these problems, but also provide SMEs with greater access to financing (Farid, 2007; Promwichit *et al.*, 2013), in that musharakah financing follows a risk-sharing principle whereby the business risks do not fall solely to the entrepreneur (Rahman, 2017).

The following comments reflect SME owner–managers' perceptions about *musharakah* financing: “[A] *musharakah* contract is [the] best financing option for SMEs which is available in Islamic financial institutions”; “I think *musharakah* financing is suitable for both Islamic banks and the SME's owner, because there will be roles for each party and each party must support and work towards achieving the goal which is [the] success of the project”; [a] “*musharakah* contract helps SMEs at the early stages...”; and, “*Musharakah* contracts are best to support SMEs, where collateral is not required of the SME's owner and this is different from commercial banks contracts”.

Interestingly, the SME owner–managers we interviewed understand the advantages offered by *musharakah* financing. This finding is, therefore, consistent with the finding of Rahman (2017) and supports the idea that *musharakah* is a viable form of financing for SMEs. Further support comes from Kayed (2012) which noted that *musharakah* appeals to entrepreneurs who would prefer to share the risk of new business undertakings rather than bear all the risk alone.

Abdalla Ahmed (2008) and Al-Jarhi (2002) both argue that when providing *musharakah* financing Islamic banks need to participate in the operation of the business they are financing because doing so secures their position as the financier and that this more hands-on involvement can replace the need for collateral and predetermined profit payments. Moreover, the partnering concept also ensures that the potential entrepreneur is not encumbered with a heavy burden of interest payments on top of the initial borrowing which has to be repaid irrespective of the success of the venture. As one Omani SME owner–managers put it:

“Islamic banks must work as a partner with SMEs in order to be successful for both parties”. “*Musharakah* contracts will be very helpful for SMEs, where Islamic banks and SMEs can be partners, and not only the SME’s owner bears the losses”.

This study’s finding on *musharakah* financing not only signifies an understanding that the bank becomes a business partner but empirically supports Abdalla Ahmed (2008) and Al Jarhi’s (2002) previous research which also highlighted the importance of the bank's participation in *musharakah* financing. The partnership between the SME and bank reduces the risk for both parties involved in any business undertaking because they undertake to share not only the profit but also the loss which may accrue according to pre-determined proportions. Kayed (2012) emphasised the significant role that partnership financing can play in promoting entrepreneurship.

However, Hussaini and Malami (2014) and Jalaluddin and Metwally (1999) stressed the point that most owners are disinclined to let banks participate in their businesses because doing so minimises their power as the founder of the business. Moreover, Dar and Presley (2000) found that small businesses are uninterested in PLS-based financing because it allows banks to interfere in the management of their business. Surprisingly, our research contradicts that finding as the SMEs which

participated in it saw *musharakah* financing positively and were willing to partner with Islamic banks. Furthermore, Rahman's (2017) finding that SMEs looked favourably upon a bank's participation in their business confirms the potential of *musharakah* financing for SMEs. Our finding here suggests that Omani SMEs would prefer to work in partnership with an Islamic bank which spreads the risk of the venture between them.

Despite the obvious advantages discussed above, *musharakah* financing enjoys only minimal take-up around the world. For example, by the end of 2010, Indonesian Islamic banks had used *murabaha* for more than 55.01% of their financing, while the percentages for *musharaka* and *mudarabah* modes of financing were just 21.45% and 12.66% respectively (Huda, 2012). Thus, it seems that Islamic banks favour more debt-like instruments over PLS instruments.

Islamic banking's unique PLS paradigm differentiates it from conventional banking, and the majority of jurists on Islamic finance much prefer Islamic finance products like *musharaka* and *mudarabah* as financing modes. In other words, experts in Islamic economics and finance recommend PLS schemes over other Islamic trading modes. Moreover, PLS schemes fit best with Islam's egalitarian philosophy (Shaikh, 2011) and dominate the theoretical literature on Islamic finance (Dar and Presley, 2000).

