E-Journal of Islamic Thought and Understanding
Academy of Contemporary Islamic Studies (ACIS), UiTM Cawangan Melaka, Malaysia

Volume 7 No 2 (2024)

CONCEPTUAL PAPER ON ISLAMIC FINANCIAL LITERACY AND SMALL MEDIUM ENTERPRISE FINANCIAL GROWTH IN MALAYSIA: THE EFFECTIVENESS OF GOVERNMENT SUPPORT

Hafizuddin Md Dali[1*], Ahmad Iskandar Mohd Kamal[2,] & Aemy Aziz[3]

[1*]Faculty of Business and Management. UiTM Cawangan Johor, Kampus Segamat 85000, Segamat Johor
* hafizuddindali@uitm.edu.my (Corresponding Author)

[2]Faculty of Business and Management,
Melaka International College of Science and Technology
75300, Melaka

[3]Akademi Pengajian Islam Kontemporari (ACIS). UiTM Cawangan Johor,
Kampus Segamat 85000, Segamat Johor

DOI: https://doi.org/10.24191/ejitu.v7i2.6038

E-JITU

Acceptence date:
16 July 2024

Valuation date:
24 September 2024

Publication date:
21 October 2024

Abstract

This conceptual paper investigates the relationship between Islamic financial literacy and the financial growth of Malaysia's Small and Medium-sized Enterprises (SMEs). The study evaluates the effectiveness of government support in developing SME Islamic financial literacy and examines its impact on SMEs' overall financial performance. The primary objective is to assess the current level of Islamic financial literacy among Malaysian SMEs, identify the challenges they face, and evaluate the effectiveness of government measures in enhancing financial capabilities and fostering financial growth. Using organizational performance as the conceptual framework, this study employs a qualitative approach, based on a thorough review of existing literature and relevant empirical research. Key findings from this study highlight that while there are several government initiatives aimed at improving Islamic financial literacy among SMEs, the effectiveness of these programs varies significantly. Many SMEs still struggle with understanding and applying Islamic financial principles due to limited access to education and resources. The study also reveals that SMEs with higher levels of Islamic financial literacy are better equipped to manage their resources efficiently, access appropriate financial services, and make informed decisions that support sustainable business growth. The implications of these findings suggest that government support plays a crucial role in enhancing Islamic financial literacy, but there is a need for more targeted and accessible financial education programs. Effective government interventions can bridge the knowledge gap, enabling SMEs to leverage Shariah-compliant financial products and services more effectively. This study provides *valuable insights into the interplay between Islamic financial literacy, government support, and the financial performance and growth of Malaysian SMEs, offering recommendations for policymakers to enhance the impact of financial literacy initiatives.*

***Keywords**: Islamic Finance, SME Growth, Governments Support.*

INTRODUCTION

Small and Medium Enterprises (SMEs) are integral to Malaysia's economic development, significantly contributing to job creation, income growth, and export diversification (Elasrag, 2016). These enterprises represent over 98% of business establishments, playing a pivotal role in driving innovation and fostering economic resilience. However, Malaysian SMEs frequently encounter difficulties in obtaining appropriate and affordable finance, which can stifle their growth and sustainability (Ramlee & Berma, 2013). These challenges are compounded by limited financial literacy, which impedes their ability to make informed financial decisions and access necessary financial resources.

The Malaysian government has recognized these challenges and implemented several initiatives to support SMEs, including financial aid programs and the promotion of Islamic finance. Islamic finance, guided by Shariah principles, offers ethical and interest-free financial products that can cater to the unique needs of SMEs. This conceptual paper aims to investigate the effectiveness of government-led efforts to improve financial literacy and SMEs' growth in the country, with a special emphasis on the impact of Islamic finance.

Islamic financial literacy goes beyond conventional financial literacy by incorporating principles such as fairness, mutual consent, and the prohibition of interest (riba). Understanding Islamic financial products like mudarabah (profit-sharing), murabaha (cost-plus financing), and sukuk (Islamic bonds) is essential for SMEs to leverage the full potential of Shariah-compliant financing. However, the current level of Islamic financial literacy among Malaysian SMEs remains insufficient, posing a significant barrier to their financial growth and sustainability (Bakar, Yasin & Teong, 2020).

According to Akhtar and Yang-ping (2018), small and medium-sized firms are more sensitive to the effects of poor financial decisions due to their limited access to alternative funding sources and financial markets. This sensitivity underscores the importance of enhancing financial literacy among SME owners, enabling them to make prudent financial decisions that support long-term business growth. Furthermore, Islamic financial principles emphasize ethical conduct and social justice, aligning with the broader objectives of sustainable economic development.

