Chapter 19
Cash Waqf Crowdfunding Model for SMEs

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ABSTRACT

Small and Medium Enterprises (SMEs) play a vital role in the economic growth. However, the industry has been facing challenges due to lack of access to finance among entrepreneurs. This chapter explores alternative financing platforms for SMEs and proposes specific solutions to the credit risk of SMEs. Authors used a structured literature review approach to analyse relevant publication to provide evidence on the application of cash Waqf as a viable source of Islamic finance for the SME sector. The donation-based cash Waqf model for SME financing is developed under the lens of stakeholder theory and Maqasid al-Shari‘ah. The model is expected to provide greater insight to Waqf institutions on their role to operationalise the conceptual model in fostering the growth of SMEs and change the perception of stakeholders about the dynamics and potential of cash Waqf in economic development.

INTRODUCTION

Small and Medium Enterprise (SME) is a source of employment and innovation that stimulate the entrepreneurial spirit (Panitchpakdi, 2006). Definition of SME varies widely from country to country. Therefore, a universal criterion to define the SME sector is non-existent. While some countries often use a number of employees as the sole criteria, other countries often the value of a firm’s assets or the size of revenues to define SME. For example, a number of employees is widely used to distinguish an SME in South-East Asia. Both the headcount and turnover are used as a common criterion to define an SME in the European Union. Nonetheless, the SME sector has proven to be the backbone of both.
developed and emerging Economy. In most OECD economies, SMEs account for around two-thirds of total employment and over half of the value-added by the business sector (OECD, 2018). In the Middle East and North Africa (MENA) region, SMEs have proven to be the main source of private sector jobs following the recent political and economic developments (Nasr & Pearce, 2012). However, SMEs are confronting various financial and non-financial challenges that are hindering their development in Asian (Ahmad & Arif, 2015), European (Irwin & Scott, 2010) and MENA region (Nasr & Pearce, 2012).

Ahmad and Arif (2015) highlight that the choice of economic activities among entrepreneurs in Asia is focused on less profitable and traditional industries. Such choices can be attributed to various challenges faced by the SME sector. The most common challenges faced by Indian SMEs are the high cost of credit and complex procedures of lending institutions (Rao, Kumar, Gaur, & Verma, 2017). A recent field survey conducted by Bangladesh Bank³, the Central Bank of Bangladesh, reports that higher interest rates contributed as the leading factor for loan default among SMEs. Shah (2014) refers to the lack of business capital and lack of knowledge on available financing alternatives as additional factors that contribute to the loan default among SMEs in Bangladesh. The bank selection and patronage behaviour in Ghana depend primarily on price competitiveness and credit availability. The stagnation of SME finance in Rwanda is resulting from the inability of SME owners to manage their projects and the normalisation of language around the collateral requirement. Nasr and Pearce (2012) provide the lending capacity of financial institutions, enterprises’ creditworthiness, the liquidity of financial intermediaries, and the availability of risk-sharing instruments as key constraints for SME development in the MENA region. Irwin and Scott (2010) found ethnic minority businesses face greater difficulty to secure finances in the United Kingdom. Cowling et al. (2016) complement the study of Irwin and Scott (2010) by providing empirical evidence that older firms have readily available finances before the global financial crisis in the UK. SMEs in Croatia continuously encounter higher cost of borrowing which has an association with the enterprise’s size, collateral and internal credit rating (Kundid & Ercegovac, 2011) and similar evidence is provided by Xiang & Worthington (2015).

Bank loan serves as the primary source of finance for SMEs (Rafay & Farid, 2018). However, banks are facing difficulties in measuring the ex-ante riskiness of SME credit which suffers from higher mortality risk, lack of credit information and collateral. In addition, Basel II has given greater emphasis on the internal ratings for Banks to assess the riskiness of loan applicants. Carey and Flynn (2005) examined the implication of Basel II for the Irish SME sector which is heavily dependent on banks as a source of finance. The study reports the competitive consequences of Basel II for Irish banks and raises the need for Irish SMEs to invest in social capital that can constitute as a cheaper source of finance. However, Basel III has increased the amount and quality of capital with a supporting factor for SME loans. The report released by the European Banking Authority (EBA)⁴ did not find any evidence that the supporting factor has provided any additional stimulus for lending to SMEs compared to large corporates and further reports greater concern relating to the access of finance for SMEs.

Such difficulties in accessing finance have attracted research attention to explore alternative sources of finance for SMEs and recent literature have proposed both conventional such as micro-finance (Armedáriz & Morduch, 2010) and crowdfunding (Cox & Nguyen, 2018), and Islamic alternative such as cash Waqf (Lahsasna, 2010) for SME financing. However, the current study makes a unique contribution to the literature by proposing a donation-based crowdfunding model for SME finance that operates on Islamic principle. The rest of the chapter is divided into three segments. In the next segment, the past literature on SME finance is critically reviewed. The third segment includes a discussion on the meth-
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