This study is a wake-up call for interest-free banking in Omani banking sectors. In order to prove themselves in a dual-banking system, they must be different from interest-based banking systems. For instance, when dealing with SME borrowers, Islamic banks must create and offer PLS schemes which are different from interest-based banking schemes. If they do not, SMEs will not adopt Islamic finance modes. Hamoud Al Zadjali, ex-executive president of the Central Bank of Oman, has also emphasised that "Islamic banking institutions in Oman need to focus on purposeful innovation in developing viable and acceptable Shariah-compliant products and services instead of replicating the conventional approach" (Business Economy, 2015).

This is a clear signal to Islamic financial institutions that they need to differentiate themselves from interest-based banking systems and to have different lending strategies such as PLS if they are to gain SME owner-managers' trust. If they

cannot see any differences between the new Islamic banks and conventional banks, SME owner–managers will have no reason to opt for Islamic financing or to leave their current banks.

5.5 Summary and conclusion

The purpose of this paper is to investigate SME owner–managers' awareness, willingness, and perceptions about Islamic methods of financing. Following a mixed methods approach, we administered a questionnaire survey via face-to-face interviews to 385 SME owner–managers operating in Muscat, Oman's capital city, and conducted further face-to-face discussion with 86 SME owner–managers on the topic of Islamic finance. Descriptive and thematic analysis were used to analyse the data.

This study reveals that SME owner–managers are aware of Islamic banking principles, and know about IFIs, even though Islamic finance has only recently been introduced in Oman. Interestingly, the majority of the SME owner–manager participants indicated an intention to adopt to this new form of financing, but for reasons other than simply finance; they were, for example, interested in special finance services, non-financial services, and banking operations. Their positive perception of Islamic finance methods could play a significant role in developing Oman's Islamic banking industry through, for instance, the concept of partnership under *musharaka* financing whereby SMEs can share the risk of loss with an Islamic bank.

The findings of this study present a wake-up call for interest-free banking in Oman's banking sectors, because, in order to prove themselves in a dual-banking system, they first have to be different from interest-based banking systems and secondly, Islamic banks must go beyond the traditional services which are available in Oman's banking industry, which are unaligned with today's SMEs' needs and expectations. Indeed, government involvement would definitely enhance SMEs' financing needs and requirements. This study also contributes to the body of knowledge on Islamic finance through its exploration of the prospects for Islamic finance in a new context, Oman, an area which has not yet been studied.

Furthermore, this study will be important for policy makers concerned about SMEs' financing, Islamic financial institutions, and new entrants into the Islamic banking industry, as it provides empirically evidence of Omanis' views, and more specifically those of Omani SME owner-managers, on the recent introduction of Islamic finance into the country. The insights this study offers should help them to develop the strategies required to attract SMEs and to construct policies and regulations to improve Oman's Islamic banking industry.

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Chapter 6

Synthesis and General Conclusions

The research reported in this PhD thesis investigated the adoption of Islamic financing instruments by SMEs in the Sultanate of Oman in the wake of the 2012 introduction of Islamic banking and finance into the country's financial services industry. As such, it is a first attempt in the Omani context to investigate Omani SME owner-managers' intention to adopt this newly available form of finance. Prior to 2012, SMEs in Oman relied on conventional financing; however, with the emergence of Islamic finance in the Omani banking industry they now have the option to choose between conventional and Islamic financing. As a result, SMEs in Oman can now choose between Islamic and non-Islamic finance options when making their financing decisions. The decision they make is important, as the option chosen will change the enterprise's financial structure.

SMEs are recognised as being of major importance to the strategic agendas of countries and economies around the world, with the potential to contribute to lower unemployment and increased economic growth. These advantages are particularly evident in the Omani context, where the government is seeking to diversify the country's production base. The Omani government's introduction of Islamic methods of finance into the country's banking industry, has played an increasingly important role as the country seeks to implement ambitious diversification plans to reduce its heavy reliance on hydrocarbons. Given that the Sultanate of Oman now operates a dual financial system where both conventional and Sharia-compliant products are available to Omani people, it is especially important to investigate Omanis' intentions, including those of SME owner-managers, to adopt the newly available form of finance. An understanding of SMEs' use/adoption of Islamic financial instruments is a prerequisite for policymakers and the managers of Islamic financial institutions that are interested in not only their own optimal growth and development, but also that of the Omani nation.