As stated in the Quranic verse: "O you who believe! Do not consume one another's wealth unjustly but only [in lawful] transaction with mutual consent. And do not kill yourselves [or one another]. Indeed, Allah is to you ever Merciful" (Qur'an 4:29). This verse highlights the importance of engaging in fair and consensual financial transactions, which are fundamental to Islamic banking. Such principles are crucial for fostering trust and integrity in financial dealings, contributing to the overall stability and sustainability of the SME sector.

The Malaysian government's endeavor to promote financial literacy, known as Malaysia Madani, has shown considerable promise. This initiative aims to enhance financial literacy across the country, recognizing its importance for economic growth and financial stability (Aziz & Kassim, 2020). Financial literacy enables individuals and businesses to manage their resources effectively, make informed decisions, and achieve financial well-being. By incorporating Islamic financial principles into these efforts, the government seeks to provide a holistic approach to financial education that resonates with the cultural and religious values of the population.

In the Quran, Allah states:

وَلَا تَأْكُلُوا أَمْوَالَكُم بَيْنَكُم بِالْبَاطِلِ وَ تُدْلُوا بِهَا إِلَى الْحُكَّامِ لِتَأْكُلُوا فَرِيقًا مِ نْ أَمْوَالِ النَّاسِ بِالْإِثْمِ وَأَنتُمْ تَعْلَمُونَ

"And do not consume one another's wealth unjustly but only (in lawful) business by mutual consent. And do not kill yourselves nor take your lives" (Quran 4:29). This verse emphasizes the need to engage in financial transactions based on the principles of fairness, mutual consent, and the protection of life, which are essential aspects of Islamic banking. (Bakar, Yasin & Teong, 2020)

Despite these initiatives, there remain significant gaps in research that need to be addressed. Firstly, there is limited empirical evidence on the specific impact of government-led Islamic financial literacy programs on SME growth in Malaysia. Secondly, the challenges faced by SMEs in accessing and applying Islamic financial knowledge have not been fully explored. This paper seeks to fill these gaps by providing a conceptual framework that links government support, Islamic financial literacy, and SME growth. By examining the effectiveness of government measures in improving financial capabilities, this study aims to offer insights into best practices and strategies for maximizing their impact.

Furthermore, this study will use organizational performance as the conceptual framework, employing a qualitative approach based on a comprehensive review of existing literature and relevant empirical research. The findings will provide valuable insights into the relationship between Islamic financial literacy, government support, and the financial performance and growth of Malaysian SMEs. This study will highlight the need for targeted and accessible financial education programs, tailored to the unique challenges faced by SMEs in the Malaysian context.

In conclusion, enhancing Islamic financial literacy among SMEs is crucial for their growth and sustainability. By effectively leveraging government support and integrating Islamic financial principles, Malaysia can foster a financially literate and resilient SME sector. This conceptual paper aims to contribute to the ongoing discourse on financial literacy and SME development, offering recommendations for policymakers, educators, and business owners.

LITERATURE REVIEW

SME Financial Growth

Small and medium-sized enterprises (SMEs) are fundamental to Malaysia's economic development, contributing significantly to GDP and employment. SMEs account for 38.2% of GDP and employ 7.3 million people (Hanafi, Pornomo, Norhidayat & Maharani, 2023). Globally, SMEs hold a unique position, with economic prosperity often dependent on the formation and growth of a vibrant SME sector (Marom, Lussier, & Sonfield, 2019). Numerous studies have identified a strong association between access to finance and the growth of small firms. This is particularly important in transition economies like Malaysia, where SMEs face significant challenges due to changes in economic, political, and social systems (Li, Li, & Li, 2019).

The Malaysian government has developed a comprehensive financial ecosystem that provides various funding options from both public and private sources. This ecosystem is crucial in supporting SMEs, especially during their growth phases. However, despite these efforts, SMEs in Malaysia often struggle to obtain appropriate and affordable finance, which hampers their growth and sustainability (Ramlee & Berma, 2013).

Islamic Financial literacy

The Malaysian government recognizes the potential of Islamic finance in fostering the growth and development of SMEs. Initiatives have been implemented to encourage the use of Islamic financial products and services by SMEs, including the establishment of specialized Islamic financial institutions and the provision of financial support and training programs (Muhammad, Char, Yasoa, & Hassan, 2009).