By acknowledging the importance of the SME sector and Islamic financial institutions not only in the Omani context, but also in other contexts as well, this

study is of significant importance to policymakers, specifically those targeting economic development through the development of the SME sector and the Islamic financial system. Accordingly, three stand-alone research papers were produced for this thesis. These papers, which were presented in chapters 3, 4, and 5, not only link together with each other, but also centre on achieving the overall objective of this study, as shown below.

Using the theory of planned behaviour, the first paper, entitled “Islamic financial decision-making among SMEs in the Sultanate of Oman: An adaption of the theory of planned behaviour (TPB)”, investigated SMEs’ Islamic financial decision-making; it is, therefore, one of only a few studies that have applied a theoretically modified version of the model of planned behaviour proposed by Ajzen (1991) as a way to investigate SME owner-managers’ financial behaviour. As is known, small firms are financed differently from large firms (Moritz, Block, & Heinz, 2016) because both economic and noneconomic motives influence their financial reasoning (Gallo, Tàpies, & Cappuyns, 2004). Moreover, it is argued that small businesses not only behave and act differently from larger firms, but that they also utilise different financing mechanisms (Berger & Udell, 1995). Thus, in order to better understand the financing behaviour of SME owner-managers, particularly Omani SME owner-managers’ Islamic financial decision-making, the researcher developed a novel conceptual model by borrowing from behavioural psychology.

It is argued that nonfinancial factors such as SME owner-managers’ attitudes, subjective norms, perceived behavioural control, and behavioural intentions largely affect the financial decisions of SMEs. Although religiosity showed a significant negative relation and is not a predictor of SME owner-managers’ intention to adopt IFIs, this study revealed that awareness did show a significant positive relation and was an important factor in predicting IFI adoption intention.

The second paper entitled “Determinants of the decision to adopt Islamic finance: Evidence from Oman” explored whether Omani SME owner-managers’ intention to adopt Islamic finance is influenced by their knowledge of Islamic finance, their own characteristics, and/or their firm’s characteristics. As has been noted in the prior literature, a complex array of factors influences SME owner-managers’ financing decisions (Romano et al., 2001). For example, entrepreneurial

characteristics (Abdulsaleh & Worthington, 2013), business life cycle issues (La Rocca et al., 2011), age and size of the firm (Cassar, 2004), and, industry sector (MacKay & Phillips, 2005) have all been found to exert an influence. Whereas it appears that this literature has not explicitly identified the specific factors that influence SME owners' decisions on Islamic finance, the present study has shown that SME owner-managers' Islamic financial knowledge of profit and loss sharing modes such as musharakah and mudarabah, their knowledge of nonprofit and loss sharing modes such as murabaha, and the owner-managers' own personal characteristics (i.e., gender and education) do all influence their intention to adopt Islamic finance. In contrast, it was found that their firm's characteristics have no significant influence on SME owner-managers' Islamic financial decisions.

The third paper, entitled "Omani SME perceptions towards Islamic financing systems", investigated SME owner-managers' awareness, willingness, and perceptions concerning Islamic financing instruments as an alternative finance-sourcing decision in SMEs' businesses. While much research has been conducted on consumer attitudes and perception towards conventional financing, and many investigations have explored consumer attitudes and perceptions towards Islamic finance, only a limited number of studies have looked at SME owner-managers' perception towards Islamic finance. In responding to the important gap between the few empirical studies related to small business finance (specifically Islamic finance) and their importance in the world economy (Zingales, 2000), this study explored SME owner-managers' financing perception and understanding of a newly available option within an emerging context, Oman. The results showed that SME owner-managers are aware of Islamic banking principles and have knowledge of Islamic financial instruments, despite Islamic finance's being new to the Omani banking industry. Interestingly, although the majority of the study participants indicated their intention to adopt this new finance method, they were motivated by particular requirements that went beyond their need for finance. Their positive perception of Islamic financing methods and what they have to offer overall could, therefore, play a significant role in developing the Islamic banking industry.

The three papers used quantitative methods to gather their primary data. The researcher conducted face-to-face interviews with 385 SME owner-managers in Muscat, Oman's capital between December 2016 and February 2017. This method

is commonly used in SME research (Berger & Black, 2011). The researcher found it illuminating to listen to the opinions of so many motivated SME owner-managers. This study is the largest of its kind undertaken in Oman. Further follow-up interviews with 86 SME owner-managers probed for additional reactions to ascertain more detailed understanding of SME owner-managers' attitudes to the newly introduced phenomenon of Islamic finance in Oman (Creswell, 2013). The data gathered from these discussions were used in the third paper.

To check hypotheses relevant in this study, the author used statistical techniques; these included hierarchical multiple regression and factor analysis for the first paper and Kruskal-Wallis' one-way ANOVA nonparametric test and factor analysis for the second paper. Descriptive and thematic analysis were used to analyse the data for the third paper.

6.1 Research Contributions and Policy Implications

This study makes a number of contributions at both the paper level and the thesis level. At the paper level, chapter 3 contributes to the SME finance literature in important ways. First, it broadens the understanding of SMEs' financial decision-making by recognising unique SME owner-manager influences on financing decisions. Second, because most studies on SME finance focus on conventional financing, the paper offers a more comprehensive perspective on SME financing by analysing Islamic financing. Thirdly, this paper not only examines the factors that influence attitude formation towards Islamic finance from the perspective of SME owner-managers, a perspective which was omitted in all previous research, but also adopts the theory of planned behaviour as the basis of this investigation. Fourth, by testing the full TPB model as described by Ajzen (2011), this chapter's paper provides the foundation for further research that aims to incorporate new developments into that model, thereby increasing our understanding of SMEs' intended behaviour around Islamic finance. Modifying the TPB model through the addition of variables like religiosity and awareness constructs may help to maximise the predictive efficacy of the model (Moon & Kim, 2001). Lastly, this research contributes to the wider research around SMEs, particularly on SME financing, by showing that noneconomic variables, especially psychological factors, can influence financing behaviour decisions.

The second paper, chapter 4, contributes to the literature on corporate finance in several ways. First, it emphasises the growing importance of Islamic finance not only as an effective financial tool around the globe, but also the importance of its key instruments, profit and loss sharing and nonprofit and loss sharing. Moreover, the study's findings clarify whether an understanding of key instruments of Islamic finance affect SME owner-managers' financing decisions. Second, this study focuses on Omani SME owner-managers' Islamic finance knowledge, their own characteristics, and factors within their firms' characteristics that are important for decision-making regarding capital structure. Lastly, the focus of prior studies has been on large listed firms; SMEs, however, significantly differ from these in terms of their financial decisions and behaviour (Abdulsaleh & Worthington, 2013); consequently, determinants of SMEs' capital structure are not well understood, especially as regards Islamic finance decisions.

The third paper, presented as chapter 5, responds to the increasing calls in the literature that encourage finance researchers to apply a more diverse approach to current research practices (Burton, 2007; Gippel, 2013; Kaczynski, Salmona, & Smith, 2014), as, for example, when Kaczynski et al. (2014) asked their fellow researchers to "imagine the benefits to finance if we expand our empirical source of data to include what people have to say" (p. 1). Doing so would motivate finance researchers to enhance current research practices through the use of a qualitative approach. As such, this approach would help us better understand social science issues. Burton (2007) too confirmed that there is a need for more research of a qualitative nature in finance, in order to generate important and novel empirical insights. Accordingly, in the third paper, the face-to-face discussion on Islamic finance that the researcher managed to conduct with 86 SME owner-managers not only advances the limited literature on perceptions of SMEs regarding Islamic banking in an understudied context (i.e., Oman), but also generates new insights, as it is the first study to comprehensively review SMEs' willingness to adopt new financial instruments (i.e., IFIs).