Islamic financial literacy extends beyond traditional financial literacy by incorporating Shariah principles, such as the prohibition of riba (interest) and the emphasis on risk-sharing and ethical investments. Understanding Islamic financial products like mudarabah (profit-sharing), murabaha (cost-plus financing), and sukuk (Islamic bonds) is essential for SMEs to utilize the full potential of Islamic finance (Bakar, Yasin, & Teong, 2020). A holistic approach, involving increased Islamic financial knowledge and effective government support, is necessary to fully realize the promise of Islamic finance in promoting financial growth in Malaysian SMEs (Huda, 2012; Elasrag, 2016).

This study emphasizes the importance of Islamic financial literacy in fostering financial growth and performance in Malaysian SMEs. Islamic banking's product innovation is crucial in developing and strengthening small businesses. Financial literacy among SME owners is necessary for accessing and utilizing Islamic financing options, with government support playing a critical role in promoting the adoption of Islamic finance (Elasrag, 2016).

Government Support

The Malaysian government has launched several initiatives to encourage SMEs to adopt Islamic finance. These initiatives include establishing specialized Islamic financial institutions, providing financial assistance and training programs, and developing supportive regulatory frameworks. Such efforts aim to address the financial constraints of SMEs and equip them with the necessary resources and support for growth (Abdullah, Mirza, Krishnan, Zakaria, & Morris, 2022).

Government support is crucial in drafting legislation and initiatives that foster an environment conducive to business survival and growth. Although some studies did not find a significant relationship between government support and SME success, other research suggests a positive correlation between government assistance and SME development or performance (Shamsuddin, Minai, Zain, & Al Idrus, 2020). Effective government intervention can bridge the financial literacy gap, enabling SMEs to leverage Shariah-compliant financial products and services more effectively.

Comparative Analysis of Islamic and Conventional Financial Systems

Islamic finance is distinct from conventional finance in several key aspects. Islamic financial products are designed to comply with Shariah principles, which prohibit riba (interest), emphasize ethical investments, and promote risk-sharing. These principles align with the broader objectives of sustainable and inclusive economic growth. For instance, mudarabah contracts involve profit-sharing arrangements between financiers and entrepreneurs, aligning the interests of both parties and promoting fairness in financial transactions (Bakar, Yasin, & Teong, 2020).

Conventional financial systems, on the other hand, typically involve interest-based lending and fixed repayment schedules, which can impose significant financial burdens on SMEs, particularly during economic downturns. Islamic finance offers an alternative by providing more flexible and ethical financial solutions that can better support SME growth and resilience.

Despite the potential benefits of Islamic finance, SMEs in Malaysia face challenges in accessing and applying Islamic financial knowledge. Many SME owners lack sufficient understanding of Islamic financial principles and products, which hinders their ability to make informed financial decisions. This gap underscores the importance of government-led financial literacy initiatives that focus on Islamic finance (Aziz & Kassim, 2020).

The Role of Islamic Financial Products in SME Performance

Islamic financial products offer several advantages for SMEs, including access to Shariah-compliant financing options and ethical investment opportunities. These products can enhance financial inclusion, provide more equitable financing terms, and promote sustainable business practices. For example, sukuk (Islamic bonds) allow SMEs to raise capital without incurring interest, reducing the financial burden associated with conventional loans (Muhammad, Char, Yasoa, & Hassan, 2009).

However, the success of these products depends on the financial literacy of SME owners. A thorough understanding of Islamic finance is necessary to navigate the complexities of Shariah-compliant products and services effectively. Government support through financial education and training programs is vital in equipping SME owners with the necessary skills and knowledge (Elasrag, 2016).

Enhancing Islamic financial literacy among SMEs is essential for their growth and sustainability. Effective government support, in the form of financial education and regulatory frameworks, can help bridge the knowledge gap and enable SMEs to leverage Islamic financial products and services effectively. This study highlights the need for targeted and accessible financial literacy programs that address the unique challenges faced by SMEs in the Malaysian context. By fostering a financially literate and resilient SME sector, Malaysia can achieve more inclusive and sustainable economic growth.

METHODOLOGY

Since this paper focuses on conceptual analysis, an archival method was employed to provide insights into SME finance, Islamic financial literacy, and government initiative. The methodology involved collecting and analyzing existing research studies to propose a new conceptual framework integrating these factors as key determinants of SME financial growth in Malaysia. This approach is well-suited for conceptual research, allowing for a comprehensive understanding of the topic based on existing knowledge.