Calling upon these multiple theoretical and practical contributions at the research paper level, the thesis proposes theoretical, methodological, and contextual contributions at a broader level. First, the overall study emphasises how small business owner-managers arrive at their capital structure decision, one of the most

important research areas in corporate finance (Cassar & Holmes, 2003; Hall, Hutchinson, & Michaelas, 2000; Michaelas, Chittenden, & Poutziouris, 1999), particularly the decision of SMEs to adopt Islamic finance instruments. SMEs' capital structure is a major area of policy concern, and, as Hall et al. (2000) has shown, there is much research to support the idea that financial decision failure is a major cause of small business decline.

Second, this study responds to the increasing calls in the finance research literatures to incorporate nonfinancial influences when researching the financing decision-making of firms (Barton & Gordon, 1988; Matthews et al., 1994). In other words, expanding the examination of SME owner-managers' finance behaviour beyond the conceptual level shows that noneconomic variables can influence financing behaviour or uncovers the role that psychological factors play on financial decision-making. Through the first two papers, it is argued that nonfinancial factors affect the financial decisions of SMEs. The first paper shows that SME owner-managers' attitudes, subjective norms, perceived behavioural control, awareness about Islamic financing, and behavioural intentions largely affect their financial decisions, while religiosity is shown to negatively affect behavioural intention to adopt IFIs. The second paper shows the influence that SME owner-managers' Islamic financial knowledge and personal characteristics have on their intention to adopt Islamic finance, while also showing that their firm's characteristics have no significant influence on SME owner-managers' Islamic financial decisions.

Third, the thesis addresses the fact that, although many empirical studies have focused on the capital structure of large listed companies the U.S. and other developed countries (Ronoowah, 2004), there is only limited research on capital structure for developing economies. This thesis attempts to supplement the existing literature on SMEs by examining a context that is rarely studied in the extant small business finance literature: Oman (Al Balushi, Locke, & Boulanouar, 2018), and thereby to bring forth new evidence on the determinants of the capital structure for SMEs in a developing economy, given that economies such as Oman's have different institutional structures compared to those found in more developed economies. In particular, the unique characteristics of the institutional structures in this context generated new insights into SMEs' finance decision behaviours,

particularly, those around the decision to embrace the Omani banking industry's newly available financing option—Islamic finance.

Given the importance of the SME sector to the economic growth of Oman, it is believed that the findings of this research can be of assistance to policymakers who are targeting small businesses, because policymakers need to recognise that the financing needs of small business are not constant, but rather change with each owner-manager's characteristics, and that policymakers should, therefore, match their policies to SME owner-managers' changing needs. Consequently, this study should enable the Islamic banking industry to design financing programmes tailored to the specific needs of SME owner-managers which will attract them to adopt IFIs, and which may in turn foster broader dissemination of Islamic financing. The findings of this study present a wake-up call for interest-free banking in Oman's banking sectors, because, in order to prove themselves in a dual-banking system, they must first differentiate themselves from interest-based banking systems. Secondly, Islamic banks must go beyond the traditional services which are available in Oman's banking industry, as many of these are unaligned with the needs and expectations of today's SMEs. Indeed, government involvement would definitely enhance the banking sector's responses to SMEs' financing needs and requirements.

Furthermore, this study will be important for policymakers concerned about not only SMEs' financing, but also Islamic financial institutions and new entrants into the Islamic banking industry, as it provides empirical evidence of Omanis' views, and, more specifically, those of Omani SME owner-managers, on the recent introduction of Islamic finance into the country. The insights this study offers should help policymakers to develop the strategies required to attract SMEs and to construct policies and regulations to improve Oman's Islamic banking industry's relationship with SMEs, which, it is hoped, will enhance Omani economic development.

For academic researchers, specifically finance researchers who are interested in the area of SME finance, the theoretical, methodological, and contextual contributions elaborated upon above should enhance their academic knowledge in the area of SME finance. This academic knowledge is likely to be of interest not only to academics in Oman who are working in this area, but also to those who are working

in similar areas in other nations, since it will permit comparisons to be made between developed and developing countries and between Islamic and non-Islamic countries. To be more specific, it will enable researchers to make comparisons between both conventional and Islamic methods of finance.