Source Selection

The sources were selected based on the following criteria:

Relevance: Only studies directly related to SME finance, Islamic financial literacy, and government support in the context of Islamic finance were included.

Recency: To ensure the timeliness of the research, only studies from 2020 onwards were considered.

Credibility: Preference was given to peer-reviewed journal articles, theses, conference papers, and books from reputable publishers and academic institutions.

Databases such as Google Scholar were utilized for sourcing relevant literature. Keywords used in the search included “Islamic Financial Literacy,” “SME Finance,” and “Government Initiative” This systematic approach ensured a thorough and focused literature base for the study.

Data Collection and Analysis

The collected literature was meticulously reviewed and analyzed to identify recurring themes and trends. The following steps outline the data collection and analysis process:

Literature Review: A comprehensive review of each selected study was conducted to extract relevant information regarding the research objectives. Notes were taken on key findings, methodologies used, and the context of each study.

Thematic Analysis: The extracted data were categorized into themes. Themes were identified based on the frequency and significance of certain topics across multiple studies. The main themes included; (1) the current state of financial literacy among SMEs in Malaysia; (2) The role of Islamic financial literacy in SME growth; (3) Government initiatives to enhance Islamic financial literacy; (4) Challenges and opportunities in implementing Islamic financial literacy programs; (5) Comparative analysis of Islamic and conventional financial systems.

Trend Identification: Trends were identified by examining changes and developments in Islamic financial literacy and SME finance over time. This involved looking at how government policies evolved and their impact on SME growth.

Gap Analysis: To identify gaps in the existing literature, the reviewed studies were compared against the research objectives of this paper. This helped pinpoint areas where further research is needed and where this paper could contribute new insights.

Discussion on Themes and Trends

Current State of Financial Literacy: Studies indicate a varying level of financial literacy among Malaysian SMEs, with many owners lacking sufficient knowledge of Islamic financial principles. This affects their ability to access and utilize Shariah-compliant financial products effectively.

Role of Islamic Financial Literacy: Improved Islamic financial literacy can lead to better financial decision-making, resource management, and sustainable business growth for SMEs. However, there is a need for more targeted educational programs to address specific knowledge gaps.

Government Initiatives: Government-led initiatives, such as financial literacy campaigns and training programs, have made significant strides in promoting Islamic finance. However, the reach and effectiveness of these programs vary, necessitating continuous evaluation and enhancement.

Challenges and Opportunities: Major challenges include limited access to financial education resources, cultural attitudes towards finance, and the complexity of financial products. Opportunities lie in leveraging technology to provide more accessible and engaging financial education.

E-Journal of Islamic Thought and Understanding
Academy of Contemporary Islamic Studies (ACIS), UiTM Cawangan Melaka, Malaysia
Volume 7 No 2 (2024)

Comparative Analysis: Islamic financial products offer distinct advantages over conventional financial systems, particularly in terms of ethical investments and risk-sharing. However, the lack of awareness and understanding of these products remains a barrier for many SMEs.

FINDINGS

This study is grounded in existing research frameworks, with its conceptual framework established from previous studies. For instance, Hossain, Ibrahim, & Uddin (2020) found that the positive relationship between finance, financial literacy, and small business financial growth emphasizes the importance of comprehensive initiatives to improve SMEs' access to financial resources and owner-managers financial management capabilities. This could include steps like boosting financial inclusion initiatives, offering targeted financial education programs, and encouraging the development of alternative financing solutions customized to the needs of small businesses.

A study by Hossain et al., (2020) also found that the lack of a moderating effect of government support on the finance-growth and financial literacy-growth relationships suggests that policymakers should carefully examine the design and implementation of current support programs to ensure their effectiveness in reaching and benefiting small businesses. This may necessitate a more thorough evaluation of program targeting, accessibility, and the integration of financial and non-financial support services.

Analogously, this paper aims to test how Islamic financial literacy and government support affect the financial performance and growth of SMEs in Malaysia. By synthesizing insights from existing literature, this study proposes a conceptual framework that integrates key determinants of SME financial growth, specifically focusing on Islamic financial literacy and government interventions.

Proposed conceptual framework

Based on the discussion of the possible frameworks above, this study will utilise SME's finance, Islamic Financial Literacy, Government Support and SME' Financial Growth in Figure 1. In addition, we used a past conceptual framework from two articles we chose to combine our independent variables that influence the SME's Financial Growth. As a result, this is a proposed conceptual framework for this study.

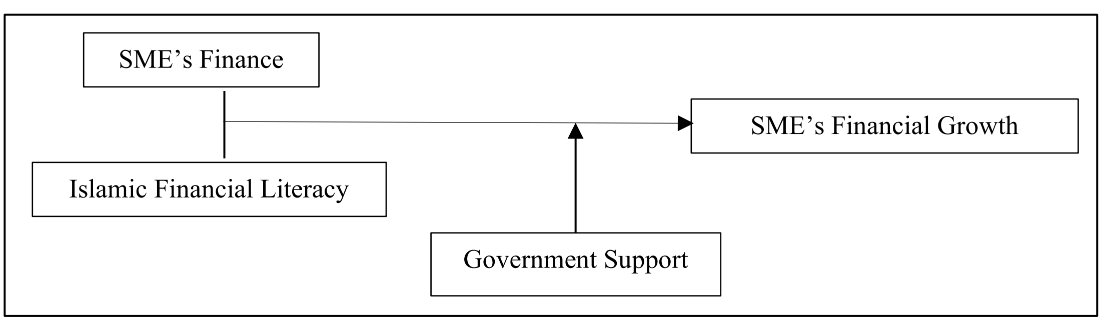

Figure 1. Proposed conceptual framework

The conceptual framework proposed in this paper explores the relationship between Islamic financial literacy, government support, and SME financial growth in Malaysia. The study aims to evaluate the effectiveness of government initiatives in enhancing the financial literacy and performance of SMEs, with a particular focus on the role of Islamic finance.

The existing literature emphasizes the vital relevance of finance in facilitating the growth and expansion of small enterprises. (Hossain, Ibrahim, & Uddin, 2020) The study also explores the importance of government support in this environment, drawing on earlier research that has studied the effectiveness of such interventions in fostering small-business growth. (Hossain et al., 2020)

A conceptual framework for determining the financing decisions of SMEs (Kumar &Ps, 2015). A study of Indian SMEs' financing preferences and practices, which provides a comprehensive understanding of the SMEs' financing landscape and can be used to inform policy formulation. (Baker, Kumar & Ps, 2020)

DISCUSSION & CONCLUSION

This conceptual study underscores the importance of understanding the factors influencing the financial growth and performance of Malaysian small and medium-sized firms. Based on the past studies, its imply that improving SME owners' financial literacy is critical to enable them to access and effectively use Islamic financing choices. This is especially relevant in Malaysia, where the government has made concerted efforts to promote the use of Islamic finance by SMEs.

A comprehensive understanding of these factors, particularly the importance of financial literacy in the context of Islamic finance discovered that a lack of understanding and awareness of Shari'ah-compliant products and services is a significant obstacle to the adoption of Islamic finance by SMEs.

To solve this issue, the government and related stakeholders must take a more comprehensive approach to improving the financial literacy of SME owners. This may include providing targeted training and education programs, streamlining the process of obtaining Islamic funding, and raising SME owners' awareness and understanding of Shari'ah-compliant products.

In conclusion, this conceptual study has emphasized the importance of Islamic financial literacy and government support in driving the financial growth and performance of Malaysian small and medium-sized firms. The study found that a holistic approach, including increased Islamic financial awareness and effective government support, is required to realize Islamic finance's full potential in aiding the financial success of Malaysian SMEs.

The government has a pivotal role in fostering the financial growth and success of Malaysia's SMEs by bridging the financial literacy gap and simplifying access to Islamic finance. Additionally, the paper references a Qur'anic verse that underscores the significance of charitable giving and providing good loans, aligning with the principles of Islamic finance and contributing to the development and growth of SMEs.

A study of the relevant literature, including studies on the significance of maqasid al-Shari'ah in Islamic banking (Ishak & Asni, 2020), and the significance of financial literacy for SMEs in Malaysia (Ripain, Amirul & Mail, 2017), the potential and challenges associated with Islamic finance for SMEs have helped to enhance the conceptual foundations of this research.

CO-AUTHORS CONTRIBUTION

The author acknowledges that there is no personal interest in the publication of this article. The first author conducted a literature review, methodology, conceptual framework, and review of references. The second author writes a literature review and discussion. The third author conducts a review of sentence structure, analysis, and discussion.