Finally, the literature review in this study looks not only at the finance of SME owner-managers in the Sultanate of Oman, but also considers research carried out in similar areas in other developing and developed nations and in Islamic and non-Islamic nations. It is, therefore, hoped that this study will encourage further work to examine the financing decision behaviour of small firms in greater detail or with a more specific focus.

6.2 Limitations and Suggestions for Future Research

This research is subject to some limitations. These, however, indicate fruitful avenues that future research could follow. This thesis focused on a sample of SME owner-managers in Oman only. The potential of selecting bias is presented; in addition, further research would be required before its findings could be generalised throughout Oman and to other countries. Further studies could also consider other geographical contexts and other factors not explored in the present study, which may influence SME owner-managers' Islamic financial decisions. An investigation of how SME owner-managers' awareness, willingness, and perceptions concerning Islamic financing instruments change over time would, for example, contribute to understanding and policy formation.

Another important issue, specifically in the Omani context, is to investigate how Islamic finance can grow and develop SMEs, and to discover whether SMEs do benefit more from Islamic methods of finance compared to conventional finance. Similarly, it would be interesting to examine whether or not expanded Islamic banking services contribute to making it easier for SMEs to gain access to funds and whether or not they contribute to greater diversify and equality of businesses and income.

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Appendices

Appendix 1: Questionnaire Survey

Waikato Management School

Te Raupapa



QUESTIONNAIRE ON SOCIO DEMOGRAPHIC FACTORS

Respondent's Name (Optional):	Mobile Number (Optional):
Business Name & location (Optional):	Email Address (Optional):

1. Gender

Male Female

2. Marital Status

Single Married Others/ please specify

3. Education

Illiterate Primary Secondary Higher Diploma Bachelor Masters Others /please specify.....

4. Age

Less than 20 years 20-30 years 31-40 years 41-50 years Above 50 years

5. How many years have you been in business?

0-1 years 2-3 years 4-5 years More than 5 years

6. Which of the following best describes your business?

Manufacturing Service Trade

7. What is the amount of turnover of your business (OMR)?

Less than 100,000 between 100,000 & less than 500,000 between 500,000& less than 3 million

8. How many worker/staff have you employed in your business?

1-5 6-25 26-99

9. Have borrowed money for your business over the last 5 years?

Yes (proceed to question no 10) No proceed to question no (11)

10. If yes, which of the banks have you borrowed money from?

Islamic Bank Conventional bank Others/ please specify.....

11. Which of the following Islamic banking finance types are you aware of?

Types of financing	Fully Aware	Somewhat	Not aware
Mudarabah			
Musharaka			
Murabaha			
Ijarah			

QUESTIONNAIRE ON ISLAMIC BANKING

In the following pages, there are number of questions that may or may not reflect your thoughts in association with Islamic Banking. These questionnaires are divided into three subsections based on the scales used in this research.

First section: This section consists of four items, using the common stem “Using Islamic banking and financial services is.” Four bipolar adjectives (i.e. pairs of opposites) are there using a mix of positive and negative endpoints. Three of the bipolar adjectives were instrumental items (good/bad, harmful/beneficial, and useful/worthless) and one item was experiential (the wrong thing to do/the right thing to do). Please choose the degree of agreement with your current circumstances by ticking (√) on the square provided in every question. You are only required to answer that most accurately reflects your perceptions. If you have trouble in understanding a question, then answer to the best of your ability.

Item	7=Good	1=Bad
1.Using Islamic banking and financial services is	7 6 5 4 3 2 1	
Item	7=Beneficial	1= Harmful
2.Using Islamic banking and financial services is	7 6 5 4 3 2 1	
Item	7=Useful	1=Worthless
3.Using Islamic banking and financial services is	7 6 5 4 3 2 1	
Item	7= The right thing to do	1= The wrong thing to do
4.Using Islamic banking and financial services is	7 6 5 4 3 2 1	

Second Section: The second section consists of three items of this questionnaire in association with your persistence to view Islamic banking. Seven-point scale items ranging from 1 to 7 is used to measure the three items.

Please choose the degree of agreement with your current circumstances by ticking (√) on the square provided in every question. You are only required to answer that most accurately reflects your perceptions. If you have trouble in understanding a question, then answer to the best of your ability.

Item	7=Definitely true	1=Definitely false
5. I intend to adopt Islamic banking services in the future	7 6 5 4 3 2 1	
Item	7=Definitely possible	1=Definitely impossible
6. I predict that I will frequently use Islamic banking services in the future	7 6 5 4 3 2 1	
Item	7=Strongly agree	1=Strongly disagree
7. I will strongly recommend others to use Islamic banking services	7 6 5 4 3 2 1	

Third section: This section consists of eighteen items of this questionnaire in association with Islamic banking. Five-point scale items are used to measure the eighteen remaining items. Please choose the degree of agreement with your current circumstances by ticking (√) on the square provided in every question. You are only required to answer that most accurately reflects your perceptions. If you have trouble in understanding a question, then answer to the best of your ability.

	Strongly Disagree				
	Disagree				
	Undecided				
	Agree				
	Strongly Agree				
8.For me to adopt Islamic financing in business would be appropriate	5	4	3	2	1
9.If I wish to I could adopt Islamic financing in business	5	4	3	2	1
10.I do have better control over adopting Islamic financing in business	5	4	3	2	1
11.It is mostly up to me whether or not I adopt Islamic financing in business	5	4	3	2	1
12.People whom I listen to could influence me to use Islamic banking	5	4	3	2	1
13.Most people who are important to me support me taking Islamic banking	5	4	3	2	1
14. Most of my friends/colleagues have taken Islamic banking agreed that Islamic finance is better than conventional.	5	4	3	2	1
15.In practice Islamic banking is different from conventional banking	5	4	3	2	1
16.Islamic banking is based on Sharia (Islamic Laws)	5	4	3	2	1
17.Islamic banking is a banking system for people of all faiths/religions	5	4	3	2	1
18.If I put my money in Islamic banks, I am confident that my money will not be invested in unethical ventures like alcohol, gambling etc	5	4	3	2	1
19.Islamic banking is strictly based on risk sharing model (profit & loss)	5	4	3	2	1
20.Islamic banks are more regulated form of banking as they are governed by regulatory bodies as well as by Sharia boards	5	4	3	2	1
21.I try to follow Islamic injunctions in all matters of my life	5	4	3	2	1
22.I always try to avoid minor and major sins as told by my religion	5	4	3	2	1
23.I have firm belief in all basic ideologies dimensions of Islam	5	4	3	2	1
24.I know the basic and necessary knowledge of my religion	5	4	3	2	1
25.I feel sorrow when I do something against my faith	5	4	3	2	1

26. Did you ever visit any Islamic banking for financial support?

Yes

No

27. Do you want to add anything on Islamic financial institution relation to SMEs?

.....
.....
.....
.....

Thanks for your kind response

Appendix 2: Ethical Approval

WAIKATO MANAGEMENT SCHOOL
TE RAUPAPA

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THE UNIVERSITY OF
WAIKATO
Te Whare Wānanga o Waikato

Yasmeen Al Balushi



Dear Yasmeen

Ethical Application WMS 16/65
An investigation of the adoption of Islamic financing instruments by small and medium enterprises in the Sultanate of Oman.

The above research project has been granted Ethical Approval for Research by the Waikato Management School Ethics Committee.

Please note: should you make changes to the project outlined in the approved ethics application, you may need to reapply for ethics approval.

Best wishes for your research.


Regards,

Amanda Sircombe

Amanda Sircombe

Research Manager

Appendix 3: Co-Authorship Form



**THE UNIVERSITY OF
WAIKATO**
Te Whare Raukawa o Waikato

Co-Authorship Form

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This form is to accompany the submission of any PhD that contains research reported in published or unpublished co-authored work. **Please include one copy of this form for each co-authored work.** Completed forms should be included in your appendices for all the copies of your thesis submitted for examination and library deposit (including digital deposit).

Please indicate the chapter/section/pages of this thesis that are extracted from a co-authored work and give the title and publication details or details of submission of the co-authored work.