REFERENCES

Abdullah, N. H. N., Mirza, N. M. A., Krishnan, S., Zakaria, A. A. M., & Morris, G. (2022, January 31). A framework of contingencies factors, government support and management accounting practices in Malaysian small and medium-sized enterprises. International Journal of Entrepreneurship and Small Business, 4(1), 1-13. https://doi.org/10.31258/ijesh.4.1.1-13

Akhtar, S., & Yan-ping, L. (2018, September 21). SME managers and financial literacy; does financial literacy really matter?. Journal of Public Administration and Governance, 8(3), 353-353. https://doi.org/10.5296/jpag.v8i3.13539

Aziz, N. I. M., & Kassim, S. (2020, March 13). Does financial literacy really matter for Malaysians? A review. Advanced International Journal of Banking, Accounting and Finance (AIJBAF), 2(2), 13-20. https://doi.org/10.35631/aijbaf.22002

Bakar, N. M. A., Yasin, N. M., & Teong, N. S. (2020, March 11). Unfair contract terms in Malaysian Islamic banks: Empowering bank consumers by Islamic education ethics. Humanities & Social Sciences Reviews, 8(2), 13-24. https://doi.org/10.18510/hssr.2020.823

Baker, H. K., Kumar, S., & Ps, R. (2020, February 1). Financing preferences and practices of Indian SMEs. Global Finance Journal, 43, 100388-100388. https://doi.org/10.1016/j.gfj.2017.10.003

Elasrag, H. (2016). Islamic finance for SMEs. SSRN Electronic Journal. https://doi.org/10.2139/ssrn.2842160

Hanafi, H., Pornomo, H., Norhidayat, N., & Maharani, A. (2023). An examination of business performance: The relationship and its relevance factors. BASKARA: Journal of Business and Entrepreneurship, 6(1).

Huda, A. N. (2012, January 1). The development of Islamic financing scheme for SMEs in a developing country: The Indonesian case. Social and Behavioral Sciences, 52, 179-186. https://doi.org/10.1016/j.sbspro.2012.09.454

Hossain, M. M., Ibrahim, Y., & Uddin, M. (2020, July 22). Finance, financial literacy and small firm financial growth in Bangladesh: The effectiveness of government support. Journal of Small Business and Entrepreneurship, 35(3), 336-361. https://doi.org/10.1080/08276331.2020.1793097

Ishak, M. S. I., & Asni, F. (2020, November 9). The role of maqasid al-Shariʿah in applying fiqh muamalat into modern Islamic banking in Malaysia. Journal of Islamic Accounting and Business Research, 11(9), 2137-2154. https://doi.org/10.1108/jiabr-12-2019-0224

Kumar, S., & Ps, R. (2015, January 2). A conceptual framework for identifying financing preferences of SMEs. Journal of Asia Business Studies, 22(1), 99-112. https://doi.org/10.1080/13215906.2015.1036504

Li, J., Li, L., & Li, X. (2019). A comparative study of digitalization effects on firm performance in developed and developing countries. International Journal of Production Economics, 207, 212-222.

Marom, S., Lussier, R. N., & Sonfield, M. (2019). Entrepreneurial strategy: The relationship between firm size and levels of innovation and risk in small businesses. Journal of Small Business Strategy, 29(3), 33-45.

Muhammad, M. Z., Char, A. K., Yasoa', M. R., & Hassan, Z. (2009). Small and medium enterprises (SMEs) competing in the global business environment: A case of Malaysia. International Business Research, 3(1). https://doi.org/10.5539/ibr.v3n1p66

Nor Izzati Mohd Aziz, & Salina Kassim. (2024). Does financial literacy really matter for Malaysians? A review. Advanced International Journal of Banking, Accounting and Finance (AIJBAF), 2(2). Retrieved from https://gaexcellence.com/index.php/aijbaf/article/view/934

Ripain, N., Amirul, S. M., & Mail, R. (2017, April 21). Financial literacy and SMEs' potential entrepreneurs: The case of Malaysia. Journal of Administrative and Business Studies, 3(2). https://doi.org/10.20474/jabs-3.2.1

Ramlee, S., & Berma, M. (2013, December 7). Financing gap in Malaysian small-medium enterprises: A supply-side perspective. South African Journal of Economic and Management Sciences, 16(5), 115-126. https://doi.org/10.4102/sajems.v16i5.641

Shamsuddin, J. B., Bin Minai, M. S., Bin Md Zain, A. Y., & Al Idrus, S. (2020). Relationship of perception and awareness towards utilization of government business support services (GBSS) in Malaysian SMEs perspective. Journal of Entrepreneurship Education, 23(1).