Chapter 3: AL Balushi, Y, Locke, S, & Boulanger, Z. (2018). Islamic financial decision-making among SMEs in the Sultanate of Oman: An adaption of the theory of planned behaviour. *Journal of Behavioral and Experimental Finance* 17(1): 1-15, 2018-2018

Nature of contribution by PhD candidate: *Data collection, English writing, writing of initial draft*

Extent of contribution by PhD candidate (%): *60%*

CO-AUTHORS

Name	Nature of Contribution
<i>Stuart Locke</i>	<i>Supervised and proof read the research paper. Conception of idea, Contribution on all versions of the research paper.</i>
<i>Zakaria Boulanger</i>	<i>Co-supervised ALL the way through from the start until the paper was accepted. Commented on all drafts of the manuscript.</i>

Certification by Co-Authors


The undersigned hereby certify that:

- the above statement correctly reflects the nature and extent of the PhD candidate's contribution to this work, and the nature of the contribution of each of the co-authors; and

Name	Signature	Date
<i>Stuart Locke</i>	<i>[Signature]</i>	<i>16/08/2018</i>
<i>Zakaria Boulanger</i>	<i>[Signature]</i>	<i>11-09/2018</i>

July 2015

Appendix 4: Co-Authorship Form



**THE UNIVERSITY OF
WAIKATO**
Te Ūātau Māori o Waikato

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Please indicate the chapter/section/pages of this thesis that are extracted from a co-authored work and give the title and publication details or details of submission of the co-authored work.

Chapter 1: is currently under review at the International Journal of Islamic Finance. Mu Bajuski, S. Locke, S. Baulanawar, Z. (2018). Determinants of the decision to adopt Zakat finance: Evidence from Oman.

Nature of contribution by PhD candidate: *Data collection, Empirical analysis, Writing of initial draft.*

Extent of contribution by PhD candidate (%): *60%*

CO-AUTHORS


Name	Nature of Contribution
<i>Stuart Locke</i>	<i>Supervised and proof read this research paper, correction notes, commented on all versions of research paper.</i>
<i>Zakaria Baulanawar</i>	<i>Co-authored it all the way through from the start until the current draft which is under review. I also, like the other 2 research papers, I commented on every single draft of the research paper.</i>

Certification by Co-Authors
The undersigned hereby certify that:
 ♦ the above statement correctly reflects the nature and extent of the PhD candidate's contribution to this work, and the nature of the contribution of each of the co-authors; and

Name	Signature	Date
<i>Stuart Locke</i>	<i>[Signature]</i>	<i>16/08/2018</i>
<i>Zakaria Baulanawar</i>	<i>[Signature]</i>	<i>11-09-2018</i>

July 2015

Appendix 5: Co-Authorship Form



**THE UNIVERSITY OF
WAIKATO**
A Place Where Things Happen

Co-Authorship Form

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Please indicate the chapter/section/pages of this thesis that are extracted from a co-authored work and give the title and publication details or details of submission of the co-authored work.

Chapters: 15 currently under review of *The Quantitative Research in Financial Markets* by Bakuski, Locke, & Boulanova, 2. *Opportunities for SMEs towards Islamic Finance Systems.*

Nature of contribution by PhD candidate: Data Collection, Empirical Analysis, Writing of initial draft

Extent of contribution by PhD candidate (%): 60%

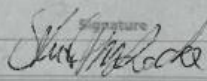
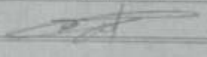
CO-AUTHORS

Name	Nature of Contribution
Stuart Locke	Supervised candidate in this research paper, conceptual advice, commented on the version of the paper.
Zakaria Boulanova	Reviewed the notes and the drafting of this research paper and having thought through the candidate's last draft when he was providing some suggestions feedback.

Certification by Co-Authors

The undersigned hereby certify that:

- the above statement correctly reflects the nature and extent of the PhD candidate's contribution to this work, and the nature of the contribution of each of the co-authors; and

Name	Signature	Date
Stuart Locke		11-09-2018
Zakaria Boulanova		11-09-2018

July 2015

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